by Ron Steinkamp

Fraud Awareness And Prevention For Government Entities

According to the 2018 "Report to the Nations" released by the Association of Certified Fraud Examiners (ACFE), occupational fraud is the largest and most prevalent fraud threat organizations may face. Businesses and government organizations across the world are vulnerable to fraud committed from within by their own employees.

This year's report reveals important information about occupational fraud including the cost of fraud, fraud schemes, how fraud is committed and detected, red flags and the characteristics of the people who commit fraud, the impact on victim organizations and some of the key ways organizations can be proactive in preventing fraud.

What Is Occupational Fraud?

Occupational fraud is fraud committed against an organization by its own officers, directors or employees. Occupational fraud can be classified into one of three categories: asset misappropriation, corruption and financial statement fraud.

Asset misappropriation occurs when an employee steals or misuses an organization's resources. This could include theft of cash and non-cash assets, such as inflated expense reports, false billing schemes, payroll schemes and more.

Corruption occurs when employees misuse their influence in business transactions in ways that violate their duty to the employer for direct or indirect benefit. Corrupt acts include things like bribery, conflicts of interest, kickbacks and extortion.

Financial statement fraud occurs when employees intentionally cause a misstatement or omission of information in an organization's financial reports. Financial statement fraud can include overstatements and understatements of income or revenues, improper disclosures, improper asset valuations and more.

Key Findings

The ACFE 2018 "Report to the Nations" provides several interesting findings, including:

- Asset misappropriations (when an employee steals or misuses the employing organization's resources) were the most common form of occupational fraud, occurring in 89 percent of cases with a median loss of $114,000.
- The median duration of fraud schemes was 16 months and, the longer a scheme lasts, the more it costs the organization.
- The leading methods of detection of occupational fraud were tips (40 percent), internal audit (15 percent) and management reviews (13 percent).
- Internal control weaknesses accounted for nearly half of all fraud cases.
- Organizations that implemented anti-fraud controls realized lower fraud losses.
- Smaller organizations (those with less than 100 employees) experienced both the greatest percentage of fraud cases and suffered the largest loss.
- Organizations employing active fraud detection methods suffered from a lower median loss from fraud.
- Some of the most common behavioral red flags of people who commit fraud include living beyond their means, exhibiting financial difficulties and a lack of willingness to share duties.
- Data monitoring/analysis and surprise audits were correlated with the largest reduction in fraud loss.

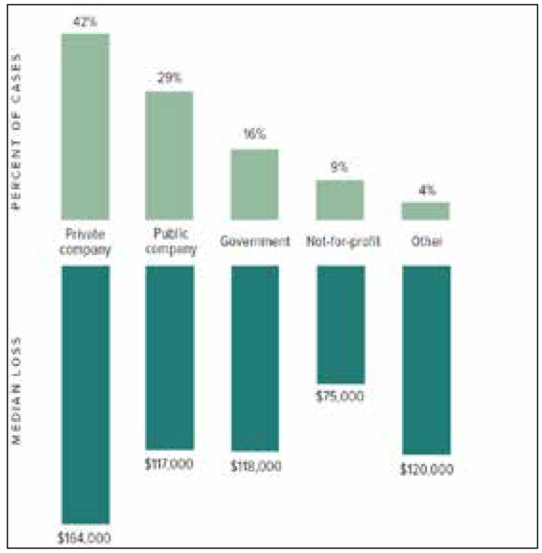
For a complete list of findings, visit the ACFE online at www.acfe.com

Unique Concerns For Government Entities

Understanding the frequency of specific fraud schemes within specific industries can help organizations assess and design controls to guard against the schemes that pose the highest threat to them. Government organizations accounted for 16 percent of all fraud cases in this study. Corruption and noncash (stealing or borrowing supplies, tools, equipment, etc.) asset misappropriation were the most common types of fraud schemes identified as impacting government and other public administration entities.

