

UNDERSTANDING FRAUDS: HOW AND WHY THEY OCCUR



We have witnessed several major alleged frauds - Satyam in India, Madoff in the United States of America and L&G in Japan. Besides these high profile cases, numerous others are reaching the headlines and many more have not even made the news.

To understand frauds, we need to examine the motives of and opportunities for fraudsters. For most frauds to occur, a motive and an opportunity must exist. Certain individuals set out to defraud their employers, and will simply wait for the opportunity to arise before they do so. Such frauds take place regardless of the economic climate, although it may become more difficult for them to cover up in a recession as organisations focus on examining their financial statements and controlling expenditures.

PERSONAL BENEFITS

Some individuals' personal financial conditions will come under strain as they take a beating from a credit crunch. People who used to live beyond their means with extravagant lifestyles may find that their salaries and bonuses are no longer at the levels to which they are accustomed to. A certain number might resort to theft or fraud in order to continue to maintain their current standard of living or to meet the increasing credit commitments and levels of debt.

FINANCIAL PRESSURE

As the recession kicks in, financial results are affected. Management has the responsibility of ensuring that the organisation's finances and results are constantly on the up trend, may be more likely to "cook the books" to reflect a better financial position than it really is. The management incorrectly believe that they are acting in the best interests of the organisation and its stakeholders. Often they do not even realise that their actions would be considered fraudulent, or the damage that they might cause to others.

The impact of a relatively small fraud can be much more dramatic on a smaller organisation than on a larger one. It is quite common that small organisations treat fraud as the least of their worries. They tend to believe that, because they have a small number of staff whom they think, they know very well, they are not likely to be the target of fraud. At times, they also believe that they can easily detect fraud at its early stages. This is always a false belief. Coping with the consequences of even a small fraud can consume huge amounts of time and resources.

Here are some red flags that may give rise to the possibility of fraud existing in your organisation:

• Accuracy, Authenticity and / or Completeness of Management Reports

Accounting losses reflect the business realities. If you feel that times have been difficult lately and yet your management reports portray a different picture, then you may wonder if someone is glossing over the losses? Double-check the numbers and ensure that you are comfortable with management reports prepared by your accountant. Do raise questions to your employees and management when they do not make sense.

• Business Locations

Operational risk increases with distance from the head office. Even for a single operation, the risk rises with physical and organisational distance from management. Are you comfortable and confident that your head of departments at the various business locations have sufficient oversight of the operations?

• Cash Management

Accounting entries can be manipulated; cash disbursements cannot. Cash should be the fundamental control in an organisation. The amount of cash held can be counted, and values can't be faked - you either have the cash, or you don't. Regular reconciliation of your organisation's cash position is essential and avoid holding large sums of cash in hand.

• Employees Behaviour

Employees who do not take vacations or always stay late at work are not necessarily role models of corporate virtue. 'Lifestyle' choices may be used to mask business realities and often frauds are only discovered when the employee is away.

• IT Infrastructure

Computer systems are an open door to the heart of the business, and their integrity and security are equally important.

• Respect Business Quality

Volume is no substitute for value: your business was likely built on key customers who returned and gave you a base to grow. If these customers start to leave and you are assured that new and smaller volume customers are replacing them, maybe something is going on.

Assessing your fraud risk can help create greater awareness of where your organisations should improve, in terms of financial systems and processes. By adopting a leading-practice approach to designing and implementing anti-fraud programs and controls, your organisation can reduce the risk of fraudulent activity along with other potentially damaging legal, financial, and reputational effects, especially, during an economic downturn.



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