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Newsletter

## Can companies' frauds be prevented?

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### Content

#### Sleeping with the enemy?

The problem of suffering an economic breakdown by disloyal employees

### The most relevant

- Is relatively easy for who has the trust of his superiors to execute and act that results in a personal benefit.
- Without pretending to create a situation of extreme distrust that lowers the personnel performance, but creating the atmosphere regarding the understanding that auditing and the controls are part in the normal life of the companies...

*As time goes on is becoming more common, unfortunately, the commission of frauds in prejudice of company's assets.*

*Factors like economy recession; global competence; excessive regulations; problems to comply with tax obligations; the investment requirements for growth; the reduction of utility margins, etc., magnify the problem to take an economic breakdown due to disloyal employees, leaving sequels of lack of confidence, and distrust in the emotional aspect.*

*It is clear that is relatively easy for who has the trust of his superiors to execute an act that results in a personal benefit, affecting in occasions the image of the company, its stockholders, work colleagues, etc. because the trust he possess, let him access to privileged information and/or custody of resources of the company.*

This document does not constitute any tax opinion, so no responsibility is assumed in regard to its interpretation and application, since a wrong interpretation of it, could be contrary to the criteria given by tax authorities in the terms of provision h) of fraction I in article 33 of the Federal Tax Law.

The internal control evaluation leads to detect possible control flaws that could enable fraud operations, reason why the observation of security minimum rules puts the company in a better position to control and protect the important assets.

Without any doubt, the moral quality of the employees is key, so the cautious selection of them when hired, could avoid future problems. One employer, when talking with students at a symposium expressed before the specific question: "When hiring a person for our organization, I'm not impressed by their grades, eulogy notes, honorary mentions, etc., what the candidate must have are the values obtained at home and that school does not give, if any, they stimulate and polish them"

### Accounting Records

In small and medium enterprises, the organization is slim, so the controls are very vulnerable, due that normally no function-separation exists that permits such control.

Likewise, in many cases with honorable exception, the accounting purpose is focused in the compliance of the tax obligations, so the importance that it has or should have to measure the fulfillment of goals, budgets, decision making, and the financial situation of the company is not given.

In the above-mentioned cases, this happens because the stockholder chart of the company is really only one person, or a family company, and situations are managed in a way that accounting result can be distort, for example: domestic employee salary is paid and recorded in the company.

The stockholder does not charge any salary or rent of building or offices, or it makes them by amounts under the market value; personal expenses are charged; incomes are delivered to other entities; all automobiles of the family are in the company, etc.

Then, the accounting reports lack of interest for the stockholders, who see in this information a "necessary evil" to comply with authorities, leaving then, the observation of deviations and irregularities that could be manifesting.

Nowadays the information gains great importance to foresee situations that could put the company in danger and that allow the decision making in time, and not when the damage is already done, not only in the fraud cases, but in general aspects of business.

### Organization Structure

It is recommended that the businessman, by himself or aided by qualified personnel of his company or a third party (professional administrators) demands that the financial reports are founded in reality, are discussed, compared with established parameters, analyzed, and that taken decisions allow to correct the company's course, including some measures that apply to himself, so that he becomes a role model for the rest of the personnel.

#### Frequent problems

In an attempt of recompilation, not a complete one, due to creativity of he who plans to take a benefit, we now comment the most common cases:

#### Income

##### *Deviations in cash operations.*

When the company receives cash directly from their costumers, and especially when a strict inventory control is not running, the cash income reports is different to the real and, most of the time cannot be detected immediately because of lack of control.

##### *Postponed deposits*

The famous **floating** occurs when someone takes cash one day and uses the income of the following days to disguise the difference.

##### *Inferior price sales*

The company's products from stock or the other assets such as cars, office equipment, etc., are invoiced for less than the market price, usually to close family or friend of the employee, so that later on they can re-sale them with a profit.

#### Expenses

##### *Petty Cash Fund*

Use of the fund for different purposes like loans to one's self or to the personnel, personal expenses, etc.

##### *Duplicity of Expenses*

Payment of invoices, either for the petty cash fund repositions or through a check, when the stamp of "Paid" was not printed in the documentation intentionally, or use copies instead of original documents.

#### **Signature falsification in checks**

Implies the subtraction of checkbooks and falsify the authorized signatures.



### Indicators

#### Exchange rates and UDIS

Date	ER	UDIS
30-09-10	12.7594	4.443196
31-10-10	12.3612	4.468266
30-11-10	12.2996	4.498813
31-12-10	12.3720	4.526308
31-01-11	12.0903	4.558235
28-02-11	12.0558	4.570274
31-03-11	12.0615	4.588899
30-04-11	11.6925	4.591417
31-05-11	11.6588	4.580857

#### Surcharge rates

	Agreement	Default
<b>Jan-Dec 2011</b>	0.75%	1.13%



**Check Alterations**

Once the checks are written and signed by an authorized person, spaces are left behind in the body of the check, the amount in number and in writing can be modified, when the checks are not elaborated by a computer system, or a security machine is not used.

