Accounts Payable Fraud: Types, Causes, and How to Prevent It



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Any business, small or large, is at risk from procurement fraud and financial fraud.

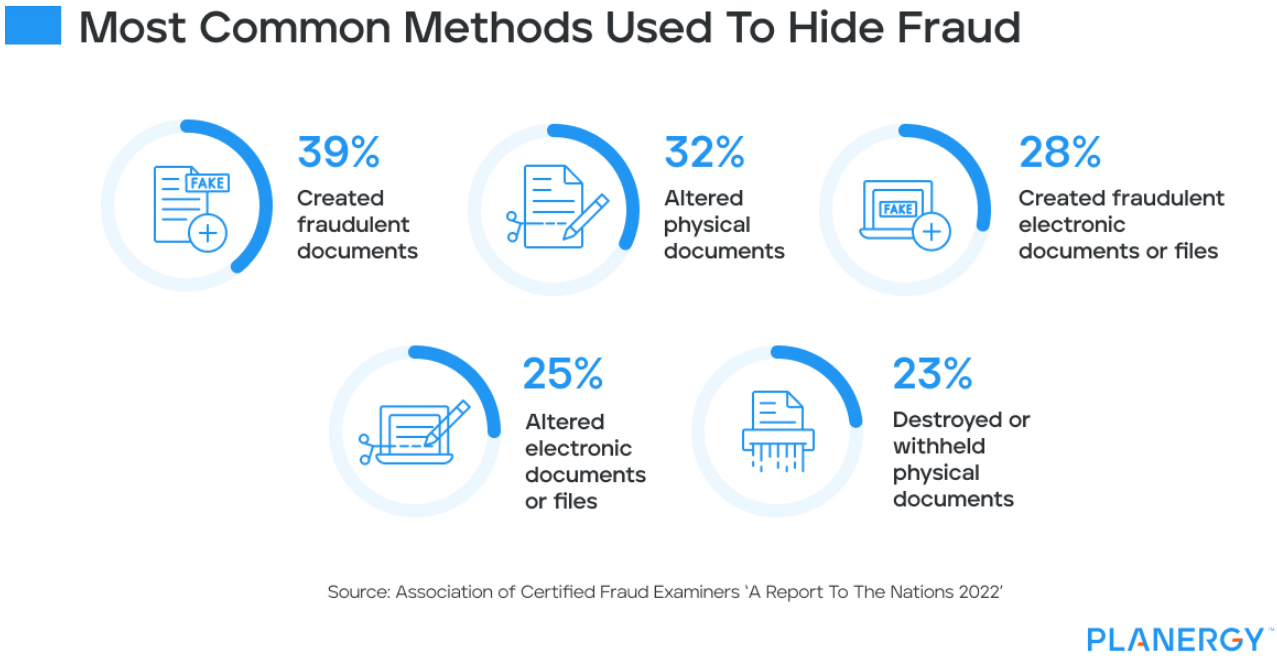
According to the Association of Certified Fraud Examiners 2022 report, the median loss per fraud case was $117,000, with the average loss totaling more than $1.7 million.

In 2022 alone, the ACFE reported that more than 2,000 businesses worldwide suffered more than $3.6 billion in losses.

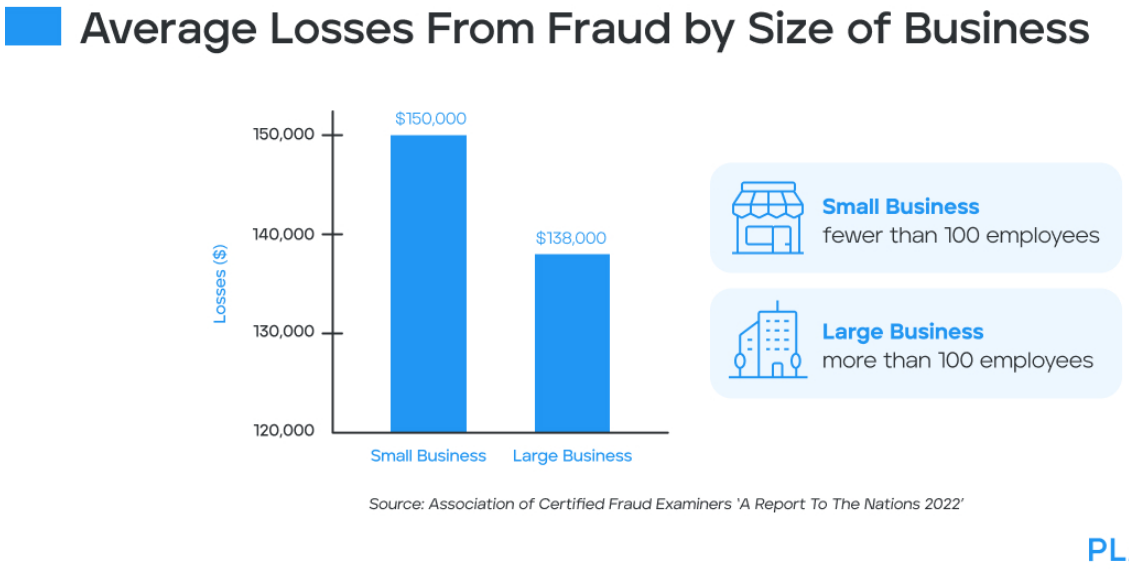
Even more alarming for small business owners, according to the ACFE study, organizations with the fewest number of employees had the highest median loss at $150,000.

