

Fraud Red Flags in Your Business

What are Fraud Red Flags?

Fraud red flags refer to undesirable situations or conditions that consistently contribute to fraud, waste, and abuse of resources. All organizations face fraud risk, which can either be internal or external. **Internal risks** come from persons within the organization who may use their position to enrich themselves by misappropriating resources and assets owned by their employer. On the other hand, **external risks** are engineered by government officers, customers, and contractors who may seek to obtain money illegally.

There are several red flags that audit and accounting professionals should look out for. They include the following:

Inventory shrinkage

Although it's normal to lose a few items of inventory when moving items, excessive inventory shrinkage may be an indicator of ongoing fraud. An auditor can detect inventory shrinkage by looking at the balance sheet, the number of products in stock, and those sold – and then comparing them with previous records and projections. In certain circumstances, the auditor may do unplanned stock-taking on random days to detect any unusual inventory characteristics.

Missing documents

An organization may experience frequent cases of reported missing documents that relate to critical departments. When the frequency of occurrence becomes too often, it may be a sign of ongoing fraud within the organization. Missing documents that are fraud red flags include registration of motor vehicles, lists of sales and purchases, checkbooks, and inventory reports. When such records disappear, it may point to an undesirable situation that may lead to the loss of certain assets or money.

Multiple payments

There are cases when a company's accounting department may erroneously process duplicate payments to a vendor or service provider. If the mistake was genuine, the officers involved ought to identify such errors and report so that urgent action can be taken.

Spikes in invoice volume

A business in its growing phase may experience huge spikes in the number of invoices as it tries to carve a niche in the market. However, the high number of invoices creates room for fraudulent behaviors, as specific internal and external parties may seek to profit from the rapid growth of the business.

Frequent complaints

Frequent complaints about certain personnel or processes may be an indicator of fraud. When an organization receives repeated complaints about a senior executive, it should not assume that it's just ordinary venting. Instead, it should conduct investigations to identify the cause of the complaints, effects, and any courses of action that they should take to make sure there are no more complaints.

Excessive number of adjusting entries

Some accounting offices may make excessive adjusting entries in the books of accounts as a way of covering money misappropriated in the past. For example, some of these adjustments may include customer adjustments that significantly affect the financial results during a specific period.

Employee Fraud Red Flags

A large proportion of fraud affecting organizations comes from within the organization itself, mainly from employees. Some of the behavioral signs of employee fraud include:

Lifestyle changes

Employees ought to live within their means, by buying assets and services that are within their income. However, some employees may change their lifestyle abruptly by spending more than their paycheck allows. The purchases can be expensive cars, houses, or luxury goods. Sometimes, the employee's lifestyle may exceed that of their superior.

History of debts

During the hiring process, an organization should conduct background checks to see if potential employees have a history of debts. When a company hires employees with debt problems, there is a likelihood that they will find opportunities to get extra income above their salary to pay debts. It may mean engaging in opportunistic fraud with the intention of obtaining money that they are not entitled to.

Excessive gambling

Some employees may continuously engage in gambling as a way of getting quick cash to meet some of their needs. Due to the addictive nature of gambling, the employee's income may be insufficient to finance their gambling activities and they may feel forced to do anything to earn extra income. This may mean engaging in fraudulent activities such as stealing the organization's assets, manipulating inventory, making extraordinary claims, etc.

