

NEW STUDY UNDERSCORES Importance of Fraud Prevention

One of the most important steps any company can take to achieve maximum profitability is the introduction of an effective fraud-detection program. A new study has documented that fraud incidents are rising in frequency, often go undetected, and are responsible for significant financial losses in businesses of all sizes.

As trusted advisors to business establishments, attorneys and accountants must work together to combat the rising tide of fraud by helping their clients introduce a reliable series of preventive procedures.

The biennial study of the Association of Certified Fraud Examiners (ACFE) just reported that U.S. organizations lost 7 percent of their annual revenues to fraud. Applying the ACFE's finding to the nation's gross domestic product, this translates into \$994 billion in annual losses, up from an estimated \$652 million just two years ago.

MOST FRAUD COMES FROM INSIDE

Perhaps the most alarming aspect of the ACFE study was the high percentage of fraud committed by employees in positions of responsibility, as well as the various types of fraud occurring simultaneously in the same businesses.

In 88.7 percent of the defrauded companies reviewed by ACFE, losses resulted from asset misappropriation, which includes payroll fraud, revenue skimming and fraudulent invoicing. The median loss on each incident of asset misappropriation was \$150,000.

Corruption struck 26.9 percent of these companies through incidents involving bribes and conflicts of interest with a median loss of \$375,000. Financial statement fraud -- including booking fictitious sales and recording expenses in the wrong periods -- occurred in 10.3 percent of defrauded companies but tallied a median loss of \$2 million.

ABUSING POSITIONS OF TRUST

Employees who are most prone to committing fraud are those who face changing personal circumstances and rationalize their misdeeds to justify their behavior. These illegal acts can take place at nearly any level of company operations.

The new ACFE study revealed that 28.9 percent of fraud was committed by accounting department employees, 17.8 percent involved upper-level management or executives, and 16.1 percent implicated operations department employees.

Detection often can be traced to an employee's personal patterns, such as living above one's means, dealing with serious family medical issues or refusing to take vacation. These traits can be particularly evident to the employee's co-workers who observe his/her behavior most closely. Therefore, it is prudent to encourage a company's workforce to come forward with their suspicions.



PRACTICAL PREVENTION

Open communication is the most effective means of detecting and deterring fraud. Company management should make it easy for employees to provide tips, especially anonymously. Fraud training also is an important tool, so that employees will recognize the telltale signs.

Division of responsibilities can serve as a practical fraud-prevention device. For example, a company should avoid having the same employee approve invoices, process purchase orders and cut checks. By involving several people in the process, a company minimizes the chances of misrepresentation.

A small business might find it difficult to segregate job responsibilities in this way, but can compensate by having monthly bank statements sent to its owner's home for independent comparison of records.

PROFESSIONALS' CRITICAL ROLES

When a case of fraud is discovered, company management should work closely with its attorney and certified public accountant, taking steps to document all losses and their causes in a manner that are admissible in a court of law. The role of the attorney is particularly important to ensure that discovery is conducted properly.

An accountant with training in fraud examination and prevention can advise management on practical steps to be taken to avoid the most common types of fraud in the workplace. Working with a company's attorney, this specialist also can guide executives through the proper steps to document and recover losses resulting from fraud when they are detected. ↕



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