

Payroll Fraud.

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What is payroll fraud

- **Payroll fraud is a theft of company/Govt/organisation's funds using a company's own payroll system.**
- **The perpetrator, who almost always is an employee, produces false documents (eg time cards, sales orders) that cause the victimised company to pay out more in salary, commissions, or governmental benefits than should be paid.**



Ghost employees

- **For a ghost employee to work, the following four things must take place.**
- **First the perpetrator must fabricate all the necessary personnel and payroll records for the ghost employee (false name, address, id, pay rate, etc) and enter them into the payroll system.**
- **This can be accomplished by any employee who has access, authorised or not, to make changes in the payroll system.**



Ghost employee

- **Another method used to create a ghost is to leave a terminated employee on the payroll.**
- **The terminated employee then becomes the ghost.**
- **This requires a perpetrator to intercept termination notices or delay them, and in some cases to change the address and bank account of the terminated person.**



Ghost paid hours

- Second, if the ghost employee is paid by the hour, the perpetrator must submit falsified time keeping documentation to the payroll system.
- This involves filling out a blank time card or entering ~~start~~ and ~~stop~~ times into an automated time keeping system.
- The fraudster does not have to enter false time data for salaried employees.
- Fewer payroll fraud schemes involve management ~~ghosts~~ because they are more difficult to conceal.



Authorising ghost info

- Third, the falsified time keeping information must be authorised.
- An employee can forge the supervisor's signature or have the information rubber stamped by a supervisor who pays little attention to the authorisation responsibilities.
- A supervisor can fill a time card and sign it or authorise it electronically.
- In an electronic system, an employee that steals or otherwise obtains the supervisor's password can approve fraudulent time keeping information.



Pay cheque for ghost

- Fourth, the pay cheque must be cut and issued, and the perpetrator must gain access to it.
- Once the hours have been entered into the payroll system, the system will automatically cut the cheque.
- The more difficult part of the scheme is intercepting the cheque.
- Depending on how payroll is distributed, this can be done by picking up the cheque or having it mailed to the perpetrator's address, the address of an accomplice or an address the perpetrator controls (eg post office box).
- The cheque can also be direct deposited into a perpetrator's bank account, the account of an accomplice, or an account the perpetrator establishes in the ghost employee's name.



Commit and conceal salary fraud

- For an employee to change his pay or salary level, he must obtain access to the payroll records or have an accomplice gain access to the records.
- He must then enter a change and have it accepted by the system.
- This is much harder to accomplish than reporting more hours.
- However, the advantage is that it is done once rather than repeated each pay period.



Case

- **An employee in the payroll department was given the authority to enter new employees into the payroll system, make corrections to payroll information and distribute paycheques.**
- **This employee's manager gave rubber-stamp approval to the employee's actions because of a trusting relationship between the two.**
- **The lack of separation of duties and the absence of review made it simple for the culprit to add a fictitious employee into the payroll system.**



Commit and conceal commission frauds

- There are two ways a perpetrator can commit a commission based payroll scheme:
 - 1. To falsify the amount of sales that were made
 - 2. Is for the perpetrator to increase his commission rate.
- An employee can falsify the amount of sales he has made by:
 - creating fictitious sales
 - Altering the pricing listed on sales documents
 - By claiming the sales of other employees
- “ For an employee to change his commission rate, he/accomplice must obtain access to the payroll records, enter the change and have it accepted by the system.



Red flags for Ghost employees

- Poor segregation of duties that allow an individual to add employees to the payroll, correct or record payroll data, authorise payroll data, process payroll, distribute cheques and reconcile payroll accounts and bank records.
- Payroll dept employee who never takes leave to allow payroll to be processed by another employee.
- Time card abuses such as cards that are submitted for hours never worked or forged approvals on time cards.
- The number of employees paid is greater than the number of employees working.
- Two employees with similar names



Red flags

- **A terminated employee who is still on the records.**
- **Poor control on payroll and personnel records.**
- **No independent review of payroll records**
- **Hiring of employees without references and conducting background checks.**
- **Failure to authorise all pay rates and rate increases in writing.**
- **Failure to authorise bonuses, overtime and commissions in writing and in advance of payment.**



Red flags

- An employee pay rate that exceeds the authorised range.
- Allowing employees to punch the time clock for their co-workers
- Discrepancies in quantities and sales prices between commission calculations and sales records.
- Fictitious sales and overstated inventory.
- Altered sales documents



Prevention of Payroll frauds

- There are two basic preventive measures for payroll-related fraud:
- Segregation of duties
- Periodic payroll review and analysis



Segregation of Duties

- The following duties should be segregated:
- Payroll preparation
- Payroll disbursement (into payroll and withholding tax accounts)
- Payroll distribution
- Payroll bank reconciliations
- Human resource departmental functions



Preparation

- If payroll is prepared by personnel not responsible for its distribution and reconciliation, it will be difficult for anyone to successfully add ghost employees.
- In smaller companies, this function often is handled outside the firm at minimal charge per employee.



Payroll disbursement and distribution

Disbursement

- After the payroll cheques are prepared, the transfer of funds from the general accounts to the payroll accounts should be handled by accounting.

Distribution

- The personnel department should distribute cheques and require identification in exchange for the payroll checks.
- This will curtail the opportunity to add ghost employees to the payroll.



Bank Reconciliation

- If the bank reconciliation function for the payroll account is assigned to someone other than those in the above-described functions, then all the payroll functions have been segregated.
- No one is able to add ghost employees or borrow the withholding taxes without the opportunity for discovery by someone else.



