The National Fraud Authority report released in 2012 suggested that payroll fraud costs the UK £334m each year in the public sector alone, while a survey of 5,000 payroll departments (across all sectors) had 11% reporting that they had been a victim of fraud in the previous 12 months. This highlights the scale of the problem, but does not address how to identify and prevent it.

Payroll fraud is a serious and expensive problem, and one which can pass unnoticed for long periods of time if your company doesn't have the correct procedures in place. Whether you have twenty employees or twenty thousand, the key imperative for every decision maker is how best to minimise the risk, if not to prevent it entirely.

Typically, there are three categories of payroll fraud to which companies are vulnerable: ghost employees, false wage claims and false expense reimbursement.

A ghost employee is a person, fictional or real, who is being falsely paid through a company’s payroll. The fraudster enters fake information, potentially that relating to ex-employees, into the payroll system to divert and claim money fraudulently. These can be employees whose details are kept on the system after they have left, with the fraudster inputting new bank details. Where a company pays pensions, a common fraud is to keep pensioners’ details on the system after the individual has died, again diverting the payments to a new fraudulent bank account. While ghost employees are probably the hardest to engineer and involve the most effort, they can add up to serious money as effectively the whole of their
pay is fraudulent. However, they appear genuine and are capable of resisting detection except in the face of strong appropriate procedures.

False wage claims, involving falsification of records by employees to get more pay, are quite common. Methods used include: inflating hours worked, fraudulently increasing benefits earned, and increasing pay rates beyond an employee’s entitlement. Other techniques involve employees being paid normal wages/salary rather than taking annual/sick leave, fraudulently reducing an individual’s withholding tax, and massaging sales figures to inflate commissions or bonuses, which might involve false invoicing for services. Although these all seem similar, in fact they represent diverse fraud methodologies and different kinds of system and company abuse.

False expense claims are the most common. In general terms, they comprise: completely fictitious expenses for items or events that never happened, duplicate claims, and inflating the cost of genuine expenses.

While expenses fraud manifests itself in myriad ways, it is possible to identify a number of the most common examples. Billing for travel and expenses that were never incurred (e.g. cancelled airline tickets) is one of the most frequent, as is seeking reimbursement for items that were never purchased (e.g. client gifts). Receipts are often submitted that have been manipulated, or outright falsified, and others will “lose” receipts to allow expenses to be recovered without scrutiny. Only supplying a credit card slip is also a strategy used, denying payroll staff the ability to gather details about the expense, and then possibly submitting the receipt itself on another occasion.

Mileage reimbursement is also commonly abused, for example through inflating mileage totals, understating private mileage on a business trip, employees colluding to all claim a ride sharing journey or rounding the length of the journey up. Fraudulent journeys are often made to capitalise on generous pence-per-mile fuel expenses rates in company cars.

When so many opportunities exist for payroll fraud, there is no single prevention strategy. Instead, multiple strategies are needed. Outlined below are ten practical things that you can do to minimise the risk.

- When recruiting staff, ensure that references from previous employers are asked for, received and thoroughly checked.
- Restrict employees’ access to data, files and systems so that they only have access to the information required to perform their role.
- Ensure that the control systems are reviewed and updated regularly: familiarity with processes often means that staff members utilise shortcuts or fail to follow the correct procedures. Make sure that there are clear policies for expenses, and consider utilising an IT-based solution.
- Password management is critical. Companies have passwords to protect their systems from unauthorised access, and this needs to include those internally unauthorised; so use them, change
them often and don’t make them obvious.

- Implement a password policy for all employees and make sure that it is properly executed.

- Payroll processes should be split so that they always involve more than one person. This ensures that no one individual can control, create and pay the company payroll. In particular, make sure there are very robust processes for changing bank account and payment details. Similarly, all expense claims should be countersigned to provide greater oversight.

- Outsourcing the payroll function creates a valuable separation in the process.

- Outsourcing automatically introduces a third party into the payroll process, lowering the chances that any attempted payroll fraud might go undetected. This does of course make your business vulnerable to the systems of control of another entity, but it also means that that entity should carry the cost of fraud perpetrated by their own employees.

- Security is paramount: keep all physical payroll files under lock and key, and ensure that anything printed is either stored securely or destroyed using a shredder.

- Keep sensitive information out of sight by providing payroll staff with separate printers to avoid any chance of pay information being accidently left on a general printer.

- Conducting random checks is a strong deterrent to payroll fraud. The knowledge that such checks take place is in itself a deterrent and, if staff members are unaware that a check is about to take place, they will be unable to correct any details prior to an audit, reducing the likelihood of any falsifications occurring.

- It is critically important to make sure that the payroll is thoroughly reviewed before it is paid. In each review, a few payroll details and expenses should be examined in greater detail.

The more visible actions you take within your company to combat payroll fraud, the greater the deterrent is to those considering it. While the risks of fraud can never be fully eradicated, following the above steps should assist in both identifying and preventing payroll fraud, saving your company financial loss, not to mention wasted management time and reduced staff morale.

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