



CPAs & Business Advisors

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Reduce fraud by keeping an eye on your employees

Have you taken the necessary precautions to protect your manufacturing business from employee fraud? According to the Association of Certified Fraud Examiners, as much as 10% of all fraud occurs in manufacturing companies, and the average business loses the equivalent of 6% of revenue to fraud each year.

Employees are the primary culprits. Workers commit a variety of crimes against their employers, ranging from fraudulent billing to misappropriating assets to noncash theft. Even though there's no guaranteed method for stopping fraudulent acts, there are ways to reduce them.

Case in point

A midsize manufacturing company has been experiencing unusually high monthly overhead variances. An investigation by an outside consulting accountant reveals that the company's controller has been embezzling money for several years by paying bogus invoices he created to funnel money back to himself. Further probing also identifies laborers who were stealing equipment and warehouse supplies during the night shift.

In light of these findings, the company examined its internal controls and made some significant changes. To deter financial fraud, it separated its accounting and finance-related responsibilities among several employees instead of letting one staff member have sole responsibility. The company also set a dollar limit on the checks employees can write without authorization and implemented a two-signature sign-off policy for greater accountability.

To cut down on equipment theft, the company instituted a policy requiring workers to sign out tools and equipment before taking them to job sites. Several unsupervised exit doors that made it easy to smuggle out tools and equipment were locked, and security cameras were installed at each exit. Additional managers were assigned to supervise the shift as well.

An ounce of prevention

It's important to focus on prevention to help discourage internal fraud. Here are several steps you can take:

Know your employees. Perform background checks on your employees — particularly those in financial and management positions. A thorough review can uncover any criminal convictions involving embezzlement, theft, forgery or other fraud.

Enlist employees' help. Encourage workers to watch what is going on around them and to alert a supervisor when they believe theft or fraud is being committed. Protect employees who report fraudulent acts by providing a confidential means — such as a toll-free hotline — for them to express their concerns.



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Ensure compensation is competitive. Employees who believe they're underpaid may be able to more easily rationalize committing fraud. Compare your pay rates to others in your industry and ensure that they're competitive.

Team up with your accountant

Your CPA can be a powerful resource in uncovering fraud and embezzlement. He or she can assist you in creating effective internal controls and help monitor bookkeeping records, invoices, bank statements, payments, journal entries, financial reports and other documents.

Ask your accountant to perform scheduled and unscheduled financial audits. Surprise audits can help identify potentially dangerous gaps in your controls and procedures and let your employees know that fraud prevention is a high priority.

Forensic accountants can also be especially useful. These fraud experts use their accounting, auditing and investigative skills to detect indications that your staff may be committing financial fraud. Telltale signs may include:

- Growing accounts payable and receivable combined with dropping or stagnant revenues and income,
- Excess inventory,
- A large number of account write-offs, and
- Increased purchases from new vendors.

A fraud expert will examine your financial statements for these and other dangers as well as assess your company's culture and business practices to determine what conditions may be causing fraud to thrive.

Put it in writing

A good line of defense against fraud is a well-written fraud prevention policy. Explain your company's code of ethics and include specific rules regarding the use of office supplies and company-owned equipment. Your policy should also spell out what constitutes fraud and how you will treat those caught committing it.

Make it clear that employees caught committing serious infractions will be terminated and prosecuted to the full extent of the law. In addition, state that policy violators will have to repay stolen funds or pay for lost or stolen equipment. Finally, require each staff member to sign an agreement stating that they have read and understand your fraud prevention policy.

Plan for peace



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Even with strong internal controls and other safeguards in place, you won't be able to stop every offense. But there are many steps, including the ones mentioned here, you can take to slow down fraudsters and preserve your peace of mind.

Sidebar: Key functions demand special attention

Several key functions of manufacturing companies are particularly vulnerable to employee fraud and, thus, demand special attention. They include:

Cash management. Employees may steal cash on hand, divert cash receipts or alter bank deposits.

Inventory and fixed-asset management. Workers can steal company assets; divert and sell shipments; or use job materials, tools or other assets for non-job-related purposes.

Accounts receivable. Staff members might forge checks, grant fake credits or take fraudulent write-offs for bad debts.

Payroll. Employees may pay nonexistent employees, pad time records, falsify salaries or commit withholding fraud.