Periodic Review and Analysis of Payroll

- Periodically, an independent review of the payroll might reveal that internal controls are not working as designed.
- Comparing deposit dates with dates of payroll disbursement or transfer may reveal ghost employees.
- An occasional independent payroll distribution may reveal ghost employees.
- A statistical sample of the following may reveal the presence of ghost employees:
 - More than one employee with the same address
 - More than one employee with the same id no.
 - More than one employee with the same account number
 - Employees with no withholding . Ghosts do not pay taxes



Audit

- The following audit program will help spot anomalies to payroll fraud:
- Are personnel records maintained independently of payroll and timekeeping functions?
- Is the payroll accounting function independent of the general ledger function?
- Are changes to payroll not made unless the personnel department sends approved notification directly to the payroll department?
- Are references and backgrounds checked for new hires?
- Are all wage rates authorized in writing by a designated official?
- Are signed authorizations on file for employees whose wages are subject to special deductions.



Audit

- Is the payroll periodically checked against the personnel records for terminated employees, fictitious employees, etc.?
- Are bonuses, commissions, and overtime approved in advance and reviewed for compliance with company policies?
- Are sick leave, vacations, and holidays reviewed for compliance with company policy?
- Are appropriate forms completed and signed by employees to show authorization for payroll deductions and withholding exemptions?



Audit

- Is a time clock used for office employees as well as factory workers?
- If a time clock is used, are timecards (1) punched by employees in the presence of a designated supervisor and (2) signed by a supervisor at the end of the payroll period?
- Are timecards and production reports reviewed and compared with payroll distribution reports and production schedules?
- Are payroll registers reviewed and approved before disbursements are made for (1) names of employees, (2) hours worked, (3) wage rates, (4) deductions, (5) agreement with payroll cheques, and (6) unusual items?



Audit

- Is the payroll bank account reconciled by a designated employee who
 - (1) is not involved in the preparing of payroll,
 - (2) does not sign the cheques, or
 - (3) does not handle the cheque distributions?

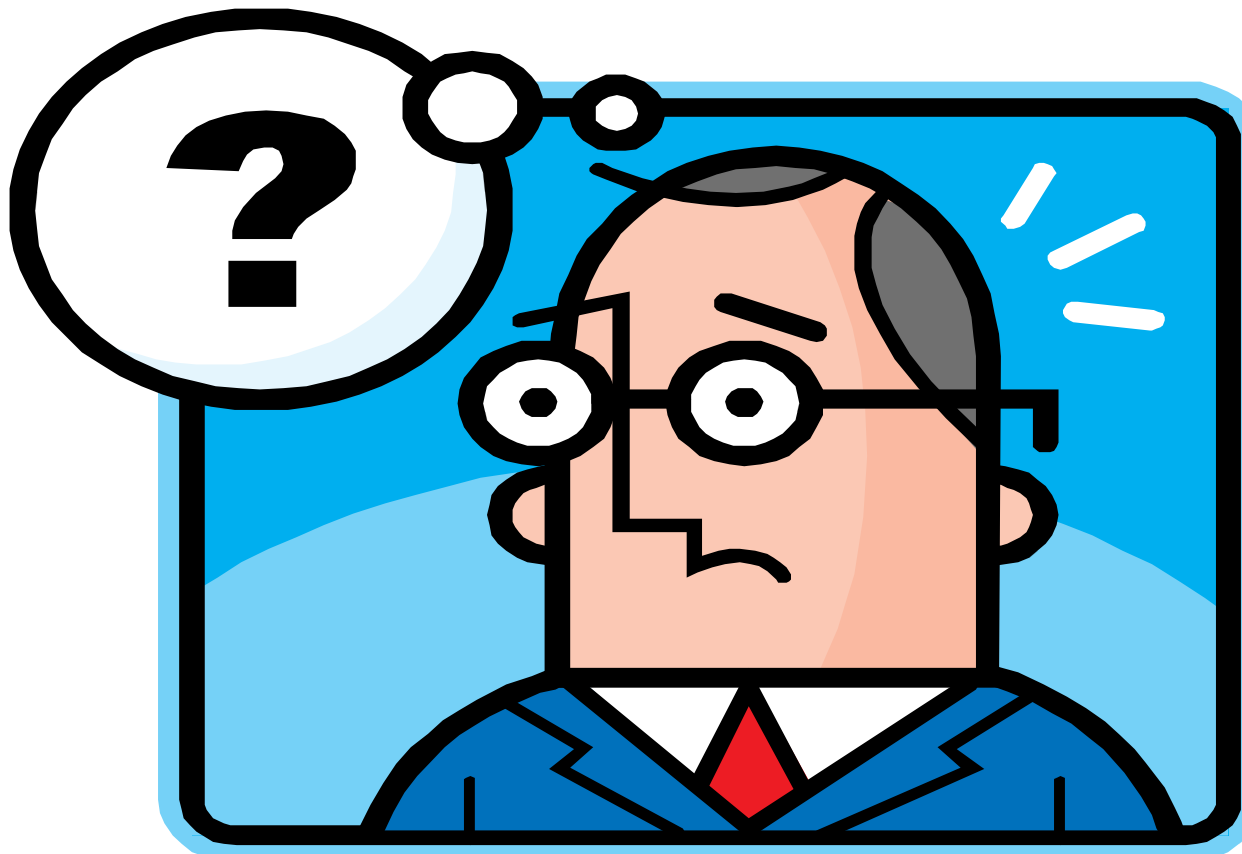


Audit

- **Are actual payroll amounts reviewed and compared to budgeted amounts, and are variances analyzed regularly?**
- **Are employee benefit plan contributions reconciled to appropriate employee census data?**



Questions / Discussion



Thank you

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Delivering executive development courses on risk management, corporate fraud governance and forensic audit, benchmarking this against best practice for maximizing value.

