Did you know… about Public Company FRAUD!

Based on ACFE Report to the Nation on Occupational Fraud & Abuse, 2006

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As I travel around the country interacting with members at conferences and other events, I sometimes ask about fraud prevention and detection techniques used in their companies, and whether or not they have experienced a fraud loss. In large companies, the scandals of 2001-2002, and the resultant Sarbanes-Oxley Act, have significantly raised the level of consciousness about fraud and the internal controls necessary to prevent it.

Occupational fraud and abuse is going on all around us, from simple pilferage to personal use of company assets to complex schemes of check tampering or wire transfers. Every two years the Association of Certified Fraud Examiners (ACFE) conducts a survey among its members asking about occupational fraud that he or she had investigated during the preceding two-year period. Following are some facts from the most recent study, which contained over 1,100 cases and about 33% of those were public company related. Below are some interesting findings from that study - either occupational fraud / abuse in general, or specific to large public companies.

1. **The median estimate is that a typical organization loses 5% of its annual revenue to fraud.** This means that an organization with revenue of $500 million will lose $25 million to fraud each year. Fraud losses come directly off the bottom-line so you need to think about how much in additional sales your company would need to get back that 5%.
2. **In the ACFE study, just over 62% of the frauds investigated by its members had a loss of $1 million or more.** Keep in mind, these are only the frauds that were identified and investigated – what else was going on in these organizations, that was not detected?
3. **Asset misappropriation (theft or misuse of an organization's assets) is the most common type of occupational fraud & abuse representing 69% of the study's cases.**
4. Corruption, where an individual uses his/her influence in a business transaction to obtain a benefit for themselves contrary to that person's duty to his/her employer, represented just over 23%, and fraudulent financial statements represented 8%.
5. **Within a given occupational fraud scheme, the perpetrator(s) will often engage in several different forms of illegal conduct.** In fact, 89% of corruption cases also involved asset misappropriation of some sort. Keep this in mind when investigating a known fraud – look for additional schemes that may also be underway. A typical example is an employee who accepts kickbacks or other bribes from a vendor in order to process invoices for fictitious goods and services.
6. Of the 1,134 cases examined as part of the study, **the wholesale trade industry had the highest median loss at $1 million per case,** (based on 30 cases). This was followed by the construction industry with a $500,000 median loss (35 cases). The banking and financial services industry has the highest number of cases at 148 and a median loss of $258,000.

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7. **The single biggest method of fraud detection in a public-company is through tips,** accounting for over 40% of the frauds detected. The substantial majority of tips (almost two-thirds overall) come from employees. Vendors, customers and anonymous sources account for the remaining third of tips reported. It is important to note that tip "hotlines" should be open to non-employees including customers and vendors, and the existence of the hotline can be communicated to them via purchase orders, invoices, requests for proposals, etc.
8. **For all companies with an anonymous fraud hotline in place, median loss was roughly half** and the time from inception of the fraud to detection was also reduced by approximately one-third. An anonymous tip line is required by the Sarbanes-Oxley Act and this must be monitored by the Audit Committee of the Board of Directors. This monitoring needs to be robust and not perfunctory to be effective.
9. **Internal audits plus internal controls accounted for 49% of frauds detected in public companies.** Surprise audits were the least commonly used anti-fraud control among those tested.
10. **Owner/executives were the least likely perpetrators of occupational fraud, but when they were the principal perpetrators the median loss was $1 million.** Perpetrators with long tenure at the organization, as well as older perpetrators also increased the size of the loss. Education level had the same effect – employees with a postgraduate degree generated the highest median loss, more than double the loss of perpetrators with only a bachelor degree.
11. **Fraud schemes by perpetrators in the Purchasing Department led the list of median losses** at $1 million, followed closely by those in executive and upper management at $900,000.
12. **Nearly 40% of frauds involved collusion between at least two people.** In this study, frauds perpetrated by two or more people had a median loss of $485,000 vs. frauds perpetrated by one person with a median loss of only $100,000.
13. **Nearly two-thirds of the victim organizations routinely conducted background checks on new employees at the time the frauds occurred** – making this a more common anti-fraud practice than internal audits, fraud hotlines, anti-fraud training or surprise audits. Yet this practice has little impact on the overall incidence of fraud as fully **88% of perpetrators in this study had never been charged or convicted of a crime.** To be sure, background checks may weed out the employee candidate with the goal of defrauding the employer, but they will not catch the typical occasional fraudster who has no prior criminal record.
14. **Almost 30% of the cases in the study were not referred to law enforcement,** with organizations citing fear of bad publicity, sufficient internal discipline and private settlement as the top three reasons why they did not report to law enforcement.
15. Of the 71% of organizations that did report to law enforcement, **74% of perpetrators pleaded guilty or no contest to the charges**.
16. **In over 42% of cases, there was no recovery of losses.** Just over 16% recovered 100%.
17. According to a separate KPMG study, overall, **74 percent of employees nationwide had observed misconduct,** which was defined as deceptive sales or anti-competitive practices; submitting false invoices to customers; breaching computer network controls; accepting kickbacks from suppliers; or doing business with third parties involved in money laundering.

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For additional information, or to download the 2006 ACFE Report to the National of Occupational Fraud and Abuse, use this link: http://www.acfe.com/fraud/report.asp.
