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A Commitment To Play By The Rules

Companies must take steps to prevent occupational fraud

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Occupational fraud can impact almost any business from multinational conglomerates to your local deli. When fraud occurs, it almost always has a major impact on a company's bottom line. One recent study by the Association of Certified Fraud Examiners (ACFE) estimates that fraud resulted in a 7 percent loss of revenue for participants in the study. You do not need a lawyer or accountant to tell you that a 7 percent loss in the current economy can be the difference between keeping the lights on and going out of business.

ONE RECENT STUDY ESTIMATES THAT FRAUD RESULTED IN APPROXIMATELY $944 BILLION IN LOSSES IN 2008 AND THE RATE OF OCCUPATIONAL FRAUD HAS INCREASED IN RECENT YEARS.

In its simplest form, occupational fraud can be defined as a misuse of company resources for personal gain. Two-thirds of occupational frauds are committed by individuals, but the remaining third of fraud cases often result in the most significant losses. Corporate fraud, in contrast, is fraud committed by an organization rather than individuals and can include instances of occupational fraud.

Outright theft and misuse of company assets are two obvious examples of occupational fraud, but more subtle misconduct is often more damaging. Twenty-three percent of fraud cases at businesses with fewer than 100 employees result from some form of corruption and more than 60 percent of those losses result from conflicts of interest. Such self-dealing or favoritism may be more difficult to detect, but can have a direct and negative impact on a company's balance sheet.

The financial costs of fraud are not difficult to understand. ACFE's study estimates that fraud resulted in approximately $944 billion in losses in 2008 and the rate of occupational fraud has increased in recent years. The reported rise in occupational fraud may be the result of better detection, but it underscores the magnitude of the financial damage that can be sustained by a company struggling to remain profitable in a challenging market.

As significant as these the direct costs have become for businesses, the consequential damage to a company's brand, reputation, and customer and investor relationships can be just as important. With larger companies, the risk of government investigations, fines and legal fees only compounds the problem. Companies now face increased scrutiny from prosecutors and regulators who have been given a mandate from top officials to be tough on corporate fraud. This is certainly true with the new Obama Administration, which has said: "It will be a top priority of the Justice Department to hold accountable executives who have engaged in fraudulent activities."

So what can a business do in the face of these financial and regulatory challenges? One answer is to create or improve a company compliance and ethics programs.

According to the Federal Sentencing Guidelines for Organizations, there are two primary requirements for an effective compliance and ethics program. The first is that a company must exercise due

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diligence to prevent and detect criminal conduct. The second is that a company must promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law. Stated more succinctly, a compliance and ethics program sets out a company's commitment to play by the rules. It also makes sure that its agents and employees live up to that commitment.

Playing by the rules might seem to be an obvious goal for most businesses and in certain contexts a formal compliance and ethics program may appear to be an unnecessary, particularly with small businesses. The rules for your local deli are simple. Don't steal from the register or skimp on the pickles. But creating an effective compliance and ethics program is not that easy, even for a small business like a sandwich shop.

A mom and pop business might not have to worry about the Foreign Corrupt Practices Act or money laundering statutes, but it still must confront compliance with OSHA regulations, wage and hour requirements, and employee misconduct.

A business can start to reduce the risks of occupational fraud and violating the law by following simple steps:

- Identify the laws and regulations that apply to the company and its employees and agents.
- Identify where the company, employees, and agents risk breaking the law or committing fraud.
- Develop procedures to lessen or prevent the risk that fraud will be committed or laws will be broken.
- Train and educate company officers, employees, and agents so that they understand the company's ethics and compliance guidelines.
- Conduct compliance audits and monitoring to ensure that the program is effective.

Experienced accountants, attorneys, and consultants can help companies address each of these steps and identify cost effective methods for reducing losses. The techniques that can be used can range from a simple fraud hotline, which has been shown to reduce losses by up to 60 percent, to skilled audits and investigations.

These steps may seem costly now, but failing to create an effective compliance and ethics program can result in higher litigation and compliance costs in the future. ■