

# Size doesn't always matter

Companies of all sizes can be affected by fraud **Interviewed by Chelan David**

**T**he high-profile corporate fraud cases of Enron, Tyco and WorldCom made front page news. However, it is not just large conglomerates that are susceptible to fraud. Companies of all sizes and across all sectors, including governmental agencies and nonprofit organizations, can be affected by fraud.

To avoid fraud, it is important to institute an anti-fraud program that creates a culture of honesty and high ethics. Such a program, says Linda Saddlemire, partner at Vicenti, Lloyd & Stutzman LLP, should be spearheaded by the management team. "Management is responsible for developing an effective anti-fraud program and should be heavily involved in assuring the proper measures are in place," she explains.

*Smart Business* spoke with Saddlemire about fraud, how anti-fraud programs should be structured and what course of actions should be taken if fraud allegations occur.

## What type of fraud risks do companies face?

The most common type of fraud is misappropriation of assets, which is any scheme that involves the theft or misuse of a company's assets. The Association of Certified Fraud Examiners (ACFE) reported that over 90 percent of frauds reported in its 2006 'Report to the Nation on Occupational Fraud' were in this category. Less frequently, companies may be subject to corruption and fraudulent financial statement frauds. Corruption involves a person using his or her influence in a business transaction to obtain an unauthorized benefit, such as accepting a bribe or engaging in a transaction where there is an undisclosed conflict of interest. Fraudulent financial statements are when a company falsifies its financial statements to make it appear more or less profitable.

## What is the typical loss for a company that has been defrauded?

As reported in the 2006 study by the ACFE, which includes reported frauds from 1,134 companies, the median loss



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caused by occupational fraud was \$159,000 and it is estimated that U.S. businesses lose 5 percent of annual revenues to fraud. Nearly 25 percent of the cases reported lost over \$1 million or more and there were nine reported cases causing losses of at least \$1 billion.

## How should an effective anti-fraud program be structured?

Major elements of an anti-fraud program include (1) creating a culture of honesty and high ethics, (2) having proper internal controls and procedures in place and evaluating the effectiveness of these programs, and (3) having proper oversight in place.

Creating a culture is accomplished by having clear codes of conduct, conflict of interest policies and ethics policies. It also includes creating a positive work environment by having recognition and reward systems, equal employment opportunities and quality professional training. Hiring practices should include thorough background checks, and promotions and evaluations should emphasize the importance of high ethics and values.

Proper internal controls include having good segregation of duties, internal audit checks and clear authorization policies for

expenses. A measure commonly taken, and required for public companies by the Sarbanes-Oxley Act, is to have an anonymous reporting mechanism in place for reporting wrongdoing.

Tips are the most common means of fraud being detected.

The oversight process may include an audit committee or board of directors. Oversight roles should include evaluating management's identification of fraud risks, implementation of anti-fraud measures and the creation of setting the 'tone at the top.'

## What considerations should be taken into account when implementing an anti-fraud program?

The first thing to consider is to identify the acceptable level of risk. Costs versus benefits of controls always need to be considered and attention should be given to those areas in which the risk of fraud is greater. Computer security is often a critical element and experts should be consulted. Knowing your business and where the risks of fraud exist is the first step.

## If a business suspects a case of fraud, what course of action should be taken?

When allegations of fraud exist, it is critical to take immediate actions. Developing a team should be the first step, which should include legal counsel, trained fraud investigators, such as a Certified Fraud Examiner, and human resources. A plan of action should be developed and agreed to by all parties. In some instances, you may want to include local law enforcement at the onset of the investigation. Assuring that a thorough and fair investigation takes place is critical due to the fact that these matters are highly sensitive and litigious. Taking the proper steps is imperative in protecting the integrity and reputation of your company.

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