



Tax & Legislative Information Series...

...Payroll Fraud and Prevention



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- **Some Background**

- Payroll fraud involves the **manipulation of an organisation's payroll system to divert funds for personal gain.**
- This type of fraud is particularly insidious because it **often goes undetected for extended periods**, leading to significant financial losses.
- In South Africa, both public and private sectors have been affected, with **cases ranging from ghost employees in government departments to falsified overtime claims in private companies.**
- In the South African context, payroll fraud is a **growing concern** due to widespread issues such as weak internal controls, limited oversight in public sector entities, and some cases, collusion between payroll officers and other employees.
- Both public and private sector organisations have reported **significant financial losses** as a result of payroll fraud.
- The seriousness of this issue has prompted **numerous investigations** by the Auditor-General, forensic accountants, and law enforcement agencies such as the Hawks.

- **Statistics of Payroll Fraud**

- **Globally**, payroll fraud accounts for about 9% of all asset misappropriation cases, with a median loss of \$45,000 per incident.
- In **South Africa**, payroll fraud is underreported, but estimates suggest it costs businesses more than R100 million annually.
- A study by Alexander Forbes revealed that **dishonest administrators siphon millions from companies'** salaries through various tactics, including ghost employees and unauthorised salary adjustments.



- **Types of Payroll Fraud**

- **Ghost Employees:** Fraudsters add non-existent staff to the payroll and divert their salaries to personal accounts. This usually goes unnoticed in organisations with poor HR/payroll controls.
- **Fabricated Work Hours or Pay Rates:** Staff may inflate their hours or manipulate pay rates, especially where manual timekeeping or minimal oversight is in place.
- **Dishonest Commission Claims:** Employees exaggerate or falsify sales figures or performance metrics to earn unwarranted bonuses or incentive payments.
- **Incorrect Worker Classification:** Deliberately mislabeling employees as contractors or part-time staff to sidestep tax obligations or avoid providing benefits.
- **False or Inflated Expense Claims:** Submitting fake invoices, personal expenses, or duplicate claims under the guise of business-related reimbursements.

- **Types of Payroll Fraud**

- **Salary Advance Abuse:** Receiving payroll advances without repayment, or exploiting system loopholes to secure multiple advances fraudulently.
- **Time Clock Fraud ("Buddy Punching"):** Colleagues clock in or out on each other's behalf to hide late arrivals, early departures, or unauthorised absences.
- **Abuse of Paid Leave or Benefits:** Claiming leave under false pretences (e.g., faking illness or submitting forged documents) to access paid time off.
- **Payroll System Tampering:** Unauthorised individuals access the payroll software to alter salaries or reroute direct deposits into their own accounts.
- **Duplicate Salary Payments:** Deliberate issuance of double salary payments, or repeated payment of a "lost" paycheck, often for personal gain.

- **Red Flags**

Early detection of payroll fraud often depends on recognising the following red flags:

- **Sudden or unexplained increases in payroll costs** without corresponding business growth.
- Employees who are **overly protective of payroll-related duties** and refuse to delegate or take leave.
- Multiple employees **sharing the same bank account** or home address.
- **Resistance to payroll audits** or changes in payroll procedures.
- **Lack of proper documentation** for overtime, reimbursements, or bonuses.



- **Consequences of Payroll Fraud**

- The impact of payroll fraud on organisations can be severe, both financially and reputationally.
- In South Africa, organisations that fail to prevent or detect payroll fraud may suffer:
 - **Financial Losses:** Repeated fraudulent payments over time can amount to millions of rands in losses.
 - **Legal Action:** Under the Prevention and Combating of Corrupt Activities Act (PCCAA), fraudulent activities in payroll can result in criminal charges, including fraud and corruption.
 - **Reputational Damage:** Organisations exposed in the media for payroll fraud face diminished public trust and damaged relationships with stakeholders.
 - **Employee Morale:** Fraudulent activity and lack of accountability can demoralise honest staff and lead to higher turnover.

- **Prevention Strategies**

- To effectively mitigate the risk of payroll fraud, South African organisations must implement robust internal controls and establish a culture of accountability:
 - **Segregation of Duties:** Ensure different individuals handle hiring, approving payroll, and disbursing salaries to limit the opportunity for one person to commit and conceal fraud.
 - **Regular Payroll Audits:** Conduct scheduled and surprise payroll audits to identify irregularities in salary payments, attendance records, and bank account details.
 - **Biometric Attendance Systems:** Implement biometric time and attendance systems to eliminate fraudulent clock-ins or “buddy punching.”
 - **Access Controls and Audit Trails:** Restrict access to payroll systems to authorized personnel only and ensure the system logs all transactions and changes. Choose software with role-based access, audit logs, and integration with timekeeping and HR systems. Avoid spreadsheets for payroll processing.