How is fraud being committed? According to the ACFE report, the top methods to hide fraudulent activity are:

- 39% created fraudulent documents
- 32% altered physical documents
- 28% created fraudulent electronic documents or files
- 25% altered electronic documents or files
- 23% destroyed or withheld physical documents



Though larger businesses with more than 1,000 employees reported more cases of fraud, smaller businesses tend to suffer the biggest losses, with businesses with less than 100 employees having a median loss of $150,000 compared to larger businesses with a median loss of $138,000.



Regardless of size, no business can afford to lose money to fraud.

Read on to learn some of the biggest challenges of facing accounts payable when it comes to dealing with fraud, along with what you can do to protect your business from fraud.

What Are the Biggest Challenges With Accounts Payable?

Until recently, business owners and managers often thought of accounts payable as the department that paid the bills. While that's technically accurate, the AP department is so much more than that.

Managing accounts payable properly leads to better relationships with vendors and suppliers, more accurate accounts payable reporting, and better cash flow management.

But managing accounts payable brings its own set of challenges, particularly when using manual AP systems.

These challenges include:

Inaccurate Reporting

When using manual systems, significant AP data is often missing from reports and financial statements.

Late Payments

Manual approvals often mean delayed payment processing, which commonly results in late fees, penalties, and a possible change in payment terms.

Lost Discounts

Each time your vendor offers you an early payment discount and you aren’t able to take advantage of it, you leave money on the table.

There’s also the very real possibility that they’ll stop offering discounts.

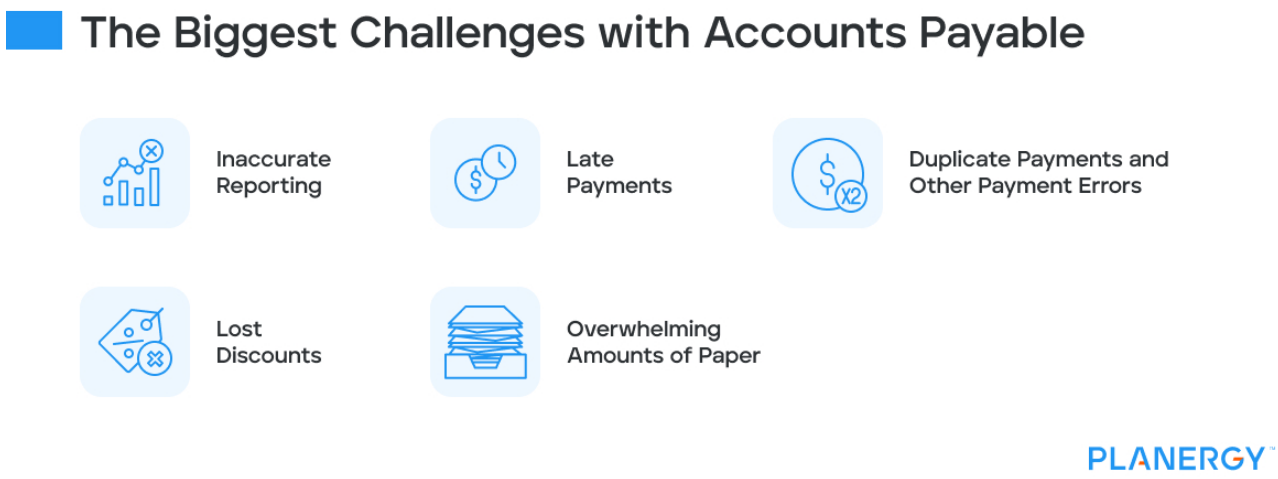
Duplicate Payments and Other Payment Errors

Duplicate payments and overpayments pose a real challenge to accounts payable. If you pay your vendors twice, it can be very difficult to get that money returned to you.

