

Fraud is prevalent!

According to the 2006 White Paper issued by the Association of Certified Fraud Examiners:

1. Five percent of business revenues are lost each year due to occupational fraud and abuse. That is an estimated \$652 billion dollars per year, or approximately \$4,500 per employee per year!
2. Of the 1,134 frauds reported in the study, the median loss was \$159,000 with 25% of the cases reporting losses in excess of \$1 million.
3. The average fraud scheme lasted 18 months before it was detected.
4. The most common method for detecting occupational fraud was a tip from an employee, customer, vendor, or anonymous source. The second most was by pure accident.
 - a. Thirty-four percent of frauds were uncovered by a tip.
 - b. That tip rate of discovery is double that found by internal auditors and is triple the number of frauds uncovered by the external auditors.
5. The typical perpetrator was a first time offender. Only 7% of the perpetrators in the study had a prior fraud related conviction.
6. Small businesses are the most vulnerable. The average small business fraud scheme caused \$190,000 in losses (up from \$98,000 in the 2006 study).
7. Organizations with anonymous tip hotlines experienced an average loss of \$100,000, while those without hotlines experienced losses of twice that amount.
8. Small businesses (fewer than 100 employees) appear to lose so much money because:
 - a. Less than 10% have a fraud reporting system.
 - b. Less than 20% have audit departments and/or conduct fraud training for managers and employees. Thus, fraud is discovered by accident.

Median Loss per Fraud Scheme by Industry Grouping

<i>Industry</i>	<i>Median Loss per Scheme</i>
Wholesale	\$ 1,000,000
Construction	\$ 500,000
Manufacturing	\$ 413,000
Governmental	\$ 82,000
Retail	\$ 80,000

Source 2006 ACFE Report to the Nation on Occupational Fraud and Abuse.

Why is fraud – particularly financial statement fraud – committed?

1. To encourage investment through the sales of company stock.
2. To demonstrate increased earnings per share or a partnership profits interest, thus allowing increased dividends / distribution payout.
3. To cover the inability to generate cash flows.
4. To dispel negative market perceptions.
5. To obtain financing or to obtain more favorable terms on existing financing.
6. To sell out for a higher price.

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7. To demonstrate compliance with financial covenants.
8. To meet company goals and objectives.
9. To receive performance related bonuses.

Examples of famous frauds:

1. Enron: Fuzzy disclosures about special purpose entities.
2. WorldCom: Improper capitalization of expenses.
3. Adelphia: Improper related party transactions and conflicts of interest.
4. ConAgra: A subsidiary included 13 months of revenue while reporting only 12 months worth of expenses.
5. Microsoft and Cisco Systems: Juggled reserves for bad debts to manipulate net income and stockholder perceptions.
6. McKesson-Robbins: Overstated inventories to disguise net operating losses.
7. Boeing Aircraft: Adjusted amortizable costs over revised production schedules to inflate net income and deflate losses.
- 8.

Types of Occupational Fraud and Abuse:

<i>Category</i>	<i>Description</i>	<i>Examples</i>	<i>Cases</i>	<i>% of cases</i>	<i>Median Loss</i>
Asset Misappropriation	Theft or misuse of company assets	False invoices, Payroll fraud, Skimming	1,038	91.5%	\$ 150,000
Corruption	Influence peddling	Bribes	349	30.8%	\$ 538,000
Fraudulent Statements	Falsification	Conflicts of interest Fictitious sales Reporting expenses in the wrong period	120	10.6%	\$ 2,000,000

Source: 2006 ACFE Report to the Nation on Occupational Fraud and Abuse.

Characteristics of Fraud:

Management or other employees have an incentive or are under pressure that provides a reason to commit fraud. Examples of pressures that commonly lead to fraud include:

1. Inability to pay one's bills
2. Drug or gambling addiction.
3. Need to meet earnings to sustain investor confidence.
4. Need to meet productivity targets.
5. Desire for status symbols, such as a house or a car.

Common Rationales:

1. I was only borrowing the money. I planned to pay it back.
2. I was entitled to it for all the hard work I did that no one seemed to appreciate.
3. I needed it for my family.
4. My employer cheats me out of a fair wage.
5. My employer is dishonest to others; he deserves to be fleeced!

Want help? Call Goodman & Company, CPAs to review your internal controls, accounting systems and procedures, and look for fraud. **610-253-2745.**