

# The Relevance of Payroll Control To Fraud Prevention In A Payroll System

## INTRODUCTION

The prevalence and increase in white-collar crimes in our organizations and societies is no longer a fiction but has become a recurrent challenge which requires quick attention and solution. This must be done if integrity, sanctity and financial security must be achieved in our organizations and societies at large.

White-collar crimes (corruption) exist in different forms and shapes and is believed to be on the increase.<sup>1</sup> One of such crimes that is common with most organizations is the payroll fraud or scheme.

In his opinion, Matthew Garrett mentions that the incidence of payroll fraud in organizations is real and that it occurs in about 27% of all businesses, twice in small organizations than in big ones and that a singular happening of payroll fraud lasts for about three years<sup>2</sup>.

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<sup>1</sup> Ahmed, S. and Bontis, N. (2009, January). *The relationship between culture and corruption: A cross-national study*. Journal of Intellectual Capital (JIC), 10(1), 165-184. Retrieved from [www.emeraldinsight.com/1469-1930.htm](http://www.emeraldinsight.com/1469-1930.htm);  
<https://www.researchgate.net/publication/228359868>

<sup>2</sup> Garrett, M. (2013, September 13). Payroll Fraud- A Big Treat and How to Avoid It. Retrieved from <https://www.forbes.com/sites/matthewgarrett/2013/09/10/payroll-fraud-a-big-threat-and-how-to-avoid-it/#3ed60218746f>

As the saying goes, there is no smoke without a fire and as such, the existence of corruption in our organizations and society, of which the pay roll fraud is a part, is caused by a lot of factors or variables. Factors such as a culture that tolerates corruption, weak government institutions, poverty, illiteracy, absence of adequate punishment for corruption amongst others, all contribute to the alarming increase in this crime<sup>3</sup>.

Thus, this paper essentially seeks to discuss the relevance of payroll control to fraud prevention in a payroll system. Accordingly, we shall look at the meaning of pay roll, payroll fraud and the various ways by which the pay roll fraud presents or is carried out. We shall also consider the various payroll control measures to fighting corruption in organizations, particularly, in a payroll system.

## **MEANING OF PAYROLL AND PAYROLL FRAUD**

Payroll is the process which an organization passes through to pay its employees. It deals with records relating to the employees' salaries, deductions, bonuses and income<sup>4</sup>.

It has also been described as the means or process by which an employee is paid by the organization for the services rendered<sup>5</sup>.

Payroll fraud on the other hand is considered as any arrangement by which an employee causes the organization to pay money to the employee vide false claims<sup>6</sup>.

It has also been argued to involve the stealing of an organization's moneys using the organization's payroll system; and can be carried out by both management and regular employees<sup>7</sup>.

Following from the above considerations of what constitutes payroll fraud, the relevant question at this point is: what are the various ways by which payroll fraud can be committed in an organization?

The above question is very important because the best way to solve a problem is to first identify

the problem and its dynamics. Accordingly, an insight as to the various ways payroll schemes/fraud are committed within an organization, will go a long way in determining a pragmatic solution that could be provided. The succeeding paragraphs consider the various ways a payroll fraud is carried out in an organization which utilizes the payroll system.

## **VARIOUS FORMS/TYPES OF PAYROLL FRAUD/SCHEMES**

While there are various types of payroll fraud, the following have however been identified as the common kinds of payroll fraud namely: Timesheet fraud, wage falsification, fraud in commissions and bonuses, expense repayment fraud, ghost staff schemes, misclassification of members of staff<sup>8</sup>.

Time sheet fraud is committed when an employee bloats the number of hours he/she has worked in his/her time sheet and/or where an employee clocks in time for another employee which was not earned.

Ghost workers scheme occurs where employment record is opened or created in respect of a non-existent employee and wages

<sup>3</sup> Mannixs, P. (2012, July 16-22). Corruption In Times Of Crises In Nigeria. Government, 10-11.

