



“The Internal Audit Professionals”™

Top Ten Actions To Prevent Fraud and Corruption

Having its roots in a Biblical proverb, “An ounce of prevention is indeed worth a pound of cure”. The same holds true for fraud detection and prevention. It is much easier to prevent fraud than detect fraud once the perpetrators have gotten a head start. The key is to make fraud difficult! The “Fraud Triangle” states that Opportunity, Incentive and Rationalization must be present for fraud to occur. Of these, the greatest is Opportunity. Fraud has never been committed by someone who did not have the opportunity, but many who might not have committed fraud, even though they may have had some incentive and/or rationale, have done so simply because they were provided the opportunity. The following actions will reduce the opportunity for fraud:

10. Stay on top of your purchasing department. Many frauds continue for years without detection. Some of these develop after many years of close relationships between suppliers and members of purchasing departments or other gatekeepers within your organization. Rotate your personnel, be suspicious of employee lifestyles, put routine purchases out for competitive bid, continuously strive to judiciously cut expenses; prune the tree. Sam Walton realized he didn’t have to have the lowest expense base; he just had to be lower than his competitors.

9. Require receipts. T&E fraud remains the most lucrative, and easiest, method used by employees to steal from their employers. If your company doesn’t require employees to provide original receipts for all expenses, you’re losing money. There must be a reason that the most common dollar cutoff required by employers for receipts is not \$25, as stipulated by the IRS, but \$.01. Schemes used by employees for T&E fraud are more creative than methods employed by Pixar in the latest Disney film. Don’t be responsible for sanctioning the slippery slope.

8. Develop a Code of Corporate Conduct and have employees sign and return it. If you already have one, go directly to #7. Codes of conduct do two things; first, they lay down the law and prevent the “Ignorance Defense”, and secondly, they provide honest employees with the mechanism to turn in their dishonest co-workers. Create an ethical environment and expect honesty.

7. Outsource your hotline. A confidential 24/7 hotline operated by a third party professional is your best option for uncovering fraud. Companies are now required to have a way for employees to anonymously submit concerns. A hotline is the best tool, and, to be effective, it should be completely independent of your company’s operations. The ACFE’s 2002 ‘Report to the Nation’ found that **companies with fraud hotlines cut their losses by 50%** because activity was reported through tips. Employees who might fear repercussion from reporting fraud via an internal channel will report fraud if a third-party option is available.¹

6. Develop internal procedures and follow up on tips immediately. Discern the truth; don’t worry about the source. Work fast; the older the trail, the harder it is to follow. Establish dual responsibility and accountability for reporting and follow up on reported fraud. It is important that all fraud tips are reported to the audit committee, internal auditors and external auditors because of the possibility of involvement by top executives who could otherwise quash reports if they are not distributed outside of the normal chain of command. Where there’s smoke...

5. Have bank statements sent to your CEO’s home. A notable fraud examiner recently stated that 90% of the frauds he’s investigated could have been prevented with a fifteen-minute monthly review of the bank statement by the CEO **before it is sent to accounting** for reconciliation. With each accounting fraud costing the average small business over \$150,000, the incremental time such a review takes is a smart investment.

4. Strengthen controls over electronic transfers. Many companies require two signatures on all checks exceeding a relatively nominal amount, but will allow one or two people to have access to millions of dollars via electronic transfer initiations and confirmations. Once the money is out of your U.S. bank account and into an off-shore account, it is virtually impossible to get it back. An ounce of prevention...

3. Conduct thorough background and reference checks. A staggering 20% of Americans have lost their jobs in the past three years – many through no fault of their own. However, this simple procedure can identify prospective employees who not only have embezzled from previous employers, but those who have committed everything from child abuse to misuse of company resources. This step cannot be skipped, no matter how urgent the need, nor important the position.

2. Analyze quarter-end manual and adjusting journal entries. There is no easier way for senior executives to manipulate accounting results and commit accounting fraud than through the preparation of journal entries outside the normal accounting process. These entries are often made directly by the Chief Financial Executive, as directed by the CEO, with no documentation, and are not independently reviewed or questioned by any party. Quarter-end reporting is typically hectic and “critical” entries are booked at the last minute. If it doesn’t “feel” right, it probably isn’t. Trust your instincts and don’t take anything at face value.

And the #1 Action to Prevent Fraud and Corruption...

1. Hire ‘The Internal Audit Professionals’™ – PRI – all our Partners and a majority of our Audit Professionals are CFE’s – Fraud Expertise making a Difference for our Clients-

¹ Taken almost verbatim from www.tnwine.com