**Electronic Transfers**

For the actual operations by the use of electronic means, we must have caution since the combination, or PIN code (personal identification number) with a “netkey” or token is like a signature, authorizing to issue money from the checking account.

The mandatory use of this system to pay contributions and other payment to suppliers frequently requires giving our employees the PIN code and token.

We suggest to open special accounts with the minimum amount established by the bank, so the funds are transferred for the exact amount to pay, verifying with the account statement issued, that the operations are executed correctly and verifying with the accounts of the SAT (Mexican IRS) in taxes case and/or suppliers.

**Payrolls**

To include nonexistent or former employees in payroll list to reflect bigger amounts to be paid from the company, but deliver less to the employees.

Frequently it happens when the same person calculates and is in charge to directly liquidate the payroll or when 2 or more employees arranged such situation.

**Exchange Rate**

When required the acquisition of foreign currency, the opportunity to get a benefit when taking advantage of exchange fluctuations.

It is recommended to operate and obtain the currency directly from a trusted supplier.

**Unnecessary or Fictitious Expenses**

To create necessities of equipment maintenance or expenses that do not correspond to proper operations of the company and support them with false documents.

**Personal Expenses**

When the employee has the authorization or does not has restrictions, frequently personal

expenses are executed, including with suppliers of the company (travel agencies, for example) and checks are issued and recorded into their account as sundry debtors, then they are not paid and adjusted to expenses as “nondeductible expenses”. Due this item has not a special attention because is for tax purposes only, with this entry disappears debt form the accounting records.

**Employee Loans**

To take money from employee loans, which appear like that, but are really used for the managers for personal purposes. Often the employees allow this because they are afraid to lose their job or for friendship.

**Resources Distractors**

Use of materials (construction, etc.) transportation equipment and also human resources for a personal benefit, in occasions for the creation of a competitor company like the one they work for.

Tolerance rules must be established for the use of installations of the company such as fax machines, copy machines, stationery products, messengers, etc. for the use of employees, but in a total understanding with manager’s office.

**Employee Retirement**

When the labor relationship ends, frequently the employee’s balance loans are not settled or their expenses report has not been documented.

**Commissions to suppliers**

When order products to our suppliers, there could be asked that, instead to give discounts to the company, give commissions to the buyer, or products are delivered directly to them (construction materials for example), gifts, vacation trips, special discounts, etc. This pushes the employee to prefer those suppliers, resulting in a lack of mental autonomy to demand the conditions compliance, reclamations, etc...

**Traveling Expenses**

Although in some places is a regular practice, the traveling expenses must be regulated, due that with frequency they become disguised wages if the employee wants to save in hotels and food to get more cash when he is authorized to spend more and he can get invoices to support it.

**Indicators**

**INPC**

Period	INPC
October	98.4615
November	99.2504
December	99.7421
January 11	100.228
February11	100.604
March 11	100.797
April 11	100.789
May 11	100.046

**Exchange rate**

**Note:** The exchange rate that appears is referred “to settle the obligations referred in foreign currency payable in the Mexican Republic (Dollar fix)



This can result even in health problems and the company may be affected in its image when employees take meals in cheaper restaurants than the ones considered in travel expenses budget.

It is recommended to set as mandatory that go to the kind of restaurants designed and /or , offer an extra payment for the fact that he is staying in a different city.

### ***Conflict of Interests***

When the contracts of goods or services are granted to persons or companies, family, friendship, or another companies related with the employee, even though at a same or better prices, it does not allow to obtain mental independence about the quality control or claims, so it should be prohibited or control by different personnel.

#### Suggestions

### ***Personnel***

As mentioned above, the most important aspect is human quality and the values that are implicit in the individual, so in the hiring period we must try to observe this aspect. Moreover, we have to be aware even of the senior personnel in the company, since there are cases where persons that have been worked many years and with a clean track, have committed this type of patrimonial crimes.

For example, in some countries candidates are tested giving them some cash (for food or so) in some excess of the amount permitted, which it must be refunded in the 2<sup>nd</sup> interview. When the cash is not given back, it is considered an expense, and better if compares with the potential problem for hiring such person.

### ***Politics and Procedures***

Establish, write down, and make public the company's policies with clarity, and get sure they are well known and understood by all personnel, obtaining form each one its acceptance confirmation.

