

Route to Profits

Summer 2008

Sometimes all you need is a little direction...

Learn to Spot Occupational Fraud and Resolve the Gaps

How much fraud is going on in your organization? None, you say? Hold on before you commit to that answer! You might just be surprised at the amount – and the fact that it is probably going on without your knowledge or suspicion. Fraud is prevalent in the business community and the losses can mount quickly. This is detrimental to the ongoing life of an organization.

According to the Association of Certified Fraud Examiners' (ACFE) 2006 Report to the Nation, "occupational" fraud results in the loss of 5 percent of an organization's annual revenue, or approximately \$652 billion in losses according to the U.S. GNP. The median loss in the 2006 study was \$159,000, with nearly one-quarter of the cases exceeding \$1 million in losses. The study also found the median time for the scheme from the beginning of the fraud until detection was 18 months.

Overall, 42 percent of detected occupational frauds produced no recoveries for the defrauded organization. Who perpetrates these schemes on businesses? I think you will be surprised.

It's been proven that the longer a perpetrator is employed in an organization, the greater the loss to the organization.

According to the ACFE's study, male white collar professionals accounted for 61 percent of cases, with age 42 being the median age of the perpetrator. The perpetrators came primarily from three groups of employees: accounting, executive management and sales, while the largest frauds in terms of dollars were carried out by personnel in the Purchasing Department.

The study also found that fraud schemes involving multiple employees are larger than those perpetrated by a single person. For example, 40 percent of frauds in the ACFE's study involved multiple people and resulted in frauds almost five times larger than the individually perpetrated fraud.

CRESSEY FRAUD TRIANGLE



The Fraud Triangle

The three factors resulting in a person committing a fraudulent act are Motive, Opportunity and Rationalization –the "Fraud Triangle." When perpetrators

have these three factors come together, they are in a likely position to carry out a fraud scheme. This happens when there is a motive (huge credit card bills), opportunity (person responsible for accounts payable without the proper internal controls in place and appropriate oversight), and rationalization ("I didn't get a big enough raise last year for all my long hours.").



It is important that an organization develop the proper controls, policies and procedures aspects of the triangle. The Motive factor is much harder to mitigate at an organizational level, but leadership should be aware of stress points and issues in their employees' lives, and be in a position to appropriately counsel and support these employees.

Every organization should learn how to reduce the opportunity for fraud. The ACFE reports the most common methods of discovering fraud were 1) tips, 2) by accident, 3) through internal audit and internal controls, and 4) external audit. Tips from employees, vendors and customers made up more than one-third of the discoveries.

Culture & Ethics

The most effective method of reducing fraud is to create a culture of integrity and high ethics among employees at all levels. This is started by the senior executive/owners setting the tone at the top regarding doing the right thing – always, without exception. Top executives can also hire and promote the right people based on skills and behaviors, not emotions. Developing a code of ethics/conduct is also critical to setting the tone at the top.

Since most frauds are found through tips from employees, companies should establish a hotline that employees, customers and vendors can use to report potential fraud and other irregularities. The calls should go to a third-party service that will take the information, protect the caller's identity, and forward to the appropriate person in the organization or specified outside interests – normally the person responsible for dealing with a fraud or employment issue. It is important that all calls be

to mitigate the Opportunity and Rationalization investigated to determine the actual situation. If employees don't see a follow through on the hotline calls, it is of no value. Instead, a tone of "acceptance" is established by management.

Regulatory Controls

Two significant activities required by Sarbanes-Oxley to reduce the opportunity for fraud include reviewing your antifraud process and internal controls, and developing a strong oversight process. These activities go hand-in-hand, sending a strong message to potential perpetrators that you are doing everything you can to reduce the opportunity to commit fraud in your company.

As the public's trust in the corporate business remains under scrutiny, companies and organizations must not only comply with regulations, but also realize a significant obligation to their stakeholders, employees and other audiences. From the accounting perspective, an internal control review and/or a fraud prevention check-up by a professional would provide your organization with the necessary action plan to reduce the opportunity to steal hard-earned dollars from your organization.

While an internal review is a solid first step to reduce fraud, remember that anyone who works for an organization – no matter how small or large it might be – has a responsibility to their company and themselves. Being a good "corporate citizen" is paramount to integrity and ethical behavior in today's business marketplace.

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