Overwhelming Amounts of Paper

Paper invoices, checks, and purchase orders create stacks of paper that can be difficult to manage, particularly if you typically process a high number of invoices monthly.

A paperless accounts payable workflow likely feels like the holy grail the larger the number of invoices.



While all of these issues can pose a serious challenge to business owners, the biggest challenge of all may be protecting your accounts payable department from fraud.

What Is Fraud in Accounts Payable?

Accounts payable fraud can threaten the livelihood of any business. Fraud can be any act of deception that is conceived and carried out by online criminals, vendors, or even your own employees.

Fraud can also be multiple parties, such as an employee and a vendor, working together to defraud the company or access company funds.

What Are the Types of Fraud Found In Accounts Payable?

Fraud risk is particularly high in accounts payable since all company funds flow through the AP department.

The ACFE classifies business fraud in three different ways:

1. ## Corruption

   Corruption can include both purchasing and sales schemes, along with bid rigging, invoice kickbacks, and even bribery.

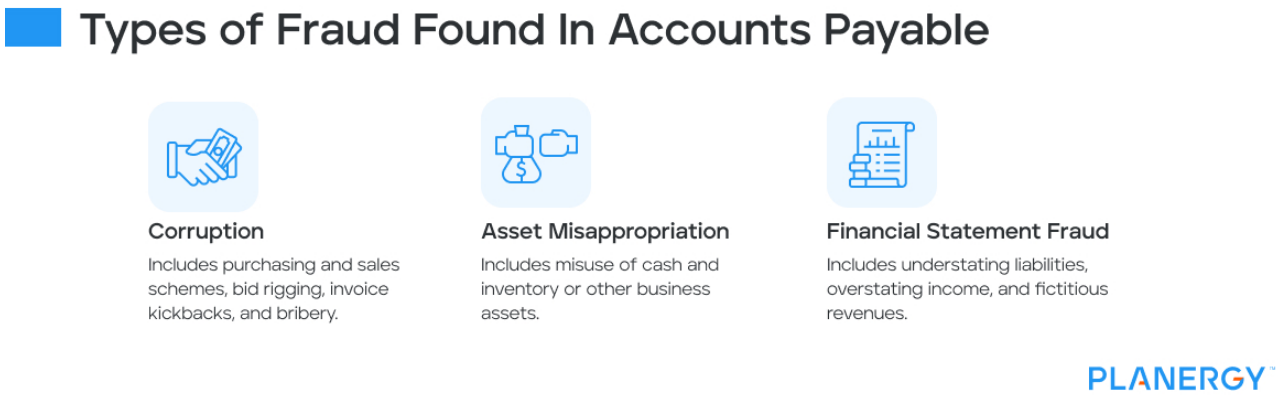
2. ## Asset Misappropriation

   Asset misappropriation includes misuse of cash and inventory or other business assets.

   It also includes payment fraud, expense reimbursement schemes, check tampering, forging materials, altered payee, false voids, and purchasing and receiving falsification.

3. ## Financial Statement Fraud

   Fraudulent activity can result in financial statement fraud. These include understating liabilities, overstating income, and fictitious revenues.



AP fraud can be internal or external, depending on whether the fraud scheme originates in-house or from outside criminal activity.

Internal Fraud

Internal fraud is perpetrated by someone within the organization and can include the following:

- ## Employee Reimbursement Fraud

  This occurs when an employee with an expense account inflates expenses for reimbursement.

  It’s easier than you may think to inflate an expense on a report if someone

is not examining it closely.

Using expense management automation software that utilizes optical character recognition or OCR can help reduce or eliminate overinflated expense reports.

- ### Kickback Schemes

  One of the most important reasons to research and review all new vendors is to prevent kickback schemes or other billing schemes.

  In a kickback scheme, an employee and a vendor work together to inflate or duplicate invoices, sharing in the proceeds.

- ### Unauthorized ACH Transfers

  If you use ACH transfers to pay your vendors, someone determined to commit fraud can easily transfer funds to the recipient of their choice.