Of those fraud cases detected within government organizations, 26 percent of frauds were found at the state/provincial level with a median loss of $110,000 and 31 percent were found at the local government level with a median loss of $92,000. For smaller municipalities or organizations with limited resources, these losses can be particularly devastating. Since smaller organizations typically have fewer anti-fraud controls in place due to limited resources, they are more susceptible to fraud.

Types Of Organizations Victimized By Occupational Fraud

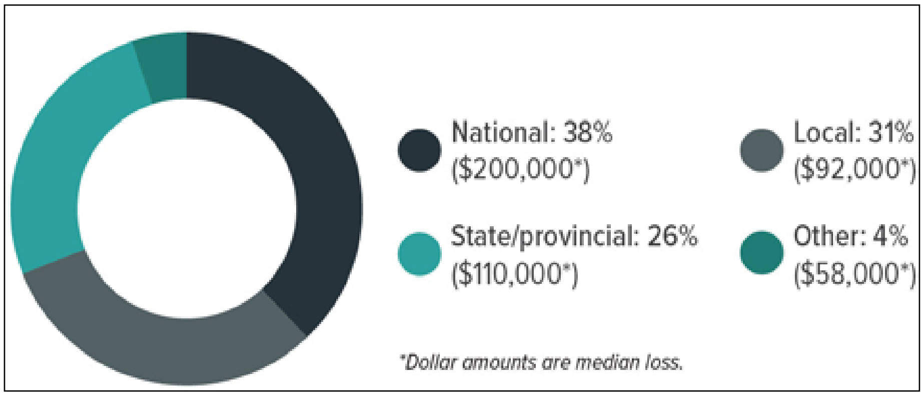


Source: Association of Certified Fraud Examiners' 2018 report.

Prevention And Detection

We hear from many government organizations that fraud is not a concern because they have an annual financial statement audit. However, according to the ACFE report, only 4 percent of fraud cases are initially detected by a financial statement audit. If your organization is relying solely on reactive measures to catch potential fraud red flags, your

Levels Of Government Victimized By Occupational Fraud



Source: Association of Certified Fraud Examiners' 2018 report.

organization is likely to be at greater risk.

Among the primary weaknesses that contributed to most of the occupational fraud cases found in the study were a lack of internal controls, an override of existing controls and a lack of any sort of management review.

The presence of a robust system of anti-fraud controls can be a powerful deterrent, as well as a proactive prevention and detection mechanism, in the fight against fraud. Preventing fraudulent activity within your organization starts with effective anti-fraud controls. Some of the most effective anti-fraud controls that reduce the duration as well as the loss from fraud include:

- Code of Conduct.
- Proactive data monitoring and analysis.
- Internal audits and surprise audits.
- Fraud hotline.
- Management review.
- Anti-fraud policy.

One of the most important actions you can take for your organization is to complete a fraud risk assessment, particularly if you're new to that office. Any government entity could be subject to risks, and a fraud risk assessment will allow you to identify and understand where fraud risks lie and learn what potential weakness in controls could impact your organization. Once risks are identified, a plan can be developed to mitigate those risks by instituting proper anti-fraud controls and procedures.

It is critical for organizations to establish an anti-fraud culture that emphasizes fraud prevention and detection through leadership, policy, training and understanding potential risks. Consider scheduling a fraud risk assessment or reaching out to discuss your organization's fraud prevention and detection strategy.

Ron Steinkamp *is a partner in the Advisory Services group of Brown Smith Wallace and leads the Public Sector Advisory Services group. With more than 20 years of experience, he focuses on internal controls, internal audit, business process improvement, enterprise risk management, fraud and forensic prevention and detection and investigation, and Sarbanes-Oxley compliance. Steinkamp's expertise spans a variety of industries, including government, manufacturing, retail, telecommunications and construction. Contact Ron at rsteinkamp@bswllc.com for a fraud risk assessment or to discuss your fraud prevention and detection strategy.*