7 Most Effective Tools Your HR Department Can Use to Prevent Company Fraud

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We're all familiar with the story that gets told this time of year...a bad guy swoops into town and steals all the Christmas presents hoping to spoil everyone's holiday. But once he realizes his theft had no real impact on the townsfolk, he returns the gifts and everyone – including the thief – celebrate the holiday together. Unfortunately, workplace thieves don't often have such a change of heart, and so it's your job to prevent company fraud before it occurs. As an HR professional, you need to ensure that your company has the controls and policies in place to prevent and detect potential fraud throughout your company – but especially within your own department.

Placing the Problem in Context

Just a little background to put workplace fraud in context. The vast majority of employees operate with the highest level of integrity and are no threat to your operations. Unfortunately, there sometimes are a few "ethically challenged" employees who take advantage of their access to a company's financial resources for their personal benefit.

According to the Association of Certified Fraud Examiners report, _Occupational Fraud 2022: A Report to the Nations_, asset misappropriation – which includes employee theft or misuse of employer resources – accounts for 86% of all workplace fraud. By comparison, financial statement fraud accounts for only about 9% of occupational fraud.

The cost of workplace fraud is staggering and impacts companies of all sizes. For example, companies with fewer than 100 employees had a median loss from workplace fraud of $150,000, while companies with over 10,000 employees had a median loss of less than $140,000.

When Fraud Arises from Within: HR Department Malfeasance

The HR department is not immune from workplace schemes to defraud the company. One of the most common payroll frauds involves setting up "ghost employees." It's quite simple: employees responsible for setting up new employees in the payroll system create a fake employee and have the payroll checks deposited into an account they control. With the growth of work-from-home policies, it may not be unusual to have employees that no one has met in person, and thus such a scam may be more easily pulled off.

Another common fraud involves expense reimbursement abuse. As the term implies, employees may generate reports with false or inflated expenses and pocket the difference. Employees may also engage in procurement fraud. This sometimes involves diverting actual business purchases to personal use or demanding kickbacks from vendors to keep the company's business.

And while taking pens and notepads home for personal use may be nominal, workplace fraud related to purchasing equipment such as business cell phones, tablets, and laptops for an employee's own personal use – or to carry out a profitable side hustle – can have a significant impact on the bottom line.

7 Most Effective Anti-Fraud Tools at Your Disposal

HR professionals have a number of tools at their disposal to prevent and detect fraud as soon as feasible. Here are seven most effective tools you should consider adopting for the new year in order to put your company in the safest position.

1. Establish Effective Policies and Programs

The foundation of any prevention program is an effective compliance and ethics program. To be effective, the policies must clearly set forth the company's expectations and standards for employee conduct. Further, you must train your employees on the policies. These programs must have a mechanism for anonymous reporting, and any issues raised need to be promptly investigated – and addressed appropriately once detected.

2. Start at the Top

One of the most important – and often overlooked – aspect of any compliance and ethics program is leadership from the top. Company leaders must set the standard and live by those standards on a day-to-day basis. Make sure your highest-level executives lead by example and take part in communicating the importance of these control measures. Ill-intentioned employees will be less tempted to attempt fraudulent behavior if your company leadership reflects the message that you take safety seriously and actively take steps to prevent it.

3. Implement Segregation of Duties

Next, it is essential to implement effective internal controls to prevent opportunities for fraudulent conduct. One of the most effective internal controls is segregation of duties. This concept involves the separation of financial transaction tasks among different employees. For example, when purchasing goods for the HR department, one employee should initiate the request for the goods, a separate managerial employee should approve the request, a third employee should execute the purchase with the vendor, and a fourth employee should receive the goods, confirm the quantity and quality, and deliver the items to the requesting employee. Smaller HR departments can set up checks and balances with another department, such as legal or finance.

4. Consider Competitive Bidding

Another effective practice is to insist on competitive bidding for goods and services every three to five years. This doesn't necessarily necessitate changing providers. It just confirms that your company is getting the most value for its purchases and casts a fresh light on relationships that could be susceptible to lax oversight or malfeasance.

5. Launch Random Audits

You should also implement some type of random audits to confirm the validity of transactions and purchases. With respect to expense reports, this sometimes entails verifying actual receipts used to support an expense or comparing expenses among all employees to see if one person seems to submit expense reports consistently higher than other employees for similar business expenses. Irregularities don't necessarily indicate fraud – but may be a justification for a deeper inquiry.

6. Involve the Use of Analytics

One advanced auditing method involves the use of data analytics to spot outliers. This can be particularly useful when dealing with vast quantities of information.

For example, when trying to identify ghost employees, it may be helpful to use a data analytics program to cross check employee bank account information. Programs can quickly identify duplicate banking information shared by employees with different names – which may indicate possible ghost employees.

Data analytic programs can also be used to check for sequential invoice numbers from the same vendor on invoices issued several months apart (the assumption would be that invoices issued several months apart would not normally be sequentially numbered) or perhaps identify invoices issued on a Sunday or holiday. As noted above, these discrepancies don't necessarily establish wrongdoing, but many justify a deeper dive into the facts.

7. See Something, Say Something

Finally, as an HR professional, you should also be on the look-out for warning signs of potential fraud. These often include such things as employees who never take time off or who refuse to let other employees perform their duties (as this could indicate someone fearful that their fraud will be discovered). Other warning signs include consistently being over-budget for items that were previously within budget, and employees who oppose utilizing competitive bids for goods and services. In general, the best fraud prevention practices typically involve some form of "trust but verify."

Conclusion

If you have questions regarding best practices for preventing or detecting workplace fraud, please reach out to your Fisher Phillips attorney, the author of this Insight, or any attorney in our <u>Corporate Compliance and Governance Practice Group</u>. Make sure you are subscribed to <u>Fisher Phillips' Insight system</u> to get the most up-to-date information on this and other employment topics directly to your inbox.

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