



Payroll Fraud Risks

The Association of Fraud Examiners refers to payroll fraud as “any scheme in which an employee causes his or her employer to issue a payment by making false claims for compensation.” This means that every organization that pays employees can be a victim of fraud.

Who are the culprits? It is often the person you would least expect -- the long-term, trusted employee. One of the best prevention measures is having solid internal controls, which includes monitoring your employees. How do you do this without upsetting folks? It is easy. You just explain that you are instituting the policies and procedures to ensure public resources are safeguarded at all times and to protect employees from false accusations.

Several common forms of payroll fraud:

- Falsified wages
- Mid-month draws
- Ghost employees
- Benefit schemes

We will describe each type of payroll fraud and what you can do to prevent and detect it.

- **Falsified wages:** This is one of the easiest schemes to execute. Employees claim hours they did not work or falsify their time sheets or timecards in some fashion. People with access to the payroll system may be able to manipulate information in the system to pay themselves compensation they did not earn.
- **Mid-month draws:** Some organizations that pay employees once a month allow employees to receive part of their salary in the middle of the month. This is called a mid-month draw and the draw payment is deducted from the main payroll run at the end of the month. In this form of scheme, the mid-month payment is not deducted from the normal salary, giving the employee compensation he or she did not earn.
- **Ghost employees:** In some cases, organizations are defrauded through payments to employees who do not exist or to former employees. In some cases, current or former employees have access to the payroll system. This fraud usually occurs in organizations that have a large number of employees and weak internal controls.
- **Benefit schemes:** Several schemes involve benefits, but they all boil down to an employee receiving benefits or extra compensation they did not earn, such as excess leave. In addition, employees often attempt to hide fraudulent payments in benefits expenditures.

Our mission:

The State Auditor's Office holds state and local governments accountable for the use of public resources.

Reporting fraud online

The Washington State Auditor's Office has a tool for reporting suspected misappropriation online at:
www.sao.wa.gov



What you can do

The best defense against payroll fraud is a good offense. Having strong internal controls with sufficient monitoring is the key to preventing and detecting payroll fraud.

Here is some guidance for preventing and detecting payroll fraud:

- Establish and follow solid internal controls, including monitoring. Be sure to question items that do not meet your expectations.
- Ensuring employees, especially those who process payroll, take vacations. This requires another employee to perform the payroll function and is a common way that organizations find out a fraud is occurring or has occurred.
- Periodically review final payroll reports to ensure the information meets your expectations.
- Review employee addresses and bank account numbers to determine if multiple payments are going to the same address or bank account. This is a common way organizations are defrauded when family members work for the same organization.
- Review benefit reports to ensure they are accurate. Look for items that do not meet your expectations, such as employee paid benefits being paid by the employer, deductions that do not make sense, etc.
- Review budget reports to ensure benefit expenditures are where they should be. If costs are not where they should be, review the transaction support to ensure they are legitimate.
- Review the vendor database for payroll vendors to ensure those expenditures are legitimate and supported.
- Departments should review payroll distribution lists for reasonableness.
- Monitor overtime payments. Are they supported and approved? Are they reasonable?
- Review leave accruals for reasonableness. Have employees taken leave? Do you know of employees who have taken leave, but reports don't show a decrease in the accrual balance? If so, follow up to find out why.
- Do you have employees who earn compensation or exchange time? Ensure you have policies and procedures to monitor the time. Ensure employees are following the policies.

The key to preventing and detecting payroll fraud is adequate monitoring. You can have the best internal controls in place, but you must monitor them to ensure they are being followed. Without monitoring, chances are the policies are not being followed.

Remember, an ounce of prevention is worth a pound of cure.

Questions or comments

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