HOW TO PREVENT FRAUD?

Ionela – Corina Chersan
"Alexandru Ioan Cuza" University of Iaşi

Abstract: *Fraud can range from minor employee theft and unproductive behavior to misappropriation of assets and fraudulent financial reporting. The risk of fraud can be reduced through a combination of prevention and detection measures. Moreover, prevention and deterrence measures are much less costly than the time and expense required for fraud detection and investigation. The information presented in this document generally is applicable to entities of all sizes. However, the degree to which certain programs and controls are applied in smaller, less-complex entities and the formality of their application are likely to differ from larger organizations.*

Keywords: fraud proofing, fraud prevention, control, accounting analysis, job descriptions, supervision

JEL Classification: K22, K14, M40

1. THE STRUCTURE OF INTERNAL CONTROL SYSTEM

Recently, in the auditing literature, has appeared a new word - fraudproofing. This word can be translated by impermeability to fraud. Unfortunately, although any entity wishes to be impervious to fraud, we must recognize that it is impossible because no internal control system cannot full eliminate risk of fraud. What is possible and desirable is that the so-called fraudproofing to represent a way to reduce the risk of fraud to a minimum.

Understanding the many factors that can contribute to the risk of fraud is first step in defining a strategy to prevent fraud. After it is necessary to be implemented policies to reduce threats. Between these policies, the most important and in the same time the most common is the existence of a **good internal control system.**

A variety of controls exist in the classical systems of internal control. The most relevant basic controls are grouped into three categories[7]: physical access control, job descriptions, and accounting reconciliations and analyses.

The best known forms of this control may already seem trivial, but they contribute more than others to protect against fraud. We can list here: locking doors and spaces where are preserved documents, computerized security systems (access card that record time of entry and exit), electronic surveillance systems, more or less sophisticated, taking into account investment which the company can afford (voice recognition systems and even iris scanning).

In principle, the access in the firm should be allowed only to those who must work within it, especially employees.

Certainly this physical access restriction will not ensure a total removal of the risk of fraud, but will decrease this risk considerably.

First, most frauds involve the physical presence of the perpetrator where it occurs, whether it's about assets misappropriated or it's about incorrect book keeping.

Secondly, physical access control is the most visible form of control for those who intend to commit fraud by sending them a signal of the very probable existence of other forms of control, which is likely to discourage them.

Thirdly, even if this form of control does not prevent fraud, it will help more accurate understanding of what happened and to discover the perpetrator by restricting number of suspects.

Formal, job description clearly outlines what duties should perform an employee, being an important tool to prevent fraud. Most often, employees do not perform duties outside of their job description. Those who do is to be category carefully monitored.

In fact, the job description is a tool for separation of tasks. A classical example of separation of duties refers to an employee who is resposanble for an object and to whom is forbidden to handle registration in accounts of operations on that object.

Here we must include mention of the job description that the employee must receive annual vacantion.

To increase efficiency through job description control is important, for any company, that job descriptions to be developed in an integrated manner, in that the development should be take account of the activities of persons other than covered.

[7] *Internal Controls and Fraudproofing*, available at http://www.aicpa.org/InterestAreas/ForensicAndValuation/Resources/ForensicAcctg/ForensicAccounting/Pages/Internal%20Controls%20and%20Fraudproofing.aspx, accesed on 10.05.2007

While the role of job descriptions has been stated by many experts, in many companies they are ignored or underestimated considering that they are among the least used documents. There are situations where job descriptions are developed, but they are ignored by employers. In fact, when employees start to do things that are not appropriate is the moment as business leaders to become worried. In addition, the same employees, unless they are rewarded for what they do, it is possible that they might try to find justification to steal.

For this reason it is good like job descriptions to be developed when is necesary, and employees to agree with them and to comply their contents.

Although it seems to be unrelated to fraud, we must show that a fraud will be easily discovered when she cease to produce for some time.

The third category of controls has as starting point the idea that a fraud reaches its purpose if not detected, ie if the result of fraudulent action is well concealed. Fortunately, controls and accounting analysis make difficult or even impossible to conceal fraud.

In the category of accounting controls are included the checks and bank statements received/transmitted from/to business partners and crosschecking between analytical and the synthetic accounting. Regarding the exact nature of accounting analysis, they depend on the nature of operations company. There may be an analysis of the temporal variation of balance sheet items, analysis of profit and loss, sales analysis on geographic areas, analyze the costs and other which also are based on analysis of accounting information.

Of course, most of these tests are not always made to detect fraud, but for making managerial decisions or to verify the accuracy of accounting records.

But, whatever the reason of the performing this controls, is established that they can reveal the existence of possible fraud.

Once established a good system of internal control, for the same purpose - fraud prevention and detecting, we identified the **supervision** how acts like a second level of control.

As a fraud prevention mechanism, a good supervision requires:

- awareness of the possibility of fraud;
- existence and implementation of clear procedures for approval, re-checking and recovery;

Awareness of possibility of fraud is perhaps the starting point in developing a fraud prevention strategy. Supervisors should be aware that an unusual event is always a risk bearer as an error occurs. It's about complaints come from customers or suppliers, discrepancies which are not found an explanation and errors reported by the audit. In these circumstances, if supervisors are not aware of the possibility of an error occurs, the risk that it occurs is very high.

Beyond the possibility of fraud awareness, supervisors must do really supervise. In the category of supervisory actions are included: verifying the existence and enforcement of clear procedures for approving operations, re-checking the work of some employees and restoration activities. In addition, the reaction of a company in front of a fraud should reduce the potential for their in the future. Thus, the company must initiate a procedure to investigate such incidents, take appropriate action against those who committed fraud, establish and implement new procedures and controls to perform specific tasks for remember to the employees the responsibilities and rules given to them into the firm.

