

# First Friday Fraud Facts+

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## QUESTIONS OR COMMENTS:

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## Inside this issue:

Welcome	1
Payroll Fraud	1
Red Flags	2
Prevention & Detection	2
Fraud Case	2
Announcements	3

*The Idaho State Controller's Office distributes this newsletter as a cost-effective method of increasing awareness about ways to detect and prevent fraud, waste, and abuse in government.*

Welcome to First Friday Fraud Facts+ (F4+). This edition will discuss payroll fraud.

Payroll fraud takes place when employers or employees cheat the payroll system to steal funds that do not belong to them.

Payroll fraud can be committed using a variety of deceptive methods, causing the government to receive an insufficient amount of payroll taxes due. Payroll taxes consist of income, social security, and Medicare taxes. When an employee is first hired, tax information must be submitted on a W-4 form to an employer, indicating the correct amount of tax to withhold from an employee's paycheck. Based on the tax information provided, employers are required to withhold and remit the applicable taxes to the government.

Generally, payroll fraud is committed when an employee does not have taxes withheld from their paycheck, or when the employer does withhold the employee payroll taxes but does not forward them to the government as required. Employers and employees share the payroll tax burden, as employers must match the amount of employee payroll taxes withheld and remit both to the government.<sup>1</sup>

Payroll fraud can be prevented, committed, and detected in a number of ways.

## PAYROLL FRAUD

The most common payroll fraud schemes include salary employees fraudulently increasing the amount they have legitimately earned, or adding fake (i.e., ghost) employees to the payroll list and collecting these wages for themselves. Other schemes may consist of hourly employees modifying the total amount of hours worked, clocking in and out of work at misleading times, or fabricating specific shifts worked.

Manufacturing employees (who are paid by how many units they produce) and commission workers can also commit payroll fraud by



deliberately misstating how many units have been produced or sales made.

Another payroll fraud scheme is submitting incorrect expense claims. Examples could include falsely claiming a meal with family or friends as business with a client, or claiming a business trip or meeting while taking a personal leisure trip.

### **RED FLAGS**

Several potential red flags are often found in cases involving payroll fraud. Some of these include:

- An employee living an expensive lifestyle beyond their means
- Sharing a physical address or bank account between multiple employees (that are not family members)
- Deliberately having records checked by staff members unfamiliar with the payroll system
- Payroll records containing unexplained anomalies

### **PREVENTION & DETECTION**

Frequently checking payroll records and educating employees about the consequences of payroll fraud can help prevent payroll fraud. However, sometimes an employee being overpaid will not be fraudulent, as unintentional errors can happen. Frequent checks of the payroll system can help to quickly correct oversights.<sup>2</sup>

### **FRAUD CASE**

This case involves a former CEO who assisted management in preparing and filing false corporate income tax forms.

The company in question was a co-employment company (i.e., it hired a client's employees, becoming their employer of record for tax and insurance purposes) comprised of 40 employees. Business owners were allowed to outsource the management of human resources, employee benefits, payroll and workers' compensation, and other strategic services.

According to court documents, one of the false corporate income tax forms stated that the company paid employees \$2.4 million, resulting in a fabricated tax liability of nearly \$600,000. In reality, the company paid its employees \$6.6 million, incurring an actual tax liability of \$1.7 million.

The former CEO pleaded guilty to \$26.7 million in tax fraud, resulting in a prison sentence of 15 months and \$12 million in restitution required. This fraud also negatively impacted the company's employees, as the tax benefits employees expected to receive were lost due to the company's fraud/tax liability.<sup>3</sup>

<sup>1</sup> Payroll Fraud At a Glance, <http://fraud.laws.com/bankruptcy-fraud/types/payroll-fraud>  
Accessed January 13, 2014.

<sup>2</sup> How to Detect and Prevent Payroll Fraud. <http://theundercoverrecruiter.com/payroll-fraud/>  
Accessed January 13, 2014.

<sup>3</sup> It Hits the Employees at the End of the Day. <http://www.fraudoftheday.com/2012/12/21/it-hits-the-employees-at-the-end-of-the-day/> Accessed January 13, 2014.

## **ANNOUNCEMENTS**

Annual Internal Control Training held at the State Controller's Office:

a) Tuesday, April 15, 2014, from 10:00 a.m. – 12:00 p.m.

OR

b) Wednesday, April 16, 2014, from 8:00 a.m. – 10:00 a.m.

Learn why internal controls are important to your organization and who is responsible for ensuring they are practiced. The training will cover the objectives of internal controls, including the COSO's 17 principles, and a round table style discussion, which will provide participants an opportunity to share their internal control concerns, insights, and receive feedback.

CPE: 2 Free

Registration details coming soon.

