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**RECESSION - A RECIPE FOR INCREASED RISK OF FRAUD**

**Your business may be at risk**

While economic indicators suggest we may have seen the worst of the recession, we are still in difficult economic times and the impact of the recession is still being felt. In difficult times, many businesses have slimmed down their employee base which will often result in the removal of control safeguards that have been successfully operating in the business in the past.

By doing so, companies run the real risk of exposing themselves to reduced management controls and the consequent increased risk of fraud.

Most people understand that fraud is always a critical issue. Reduced controls in a recession is often the exact opposite of what is needed - i.e. directing more resources at this risk. In these difficult times, the temptation to commit fraud increases, making it an ideal time for businesses to take a hard look at internal controls and make sure that the appropriate defences are in place.

Consider this:

- Have you implemented redundancies or lay-offs?
- Have you reduced the level of internal control as a result?
- Are remaining staff doing more work with less supervision and segregation of duties?

If so, your employees may be stressed and this puts your business at risk.

**Which businesses have the highest risk of fraud?**

Undoubtedly, recession can increase the risk of fraud. Small companies are the most vulnerable because financial responsibilities in smaller businesses are usually handled by a few people, or even by one person. You may have "trusted" long time employees who have access to both assets and records, with an opportunity to commit and conceal fraud. Larger businesses with more resources usually have a lower risk of becoming victims.

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## What is fraud?

Auditing Standards define fraud as:

*“An intentional act by one or more individuals among management, those charged with governance, or employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.”*

It can also be thought of as:

- Theft of assets
- Falsifying or altering accounting records or other documents
- Deliberate misapplication of accounting policies
- Spreading or omitting the impact of transactions from records or documents
- Wilful misrepresentation of transactions or of the company's state of affairs

## The fraud triangle

There are three key elements in the fraud triangle:

- Opportunity - “this is easy, no-one will know”
- Motivation - “I need the money”
- Rationalisation - “they can afford it”, “I deserve it as I should be paid more”

Opportunity exists when an individual believes they will get away with it because of lack of control.

Motivational pressure exists where external factors mean an individual needs more money. Rationalisation can be as simple as intending to do it only once and repay the funds at a later date.

Typically, fraud is committed by a first time offender under extreme pressure and is often only discovered accidentally or by tip-off, or when the culprit leaves. It is likely that many frauds are never discovered.

## Do you want to reduce the risk of fraud?

Most frauds are small but the impact of even a small fraud on morale and reputation can be enormous. The first step in reducing the risk is for business owners to develop a climate that is hostile to fraud. Secondly, business owners should implement strong internal controls to minimise fraud opportunity - especially focussing on those staff members who handle the day to day finances.

Owners and management should be at the forefront of a fraud management process that includes these key components:

- Detection
- Deterrents
- Response
- Remedial action

Once a plan is in place to deal with each of these components, the risk of fraud occurring is reduced.

## Fraud risk check-up

Conducting a fraud risk check-up is a worthwhile investment of time.

For further information on a fraud risk check-up, contact John Black ([john.black@aab.co.uk](mailto:john.black@aab.co.uk)) or Allan Hunter ([allan.hunter@aab.co.uk](mailto:allan.hunter@aab.co.uk)).



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