<sup>4</sup> Murray J. (2017, December 30). What Is the Definition of the Term Pay Roll. Retrieved from <https://www.thebalancesmb.com/what-is-payroll-398399>

<sup>5</sup> Rietsema, D. (2018). Payroll Systems. Retrieved from <https://www.hrpayrollsystems.net/payroll-systems/>

<sup>6</sup> Marasco, J. (2007). Fraud Matters. Retrieved from <https://stonebridgebp.com/library/uncategorized/payroll-fraud-how-its-done-how-to-prevent-it/>

<sup>7</sup> Lomer, D. (2018). 31 Ways to Detect and Prevent Payroll Fraud. Retrieved from <https://i-sight.com/resources/31-ways-to-prevent-and-detect-payroll-fraud/>

<sup>8</sup> Lomer, D. (ibid)

paid to the fake employee, which is later withdrawn and used by the criminal.

On the other hand, an expense reimbursement fraud would occur where an employee claims expenses which he/she never incurred. For instance, making claims for travel cost which were cancelled or presenting more than one claim for the same expense, submitting fake receipts for payment and altering receipts in order to increase re-imburements.

Misclassification of members of staff also occurs where an employee is wrongly classified for the purpose of avoiding tax payments. For instance, a management staff could be deliberately classified as a junior staff just to reduce the organization's tax liability.

In the case of a commission or bonus fraud, an employee inflates his/her sales records just for the purpose of claiming higher bonuses or commission on sales.

Wage falsification as a form of payroll fraud occurs where an employee's salaries are cooked (usually increased) with the intention of later utilizing the excess. This scheme is often times perpetuated by collusion of the employee and those responsible for paying salaries or wages.

There is no gainsaying the fact that the effect of corruption generally and in this case, payroll fraud, is colossal both to the organization and the society at large. This is because, whether in private or public institutions, the payroll is an inevitable factor.

Thus, a payroll fraud, say for instance ghost workers' scheme affects the overall economic or financial state of the organization or the society at large and which will in turn affect everybody within the organization one way or the other.

For example, huge financial losses as a result of unchecked monumental payroll fraud could lead to the liquidation of the organization, resulting in massive loss of jobs.

The above view finds strong support in the opinions of a good number of scholar practitioners. For instance, [Alexandra Levit](#)<sup>9</sup> while considering the danger of corruption generally, advises business owners to expose and stamp out activities of corruption in their organizations or risk getting their culture sabotaged.

Similarly, Patrick Enoch Nmah<sup>10</sup>, mentions that corruption features predominantly in the social, political and even religious lives of Africans, with attendant negative effects. He states further that the consequences of corruption are numerous, which include the inhibition of economic development and increased poverty rate in the society<sup>11</sup>.

It has also been argued that corruption is a cancer which fights the very essence of private and public life and structure<sup>12</sup>.

Some schools of thought believe that amidst other deleterious effects, corruption, which includes payroll schemes, usually result in huge revenue loses to the government, distorts merit and encourages lawlessness<sup>13</sup>.

The point has been made, for instance, that the misclassification of an employee as an independent contractor by an employer exposes everyone to some form of suffering. Citing a 2009 report by the United States Government Accountability Office (GAO), it was projected that payroll fraud diminished federal revenues by \$2.72 billion in 2006<sup>14</sup>.

<sup>9</sup> Levit, Alexandra (2013, September 3). 5 Steps to Preventing a Culture of Corruption. Retrieved from <https://www.americanexpress.com/us/small-business/openforum/articles/5-steps-to-preventing-a-corrup-culture/>

<sup>10</sup> Nmah, P.E. (2017). Corruption in Nigeria: A Culture or Retrogressive Factor. *Ogirisi: a nee Journal of African studies*, 122(13), 117-130. Retrieved from <http://dx.doi.org/10.4314/og.v13i1.6>

<sup>11</sup> Nmah, P.E. (2017). (op. cit).

<sup>12</sup> Modugu, P.K, Ohonba, N and Izedonmi, F. (2012). Challenges of Auditors and Audit Reporting in a Corrupt Environment. *Research Journal of Finance and Accounting* 3(5), 77-82. Retrieved from [www.iiste.org](http://www.iiste.org)

<sup>13</sup> Everett J., Dean Neu, D. and Rahamam, A. S. (2006). The Global Fight Against Corruption: A Foucaultian, Virtues-Ethics Framing. *Journal of Business Ethics*. 65: 1-12.

