Common Fraud Scenarios for Small Businesses to Avoid

Fraudulent practices small business owners should know about

According to the 2020 Global Study on Occupational Fraud and Abuse, businesses lose about five percent of their annual revenue to fraud. And while large businesses can implement internal checks and balances for their accounting systems, small businesses often lack the resources to do so, making them even more vulnerable to certain types of fraud.

To help counter this, small business owners need to be aware of the most common types of fraudulent practices that can prey on them, to better help them maintain the necessary degree of oversight on their financial affairs.

Payroll fraud

Small businesses with fewer than 100 employees experience payroll fraud at twice the rate as large organizations. One of the most common types of payroll fraud is timesheet falsification, which involves employees incorrectly reporting the amount of time they work. They may conveniently "forget" to clock in or out and subsequently add extra hours via manual entry. Employees may even have coworkers' clock in and out for them on days they aren't scheduled to work. Other forms of payroll fraud include ghost employees and worker misclassification.

These frauds can usually be stopped quickly via regular audits, employee schedule reviews, and strict policies governing timesheet changes and submissions. Additionally, internal discipline can go a long way toward ending this type of fraud. According to the Association of Certified Fraud Examiners, 46 percent of victim organizations decline to refer cases to law enforcement because internal discipline proves sufficient to end the fraudulent practice.

False invoicing

False invoicing is when your business pays for a service or product that was never actually purchased or delivered. Alternatively, the invoice may be duplicated or have inflated pricing. Julie Johnson, a research specialist at the ACFE, says that, "The rise in technology offers fraudsters new and creative ways to commit invoice fraud as well as more options to hide their tracks." It's important that you incorporate safeguards into your invoice payment process to help avoid being the victim of invoice fraud. Fraudsters will typically test your process with a small invoice for a common product to test your safeguards before attempting further, larger false invoices.

Cash theft

Insurance consultant Marianna Bonner explains there are three major forms of cash theft: skimming, cash larceny and fraudulent disbursement. The first is when an employee pockets money before it ever enters the accounting system, such as taking a customer's cash but never ringing up the purchase.

Cash larceny is stealing cash that is already recorded in your books. This is more difficult to conceal than skimming, but not impossible. "The worker may try to cover his tracks by creating a false refund, voiding a sale, or altering or destroying the cash register tape," Bonner says.

Finally, fraudulent disbursement is when cash is used for a purpose you haven't authorized. For example, an employee may alter a customer's check and deposit it into their own account, submit personal expenditures as business expenses, or steal cash from the register by creating a fake refund.

While fraud can take many forms, there are also many steps you can take to prevent or at least discourage employees from taking advantage of your small business. A very straightforward method is to stop accepting cash entirely. Another is to separate duties. The person who processes payroll, for example, shouldn't be the same person who makes changes to employee records.