



DRM, Inc.

Summary of Findings:

2010 Worldwide Study by the ACFE

September 2010

This month, I thought we would take a global perspective into the plague of occupational fraud as it affects all industries. By doing so, perhaps we can gain insights into the issues we face today in the timber industry as well as identify those we may be facing in the future. I'll do that by sharing information from the 2010 Report to the Nation on Occupational Fraud & Abuse, copyright 2010 by the Association of Certified Fraud Examiners, Inc. The 2010 report is based on data compiled from a study of 1,843 cases of occupational fraud that occurred over a two-year period between January 2008 and December 2009. All information for the study was provided by the Certified Fraud Examiners (CFEs) who investigated the particular case. The cases came from 106 nations with more than 40% from outside the US. Although the results give a truly global view of occupational fraud, I think you'll find this report provides an intriguing perspective and insight for us.



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DRM, Inc.
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Since I can't possibly cover all the key findings of the study in such a brief space here, I'll glean the most pertinent take-aways for the timber industry and present them in three newsletters as follows:

1. Summary of Findings: An Overview of the Study and the Key Results
2. Fraud Schemes and How to Detect Them
3. Victim Organizations and Fraud Perpetrators: What do they look like?

Background and Basic Stats

The study found that, world-wide, the typical organization loses 5% of its annual revenue to fraud. Applied to the estimated 2009 Gross World Product (GWP), this translates to a potential fraud loss of more than \$2.9 trillion. The median loss for each case in the study was \$160,000 and ¼ involved losses of at least \$1M - amounts worth Schemes broke down as follows:

- Asset misappropriation schemes represented 90% of the cases, though they were the least costly with a median loss of \$135,000.
- Financial statement fraud schemes were on the opposite end of the spectrum. They made up less than 5% of the cases, but caused a median loss of more than \$4M - by far the most costly category.
- Corruption schemes comprised just over 1/3 of the cases, causing a median loss of \$250,000.

The frauds lasted a median of 18 months before being detected and were more likely detected by tip than by any other means. Small organizations are disproportionately victimized, apparently because they lack adequate anti-fraud controls which makes them particularly vulnerable. Perpetrators are more likely to go after what they perceive as easier targets. Victim organizations that had the 15 most common controls in place experienced significantly lower losses and time-to-detection.

More than 80% of the frauds in this study were committed by individuals in one of the following departments:

- Operations
- Sales
- Executive/Upper Management
- Customer Service
- Purchasing

More than 85% of fraudsters in this study had never been previously charged or convicted for a fraud-related offense. This finding has been consistent over time. Perpetrators often display warning signs that they are engaging in illicit activity. The most common behavioral red flags are living beyond their means (43%) and experiencing financial difficulties (36%).

Conclusions and Recommendations of the Study

Here are the basic findings of the study:

1. Fraud reporting mechanisms are a critical component of an effective fraud prevention and detection system. Hotlines are an effective way to receive tips from both internal and external sources, especially when they provide anonymity and confidentiality. Employees should be encouraged to report suspicious activity without fear of reprisal or breach of trust.
2. Although audits are an important part of a strong prevention plan and can have a strong preventative effect, organizations tend to over-rely on them. In the survey, it ranked comparatively poorly in both detecting fraud and limiting losses due to fraud. However, surprise audits proved to be an effective tool against fraud, yet is underutilized as less than 30% of victim organizations conducted them. Surprise audits are especially effective in prevention. Generally speaking, fraud perpetrators only commit fraud if they believe they won't be caught and surprise audits increase perception that they will be detected.
3. Employee education is the foundation of preventing and detecting occupational fraud. Employees must be trained in what constitutes fraud, how it hurts everyone in the company and how to report any questionable activity. Not only are most frauds detected by tips, but also organizations with anti-fraud training for employees and managers experience lower fraud losses.
4. Since small businesses are particularly vulnerable to fraud, these organizations should focus their control investments on the most cost-effective mechanisms, such as hotlines, setting an ethical tone for their employees and other strategies to help prevent and detect fraud schemes.
5. Internal controls alone aren't sufficient to fully prevent or detect occupational fraud. Auditors and employees alike should

one's means or exhibiting control issues. Although these aren't proof of fraud or even wrong-doing, they can be red flags and shouldn't be ignored.

6. A fraud prevention checklist helps organizations plan, implement, and monitor their strategy.

Application to the Timber Industry

I was especially struck by this study in that so much of what has been identified here matches my own experiences and observations as well as those of colleagues in the companies I've worked with and findings from other research and case studies that target the timber industry specifically. Apparently fraud has the same face even though the stage may change. Even in this study, although companies varied and the cases were worldwide, the research showed only slight differences from region to region. I find the results only served to solidify my own beliefs. I would concur with all of the recommendations given here and would encourage you to consider your own organizations in light of these findings. We'll look at more of the findings from this research in the next issue.

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DRM, Inc.

With over 23 years' experience in the forest products industry, Dendro Resource Management, Inc. (DRM) is a leader in timber audit services. DRM is committed to supporting the integrity of the forest industry by providing independent analysis and recommendations regarding internal controls as well as actively detecting and documenting theft and fraud incidents.

Custom Programs can be tailored with your company's needs in mind. With DRM you are guaranteed independence and confidentiality.