

TOUGH TIMES

Fraud is a constant threat to any business whether times are good or, as they are now, bad.

In bad times employees who might not otherwise be tempted to commit fraud may become so worried about their jobs and personal finances they might be tempted to exploit weaknesses in internal controls to steal money or inventory. This is the time when the so-called "trusted employee", shielded by a reputation for reliability but performing duties, which in larger firms would be segregated, may cross the line into dishonesty. As a result, owner/managers who in the past paid little attention to accounting controls, are advised to pay closer attention to the various accounting cycles, especially the cash conversion cycle.

Every owner/manager should know what is going on day-to-day in areas remote from operations. Some things can be checked out quite easily and quickly. For example, are all suppliers and customers known? Do any have similar names such as "W. A. Smith" and "W. B. Smith" or unbusinesslike addresses such as P.O. Box numbers or private residences? Such simple reviews give a "feel" for company transactions that may raise questions when something seems amiss.

Accounts Receivable

Because the likelihood of collecting aged receivables decreases with time, aged receivables should be reviewed every two weeks. Any receivable older than 60 days needs to be examined to make sure it has not already been collected and applied to the incorrect account. Payments in unusual amounts may indicate misappropriations or the presence of a "lapping" scheme. Lapping is a fraud in which funds received from one company are used to cover funds misappropriated from another company. Large accounts should be reviewed for unusual payment amounts and reconciled with the invoices.

Ensure that the accounts receivable control account in the general ledger agrees with the aggregate total of the accounts receivable sub ledger. Most integrated accounting systems ensure that the control account is updated when entries for sales, payment or adjustments are made to the specific customer file. Enterprising bookkeepers can, however, override the automatic link from the sub ledger to the general ledger thereby falsifying the overall accounts receivable.

During the accounts receivable review any unusual adjustments or accounts that take the form of credits, bad debt write offs, or other adjusting journal entries should be noted and followed up.

New clients should have assigned credit limits; credit checks should be run and the new customer's place of business visited to establish authenticity. These simple precautions will reduce the possibility that your inventory will be "sold" to a new client who has set up shop solely to get product and dispose of it at a deep discount without paying your bill.

Personal Accounts

Owner/managers are notoriously casual about keeping track of their personal expenditures and withdrawals. Enterprising staff can cover up their own misappropriations by processing phony expenses to your expense account or by charging missing funds to the draw account. Not only is your company out the funds but the owner may also end up paying personal income tax on the draw.

The "Till"

In any retail business the cash drawer must be reconciled daily. Cash, cheques, debit, charge card, and "out of till" disbursements should be recorded each day and the tape amounts reviewed and reconciled. Shortages and overages should be recorded on the reconciliation.

At the end of the month bank deposits should be reconciled to the daily tapes to ensure no funds have been removed between the till and the bank deposit. Discrepancies should be investigated and staff informed that shortages have been discovered.

All overrides should be reviewed to ensure that a dishonest manager with override authority is not selling deeply discounted merchandise to accomplices for a subsequent street sale or a return to get a refund at the full retail price.

Reconciling Bank Accounts, Term Deposits and Lines of Credit

Management must review all bank accounts monthly. Miniaturized photocopies of cheques now provided by most financial institutions make it possible to review quickly the payee, amount, and authorizing signature. Such an examination will catch cheques paid to unauthorized suppliers or approved with fraudulent authorization.

It is also important to understand how the company's line of credit works and know the upper limit set by the bank. Lines of credit that are automatically accessed for a prearranged amount when your operating account goes into a negative balance provide an easy way for an employee to cover any theft from the company bank account, especially if management is not provided with the line of credit statement.

Transfers between all bank accounts should be reconciled. Many fraudulent transactions are intentionally committed near month end to enable the fraudster to cover the misappropriation by indicating that it is an outstanding deposit or cheque in transit. This usually leaves 30 days time for management to forget about the discrepancy or for the employee to cover the misappropriation.

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Accounts Payable

In an accounts payable fraud the business honours fraudulent invoices for goods or services never ordered or for goods ordered but delivered to another site and subsequently sold. To guard against these possibilities owner/managers should consider the following:

- Purchase and credit limits should be established for each approved supplier. This will discourage dishonest personnel from purchasing unauthorized material and selling it or taking it back for refund.
- Follow up on invoices with names that are similar to actual suppliers or with unfamiliar addresses. Scam artists often mass mail invoices with logos and names similar to real suppliers but with different addresses. An accounts payable clerk may simply write out a cheque for the fictitious but similar invoice and the unsuspecting owner/manager signs it. This deception occurs frequently during the renewal of contracts for Internet, magazine, telephone, or newspaper advertising.
- All statements from suppliers as well as the accounts payable sub ledger listing should be reviewed. Unusual purchases or returns should be queried as should any accounts not paid within 60 days. The account may be in dispute, but it is also possible that payment has been diverted to another account to cover up a misappropriation.

Expense Accounts

Padding of expense accounts for personal gain has been around since the beginning of time. Expense account and travel costs, including vehicle costs, should be closely reviewed.

Payroll

Payroll fraud is not normally an issue for smaller businesses because the boss normally knows everyone and it is virtually impossible to add ghost employees to the roster. Just the same, it pays to review payroll records and employee data stored in accounting programs to ensure the business is not paying for non-existent employees, unauthorized overtime or a raise.

Owner/managers should approve all hiring, dismissals and pay grade assignments or changes. Without this surveillance, the payroll system could easily be used to defraud a small business. Not only are the salaries and wages lost, but also the associated CPP, EI and workers compensation costs may have to be absorbed.

Review Your Financial Statements

Management should review the company income statement and balance sheet every month. Accounting software can now easily generate month-by-month and year-to-date comparisons, ratios, percentage changes and budgets; areas of concern can become visible sooner and follow up can be faster than ever before. Any issues of concern should be referred to a chartered accountant.

Owner/Managers Must be Pro-active

An owner/managers' active involvement in all aspects of the business not only allows management to take the pulse of everyday business operations but also reduces the probability of employees taking advantage of lax protocols. Prevention of fraud is less expensive than the time and effort required to recoup lost assets, dismiss dishonest employees, file police reports, replace employees, and absorb any increase in insurance premiums.

This 'n That at Logan Katz

Logan Katz is currently looking for an Intermediate/Senior Accountant. Please send us your resume or, if you know of someone, have them contact Kathy Grezaud at kgrezaud@logankatz.com. You can also visit the careers page on our website for more details at www.logankatz.com.

Sharing our Knowledge

Denis Chainé and Priscilla Ogouma recently spoke to an audience of new Canadians and potential investors who want to start a small business in Canada. This presentation was hosted by the Social Planning Council of Ottawa.

Denis Chainé and Jason Valente spoke on Tax Planning for Retirement to Alterna Bank members as part of the Alterna Bank Lunch 'n Learn Series.

Janeta Odstreilik is participating as a mentor in the Summer Company program held by The OCRI Entrepreneurship Centre. This program is designed to assist students interested in operating their own business.

Sponsorships

Logan Katz was a major sponsor of The Ottawa Art Gallery Stimulus Art Auction. This event hosted over 450 guests including artists, business leaders, restaurateurs and other sponsors. The event featured artwork by over 60 regional artists and was a resounding success.

Questions or comments?
Email us at
office@logankatz.com
or call 613-228-8282 ext 0.