- **Prevention Strategies**

- **Verify New Employees:** conduct background checks, verify ID numbers with the Department of Home Affairs, and match new hires to signed employment contracts and actual departments.
- **Whistleblower Protection Mechanisms:** Establish anonymous reporting channels and protect whistleblowers from victimisation or retaliation under South Africa's Protected Disclosures Act.
- **Verify Employee Bank Account Changes:** Verify banking detail changes by contacting the employee in person or telephonically and verifying the changed banking details.
- **Monitor for Unusual Payroll Activities:** Flag duplicate bank accounts, sudden salary increases, and payments outside of normal cycles. Use automated reports and alerts.
- **Enforce Mandatory Leave/Vacation:** Make employees take leave annually. Fraud is often uncovered when the perpetrator is away and others take over their duties.

- **Prevention Strategies**

- **Train Staff to Recognise Fraud:** Run regular fraud awareness workshops, especially for payroll and HR staff. Include real case studies to illustrate red flags.
- **Perform Reconciliations Regularly:** Reconcile payroll with general ledger entries and bank statements monthly. Discrepancies should be flagged and investigated promptly. Include in your reconciliation's regular headcount checks.
- **Implement Whistleblower Channels:** Set up anonymous reporting systems. Make sure employees know how to report suspicious activity without fear of retaliation.



- **Interesting Cases:**

- **Ndwedwe Municipality Payroll Fraud (KwaZulu-Natal):**
 - **What Happened:** Between 2015 and 2016, Nkosingizwile Gama, a payroll administrator at the Ndwedwe Local Municipality, created fictitious employees ("ghost workers") and processed salary payments to their accounts, which he controlled. This scheme resulted in the municipality losing nearly R488,142.60.
 - **Outcome:** In June 2023, Gama was sentenced by the Durban Specialised Commercial Crimes Court to six years in prison, with two years suspended for five years, on the condition that he does not commit a similar offence during the suspension period.
 - ***<https://iol.co.za/mercury/news/2023-06-04-kzn-municipal-employee-sentenced-for-creating-ghost-employees-defrauding-municipality-of-nearly-r500-000>***

- **Interesting Cases:**

- **Newcastle Municipality Payroll Fraud (KwaZulu-Natal):**

- **What Happened:** From February 2012 to June 2020, Dedre van Rooyen, a payroll supervisor at the Newcastle Municipality, manipulated the payroll system to continue payments to former employees. She redirected these funds into her own and associated bank accounts, amounting to R3.1 million over 88 fraudulent salary transactions.
- **Outcome:** Van Rooyen pleaded guilty to all 88 counts of fraud. In June 2023, she was sentenced to 10 years in prison, with two years suspended for five years under strict conditions. Additionally, she forfeited her pension to the municipality and repaid the remaining amount in full.
- ***<https://www.sowetanlive.co.za/news/south-africa/2023-06-04-kzn-municipality-payroll-supervisor-jailed-for-paying-ghost-workers-r31m>***

- **Legal and Compliance Framework**
 - Organisations must align their payroll practices with the following laws:
 - **Labour Relations Act (LRA):** Guides employer disciplinary processes when fraud is detected.
 - **Companies Act:** Places fiduciary duties on directors to act in the company's best interest and prevent financial misconduct.
 - **Prevention and Combating of Corrupt Activities Act (PCCAA):** Criminalises bribery, fraud, and corruption, including payroll-related offences.
 - **Municipal Finance Management Act (MFMA):** Governs the financial conduct of municipalities, including payroll transparency and accountability.



- **Implementing a Payroll Fraud Risk Management Plan**
 - An effective payroll fraud prevention plan should include:
 - **Risk Assessments:** Periodic evaluations to identify vulnerabilities in the payroll process.
 - **Policy Development:** Establish and regularly update payroll policies, including approval protocols and disciplinary procedures.
 - **Training and Awareness:** Continuous staff education on ethics, payroll procedures, and fraud detection.
 - **Technology Integration:** Implement secure, modern payroll systems with analytics and automation.
 - **Oversight Committees:** Assign responsibility to a finance or audit committee to oversee payroll processes and ensure compliance.

Payroll Fraud and Prevention – In Summary

- **In Summary**

- Payroll fraud poses a significant risk to organisations across South Africa.
- However, with proactive management, strong internal controls, and employee accountability, it is possible to detect and prevent most forms of fraud before they cause serious damage.
- Organisations must take a holistic approach—combining people, processes, and technology—to create a fraud-resistant payroll environment.
- Companies and Payroll Departments can **minimise their risk by:**
 - Implementing a **Payroll Fraud Risk Management Plan**
 - Implementing **Fraud Prevention Strategies**





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