

## **Business Finance II – 515 - Summer 2016**

### **Book Review Template**

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| <b>Book Title</b>                      | Global Fraud Study – 2016                       |
| <b>Author(s)</b>                       | Association of certified fraud examiners (ACFE) |
| <b>Publisher &amp; Publishing Year</b> | ® ACFE , 2016                                   |

#### **Author (s):**

Founded in 1988 by Dr. Joseph T. Wells, CFE, CPA, the ACFE is the world's largest anti-fraud organization and premier provider of anti-fraud training and education. Together with more than 75,000 members in more than 150 countries, the ACFE is reducing business fraud worldwide and providing the training and resources needed to fight fraud more effectively.

#### **Synopsis:**

The Global study on Fraud – A report to nations explores occupational fraud, is conducted by Association of certified fraud examiners (ACFE). It raises awareness about occupational fraud, and dwells a great deal on the cost of business frauds that are conducted around the world.

The report is interesting and incisive as it presents a different presentative about this crime in depth. It is interesting to know that even in the most modern economies the crime remains unabated. Certified fraud examiners estimate that on average a firm losses 5% of revenue in fraud. Report contains an analysis of 2,410 cases of occupational fraud investigated between January 2014 and October 2015. The total loss caused by frauds was \$ 6.3 billion, meaning average loss of 2.7 million per case.

The report has been conducted on a wide scale with help of 75000 members around the world in 120 countries. The report goes in considered details of categorizing the frauds on basis of fraud tree, industry, time duration, detection, losses, government level, level of controls and organizational structure. The report also examines the measures in place for detection of fraud and controls an organization employs to forestall occurrence and if occurs early detection to immunize loss.

The report has in detailed data based on the survey and it is immaculately presented in form of graphs, tables and figures. The data has been sorted in basis of regions, countries, fraud type and losses. Towards the end it has detailed index for ease of finding relevant data or figures. Glossary of terms is also attached at the end. Lastly, the report end by delineating Association of certified fraud examiners (ACFE) functions and how they help the business fight frauds.

## **Key Learning:**

Almost everything that this report mentioned was new to us. It was an eye opener that how the business are vulnerable to the risk of fraud. Few key aspects are enunciated in succeeding paras:

- **Asset misappropriation** happens to be the **most common form of occupational fraud**, occurring in more than 83% of cases, but causing the smallest median loss of \$125,000. **Financial statement fraud** being on the other end of the spectrum, occurring in less than 10% of cases but causing a median loss of \$975,000. **Corruption cases fell in the middle**, with 35.4% of cases and a median loss of \$200,000.
- Duration of fraud was another important aspect. The **longer a fraud lasted, the greater the financial damage it caused**. While the median duration of the frauds in our study was 18 months, the losses rose as the duration increased. Schemes that lasted more than five years caused a median loss of \$850,000.
- In 94.5% of the cases in study, the perpetrator took some efforts to conceal the fraud. The **most common concealment methods used were creating and altering physical documents**.
- The most common **detection method in was tips (39.1% of cases)**, but organizations that had reporting hotlines were much more likely to detect fraud through tips than organizations without hotlines (47.3% compared to 28.2%, respectively).
- If fraud was detected through active detection methods, such as surveillance and monitoring or account reconciliation, the median loss and median duration of the schemes were lower than when the schemes were detected through passive methods.
- Approximately two-thirds of the cases targeted privately held or publicly owned companies. These for-profit organizations suffered the largest median losses among the types of organizations analyzed, at \$180,000 and \$178,000, respectively.
- Of the **cases involving a government victim (that occurred at the federal level) reported the highest median loss (\$194,000)**, compared to state or provincial (\$100,000) and local entities (\$80,000).
- Size of Organizations makes these vulnerable to different fraud risks. **Corruption was more prevalent in larger organizations**, while check tampering, skimming, payroll, and cash larceny schemes were twice as common in small organizations as in larger organizations.
- The banking and financial services, government and public administration, and manufacturing industries have maximum the fraud cases. While, mining and wholesale trade had the fewest cases of any industry.
- External audits of the financial statements were the most commonly implemented anti-fraud control; nearly 82% of the organizations in our study underwent independent audits.
- Small organizations had few anti-fraud controls than large organizations. This gap in fraud prevention and detection coverage leaves small organizations extremely susceptible to frauds that can cause significant damage to their limited resources.

