

BUSINESS

PROTECT YOUR BUSINESS FROM FRAUD

By Suzanne Cloutier, CPA

Webster defines fraud as "(1) deceit, trickery; intentional perversion of the truth in order to induce another to part with something of value... (2) act of deceiving or misrepresenting."

There is an increase in fraudulent activities in our society. A week doesn't go by without the reporting of a new fraud. And the internet creates new possibilities for the potential fraudster. The potential for fraud must be taken seriously. It is much more costly to allow the fraud to occur and have to investigate the problem and prosecute later than it is to implement a proactive program.

Managers are often busy in other areas or deny that fraud could happen to them. Nevertheless, it is management's responsibility to detect and prevent fraud.

You need to identify where you have exposure. Ask the tough questions: Where? Who? What? How? Where am I at risk? Who has the opportunity? What assets are susceptible to misappropriation? How effective are my controls?

THE FRAUD TRIANGLE

It is estimated that about 90% of all frauds go undetected. That's because by their very nature they are hidden. In order for fraud to occur the three elements of the "Fraud Triangle" must be present:

- * perceived opportunity
- * perceived outside pressure
- * rationalization

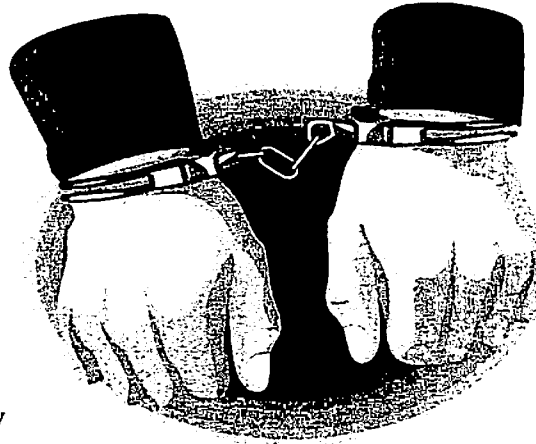
Outside Certified Public Accountants cannot do much about an individual's pressure or rationalization but they can reduce opportunity.

Fraud detection and prevention goes way beyond improving internal controls. Fraud may be hidden, but the symptoms,

or "red flags," must be recognized and vigorously pursued. Question anything that doesn't look right. Strengthen internal controls. Ask questions if you see one of your employees living beyond his or her means or appearing under more and more stress. Most frauds are uncovered by accident, some from tips, very few by auditors.

Every fraud involves a theft act such as stealing of assets, concealment and conversion, or spending company assets. The coverup distinguishes fraud from other crimes. The typical fraudster is friendly, outgoing, first to arrive in the morning and last to leave at night. Fraudsters are the most trusted employees. Let me repeat that. They are the most trusted employees.

"The controller perspired profusely....He was taken away in handcuffs."



Fraud is usually perpetrated by the ones closest to you. In every fraud I have witnessed the first words out of the victim's mouth upon learning of the fraud was, "but I trusted him [or her]." Of course. If they hadn't stolen trust, they would not have the opportunity to steal money. An owner or manager must have confidence in the fraudster to allow fraud to happen.

BE ALERT TO RED FLAGS

The first fraud I personally discovered was by accident. A controller was supposed to send me the trial balance and certain schedules on a Thursday. He told me the documents had been mailed. The following

Monday, he said he was still working on them. I heard the lie (red flag) and asked the owner to meet me at the office the following morning.

When we arrived the controller said that the workpapers and bank statements were at home (red flag). Documents are not supposed to leave the premises. He promised to bring them the following morning. The owner sent him out on an errand. We found copies of two checks which looked like they had been signed by the owner, but had not been. I suggested that the owner call the bank and get a copy of the most recent bank statement. Meanwhile, she called the Police. A uniformed officer arrived and listened skeptically to our suspicions. When the controller returned, the officer proceeded to interrogate him in his office. The controller perspired profusely.

Luckily, the bank had started faxing the statements and canceled checks to the office while the uniformed officer was there. The controller had written checks to himself totaling approximately \$45,000 in one month and had forged the owner's signature. He was taken away in handcuffs.

PUT A PREVENTION PROGRAM IN PLACE

Billions are lost to fraudsters every year. Putting in a good fraud prevention program is far less costly than trying to investigate fraud and recover the loss. A good fraud prevention program should include:

- * Good hiring practices
- * Educating employees
- * Eliminating opportunities
- * Dealing with fraud symptoms
- * A written fraud policy

A formal fraud policy should be included in the employee handbook and include a management statement that fraud perpetrators will receive certain, severe and swift criminal action.

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