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## 11 SAD WORDS ABOUT FRAUD — BUT HELP IS ON THE WAY!

By David L. Cotton, CPA, CFE, CGFM

Fraud has been with us since the serpent told Eve it would be okay to take a bite out of that apple in the Garden of Eden. Since then, fraud schemes have multiplied, prospered and grown in ingenuity and deviousness. Fraud is not diminishing, and we need to acknowledge that fraud will not go away. Some experts believe that less than one in 10 frauds is ever discovered.

### Four sad words *precede* every fraud

At some point, prior to an organization becoming a fraud victim, someone in that organization uttered the phrase, “It can’t happen here.” Often, those words followed someone else’s — usually an accountability professional’s — urgings to strengthen control procedures. We’ve all heard the arguments against spending resources on control processes and procedures: “It’s too expensive;” “We don’t have enough people to segregate duties;” “That control stuff is a bunch of bureaucratic red tape;” and, the ever-present, “We only hire and only do business with trustworthy, honest people; so our organization is different.”

### Seven even sadder words *follow* every fraud

Immediately following the discovery that one of those trusted associates has made off with valuable assets, leaving heartache, pain and disarray where those assets used to be, the victims always shake their heads and say, “We didn’t think it could happen here.” Victims of fraud will always admit that they should have listened to those accountability professionals. Too bad there is not a way to promote that “better-safe-than-sorry” attitude in organizations *before* the damage is done.

### Good news — Help is on the way

Given the sad words above, the good news is that there are things an organization can do to minimize the chances of being a fraud victim. An Anti-Fraud Task Force, under the leadership of David Richards, CIA, president of the Institute of Internal Auditors, has been working diligently for 10 months to produce a comprehensive manual on fraud deterrence, prevention and detection. What the COSO “Integrated Framework” is to internal control policies, this new “Fraud Risk Management” guide will be to anti-fraud programs and controls.

The Anti-Fraud Task Force is sponsored by the Institute of Internal Auditors (IIA), Association of Certified Fraud Examiners (ACFE) and the American Institute of CPAs (AICPA). Task Force members include accountability professionals from a wide array of large, small, public, private, governmental and academic organizations and institutions.

The published document ([\*Managing the Business Risk of Fraud: a practical guide\*](#)) sets forth a comprehensive framework for designing, implementing and maintaining anti-fraud programs designed to manage fraud risk. Enlightened organizations and executives will be able to turn to this guide as the blueprint for constructing strong barriers to protect assets from theft through deception. The guide will set forth the best practices that should be implemented and serve as the measuring stick for assessing an organization’s fraud risk exposure.

The current draft of [\*Managing the Business Risk of Fraud: a practical guide\*](#) is being reviewed by a number of endorser organizations and should be finalized and ready to join the front lines in the war against fraud by the end of this year. The guide will contain the following key sections:

- An **Introduction** section designed to inform readers of the value of embracing a comprehensive set of anti-fraud criteria

- A section on **Fraud Risk Governance** that explains the importance of involving every organizational element in the fight to prevent fraud, explains the **Fraud Risk Management Program** and defines the fraud management roles of key organizational elements:
  - The governing body
  - The audit committee
  - Management
  - Staff
  - Internal audit
- A section that explains how to conduct a **Fraud Risk Assessment**, structured around a three-part conceptual process:
  - Identifying inherent fraud risk
  - Assessing the likelihood and significance of inherent fraud risks
  - Responding to the *reasonably likely and significant* inherent and residual fraud risks
- A section on **Fraud Prevention** that uses the fraud risk assessment foundation to design prevention mechanisms in the areas deemed to be vulnerable to fraud risk
- A **Fraud Detection** section that recognizes that, while the ideal would be to *prevent* all frauds from occurring, that is not possible, and often not practical from a cost-benefit perspective. This section defines a number of detection techniques that can be used to minimize the damage when prevention mechanisms fall short.
- A final section on **Fraud Investigation and Response** that sets out best practices for dealing with allegations or evidence that fraud may have occurred

The guide will also include a number of appendices, including a comprehensive list of reference materials, a model “Fraud Governance Charter,” a sample anti-fraud policy, a fraud risk assessment framework example and “scorecards” for grading the strength and effectiveness of an organization’s prevention and detection programs and enabling progress measurement.

Task force members are confident that this new product will make a significant contribution to the never-ending war on fraud ... and perhaps reduce the number of times in the future we will have to hear those 11 sad words.

*David L. Cotton, CPA, CFE, CGFM, is chairman of Cotton & Company LLP in Alexandria. He is presently serving on the Anti-Fraud Task Force and has served on the VSCPA Professional Ethics Committee and the Technical Standards Subcommittee of the AICPA Professional Ethics Executive Committee. He is currently serving on the Greater Washington Society of CPAs Professional Ethics Committee. He can be reached at [dcotton@cottoncpa.com](mailto:dcotton@cottoncpa.com).*