organizations, and the effects can be more damaging. The types of fraud that businesses need to be aware of generally fall into three categories: Theft, financial statement fraud ...

Isaac M. O'Bannon • Sep. 14, 2018

Small and mid-sized businesses are more vulnerable to fraud than larger organizations, and the effects can be more damaging. The types of fraud that businesses need to be aware of generally fall into three categories: Theft, financial statement fraud and asset misuse. Theft, or misappropriation of assets, makes up the majority of fraudulent activity, according to the Association of Certified Fraud

The reason small and mid-sized businesses face a greater risk from fraud is due to many factors, including employees performing many functions across the organization, the close relationships between staff that leads to less scrutiny, few formal oversight procedures, less expertise on financial matters, and the large impact on cashflow that even a comparably small fraud event can have on the fiscal health of the business.

Therefore, it’s vital that small businesses take steps to deter fraud, and to detect it as soon as possible.

1. Segregate Accounting Duties.

Because of their size, many small businesses have one person that always handles bookkeeping functions such as client receivables, processing client payments, paying invoices, managing petty cash and recording these functions in their accounting system. This makes it easy for cases of fraud to go unnoticed. Businesses should have at least two persons handling these functions interchangeably, keep the handling of cash and accounting functions totally separate, or have the functions performed through a virtual CFO relationship with an accounting firm.

2. Know Your Employees.

While every business strives to hire honest employees, having a formal hiring routine, even at a small business, can help prevent fraud. Background checks should be performed for all staff handling cash or managing payments (and bank account information) from customers. As the employee’s level of interaction with finances increases, so too should the scrutiny paid to their past, and present, situations.

Although it may seem counterintuitive, employees committing fraud are often found to be the most endeared by their coworkers, because the person will go out of their way to help and gain trust, often working longer hours and rarely taking time off.

This results in them handling several duties, and with less oversight. Likewise,

check writing functions, and other accounting or payroll functions, and performing an overview of audit logs to ensure the integrity of the books.

4. Scrutinize Business Bank Accounts.

With online banking options, it's easy to view account activity and statements whenever is convenient, and business management should do this frequently to make sure that paper-based statements in the office have not been manipulated. The key items to look for are missing or out-of-order checks, unknown payment recipients, and checks that were signed over to a third party instead of deposited in a business account. Simply letting staff know that reviewing check activity is part of the accounting review process can help prevent fraud.

5. Audit the Books Regularly.

Businesses should routinely audit areas that deal in cash, refunds, product returns, inventory management, and accounting functions. Additionally, occasional non-scheduled audits can also help detect fraud in high risk, critical business areas. The ACFE offers a Fraud Prevention Check-Up to help businesses identify the risk of fraud and develop controls to prevent losses: http://www.acfe.com/fraud-prevention-checkup.aspx.

6. Train Employees To Prevent Fraud.

Employees in fraud-prone areas of the business should know the warning signs of fraud, prevention skills and how to report suspicious behavior or actions by coworkers and customers. Establishing an anonymous reporting system or process can also set their mind at ease about letting their bosses know about a fellow coworker. The management, including owners of small businesses, should create a code of ethics that makes it clear that unethical behavior will not be tolerated.

7. Protect Credit Card Information.

eliminating the potential for check fraud or theft.

8. Know Your Business Partners.

Before getting into a business relationship with another business, or individual, that requires some level of trust – such as sending them an invoice after they've received a product or service – make sure you at least know the basics. Knowing their physical address is a major deterrent to fraud, as is having alternate contact methods and persons, and references. Even a simple web search of a company should provide enough information as to whether they are really in business, and for how long. Additional resources that can provide background information include the Better Business Bureau and your local, state or provincial government commerce department.

9. Check Into Every Case.

If you've set up fraud prevent steps and reporting procedures, but you don't follow through by looking into reports or suspicions, then you're defeating your own security. In order to reinforce the business' policy of no tolerance for unethical behavior, each case should be looked at, regardless of size.

10. Get Expert Help.

If a business has implemented fraud prevention steps and the numbers still aren't adding up, or when there are larger legal implications, in may be prudent to hire a professional accountant to come in and perform a more extensive review and audit of the business' books and control processes. CPAs and Certified Fraud Examiners can provide extensive help in fraud detection and prosecution, if necessary.