

Business

Straight Talk About Fraud

by Leslie Shiner

In 2006, occupational fraud cost U.S. businesses about \$600 billion, or roughly \$4,500 per employee, according to the Association of Certified Fraud Examiners. Building contractors rank second in the list of targets, after retail stores. Most builders already know how field employees can skim money (padding their hours, for instance, or fueling their personal vehicles with the company credit card), but few are aware of the many ways that a dishonest bookkeeper can rip them off.

Small contractors leave themselves open to fraud by not paying attention to the books. This isn't surprising: People become contractors because they like doing construction; they're often so ecstatic when they find someone reliable to track the numbers that they walk away from that part of the business. They put their complete faith and trust in the bookkeeper, and assume that person is watching their back. But while most bookkeepers are honest, there are clearly enough

who aren't to make fraud a serious problem — and spotting the bad ones is not always easy.

Case in Point

For instance, I once worked with a company that never seemed to have enough cash. I dug into the books and found that the bank statements had not been reconciled in quite a while. When I presented this problem to the bookkeeper, she started coming in at 6 a.m. to do the reconciliations. But she was never able to balance them, and eventually made a teary confession: She had been stealing money for three years, but she didn't think it was more than \$100,000. She was wrong — it was actually around \$550,000.

This bookkeeper was married to the owner's best friend, and was the last person the owner would suspect of cheating the company.

To protect yourself, make sure your software has an audit trail. This feature keeps a record of all entries and changes, and the users who made them.

The image shows a screenshot of a software application window titled "Quality-Built Construction Audit Trail". Below the title is a subtitle "Business Audit Trail for December 1, 2006". The window displays a table with multiple columns, including "Date", "User", "Description", and "Amount". The table contains several rows of data, including entries for "Payroll", "Materials", and "Equipment". The interface is designed to provide a detailed audit trail of all transactions within the software.

That particular scheme was an unusually long-lived one; a typical case of fraud takes 18 months to solve. But because fraud usually announces itself only when the thief gets greedy, someone who's content with stealing small amounts can hide it for a long time.

Reading the Signals

In one of the most common schemes, the person keeping the books sends an invoice to the client, then deletes the accounts-receivable entry and pockets the cash when the check comes in. This is often the reason a small company doesn't have as much money in the bank as its work volume says it should.

Fraud tends to first come to light as unexplained bookkeeping anomalies. One of my clients received three job-cost reports on the same job: one with \$20,000 in plumbing, the next with *no* plumbing costs, and the third with \$30,000 in plumbing. That kind of anomaly could be a sign of incompetence, or it could signal fraud in process. Either way, something is wrong and it's absolutely critical to find out what.

The best way to protect yourself is with an early-warning system. Your software should have an audit-trail feature and everyone in your company should be accountable to someone. The audit trail (see example, previous page) keeps a record of every entry and every change, even the smallest ones. If a check never makes it to the bank, you can confirm that an invoice actually went out and see if someone tried to delete it.

Everyone who has access to the books should have a unique user name and password, so that the audit trail can keep track of who made each change. QuickBooks 2005 (and older) lets you turn off the audit trail, so if you're using an older version I recommend upgrading to a new one.

Preventive Measures

Other steps you should take to protect yourself against fraud include the following:

- Have a certified tax professional review your financials on a regular basis, in June and again in December, before the end of your financial year. This sends a message to your bookkeeper that someone else is watching the books — even if that person isn't necessarily looking for fraud. (And, as a side benefit, you'll have someone who can also help you make wise business decisions.)
- Segregate duties. The person who cuts the checks shouldn't be the same person who reconciles the bank statements, even in the smallest office.
- Review your bank statement before the bookkeeper gets it. Make sure the check amounts make sense to you. You may want to look at your check register, too, and verify the payee of any check that exceeds a specific amount.
- Review other financial records on a regular basis.

If all of this seems overwhelming, hire an internal controller or simply have an outside professional come in to check the books periodically. One company hired me to do just the bank reconciliation. Could the controller have done the bank reconciliation? Absolutely. But I came in and asked a lot of questions, and everyone knew that someone else was reviewing the books.

The point is that you need to have controls in place — and you need to trust those controls, not the people. This doesn't signal a lack of faith; it's simply good business practice. Everyone needs to be accountable to someone.

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Recognizing Client Types

by David Getts

If you've been in business for a while, you've probably had clients who left you thinking, "Why am I working with this person? I should have known better!"

After years of trial and error, I've learned how much better it is to ask the questions *before* taking on a project. Now I ask myself "Is this a person I want to work with?" when I meet with prospects — a pre-emptive strike, so to speak, rather than a post-calamity reaction.

Then, once I'm working with clients, I try to tailor my approach to their personality. The key to this approach, of course, is being able to recognize various types of clients and understanding how to deal with them.

Learn to tailor your approach
to your client's personality.

Over time I've come to identify four personality types, each of which tends to behave in fairly predictable ways during projects. I call them The Grinder, The Retentive (as in anal-retentive), Miss Lonelyhearts, and Joe Six-Pack.

