



Investigating Guidelines For Small and Mid-sized Companies When Suspecting Occupational Fraud

Summary: Even though medium-sized and small businesses are generally not as prepared as large corporations when it comes to dealing with occupational theft, investors and management need to follow basic guidelines when facing fraud and embezzlement schemes.

In the 2010 Report to the Nations on Occupational Fraud and Abuse, the American Society of Certified Fraud Examiners (ACFE) found that nearly one-quarter of the cases studied involved losses in excess of \$1 million dollars. Additionally...

- Only approximately one-seventh (15%) of the culprits who were caught had prior charges or convictions for fraud. The remaining 85% had no record.
- The median theft loss perpetrated by an employee is \$80,000. The median theft loss perpetrated by a manager is \$200,000. The median loss conducted by an owner or executive is \$723,000.
- On average, frauds will occur for 18 months in a company before being detected.
- Tipsters account for over 40% of fraud discoveries; however, many thefts are only found by accident.

In today's market, small and medium-sized companies are increasingly more vulnerable to fraud and employee embezzlement schemes. In general, these organizations have fewer controls in place and, even when in place, do not implement consistent enforcement. Subsequently, when fraudsters victimize companies, management usually does not know where to turn or how to perform a proper investigation. The following rules are basic guidelines companies should consider when commencing an investigation. Following these rules will generally allow owners to assess damages and take appropriate action without "breaking the bank" in legal and investigative fees.

RULE #1 – Seek Independent Experts - Regardless of a company's size, businesses far too often find themselves engaged in lawsuits due to the lack of independence and investigational bias. Victimized companies, in an effort to mitigate further financial loss, attempt to use internal resources to determine how the fraud was perpetrated and calculate financial damages. However, external independent experts should, in this case, be retained.

Attempts to perform the investigation internally will many times become a costly decision. The company may decide to pursue legal action against the perpetrator, and one defense is usually an allegation that the person who performed the investigation either had the same or greater capacity to perpetrate the fraud or may have a bias against the alleged fraudster. This is more common when the employee performing the investigation is within the chain of command of the fraudster. As a result, many these companies find themselves spending even more financial resources and incurring even greater risks after being sued or counter-claimed by the alleged perpetrator.

Companies should be aware that the need for both independent counsel as well as an independent financial investigator are critical in creating and protecting unbiased results. This is particularly true when the investigation surrounds company management and the suspected amount of stolen money is significant.

Financial investigators that are retained should be engaged by outside counsel whenever possible to preserve attorney / client privilege. Companies should be aware that, when retaining a financial investigator, it is generally unwise to retain the company's CPA or tax firm to perform the investigation. Many times these personnel are unqualified to perform such investigations and may be concerned about their own legal exposure in the matter due to mistakes in the audit, review, or tax preparation.

RULE #2 – Seek Competent Experts– Both your attorney and fraud investigator need to have adequate experience and training to assist you throughout the investigation process.

To determine if you have the right resources, perform interviews of each person involved and ask for references. Too often companies pick the attorney or investigator that has the best search engine optimization and hit the top of the first Google or other Internet search. While this may be an effective start, it should never be the sole method in choosing your investigation team. Both the attorney and the investigator need to have sufficient experience to handle your case. If not, the fraud plan may not be well designed; ultimately driving up costs and leading to additional problems in the event criminal or civil remedies are pursued.

For the fraud investigator, be aware there are many credentials in the marketplace. The two most common are the Certified Fraud Examiner (CFE) issued by the Association of Certified Fraud Examiners (ACFE) and a more recent sub-designation to the CPA, Certified in Financial Forensics (CFF) from the American Association of Certified Public Accountants. Credentials should only be one criterion in assessing the capabilities of your investigator. Your expert should be competent, experienced and have adequate resources to perform the investigation in a timely manner. He should also be qualified to testify as to his results. Expert witness testimony is one element few investigators have the experience and training to perform well. Understanding your investigators expert testimony track record is important in selecting your expert.

RULE #3 – Understand the Financial Cost – Performing a fraud investigation can be quite expensive and time consuming. When retaining an attorney / investigator, a well-defined scope and discussions concerning budgets with counsel and the investigator are generally the best and first course of action. Many times the question of costs doesn't arise until sticker shock hits the owners on the first invoice. The scope of an investigation can quickly expand without the owner's awareness and understanding of the costs associated with the investigation. Owners and upper management should be actively aware of the fraud plan that is being performed, the anticipated costs to conduct each element of the investigation, as well as any scope changes in the investigation as they occur.

Ask both the attorney and investigator for a rate sheet. Understand what level of staff will be used to perform the investigation. Negotiate with the investigations team for reduced cost for travel time, particularly if out of town trips are necessary. Many consultants are willing to take very reduced rates for travel time, which gives significant savings to the company.

Most importantly, understand that hourly rates vary greatly among attorneys and investigators. Higher hourly rates do not guarantee higher quality services nor does the lowest price mean the weakest

attorney or expert. Company management should focus more on investigative methodology, experience, recent cases and outcome of those cases. Ask for references and follow up to assure that the attorney and expert are able to meet your needs.

RULE #4 – Implement Remedial Action – While internal controls themselves will not fully eliminate occupational fraud; strong internal controls as well as anti-fraud controls generally help deter fraudsters. Additionally, when companies are victimized, these controls can help reduce the extent of damages and the duration of occupational fraud schemes. A good fraud investigator should assist the company by not only performing the investigation, but also providing guidance to reduce the risk of future exposure. Additionally, investigators should identify the most cost effective controls to implement to reduce fraud based upon the schemes that pose the greatest risks to their clients. Rules such as segregation of duties, assets and inventory controls, and proper authorizations are key elements in the creation of strong controls to protect and preserve corporation assets.

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