FRAUD DETERRENCE

In dictionary Fraud means " Deception deliberately practiced with a view to gaining an unlawful or unfair advantage ; artifice by which the right or interest of another is injured" . There are as many types of fraud as there are different types of people who commits fraud. The important thing to remember about fraud is that every one is at risk of being a victim of fraud. Due to this it is imperative for each people to understand various risks of fraud and how to protect themselves from being victim of fraud.

In this article , I would focus on various fraud deterrence measures that should be implemented in order to reduce the probability of risk of fraud.

But before we understand the various fraud deterrence measures it is necessary to understand why people indulge in doing fraud or what are the motives behind committing fraud.

In order for fraud to be committed, three conditions need to be present which is called as Fraud Triangle .

1. Motivation to commit the fraud,
2. Opportunity to commit the fraud, and
3. Ability to rationalise his or her behavior.

Looking at each one individually in more detail.

Motivation

The motivation is the prime reason behind the fraud – the reason that the individual chose to commit fraud. The motive list can only be inclusive and not exhaustive, however some of the common factors include:

1) Internal pressure from top management to meet other's expectations (e.g., market or revenue expectations, etc.). Not meeting their expectations could lead to job loss or demotion.
2) External pressure from financers that threatens the organization's financial stability.
3) Lifestyle maintenance
4) Pressure to maximize bonuses or compensation when it is performance based

Opportunity

Having the desire to commit fraud will not allow a person to commit fraud if they do not have the opportunity to do that. Without opportunity, fraud could not, or would not be committed.

Some of the conditions that provides an opportunity to commit fraud include:

1) Weak internal control systems,
2) Readily access to accounting records or assets,
3) Lack of supervision,
4) Belief that the person will not get caught.

It is the presence of opportunity to commit fraud that leads to fraud being committed. it is the management responsibility to identify such opportunities and to minimize the risk of fraud by reducing the opportunities that exist and identified.

Ability to Rationalise Behavior

Unless fraudster is not able to rationalise his or her behavior of committing fraud even the first two is present the probability of committing fraud is less. If what you are doing here is convincing yourself that there is a perfectly acceptable reason for what you are doing. The sense of ethics, morality and the idea of right and wrong is what prevents some individuals from rationalising the behavior.

Some examples of rationalisation are:

1) Belief that they are not properly rewarded or compensated.
2) Believe the company owes them something for work that they have done in the past.
3) Need money to maintain personal life
4) Not getting the due recognition

Again, without some form of rationalisation, together with the motivation and opportunity to commit fraud, fraud is not going to be committed.

Fraud Deterrence

Since the factors that lead to committing fraud, we will discuss about how to identify fraud risk and mitigate the risk by creating deterrence environment and fixing of responsibilities .This is one of the most important responsibilities for Risk Manager in setting up the internal control system.

It is know that no system, process is fraud free hence instead of putting the whole energy in achieving fraud free environment, effort should be put to reduce the probability of fraud being committed. The two main inherent risks that all System/Processes faces are collusion and override of controls.

Having this inherent risk in mind ,the Risk Manager should implement

1) Whistle blower / Fraud control / Anti -Fraud policies
2) Robust Internal control system;
3) Identifying, Measuring,Mitigating and Monitoring fraud risk.

First it should be understood that fraud management is every ones responsibility, which starts from management. It is the management that has to sets the standard of fraud risk management by adopting and implementing Fraud Control policies, Whistle blower policies, anti Fraud policies in their organisation. Management should set up proper framework of what is acceptable, fraud deterrence, what risk is acceptable . since there is a cost involved in implementing fraud prevention mitigants , management should clearly spell out the cost benefit, acceptable risk after meeting the compliance requirement.

Proper implementation of whistle blower policies shows the seriousness of management of dealing with frauds. In many cases when fraud is detected by an employee, or is known to be occurring, people are afraid to raise the matter as they do not know what will happen to them. Management should encourage people to report any fraudulent activities identified or observed and should ensure that anonymity would be maintained.

The Second pillar is to have a robust internal control system. The benefit of having an effective control system is that it can improve Internal / External stakeholder confidence in the company. The internal control system if effective reduce the probability of doing fraud since people know that they would be caught and could not by pass the process. Some of the effective internal control system can be

a) Timely Reconciliation of the activities

b) Implementing proper authorisation matrices

c) Real time monitoring of the high risk transaction

d) Segregation of duties

The third and last fraud deterrence measure is Fraud Risk Management. It means that the management should identify as many fraud risk as possible, measure the risk and evaluate them to determine which ones require action, and the priority for that action.Suggest steps to mitigate the risk and device ways to monitor the same.

Any review of controls, reviewer should be aware of some of the high risk factors that could indicate the presence of fraud risk. These high risk areas , which are a source of risk identification for management, include:

1) Improper segregation of duties and responsibilities,
2) Unlimited access to assets,
3) No timely reconciliation
4) Executing transactions without proper authorisation,
5) Lack of training on key risk areas that leads to improper controls,
6) Collusion among employees,
7) Unrestricted access to computer/system disks,
8) The ability of management to override the controls in place

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We can observe that fraud risk management is a comprehensive activities. But, once the assessment is complete the company should be able to work on implementing controls that are able to reduce the risks to an acceptable level.

A fraud risk assessment is not the end of the process. Circumstances change constantly and some changes may trigger the need to revise the assessments.

Disclaimers : The views mentioned are the personal views. Any reference should be at own risk. The author is not any way responsible for any action taken based on the content of the article.

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