2. AUDIT AND FRAUD

The last level of internal control system, in terms of preventing fraud is the **audit**, both internally and externally. Internal auditors perform activities which are determined by the highest levels of company management. Among the specific tasks they may be listed: detect fraud and develop mechanisms to prevent fraud. In this regard, it should be noted that all organizations of internal auditors have issued rules for fraud. Unlike internal auditors, external auditors are independent, ie he is not employee of firm. Fortunately, the role of auditors has evolved so that may be included among their objectives detection of fraud, although only like operation derived from the tests that evidence are obtained. However, it is almost generally accepted that, despite all the rules and procedures in the world, if people are dishonest, they will always find ways to violate them. No tools for an auditor to defend in front of a client who intends to commit fraud. The safest way to protect themselves is to ensure that deals with a reliable customer. However, many audit firms ignore this. Auditors should adopt a responsible attitude and demonstrate common sense instead to respond to the wishes of companies that are willing to resort to subterfuge. Otherwise, you can reach the situation where investors no longer trust in company or in the audit firms. To avoid such a situation - neglected - the profession has taken steps to regain investor confidence. Thus, in recent years, attention of the regulators and the academic is given to audit committee since it was formed the belief that the quality of financial reporting depends on the characteristics of the audit committee. Audit committees have the task of selecting auditors of the company. If the reputation of members of audit committees depends on the quality of the auditors'mission, audit committees becomes evident concern in the selection of good auditors. An auditor can be appreciated for its ability to detect and report errors and omissions in financial statements.

Moreover, the market becomes increasingly more critical in terms of reliability audit opinions issued by the audit firms. Thus, analyzing more cases of bankruptcies of firms in the UK and USA, we found that audit is not a sign far safer than a financial analysis to determine the health of a business: most of the companies whose certified financial statements were qualified survived and most businesses have gone bankrupt even if financial statements were certified non-qualified. Therefore, the appearance of audit committee doesn't offer the guarantee that frauds will disappear. However, these committees must assess if the company's managers have identified the risks of fraud, how the measures to fight against the frauds were implemented and to appreciate the message sent by the managers to employees. Features in detecting and preventing fraud can be identified in small firms because for these firms doesn't exist a legal requirement to have certified financial statements. But the more of these companies should be worried about the possibility of fraud and that there are greater risks of nondetection. However, these companies may be offered by accounting and auditong firms with various other services to help prevent and detect fraud. Thus, these services can be listed categories: staff training, review of internal control, control of cash, verification of assets, employment counseling staff, tasks, boosting confidence in employees. Staff training has as starting point the idea that a company's employees are the first to hear about some fraud or actions that may adversely affect the activity of the company where they are employed. Thus, their training should be focused on the following areas: why fraud occurs, how to recognized a fraud and what to do if they suspect a fraud. We know that in small firms internal control is, mostly, very well tuned. For this reason, it is recommended the intervention of external specialists to review the internal control system and propose solutions to improve it.

In terms of their frequency, it was found that fraud involving the company treasury occur most often, so is absolutely necessary to focus on the operations with cash and on the operations with banks. The control of assets supposes the verification of cash transactions because both can lead toward misuse of assets or use them to achieve fraud. In addition, assets can be destroyed or stolen by employees. The counseling the firms that hire employees is necessary all the time because it was found that small firms do not spend too much money in recruitment or to obtain references or information about criminal records or professional or psychological testing of prospective employees. There are studies how show that 7% of employees have stolen or committed fraud in the workplace, what suggests that is becoming more necessary to check all prospective employees before hiring them. As we saw above, segregation of duties is a sure way to prevent fraud that could be committed by employees. Unfortunately, in small firms that operation can not be achieved because of the small number of employees. For this reason, the manager has the obligation to scrupulously monitor employees's activity if it encompass many tasks. Finally, the trust between employees of small firms is an element that contributes to the proper functioning of the company, but also a factor which may contribute to the production of fraud, particularly by weakening control and by associating with each other to commission of illegal acts. Based on these findings, small business owners are advised to take the following measures which are designed to prevent and detect fraud:

- hiring an accountant or an auditor to verify the accounting firm;
- restricting access to bank accounts and conduct regular crosschecking with bank;
- taking appropriate measures to protect assets;
- improving procedures for selection and recruitment;
- establish procedures for reporting fraud discovered by employees.

3. CONCLUSIONS

As a consequence of more frequent financial scandals caused by managers's frauds and not by the fraud of the employees at lower levels, fraud whose production could not be prevent by internal and external auditors or by the existence of the committees audit, appeared the Association of Certified Fraud Examiners whose role is to reduce the number of fraud, providing confidence for public in the integrity and objectivity of the profession. These experts assist audit committees and the management overseeing the activities, either directly or in their capacity as members of teams of internal and external auditors. In fact, these professionals have practical experience and competence in identifying fraud that firms could hardly have by their employees. In addition to advisory work in risk assessment and implement measures to detect fraud, fraud experts may conduct investigations into allegations or suspicions of fraud case and to convey the outcome of these investigations to the appropriate level of management, audit committee or board, given the nature of fraud and the individuals involved.Beyond the emergence of these professionals increasingly specialized in fraud detection, is important that internal and external auditors to conduct business with professional skepticism in the sense that it must always start from the premise that a fraud may occur whatever experience they have in that company and even they have confidence in the honesty of management.

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