External Fraud

External fraud is fraudulent activities committed by outside fraudsters or cyber criminals.

Outside fraud can end up costing your company even more than fraud committed by an employee.

Common examples of outside fraud include:

- ### Phishing Attacks

  Even the most experienced staff can be fooled by phishing attacks.

  Using a business email address, a phishing attack tries to entice email recipients to click on a link, pay a fraudulent invoice, or provide financial information.

  With better tools at their disposal, phishing attempts have become much more successful, with even experienced staff finding it difficult to

determine its authenticity.

- **ACH Fraud and Wire Transfer Scams**

  Similar to phishing attacks, these scams appear to come from a company or individual that you trust and often involve a request for payment.

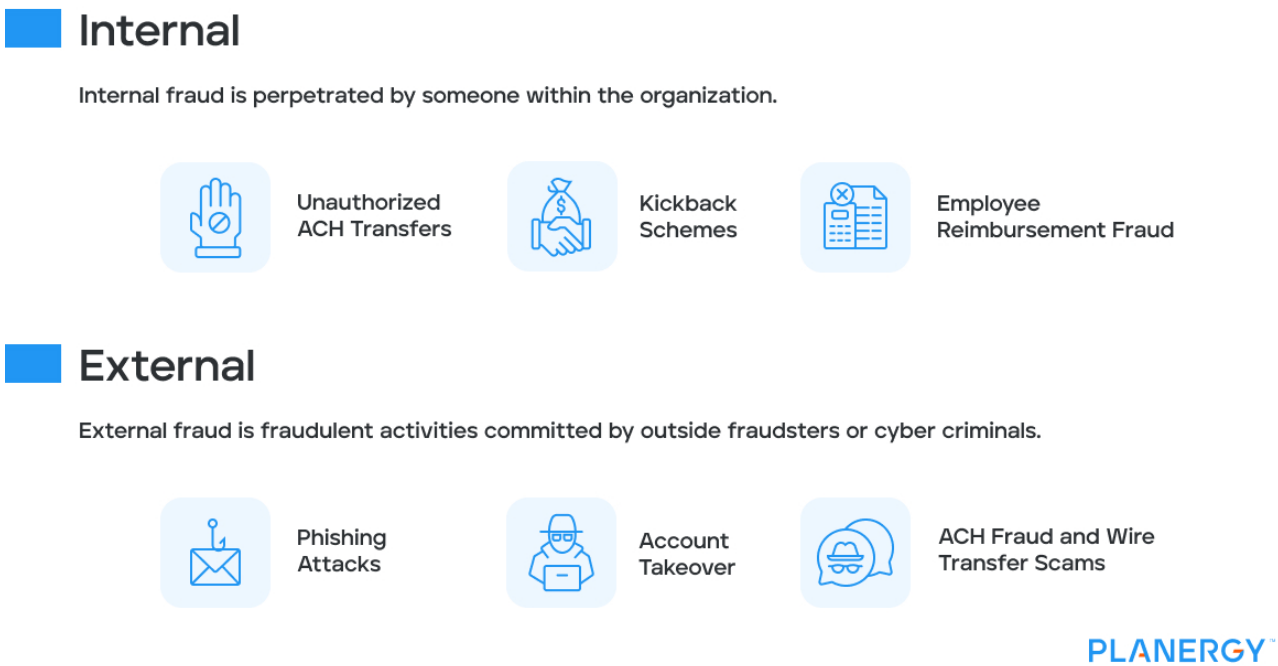
  Again, the requests look legitimate, making it easy to wire a payment to someone you think is your vendor or supplier, but is really a cybercriminal.

- **Account Takeover**

  An account takeover can happen when an unauthorized party gains access to system credentials.

  This can happen with inside help or by someone hacking into your system and obtaining access illegally.

  Either way, account takeover gives the perpetrator complete access to your financial system, including bank accounts.



How Can You Detect Accounts Payable Fraud?

Though there are occasions when AP fraud can fall completely under the radar, there are some red flags to look out for.

And while not all red flags are proof of fraud, they should be investigated.

Some common red flags include:

- New vendors that haven't gone through the standard approval channels
- Unusually large payments to someone you've never heard of
- A series of smaller payments that fall under the approval minimum
- Duplicate payments made to the same vendor
- Unusually large expenses claimed on employee credit cards
- Invoices that look unprofessional in appearance

In many cases, there may be no red flags at all. The best way to detect fraud, or even better, prevent it in the first place, is to implement a series of best practices that are followed by all AP team members.

