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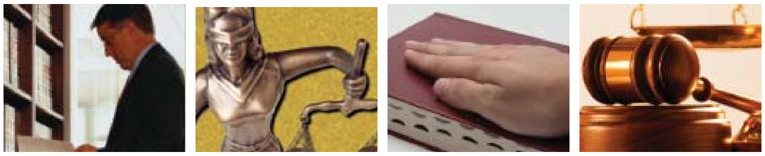

Litigation Support

Keep an Eye on Fraud

By Irina Balashova, CPA, CFE, CIA

The Association of Certified Fraud Examiners (ACFE) publishes its *Report to the Nations on Occupational Fraud and Abuse – Global Fraud Study* every two years. The 2014 version is based on 1,483 cases of occupational fraud as investigated by the ACFE that took place in more than 100 countries. A primary goal of this publication is to raise public awareness about the costs and universal nature of fraud, as well as to provide lessons about how fraud is committed, how it is detected, and how organizations can reduce their vulnerability.

Occupational fraud comprises financial statement fraud, corruption, and asset misappropriation. The categories may be labeled generally, but fraud has a complex nature and is pervasive in the business world.

Fraud Facts

The survey revealed that a typical organization loses about 5 percent of annual gross revenues to fraud. This is staggering when you apply this percentage to the 2013 Gross World Product: the projected fraud loss would be $3.7 trillion. In addition to the loss of cash, there are hidden costs of loss of reputation, productivity slowdown, and investigation costs that are hard to quantify. CPAs and their clients need to stay alert and armed with knowledge to prevent, discover, and mitigate fraud at its earliest stages. The ACFE report provides significant insight on fraud fundamentals, and among its many noteworthy points are the following:

- Asset misappropriation was the most common fraud in the survey, occurring in 85 percent of the cases, causing a median loss of $130,000. Only 9 percent were financial statement frauds, although the median loss was much greater at $1 million.
- Banking, financial services, government, and public administration are at the most risk of fraud.
- The impact of fraud is not universal: the smallest organizations suffer most, with 29 percent of fraud cases. An average loss of $154,000 is attributable to organizations with fewer than 100 employees.
- The higher a perpetrator's position in an organization, the greater the loss from fraud: owners/executives cause losses of $500,000 on average, while fraud conducted by employees cost organizations about $75,000.
- Most fraudsters work for their employers for several years before engaging in fraudulent activity.
- Losses increase considerably if collusion takes place – from an average of $80,000 when one person is involved, to over $500,000 in the cases of five or more perpetrators.

Management should continuously search for better ways to discover and prevent fraud. It is important to detect and deter fraud early, since duration adds to its costs: a median financial damage of $50,000 is attributable to fraud schemes with a duration of less than seven months, which increases to $965,000 when fraud continues un-detected for 61 months or more.

How to Combat Fraud

Statistics show that some personnel procedures used by organizations may not be preventing fraudsters from getting through the door. Background checks, for example, being overall useful as selective criteria, do not guarantee that a new hire will act with integrity. Similarly, long-term employees with a good reputation are not immune to becoming perpetrators. After all, most fraudsters are first-time offenders, 82 percent of which were never convicted of a fraud-related offense and never terminated as a result of involvement in fraud.

Anti-fraud controls such as proactive data monitoring and analysis or employee support programs are capable of bringing down the number of fraud cases by more than 50 percent.

Fraud detection methods categorized in the ACFE study consistently display the same effectiveness during the past several years:

- Tips help uncover more than 40 percent of all fraud cases, far better than other techniques.
- Management review detects 16 percent of fraud cases, and internal audit accounts for 14 percent.
- Seven percent of cases are discovered by accident.
- External audits reveal 3 percent of fraud cases.

While tips are the most fruitful detection method, it is one where organizations have limited control. Statistics show that internal and external audits, along with other popular methods of detecting fraud such as account reconciliation and document examination, account for only 28 percent of detection. Implementing hotlines increases chances of receiving a useful tip by 17 percent. This is particularly important, since employees tend to produce the greatest number of valuable tips: almost 50 percent of tips come from them.

CPAs of different practice areas need to be aware of, and prepared to identify, the warning signs of fraud. Most perpetrators show one or more behavioral red flags that may be recognized early, leading to the eventual discovery of the fraud. At least one red flag was present in 92 percent of cases studied by ACFE. Frequent behavior inconsistencies to look at include living beyond one's means, financial difficulties, close association with vendors/customers, and unwillingness to share duties. Proper fraud-awareness training needs to be implemented through all levels of an organization to notice and act upon early signs of fraud.

Management should continually assess the organization's specific fraud risks and evaluate its accounting and control systems to address the prospect of fraud. More detail can be found about the ACFE report on its website at www.CFE.com.

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