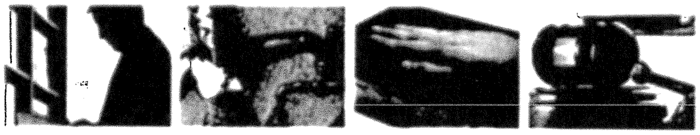

Litigation Support

Breaking Down Some Stats on Fraud

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Every two years the Association of Certified Fraud Examiners (ACFE) publishes its *Report to the Nations on Occupational Fraud.* The publication can be a useful tool for CPAs, business owners, and the general public when it comes to identifying, investigating, and preventing fraud. The ACFE's 2012 report was compiled from analyzing 1,388 cases investigated worldwide.

The range of possible fraud schemes is large – from writing checks to oneself, to identity theft, to padded expense reports, to Ponzi schemes, and so many more. At the core, however, all involve a violation of trust. For businesses to operate and have commerce flow, whether they be small or large, they must entrust their employees with resources and responsibilities. Violations of this trust can have a fallout that goes far past financial loss, and the repercussions can be dire.

It is therefore essential that CPAs and their clients know as much about the nature of fraud as possible. The following is a summary of some of the key points contained in the ACFE report, several of which may surprise you:

- The typical organization loses 5 percent of its gross revenues to fraud each year. This translates into a total of more than $3.5 trillion dollars.
- Fraud events have a median duration of 18 months before being detected.
- Average amounts of some frauds:
  Asset misappropriation – $120,000. This is the most common type of fraud at 87 percent of all cases reported, and includes theft of cash, false billing, inflated expense reports, payroll, and check tampering.
  Corruption schemes – $250,000. These include bribery and conflicts of interest.
  Financial statement fraud – $1 million. This makes up 8 percent of all frauds reports, and involves recording fictitious revenues, understating expenses, or inflating assets.
- Industries most commonly victimized include banking and financial services, government and public administration, and manufacturing.
- The primary sources for how occupational fraud schemes are detected are listed here, and external audits did not make the top five:
  Tips – 43.3 percent. Insider tips from employees are the No. 1 source.
  Management review – 14.9 percent.
  Accident – 7 percent.
  Account reconciliation – 4.8 percent.
  Document examination – 4.1 percent.
  External audits represented 3.3 percent of fraud detection sources, which is a significant divergence from the public expectation of auditors. The public does not necessarily understand that auditors are supposed to plan audits to address the risk of fraud and perform procedures accordingly, not actively investigate it through the audit.
- Higher levels of authority cause much greater losses. The median loss committed by owners/executives was $573,000; by managers was $180,000, and by employees was $60,000.
- Anti-fraud controls do correlate with decreases in the cost and duration of occupational fraud schemes. This means companies can reduce the risk of fraud in their companies by taking proactive measures.
- Most occupational fraudsters (87 percent) are first-time offenders.
- Nearly half of victim organizations do not recover any losses that they suffer due to fraud.
- In 81 percent of cases, the fraudster displayed one or more behavioral "red flags," such as living beyond means (36 percent), financial difficulties (27 percent), or unusually close relationship with vendors or customers (19 percent). Employers must become well-versed in how to spot these red flags, and design procedures to address them.

Recommendations

The threat of occupational fraud is universal. While the risks can be modified, fraud can never be eliminated. Providing individuals with a means to report suspicious activity is critical. Fraud reporting mechanisms, such as hotlines, should be set up to receive tips from both internal and external sources. External audits should not be relied upon as a main source of fraud prevention since, as noted above, they only detect about 3 percent of frauds. While audits are important for several reasons, they have limited usefulness in uncovering fraud.

Targeted awareness training for employees and managers is a critical component of a well-rounded fraud prevention and detection program. Anti-fraud training has been shown to both reduce fraud losses and the duration that frauds are perpetrated. This could be vital for small businesses, which are particularly vulnerable to fraud because they typically have fewer resources and less-effective controls.

Management should continually assess the organization's specific fraud risks and evaluate its fraud prevention programs. More detailed information about the occupational fraud report can be found on ACFE's website at www.ACFE.com.

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