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Protecting Yourself From Fraud: An Introduction

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The first in a series of articles on preventing fraud from affecting your business.

Theft doesn't have to happen with a gun. You can be robbed in broad daylight while you're out working on a job site, as you sit at your desk talking to a vendor or while you're on vacation. And you won't even know it happened until well after the fact — if ever!

Through my years of experience as a certified public accountant, certified internal auditor and QuickBooks® ProAdvisor, I have seen a surprisingly high rate of significant internal frauds. I have investigated instances of embezzlement and have studied various documented fraud cases, specifics and fraud warning signals.

When I help my clients develop management and cost accounting systems, I typically advise them about implementing basic, cost-effective controls to help minimize, prevent or detect fraud. When I work with owners of small businesses I normally find that, unless they've personally experienced prior theft, they have little or no knowledge about:

- How they may be at risk
- How simple frauds are easily perpetrated
- Warning signals ("red flags") of fraud
- Basic anti-fraud controls
- How to proceed if they suspect or discover fraud in their company

Without this information, small business owners (and particularly those in the construction industry) are exceptionally vulnerable to major loss. Fraud is a quiet, insidious form of theft that can rob you, your employees and your family of your financial security and everything you've worked for over the years. It is not uncommon for a major fraud to cause a company to fail. And the criminal seldom makes restitution or goes to jail.

It's a darn shame — and it needn't happen to you. I've developed this series of business management articles, which will appear in upcoming issues of Nation's Building News Online, to brief you in the following areas:

- Assessing your knowledge of fraud
- Why construction businesses are at increased risk for fraudulent activity
- The power of self-defense strategies (awareness, preparation and action)
- Warning signs and what to do if you suspect or discover a problem
- Analyzing and recognizing the specific risks that your company faces
- The importance and impact of environmental controls
- Preventative and detective controls for bank accounts, credit cards, payroll and employees, purchasing and company costs and computer and accounting systems
- Avoiding identity theft

I'll include real-life examples of actual frauds and discuss controls that could have prevented the fraud or detected it in its early stages.

A Quiz to Get You Started

The following quiz will get you thinking about your areas of risk (answers are at the end of the article). This actually is the first half of the quiz. The second half will be provided in the next article of this series.

1. Most frauds are committed by (choose one):
 - a. Smooth-talking, deceptive con artists
 - b. Long-term, trusted management level employees
 - c. Sharp, young employees who are new to the job
 - d. Front-line or field employees with access to assets
2. Which of the following scenarios might encourage the bookkeeper for a small company to “temporarily borrow” some funds from the company (choose all that apply)?
 - a. The job duties include:
 - Posting deposits and checks to the accounting records
 - Creating checks for the owner to approve and sign
 - Mailing checks after the owner signs them
 - Promptly reconciling the checking account at the end of the month after you receive the bank statement
 - The boss doesn't understand the accounting reports and seldom reviews the financial statements.
 - b. The company owner has a clearly posted “immediate dismissal and report to the authorities” policy for theft within the company.
 - c. As a part-timer, the bookkeeper is paid at a very modest hourly amount,

doesn't qualify for benefits and has some high expenses and several large credit card balances.

3. True or False: The bank will only clear checks that show the name(s) of authorized signers.
4. True or False: The bank checks authorized signatures on checks exceeding \$10,000.
5. Your blank checks are stored in a drawer in your bookkeeper's desk. Without your knowledge, several checks are removed from the bottom of the box and made payable to "Pam Wilson." Your name is forged and the checks are cashed. They clear for a total of \$14,500. Your actual loss is (choose one):
 - a. \$0; because the bank is responsible for any forged checks.
 - b. \$0; because you discovered the forgery two months later while performing your bank reconciliations and promptly reported it to the bank.
 - c. \$0; because your employee bonding insurance will cover the loss.
 - d. \$14,500; because you were negligent. The checks were not properly secured, you did not report the theft to the bank within 30 days of receiving your statement and your insurance deductible is \$50,000.

Answers:

1. b. Why? Because they are in a position to do so and the work of trusted employees is seldom reviewed or questioned.
2. a. The bookkeeper controls all accounting activities so there is minimal opportunity to spot fraudulent transactions. And if owners don't understand or review work, it's like announcing that they are putting a large sum of money in a drawer but will never check to see that it's all there.
 - c. Underpaid employees can develop a "they owe it to me" attitude.
3. False. Although a sharp teller might catch a bad signature at the teller window, most checks are processed by the thousands in batch mode and signatures aren't checked.
4. False. See number 3. Banks may check signatures on a small percentage of checks written for large amounts (e.g., more than \$5,000 to \$25,000, depending on the bank), but you should always assume that the authorized signature "control" is nearly non-existent.

5. d. Self-explanatory answer. Banks can require you to notify them of discrepancies within 14 to 30 days. You'll probably want to check your bank to see how much notification time you are allowed and then be sure to reconcile within that time frame.