

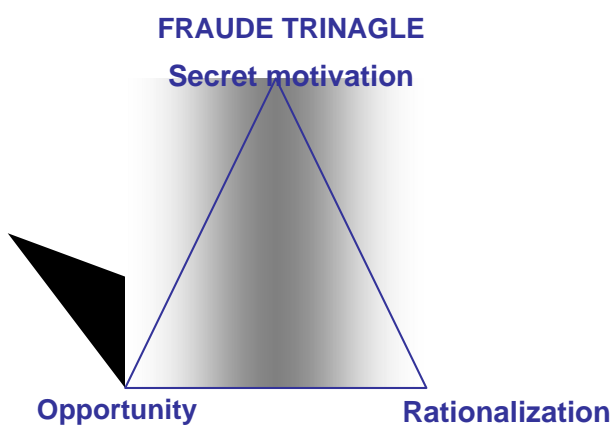
Economical Frauds and Their Authors

Fraud occurs everywhere. With individuals, in business-to-business relationships, between employers and employees, with government agencies, with non-profit organizations. In all industries and all countries.

Globally, in recent years (2005-2007), 43% of the companies have been victims of economical frauds.

At first sight a fraudster isn't in any way different from a trustworthy, honest person. He doesn't have an arrest record, he is socially conforming, he is educated, he keeps his commitments, holds a position of responsibility and is member of a church. Why do fraudsters and honest people share these characteristics? Because fraud can be committed by anyone under the proper set of circumstances. Nice people commit economical frauds.

Statistics made by the American Justice Department reveal that the average loss caused by armed robbery is of 250\$ and the probability of the villain being caught is high. While in the case of economical frauds the financial loss is much greater (hundreds of thousands to millions of dollars) and the probability of the fraudster being caught and prosecuted is very low.



Opportunity- rises when the Internal Control Systems are weak. The deficiencies appear when the Internal Controls create the premises in which the embezzlers are convinced they will succeed and won't get caught. This is the one factor in the fraud triangle that the management of the company

can control by introducing control systems and applying an efficient risk management policy. Although trust is an important element in a company's evolution is also often an element that facilitates fraud.

Rationalization- is the perpetrator's ability to justify his fraudulent or abusive activity. He convinces himself that the employer owes him because he is underpaid, under appreciated, deserves more, the company can afford the financial hole he is about to make or he just sees it as a loan he plans to payback later.

Secret motivation- the financial pressures caused by the difference between income and responsibilities, pressures to reach a certain financial objective, personal weaknesses resulted from an excessive life style (gambling, mistress, alcohol, drugs), or the need to keep up with peers, friends, neighbors.

The Portrait of the economical fraudster (KPMG study, 2007)

- 70% of the perpetrators have ages between 36-55;
- 85% of the fraudsters are men;
- in 69% of the cases they act independently;
- 89% of the frauds are made against the employer;
- in 20% of the cases an outside accomplice is involved;
- only 11% of the frauds are made by outsiders;
- in 60% of the cases the senior management was involved (including CEO members). In other 26% of the cases management personnel was involved, reaching a cumulated result of 86% in which the fraudsters were part of the companies' management. This result draws attention to a risk all companies are exposed to: executive management entrusted with confidential corporation information who are able to avoid internal controls.
- in 36% of the cases the authors of the fraud had been employed for 2-5 years;
- in 22% of the situations the perpetrators had been working in the company for more than 10 years;
- only 13% of the perpetrators had been working in the company for less than 2 years;
- the internal fraudster most likely worked in the financial department, followed by the employees in the operation/sales department;
- the undue appropriation of money has proved to be the most common type of fraud;
- in 83% of the cases the perpetrators have acted on a national level, rather than an international one;
- in 91% of the cases the perpetrators didn't stop at a single fraud but continued with various ones; one in three fraudsters acted more than 50 times;

- a total loss of one million dollars has been registered in one in two cases in Europe, one in three cases in South Africa and one in four in India/ the Middle East.

Prevention and Detection

Setting high ethical standards is one of the most important mechanisms of communicating to the employees the acceptable activity standards and attracting attention to the commitment made by the management to respect the integrity (a clear organization chart, elaborating a conflict of interest policy, an internal audit department).

Communication and Training Program, carefully planned will augment the employees' comprehension of the obligations they have concerning fraud control and professional digressions (periodical discussions about ethics, establishing a fraud hotline).

Recognizing the Early Warning Signs

The red flags must be recognized by the management: changes in personal behavior, changes in lifestyle, drug addiction, gambling, vacations not taken.

Creating and promoting a confidential employee support system that should include: family counseling, drug/alcohol/gambling counseling and financial counseling.

Establishing Adequate Internal Control with a fraud prevention and detection function:

- segregation of functions (one individual is not able to execute an entire cycle of transactions, front office and back office activities should not be combined)

- verifying the personnel's qualification, competence, education, work history, periodic performance evaluation, required vacations.

- access to the company's assets, comparison of accounting records with assets.

- thorough investigation of the employees and third parties is part of the fraud and professional digression prevention strategy, especially for the authority positions in the financial reports process. Proactive analysis of the known fraud data- search history in data bases that may show the connections between different persons, verifying the employees' background- sentence serving, financial incidents, credit incidents etc- should help to detect the possible acts of fraud or professional digression, which may otherwise pass unobserved for years.

Detailed evaluation of fraud and professional digression risk helps the management understand the unique risks their company is up against, identify the control gaps of deficiencies and elaborate a resource and adequate control identification plan.

Actions to take against the fraudsters

An important step in creating a culture of intolerance towards fraud is taking consistent action for determining economical frauds. Thus the personnel understands what the consequences of fraud involvement are and the fact that its detection is certain and unavoidable due to the efficient system of risk management and control. Such an attitude leads to the dissuasion of most fraudsters. It is also essential that the employees are shown that all the perpetrators are treated equally, regardless of their position in the company.

Fraud Approach

- public disclosure of the fraud or professional digression

- once the fraud or digression are discovered, reparatory actions must be taken: disclosing the investigation results to the proper authorities, reparation of the prejudice, examining the causes in order to reduce further risk

- discussions with the fraud involved parties as well as with the management who wasn't able to prevent or to detect the fraud

- communicating to the employees that the management took action and reacted properly.

A disciplinary system that details the liability protocol is essential to efficiently prevent fraud and professional digression and to point out that risk management has precedence.

Fraud remains a difficult matter. Globally, in the past ten years, the economical criminality has not decreased significantly but despite this fact the companies continue to be confident that their internal controls will limit future risk fraud.

The American Treasury Department Secretary, Henry Paulson, said that when he was Chairman and Chief Executive Officer of Goldman Sachs bank, he was never able to completely eliminate fraud because large banks are like small towns.

“We will never be able to eliminate all the wrongdoers, so in every town with 20.000 citizens there is a prison”, commented Paulson.