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Avoid fraud with leadership and adequate controls

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Fraud can happen anywhere, even in real estate. It doesn't take much for an employee to commit fraud. First, they feel a personal, financial pressure, identify an opportunity, and then be able to rationalize it. There are many ways fraud can occur within any real estate organization.

Beware of Common Areas for Fraud

Accounts payable fraud is one of the most widespread. It can occur in a number of ways. An accounts payable clerk has access to the accounts payable vendor master file. In the absence of good internal controls, they can create an approved vendor and phony invoices for goods or services not provided. Further, the financial statements would be inaccurate and could be provided to third parties such as investors. Fraud can also occur in a construction contract. Without adequate oversight, the general contractor could include charges from other projects in their requisition. There are countless ways to overbill. Without proper controls in place, fraud may go undetected.

Fraud can also occur in payroll. Be watchful for inflated wages where employees receive wages above the amounts authorized. Ghost employees are not as cool as they sound; it is just another classic payroll scheme. A ghost employee is one you pay who does not work for the company at all, or an employee who is no longer employed but continues to get paid. In the latter case, they might not even receive the cash; it could be going to someone else.

A third area where fraud can occur is accounts receivable. A property can generate revenue that is not recorded on the books and records. This can occur with an operating expense reimbursement true-up. Alternatively, revenue may be recorded and the accounts receivable are later written off. Keep an eye on credit memos.

Fraud can occur in financial reporting. Financial or operating data provided to investors or financial institutions may be inaccurate. For example, undisclosed or unrecorded liabilities would make a company look healthier than it is. If financial statements are reported at fair value, someone could inflate asset values to make the property look more valuable.

Protecting your Company Starts with Leadership

What can you do to protect yourself and minimize the likelihood that fraud can occur within your organization? The key starts at the top. Leadership needs to set the proper tone. If you are willing to trust your employees blindly, then fraud may occur while you are closing your eyes. If upper management is known to cut corners, then some employees may feel entitled to do the same. Setting the proper culture, anti-fraud training, and a code of conduct all help minimize the risk of fraud.

Establish policies and follow the procedures you have put in place. Utilize proper segregation of duties and limit user access controls. The accounts payable clerk does not need to have access to the vendor master file. Another person should be responsible for entering new vendors, or updating a vendor's profile.

There are also procedures you can put in place to minimize your risk and to help detect fraud. Good internal controls, implemented and followed, help to keep your employees honest, and to make the risk of detection too high for those who might consider committing fraud. It is simply good business to consider the risk of fraud, and good sense to talk to your CPA about the costs and benefits of a well-designed internal control system.

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