Addressing fraud: A brief guide to fraud prevention for practitioners
"Fraud prevention costs less to an organization than the cost of fraud occurrence"

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The recent crises i.e., the current pandemic and the financial crisis of 2008 resulted in the dramatic increase of (not only) occupational frauds all over the world. According to the latest Report to the Nations on Occupational Fraud and Abuse (2020), published by the Association of Certified Fraud Examiners (ACFE), the median estimate was that fraud costs organizations 5% of revenues each year. In order to highlight the magnitude of this estimate, applying this percentage to the 2019 Gross World Product of $87.5 trillion, results in a projected potential total fraud loss of up to $4.4 trillion worldwide.

As a result, organizations worldwide realized, more than ever, the urgent need to have an adequate fraud prevention policy in place so as to mitigate fraud perpetration. In order to achieve this, firms have to implement well-designed and structured anti-fraud mechanisms, efficient and effective internal controls and written policies and procedures as analyzed below:

✓ **Internal Controls**

The existence and proper implementation of internal controls is widely considered as the key mechanism for deterring as well as detecting fraud. Internal controls are the rules and procedures implemented to safeguard the integrity of an organization's objectives, promote accountability, and prevent fraud occurrence. The most common of them are authorization systems, four eyes principle (or two-man-rule), red flags, segregation of duties, documentation of procedures, written policies and reporting mechanisms. But internal controls have to be monitored and revised on a regular basis to be efficient and effective, as well as to be consistent with the current developments. And those in charge of designing, implementing, and auditing these controls must be experts in this field so as to have the ability to monitor a firm's existing policies and procedures, provide proper recommendations and apply corrective actions in time.

✓ **Fraud risk assessment**

A robust fraud risk assessment plan must be an integral part of every business strategy in order to protect, on a constant basis, the company from both the existing and potential vulnerabilities it is exposed. A successful fraud risk assessment is based on the following two simple steps:

i. Risk identification & quantification: The first step is to evaluate the company's entire operations and procedures to identify, prioritize, and quantify all types of risks. For this purpose, firms must develop risk maps, a process that helps them in understanding their risk environment as well as how individual risks compare to each other.

ii. Risk mitigation & monitoring: After the identification and quantification of the company's risks the next step is to properly mitigate them to tolerable levels and establish an efficient mechanism for monitoring them. For risk mitigation the “4T’s process” can be used as analyzed below:

1. **Treat**: the process of controlling risks by reducing the likelihood of their occurrence and minimizing the impact prior to their occurring. This procedure includes changes that have to be made to system and processes and the training of both risk owners (the managers dealing with everyday operational risks and control processes) as well as those involved in the risk-producing activities (daily operations).
2. **Transfer**: the process of transferring the financial consequences to third parties. This is achieved via the usage of various forms of insurance or payments to third parties that are willing to undertake the risks on behalf of the firm.
3. **Terminate**: the easiest but also most often overlooked approach of addressing risks. In simple words it is the elimination of risks and it can be achieved by changing an inherently risky process or practice in order to totally remove a risk.
4. **Tolerate**: the point where no measures are taken to mitigate or reduce a risk. This is based on the fact that, while acknowledging risks’ potential impact, the cost of undertaking mitigation or risk reduction actions is not cost-effective, or the impact of these risks is considered too low so that they are considered acceptable to the management. As this is the most complicated area it should be highlighted that even when such risks are tolerated, they must be regularly monitored as future changes may make them no longer tolerable.

As for monitoring it is crucial that risk assessment is seen by firms as an ongoing process that must always be updated rather than a one-off task. Dealing with an ever-changing environment and numerous threats calls for continuous readiness by developing and reviewing an efficient and effective monitoring mechanism of all existing and potential risks.

✓ **Fraud Awareness**

Fraud awareness along with reliable reporting mechanisms are of critical significance in preventing and detecting fraud incidents and must be an indispensable part of every business overall anti-fraud strategy. All the staff must be aware of the firm’s fraud risk policy, including certain types of fraud as well as the consequences associated with them, and have to attend fraud awareness educational programs periodically to stay ahead with the ever-growing fraud incidents. Such actions develop honest employees that are a valuable asset in the fight against fraud for every company, as they act as whistleblowers.

✓ **Reporting mechanisms**

Making employees aware of possible signs of fraud will not have the required results without the existence of a formal, anonymous reporting system in place. According to the ACFE 2020 Report, most cases of occupational fraud are uncovered because of a tip (over 40%), while organizations with fraud awareness training are more likely to gather tips. Regarding the source of these tips, 50% come from the staff, while a substantial number of tips can come from outside parties, including customers and vendors. And since many employees are hesitant to report incidents to their employers, firms must consider setting up an official, anonymous reporting system (whistleblowing) where everyone (inside or outside the company) will have the ability to report fraudulent activity. The most common formal reporting mechanisms include a telephone hotline, a secured online form and email. However, setting a whistleblowing system is the first step, the next and most important is to be effective in its fraud deterrence role. To do so, companies must build trust among their employees, guarantee confidentiality and transparency of the mechanism, and make it user friendly so as people to use it freely and without any fear/doubt.

- ✓ **Corporate ethical culture**

An ethical working environment can assist companies in preventing fraud occurrence so there should be, beyond written policies and procedures, a clear and adequate organizational structure as well as fair working practices. All these create a corporate ethical culture that is critical for establishing a reliable fraud prevention system. In this direction it is considered vital for companies to apply an open-door policy that develops open communication channels among employees and management and allows the former to take their workplace concerns, questions and/or suggestions outside their own chain of command without worrying. And those in charge of managing the company must lead by example and hold every employee, regardless of position, responsible for their actions.

- ✓ **Know your staff**

As certain behavioral traits and attitudes can imply fraud perpetration, getting to know your employees can be very helpful in identifying potential fraud risks. Managers have to spend time to listen to their staff and be as more involved with them in order to be able to recognize behavioral "red flags" of fraud. Such red flags include living beyond one's means, financial pressure, unwillingness to share duties and personal/family problems. Of course, while the presence of these red flags does not imply that fraud is actually being committed, understanding, and recognizing the behavioral red flags displayed by fraudsters can help companies detect fraud as well as mitigate losses.

References

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