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http://hibernia.com/Common/Pages/Hub_Site_Front_Door_A/0,2499,3584_0_41007622_Want%2Bto%2Bminimize%2Bfraud%2Blosses%253F,00.html

Want to minimize fraud losses? Focus on curbing employee crime

Fraud continues to be a major financial drain on U.S. companies, and employees are the major perpetrators, according to recent industry studies. But the good news is that there are effective employee-fraud prevention strategies.

In KPMG's Fraud Survey 2003, 75% of companies reported experiencing fraud in the past year, or 13% more than responded in a similar 1998 survey.

Both KPMG and the Association of Certified Fraud Examiners (ACFE) agree that the majority of business fraud is committed by employees. Some 60% of fraud in the KPMG study was employee fraud, while the figure was 64% in a 2004 ACFE study.

And the cost of all of this employee fraud? – An estimated \$660 billion a year, according to the ACFE.

Forms of fraud

The ACFE segments fraud into three categories:

Asset misappropriations involve theft or misuse of an organization's assets. Common examples include skimming revenues, stealing inventory and payroll fraud.

Corruption occurs when employees wrongfully use their influence in a business transaction in order to procure some benefit for themselves or another person. Examples of corruption are accepting kickbacks and engaging in conflicts of interest.

Fraudulent statements generally involve falsification of an organization's financial statements, such as overstating revenues or understating liabilities or expenses.

The median fraud loss in the ACFE study was \$100,000. Asset misappropriations accounted for 90% of the fraud cases but only hit companies for a median loss of

\$93,000. Meanwhile, fraudulent statements were the least commonly reported frauds at 7.9% but had the highest median loss of \$1 million.

One key to minimizing employee fraud losses is basic vigilance, according to consultant **Claudia Volk**, who spoke on the subject at the 2004 **Association for Financial Professionals (AFP)** Conference in San Diego.

“Most fraud perpetrators aren't brain surgeons,” she says. To illustrate, she tells the story of an internal auditor at a large firm who thwarted a case of expense account padding. The auditor rejected three employee requests for mileage reimbursements when he noticed that all three were for the same amount and he had personally seen the three employees get into the same vehicle and head to their conference.

“The conference they were attending was a seminar on ethics,” she adds.

Uncovering, preventing fraud

More than three out of four organizations in the KPMG survey reported uncovering fraud through internal controls, while two-thirds of respondents reported detecting fraud by internal audit. The third most-cited method for uncovering fraud was notification by employee (63%).

“Tips” were most often cited as the method of discovery in the ACFE study, which concluded that confidential reporting mechanisms, such as employee hotlines, reduce fraud losses significantly.

In addition to employee hotlines, Volk's list of suggested fraud mitigation measures includes:

- Strengthen internal controls
- Conduct periodic compliance audits
- Designate compliance personnel
- Establish codes of conduct
- Conduct background checks for finance personnel (i.e., ask for annual financial statements)
- Provide fraud awareness training
- Tie ethics objectives to employee evaluations

The most cost-effective way to deal with fraud is to prevent it, the ACFE says. Its study revealed that the median recovery among victim organizations was only 20% of the original loss, and almost 40% of victims recovered nothing.

To learn how Hibernia can help your company deter employee fraud, contact your Treasury Management advisor.