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At-A-Glance

In the first article of this issue, we observe that business operations today are subject to the same atmosphere of legal and ethical questions that pervade the broader world. Our first article presents the latest results from the industry experts on commercial fraud, The Association of Certified Fraud Examiners. Their report reveals that motivations and causes for dishonesty have changed little over the past twenty years.

In the second article, we return to the new lease accounting standard. With the effective date rapidly approaching, time is growing short for organizations to complete the preparation necessary for effectively implementing the historic changes. Helping ease the burden, new refinements have been issued and proposed that put in place practical measures to smooth the way. Even so, there is no time to lose, especially for entities with numerous leases.

Finally, our Worldwide Update covers news from organizations across the globe.

Latest Fraud Report Confirms Prior Results

Despite advances, underlying motivations, methods and detection remain consistent.

The Association of Certified Fraud Examiners (ACFE), in an effort to better inform members of the characteristics of the financial crimes they were fighting, in 1996 created the first ***Report to the Nation on Occupational Fraud and Abuse,*** a comprehensive analysis of the causes and effects of occupational fraud in the United States. The stated goal was to "compile detailed information about occupational fraud cases in five critical areas:

- The methods by which occupational fraud is committed,
- The means by which occupational frauds are detected,
- The characteristics of the organizations that are victimized by occupational fraud,
- The characteristics of the people who commit occupational fraud,
- The results of the cases after the frauds have been detected and the perpetrators identified."

Now produced biennially and covering the whole world, in 2018 the tenth edition is based on survey data provided by certified fraud examiners (CFE) from 2,690 actual cases across 125 countries and 23 industry categories. The median response by CFEs of the annual loss to organizations from fraud is 5% of revenue. Applying that percentage to Gross World Product, the authors theorized that the potential cost of fraud worldwide is nearly $4 trillion annually. In comparison, the first report in 1996 reported an annual amount of $400 billion lost in the US alone.

As in the past, owners/executives only accounted for a small percentage of cases (19%), but caused a median loss of $850,000, compared to the overall median loss of $130,000. Losses of $1 million or more occurred in 22% of the cases. Losses caused by men were 75% larger than those caused by women.

Asset misappropriation schemes accounted for 89% of the cases, but only incurred a median of $114,000 in losses, while financial statement fraud schemes were present in only 10% of the cases, but incurred $800,000 of median losses. Corruption appeared 38% of the time, sometimes in conjunction with one or both of the other two types.

The most common and costly asset misappropriation schemes entailed check and payment tampering (forged maker or endorsement, altered payee), billing (shell company, personal purchases), and theft of non-cash assets (larceny, false sales and shipping).

The external independent audit, employed by 80% of companies in the study, continued to be the most common anti-fraud control. Still, only 4% of frauds were detected by routine audits, while tips were the most common detection method, representing about 40% in the last three studies. Furthermore, detection of fraud through tips was about 16% higher in companies that had hotlines. Employees were found to provide over 50% of the tips, followed by outside parties with almost a third.

Internal audits revealed 15% of frauds, while management review was responsible for detection of 13%. Overall, companies with anti-fraud controls in place still experienced lower fraud losses and quicker detection than companies without them. Other anti-fraud controls found in at least half of the companies surveyed included a code of conduct, management certification of financial statements, an independent audit committee, employee support programs, anti-fraud policies, and fraud training.

The top methods of concealing fraud in order of prevalence were:

1. Created fraudulent physical documents
2. Altered physical documents
3. Created fraudulent transactions in the accounting system
4. Altered transactions in the accounting system
5. Altered electronic documents or files
6. Destroyed physical documents
7. Created fraudulent electronic documents or files
8. Created fraudulent journal entries

As expected, small businesses continue to be more susceptible to fraud, typically because of more limited resources for anti-fraud controls. While corruption and non-cash factors stand out at larger firms, most other factors, such as billing manipulation, check & payment tampering, expense reimbursements, skimming, and cash on hand, plague smaller firms more. Lack of, or overriding, internal controls were the biggest contributors to fraud.

Only about half of victim organizations ran background checks. Even so, few of those background checks revealed warning signs. Of course, that does not quantify the number of organizations where fraud was avoided altogether because of the effectiveness of background checks.

Since the report was first initiated in 2008, the six most prevalent warning signs have always been 1) living beyond means, 2) financial difficulties, 3) unusually close association with a vendor or customer, 4) excessive control issues or unwillingness to share duties, 5) a general “wheeler-dealer” attitude involving shrewd unscrupulous behavior, and 6) recent divorce or family problems.

Almost two-thirds of perpetrators that were caught were terminated, while others face lesser punishment, and 6% were not punished at all. Owners or executives were more than twice as likely not to be punished as compared to other employees. The rate of criminal litigation has steadily declined over the past ten years to 58%, while civil litigation has remained steady at 23%. Fear of bad publicity was the most likely reason not to pursue litigation.

As the report has shown, the more things change, the more they remain the same. While methods and techniques change with the ongoing advancements of business operations, the underlying concepts driving motivations and prevention endure. Displaying the essential tone at the top is always a good place to start in order to assure an atmosphere that diminishes the potential and impact of fraud.

Further details can be found at [ACFE Report to the Nations - 2018 Global Study on Occupational Fraud and Abuse](http://www.acfe.com/report-to-the-nations/2018/)

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