- External audits of the financial statements, code of conduct, and management certification of the financial statements—were consistently among the most commonly implemented across organizations irrespective of geography.
- The presence of anti-fraud controls was correlated with both lower fraud losses and quicker detection. **Where controls were present, fraud losses were 14.3%–54% lower and frauds were detected 33.3%–50% more quickly.**
- The **most prominent organizational weakness that contributed to the frauds was lack of internal controls**, which was cited in 29.3% of cases, followed by an override of existing internal controls, which contributed to just over 20% of cases.
- The **perpetrator’s level of authority has strong correlation with the size of the fraud**. The median loss in a scheme committed by an owner/executive was \$703,000.
- Most of **occupational frauds originated in the accounting department (16.6%)** than in any other business unit. More than three-fourths were committed by individuals working in **seven key departments**: accounting, operations, sales, executive/upper management, customer service, purchasing, and finance
- **The more individuals involved in an occupational fraud, the higher losses**. The median loss caused by a single perpetrator was \$85,000. When two people conspired, the median loss was \$150,000; three conspirators caused \$220,000 in losses; four caused \$294,000; and for schemes with five or more perpetrators, the median loss was \$633,000.
- **Fraud perpetrators showed behavioral warning signs when they were engaged in their crimes. The most common red flags were living beyond means, financial difficulties, and unusually close association with a vendor or customer, excessive control issues, a general “wheeler-dealer” attitude involving unscrupulous behavior, and recent divorce or family problems. At least one of these red flags was exhibited during the fraud in 78.9% of cases.**
- **Most occupational fraudsters are first-time offenders**. Only 5.2% of perpetrators in this study had previously been convicted of a fraud-related offense, and only 8.3% had previously been fired by an employer for fraud-related conduct.
- **In 40.7% of cases, the victim organizations did not refer their fraud cases to law enforcement, with fear of bad publicity**. Only, 23.1% resulted in a civil suit, and 80.8% of such completed suits led to either a judgment for the victim or a settlement. In final outcome, 8.4% of the victim organizations were fined as a result of the fraud. The proportion of victim organizations fined was highest in the Western Europe.

## **Application:**

### **An Emerging Field**

Fraud investigation is an emerging field of study and expanding with the passage of time in Pakistan and various awareness and training programs are being offered by different institutions on fraud investigation its causes and dealing with such incidents and to deter fraud. Many organizations in Pakistan are exploring this aspect of business and have developed Fraud Investigation departments as well to deal with unusual transactions conducted in their organizations. Some organizations have outsourced this to firms of chartered accountants and other firms having specialized professionals in this area of the business to execute the task of fraud investigation in their organizations.

### **Legal Requirements**

Recently it has been the requirement issued to commercial banks in Pakistan to implement internal control framework, which plays a significant part in deterring fraud in any organization. Besides, Internal Audit, Risk Management and Compliance departments also play significant part in organizations specially the listed companies in strengthening the internal controls and deal with fraud related issues and red flags like sudden change in the lifestyle of an employee and unusual profits etc raised by the company's internal auditors or other personnel, also known as whistle blowing. Separate specialized departments have been developed by some consultancy firms in Pakistan to provide services to investigate fraud and other financial issues that have been arising or could arise in the company due to their nature of business.

### **Regulatory Body's Actions**

Besides, recent unusual increase in the stock prices of different companies was noticed by SECP and notices were issued accordingly for its review and justification. This was also a fraud indicator, depicting illegitimate status of the companies and getting unusual financial gains by various investors with the probable collusion with the strategic or upper level personnel of the company. However a timely action was taken in this regard.

### **Future – Minimizing Risk of Fraud**

People in Pakistan now a days are pursuing studies pertaining to fraud investigation and its avoidance, like CFE (Certified Fraud Examiner) etc and companies are hiring and developing separate departments to secure themselves and their reputation from such issues which can not only bring financial losses to the company but also may hurt the credibility and reputation of the business.