### Internal Control

*Get procedures like:*

1. Separate the functions of accounting and assets custody
2. Get an insurance for the personnel that manages cash or financial instruments.
3. Issue only nominative and not negotiable checks, or even better, transfer funds payments only.
4. Control canceled checks or not used checks, cutting the signature, if its case.
5. Do not maintain cash pending to be deposited.
6. Invariably stamp the seal of "Paid" in all vouchers at the moment they are paid.
7. Use joint signatures in at the issue of checks, specifying the functions of the first and the second signature.
8. Open check accounts to receive incomes in a separate way and with special control and via transfers, assign the resources to accounts for a special purposes such as payroll, taxes, suppliers' payments etc., leaving these with the minimum balances requires for banks.
9. Rotate personnel that manage cash or financial instruments.
10. Perform surprise audits to cash or investments personnel.
11. Be sure that all merchandise exits are supported by an invoice or receipt.
12. Verify that the discounts authorization was authorized by a responsible functionary.

13. Have a permanent internal auditing, either by the company's personnel that reports directly to the Directors or through an outsourcing firm with a work program.
14. Install surveillance cameras in designated areas.

### Accounting

1. Establish that the accounting reports become a reference point for decision-making and make sure that it includes all the company's operations. In the other hand, don't mix them with personal operations.
2. Be sure the accounts catalog allows the operations control in accordance to the authorized budget, and cut away from the catalog the subaccount of "Nondeductible expenses" because it takes control complicated. Due lack of tax requirements, some expenses have to be considered as nondeductible, it is an accountants labor to separate records and reconcile at the end of the year to calculate annual income tax.

### Some more advices

*Here the imagination must not be limited:*

1. There are companies that weight their personnel in a scale at the beginning and end of their labor because of the products they manage. Even though it's difficult that felonies are detected this way, an atmosphere to be under surveillance is created and has an influences in the results.
2. The use of "shoppers"- persons that are disguised as customers hired by the company, especially in supermarkets, hotels, etc. have reported good results to detect disloyal conducts to the company.
3. Check the car trunks, portfolios, etc. in a systematic way.
4. Observe important conduct change in the employees in regard to external signs of unusual income.

Without pretending to create a situation of extreme mistrust that lowers the personnel's performance, but creating the atmosphere in the understanding that auditing and controls are part of a normal company's life, this way we can obtain a reasonable security that all resources are canalized in benefit of everybody including the employees, it will reflect a security in keeping jobs and, eventually in a better payment, profit sharing, productivity bonuses, and social benefits in general, this wouldn't be obtained if controls become relaxed and the company suffers prejudices in its patrimony.

A Grandfathers advice for the end:

***"Trusting is good...but mistrusting is better"***



## Mexicans spend more money than they make

El Universal.

Aproximately 30% of Mexicans spend more money than what they make, showing up the lack of financial culture in the country.

In the country, 30% of Mexicans spend more money than what they have, showing the lack of financial culture, affirmed the president of the National Commission for the Protection and Defense of Financial Services Users" (CONDUSEF), Luis Pazos.

Participating in the round table "Financial Culture and Welfare", taking place at the Interactive Economic Museum (MIDE), considered necessary to advance in this issues since the financial education implies basic principles like paying what one owes.

At the National Financial Education Week 2010, he said that 30 per cent of Mexicans does not budget for; other 30% spends more than what he earns and 75% misuses their credit card.

The functionary considered that this financial education must be embraced and learned by all population, in other words, since people with lower income to professionals and legislators.

Luis Pazos pointed out that the principal challenge to advance in the financial education matters is to "rescue the trust in institutions", since many persons have a bad experience that they keep this perception and don't change their way of thinking.

Lack of trust generates some risky practices like saving money "under the bed", or give it to a third party so he can save it, was commented in the seminar in charge of the Afores Mexican Association (Amafore) –Mexican Retirement Funds Association - .

These practices, he added, make people lose the benefits that new instruments offer like investments through the Retirement Funds Administrators (Afore), that have reached a 13% interest income annual rate thought the first 13 years of the Saving Retirement System (SAR).

In this sense, the president of the National Commission of Savings Retirement System (Consar), Pedro Ordioca, said that one of the challenges of the agency of who he is in charge, is to transmit to society the opportunities to voluntarily savings.

These instruments, he said, are a savings vehicle in

the long term that generate very good return rates and are a great alternative for workers affiliated to IMSS o to ISSTE or for who works in his own.

In the same way, he considered that financial culture "is not a luxury, nor an academic concept but a vital subject to people", he insisted that the decisions taken now will have an impact in the future and must be for all economic levels.

At the round table also participated the Director of External Relations of Banxico, Federico Rubli, the professor-investigator of CIDE, Alejandro Villagoomez, and the Director of the Economic Department and Strategic Studies Center of the Technological Institute of Monterrey, Hugo Fuentes.

The expositors agreed in the importance to present to the users information in a simple and direct manner, since this is a key in financial education. ❁

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*"There is only one good: Knowledge. There is only one evil: Ignorance"*

Socrates

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