<sup>14</sup> Mckay, Carol. (2013, March 13). Payroll Fraud Costing workers, government. A publication of NCL Communications. Retrieved from [www.nclnet.org/payroll\\_fraud\\_costing\\_workers\\_government](http://www.nclnet.org/payroll_fraud_costing_workers_government)

In similar fashion, it was posited that at some point that the Local Government Areas and Rural Development Areas in Bayelsa State were unable to pay workers' salaries and carry out developmental projects as a result of false wages or wages fraud<sup>15</sup>.

Given the above consequences, the need to fight, prevent and check the incidents of corruption in general and payroll fraud in organizations becomes inevitable. Thus, this leads us to the issue of possible payroll control measures that can be adopted to prevent the incidence of this form of corruption.

## **WHAT ARE THE VARIOUS PAYROLL CONTROL MEASURES FOR FIGHTING OR PREVENTING FRAUD IN A PAYROLL SYSTEM?**

Payroll internal control comprises of actions or steps adopted by an organization in order to protect its payroll data<sup>16</sup>. The essence of this control and procedures is to prevent employees from having access to organizational payroll information that could aid the opportunities of payroll fraud on the organization.

Scholar practitioners have come up with several suggestions on effective payroll control mechanisms that can be applied in organizations to prevent or check the occurrence of the various payroll fraud discussed above, with the goal of preventing the incidence of this fraud.

To stem the fraud associated with falsified wages, it may be good for the organization to adopt some crucial and key procedures. The introduction of stricter access code system for all employees which will require unique pass codes from the employee would prove useful.

Also, it is necessary to adopt a work place practice which requires that every compensation by way of bonuses must be approved by the organization's executive.

In order to check the incidence of falsified wages, it is important for the organization to carry out periodic change of employees in charge of workers' payroll; see that all cheques must be approved by the executive and ensure that the responsibility of wage modification is assigned to certain individuals whose records should be reviewed from time to time by the management<sup>17</sup>.

To forestall the challenges of time sheet fraud, it is suggested that the organization should introduce electronic time sheet entering system by employees and also ensure that all time sheets and overtime must be approved by management.

Jim Marasco also believes that the problem of ghost workers can be solved by carrying out periodic payroll audits which would require all staff to be present in person to receive pay cheques after proper identification.

To deal with the problems associated with the misclassification of employees, it is advised that an organization should effectively carry out periodic audit of its employees, draft correct employee job descriptions and train management staff on the legal implication of properly defining employees' job descriptions<sup>18</sup>.

Accordingly, with adequate internal control measures in place, organizational fraud, including of course, payroll fraud can be detected and prevented before they occur.

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<sup>15</sup> Allen, O. U and Joab-Peterside, S. (2017). Ghost Workers and Related Payroll Fraud: The Impact of Unauthorized Employment on Local Government Areas (LGAS) & Rural Development Areas (RDAS) In Bayelsa State. *IIARD International Journal of Economics and Business management* 3(8), 24-37. [www.iiardpub.org](http://www.iiardpub.org). Retrieved from <https://iiardpub.org/get/IJEBM/VOL.%203%20NO.%208%202017/GHOST%20WORKERS.pdf>

<sup>16</sup> DeWitt, K (2006, August 10). What Are Payroll Internal Controls? Retrieved from

<https://www.patriotsoftware.com/payroll/training/blog/payroll-internal-controls/>

<sup>17</sup> Marasco, J (op. cit)

<sup>18</sup> Fullerton III, J. F. (2012, May 18). Three Best Practices to Help Avoid Employee Misclassification Problems. Retrieved from <https://www.financialservicesemploymentlaw.com/2012/05/18/three-best-practices-to-help-avoid-employee-misclassification-problems/>

## CONCLUSION

In the light of the views expressed above, the significance of the payroll system cannot be overemphasized. The reality of payroll fraud and schemes cannot be wished away and the need to have proper organizational control mechanisms in the circumstance is inevitable.

Thus, while it may not be possible to completely eradicate the problem of payroll fraud in organizations both in the private and public sectors, the implementation of the preventive and curative suggestions and recommendations above, would go a long way in reducing the incidence of these white-collar crimes in our organizations and the society at large. This would in turn significantly reduce organizational risk and financial losses occasioned through payroll schemes.

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