The Grinder

The Grinder is easily recognized — he's a control freak. The first time you meet him he'll lay out his demands. I had one Grinder at a meeting pull out a three-ring binder with tabbed sections of expectations for each trade. Grinders want total control of the project. They're often wealthy or successful people accustomed to getting their way.

The best way to deal with Grinders is to confront them immediately, because if you give them the upper hand you'll never get it back. Grinders will fight you on design, cost, material choices, construction details, and anything else you allow them to. They view every situation as a competitive challenge; if you back down they won't respect you.

If you suspect that a prospect has strong Grinder ten-

dencies, you have two choices: Either politely decline to work for them, or make it very clear that as the contractor, you'll be in charge of the project. If they act up while the job is in progress, you'll need to confront them in a brutally honest way.

One Grinder client of mine tried to take control of the job after signing a large change order. His feeling was that since he was paying me so much to do "blue-collar work" I would need help managing the subcontractors. I immediately confronted him on this and explained that both the subs and the project as a whole were my responsibility (as outlined in the contract). If he had a problem with this, he needed to find another contractor to finish the job. Surprised by my candor, he let go of the reins and began to treat me like the professional that I am. The confrontation helped our relationship and he has since had me back to do several more projects.

The Retentive

Retentives are perfectionists — not just about craftsmanship but about the whole process of building. Obviously there's nothing wrong with doing high-quality work and having a good building process, but Retentives are concerned about these things in a rather neurotic way. This behavior reveals itself in two forms: obsession with peripheral issues and absorption with job specifications and procedures.

Many Retentives have a hard time separating their personal habits and routines from the concerns of the job. They don't leave the front door open and can't see why you should either — even if you're stocking 12-foot sheets of drywall. They don't wear shoes indoors and may request that you follow suit — even though it's a construction site and the floor has been protected. Sometimes the issue involves working hours: They arrive at work the same time every day and can't accept the fact that you or your subs might need to stop by the supply house or visit another job site.

It's one thing if customers make these requests while you're bidding the work — but what if they spring them

on you after you've begun the project? Your best bet is to prepare clients in advance so they know just what to expect. Tell them how you plan to do the job and explain that even though you'll do your best to accommodate their routine, some disruptions are simply part of the construction process.

Other Retentives become so absorbed in the details of the job they want to know the whys and hows of everything. I had one client who did so much research she would instruct the subs and me about the best way to install products. It wasn't so much a matter of needing to be in control — she actually couldn't sleep at night unless the product was installed exactly the way the manufacturer said.

Clients like that can drive you crazy — but they can also provide a service. I had such a client on a project where the architect specified some brand-new products and various conventional materials used in unconventional ways. Recognizing my client's thirst for perfection, I asked her to research the products and installations. She produced a ton of good information and found a couple of local installations with similar details for us to visit. We kept her so busy researching the unusual items she left us alone while we handled the routine aspects of the project.

Miss Lonelyhearts

Miss Lonelyhearts is the agreeable client — so agreeable you often fail to charge enough and maybe even throw things in for free. These personality types can be nice, yet so needy you find yourself wanting to take care of them. This has nothing

to do with whether they can afford your services — some clients, even wealthy ones, are just magnets for unpaid work.

I had one client who was a socialite: wealthy, well-traveled, and apparently living the kind of life most people can only dream of. But beneath the façade, she was lonely and starved for attention. She may not have been concerned about price, but if you think that made her the answer to a contractor's dreams, think again. In addition to not charging enough, I found myself working on this client's honey-do list (tasks I don't normally perform) just to please her. When all was said and done, I spent a lot of time working for not much money.

I've been sucked into this dynamic of wanting to please Miss Lonelyhearts-type clients too many times. Some folks are just very good at recognizing and exploiting their contractor's impulse to be helpful. I have finally learned to recognize this client type, to make sure that the relationship remains all business, and to remember that I'm there to make a profit.

Joe Six-Pack

Joe Six-Pack is just an average guy who is interested in hiring you to do a particular job. I like Joe because he's like many tradesmen: He understands what it means to do hard physical work and believes in paying a fair wage for it.

Joe can be a great person to work for, but sometimes he suffers from an overly narrow view of the world. He works for wages and may not appreciate your need as a businessperson to make a profit. All too often, his idea of a fair

wage is whatever he earns per hour, and his idea of a fair price is whatever the big-box store charges.

This is the kind of person who tells you, "I would do the job myself if I had the time." I try to avoid clients who have that attitude, because they typically expect to pay bottom dollar and want to scrutinize every line of the contract and every cost on the job. This is not someone you want to work for on a time-and-materials basis.

Pay Attention, and Your Business Will Benefit

Many contractors focus too much on the type of job and not enough on the type of client. In my experience, the client is just as important as the job.

Remodeling a kitchen for a Grinder is much different from remodeling a kitchen for Joe Six-Pack. And while most of us would agree that framing an addition is totally different from installing fine cabinets, the expectations for both projects might be the same if you're working for a Retentive.

I tend to do more work for Grinders and Retentives than I do for Joe Six-Pack and Miss Lonelyhearts types. In my case it's simply a matter of economics: I'm able to make a greater profit with those temperaments. But whoever I'm working for, I pay close attention to the kind of people they are in order to better manage my business.

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