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TECHNOLOGY AND YOUR MONEY

Fraud prevention

Financial institutions enhance value of internal audits by including fraud prevention

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As financial institutions face new technology and changing regulatory practices, fraud prevention, which has always been crucial, gains more importance. Certified public accountants suggest that incorporating fraud prevention with internal audits will enhance the value of audits while addressing the problem of fraud.

Hans Pettit, a partner in the financial institutions practice at Jackson accounting firm HORNE LLP, says including fraud prevention in audits takes audits from compliance to prevention.

“With the current downturn in the economy, which is widely considered the worst since the Great Depression, the banking community is bracing for a complete overhaul of their federal regulations,” he said. “We know at this point that change is coming, but the extent of that change and its impact to operations remains uncertain. However, when it comes to an economic crisis, the one thing we know for sure is that the risk of fraud is higher than ever.”

Previously, the focus of an internal audit has been on testing controls surrounding bank operations to ensure the compliance of the institution’s financial statements and disclosures with generally accepted accounting principles.

“As a result of this compliance focus, banks now have much more robust internal control documentation associated with



Pettit



Alexander



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operations and financial reporting and their impact on the financial statements,” Pettit says. “The enhanced documentation, processes and knowledge resources that have been developed as a result of the compliance focus presents a great opportunity to leverage those resources in gaining greater benefit from internal audits.”

As a partner and the director of fraud, forensic and litigation services for HORNE, Robert Alexander feels now is a great time for banks to expand those knowledge resources to focus on the prevention of the greatest risk affecting banks each year — fraud.

“It is true that if someone really wants to commit fraud, it is very difficult to stop them. However, the implementation of good internal controls that focus on the detection and prevention of fraud significantly reduces the number of occurrences and the length of time it takes to uncover the fraud. This is an expenditure of resources that can result in significant benefits over the cost incurred,” he said.

Hancock Bank, based in Gulfport, definitely sees the value of including fraud prevention in its internal audits, according to Jeff Theiler, senior vice president and senior risk officer for Hancock Holding Company, the parent of Hancock Bank.

“Fraud prevention, whether internal or external, is part of the process,” he said. “Although fraud may not be specifically mentioned in an audit, the purpose of conducting audits is to assure that established policies and procedures are followed.”

Deviations from standing operating procedures are documented in Hancock Bank audits and reviewed further to determine potential fraud as well as other controls required by bank or industry guidelines. As changes occur in the industry, Theiler says the company is looking more closely at fraud and internal audits.

“Policies are reviewed as new threats are determined and existing operating processes are being supplemented with technology improvements such as fraud systems for debit card, wire, e-banking, etc. to enhance rules-based or behavioral models to identify red flags requiring further review and investigation,” he said.

Alexander and Pettit point out that a business banking study performed in 2010 involving more than 500 executives and business owners from small and medium businesses uncovered the following information on fraud as it relates to banks and their customers:

FRAUD ATTACK RATE: 55 percent of businesses reported experiencing fraud in the last 12 months, with 58 percent of fraud enabled by online banking activities.

FRAUD DETECTION RATE: 80 percent of banks failed to catch fraud before funds were transferred out of their institution.

FRAUD LOSS RECOVERY: In 87 percent of fraud attacks, the bank was unable to fully recover assets.

FRAUD LOSS REIMBURSEMENT: 57 percent of the respondents that have experienced a fraud attack were not fully compensated

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by their banks. 26 percent were not compensated for any part of their losses.

CUSTOMER CARE:

Forty percent of businesses said they have moved their banking activities elsewhere after a fraud incident. 11 percent of businesses that have experienced fraud claimed they have terminated their banking relationship following fraud attacks, and an additional

29 percent said they did not fully terminate their relationship, but moved their primary cash management services to another institution.

TRANSPARENCY: Twenty-four percent of businesses claim their banks do not provide a policy explaining the bank’s responsibilities to secure and protect their companies’ accounts from fraud. 39 percent are unsure if such a policy exists.

“The most effective way to incorporate fraud with an internal audit is to perform an extensive fraud risk assessment,” Alexander said. “A thorough risk assessment should involve evaluating the bank’s fraud risk factors; identifying possible fraud schemes; prioritizing fraud risks; evaluating mitigating controls; and incorporating this information into the overall enterprise risk management process.”

Pettit adds that the success of incorporating fraud prevention in any internal audit structure will depend entirely on the commitment of the organization and its decision makers. “It is a success that depends entirely on the involvement of all individuals and the execution of a well designed strategy,” he said.