Accounts Payable Best Practices

Implementing a series of accounts payable best practices can reduce or eliminate errors, eliminate late payment penalties, and help you maintain a strong, healthy relationship with vendors and suppliers.



Establish and Maintain Internal Controls

Everything starts with having the proper internal controls in place.

These internal controls should include the following:

Separation of Duties

Separation of duties is essential for maintaining best practices. AP tasks should never be solely handled by a single employee.

Tasks should instead be separated so that there are checks and balances throughout the entire AP process, from initial vendor selection, to who is responsible for approving invoices and finalizing payments.

Proper System Access

Many issues can be resolved or eliminated by assigning the proper system access to AP staff.

While it’s imperative that staff be able to perform their job duties completely, they should be provided with the access to do that and nothing more.

Using Detective Internal Controls To Spot Issues

Proper inventory management, promptly reconciling bank statements, running financial statements, and reconciling general ledger accounts regularly are all designed to spot issues.

Taking Corrective Action

Locating issues promptly is important, but just as important is taking the proper corrective action once an issue has been identified.

This action can include anything from updating current policies

and procedures to taking disciplinary action such as issuing a warning or terminating an employee, depending on the issue that is discovered.

Create Simplified Workflows and Document Management

Creating simplified workflows and document management procedures can have a significant impact on your business.

This starts with streamlining the accounts payable process, which includes the initial invoice matching process (ideally three-way matching), routing invoices to the correct individuals for approval, and reviewing reports and other relevant documents to search for duplicate payments.

Manage Invoices for Better Cash Flow

Though your first instinct may be to pay an invoice immediately, that's not always recommended.

Instead, you may want to pay invoices that offer a discount and take advantage of the payment terms you have with your vendors.

These terms commonly range from 30 to 60 days net, to pay the rest.

Doing so ensures that your invoices are paid on time, but still allows you to put your available cash to better use.

Keep the Lines of Communication Open

Effectively communicating with your vendors and suppliers can strengthen business relationships.

For example, if you always pay your bills on time, your vendor may be open to giving you better payment terms.

And if you run into financial difficulty, letting your vendor know their payment will be a few days late will be better received than your silence.

Automate Manual Processes

If you’re ready to simplify accounts payable, consider implementing one of the many products designed to automate AP processes.

Optical character recognition (OCR) software, artificial intelligence (AI), and machine learning can all be utilized to automate AP while eliminating manual, repetitive tasks.

While automation can benefit even the smallest business, if you have a large number of invoices flowing through AP regularly, you should consider implementing a Procure-to-Pay software solution like PLANERGY, which incorporates AP automation software and works with your accounting software to automate the AP process from purchase order to payment.

Regularly Review Accounts Payable

Even with automation, you should still take the time to review and reconcile AP accounts, which can ward off potential problems before they become serious.

For a more in-depth review of your AP department, consider implementing a yearly accounts payable audit program.

What Are the Most Effective Ways To Prevent Fraud in Accounts Payable?

Fraud detection starts with the implementation of control measures which should include:

Have a Vendor Approval Process in Place

The vendor approval process should ideally be completed by someone other than the person who approves invoices.

Regularly Review All AP Transactions

Even if you have automated systems in place, regularly reviewing transactions can help you pinpoint trouble spots.

Keep All Bank Accounts and AP Accounts Reconciled

It’s easy to slip unauthorized charges through the system when statements aren’t reviewed regularly.

Conduct Unplanned Audits

If you’ve had issues in the past or have seen some red flags popping up from time to time, conducting an unannounced AP audit may be a good idea.

Reduce the Number of Last-Minute Checks You Process

While an occasional manual check is not a major issue, if you’re always bombarded with last-minute check requests, it might be time to issue new check guidelines.

Implement and Maintain Fraud Protection Measures

Internal controls like three-way matching and separation of duties can reduce fraud. Ensure you follow up to be sure they’re being used properly.

Implementing the process is the first step, but always ensure that those guidelines are being followed at all times.

The Best Protection Against Fraud is Automation

Instituting best practices and fraud prevention techniques is important. But the most important thing you can do to prevent fraud is to use AP automation.

The use of AP automation software reduces human error and offers a complete audit trail so that suspicious activity can be identified and handled immediately.

AP automation also allows you to set system access levels for all employees, and create spending levels, while also streamlining the entire AP process from approvals to payment.

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