Fraud
A stain on the road to recovery

Fraud poses great risks to companies in the Middle East as they struggle to maintain or recover their market position. The reverse side of the coin is that combating fraud presents these same companies with opportunities. The region should not ignore the chance to redefine itself as an archetype of transparency and good governance.

As recent corporate actions and economic activity across the Gulf spark a new wave of international interest and awareness, little doubt remains as to how important the region has become to the global economy: few had anticipated the extent and the effect of the global downturn on the region or, inversely, the impact that regional events would have globally. The Gulf Cooperation Council (GCC) states are recognised as key economic and financial hubs in the region by the international business community: the impact of the international debt crisis on the region, and vice versa, only reinforces this view.

The question that now begs itself is how the economy and the markets in the region continue to weather the storm and how businesses are responding to the new economic realities. The restructuring of debt by major conglomerates and the flurry of reorganizational activities indicate that the focus is certainly on recovery and long-term stability.

What recovering firms should look out for, however, is fraud, which tends to take an upswing in a downturn. An increased exposure to fraud, waste and abuse is one of the harsh realities of tighter credit and an economic slump. Companies need to respond by adopting more effective measures of eradication. A company's intolerance to acts of fraud, bribery and corruption are essential components of corporate recovery, central to long-term survival and success.

As companies adapt to new business realities, the opportunity to embrace enhanced corporate governance should not be overlooked – as they restructure and recover, their organizational structure should enable better governance, transparency and accountability. It is more and more apparent that stakeholders are influenced by these factors and in this climate it is as important as ever for the region's reputation to be untainted.

Transparency International's Corruptions Perception Index (CPI) positively reflects the region's changing attitude towards fraud and initiatives taken by the leadership of several Middle Eastern states to fight corruption – the 2009 index showed Qatar, UAE and Oman moving up in their ratings and Saudi Arabia moving up 17 places in the past year alone.

Fraud Risk Factors

Three factors generally characterize fraudulent activity: incentive, opportunity and rationalization. These three factors are exaggerated in an economic decline, resulting directly in an increased exposure to the risk of fraud.

In challenging economic times, the capacity for individuals and corporations to rationalize their actions often intensifies. Individuals and organizations alike can be under additional pressure to perform, which can often lead to companies "cooking the books," or individuals manipulating results. The need for personal gain, or indeed the avoidance of corporate and/ or personal loss can be more acute in a downturn, which can often act as the motivation for fraudulent behavior. Companies that are cutting costs may have fewer staff and a reduced level of internal control, which can in turn present additional opportunities for fraud.

The true cost of Fraud

Fraud represents a constant drain on company profitability. The true cost of a fraud scheme is often not assessed entirely: an employee stealing $500,000 is only the tip of the iceberg, a company with a 10 percent profit margin must sell $5 million to make up for the loss. Then there is the reputational damage to the organisation, operational losses that may have been incurred, and the effect of disruption on the business and waste of valuable management time that need to be factored in. Unfortunately, many businesses look at the money spent on fraud prevention as a cost centre, subject to budgetary constraints. However, fraud prevention should be viewed as a profit centre as losses due to fraud generally come straight off the bottom line. Companies without preventative measures in place often simply cannot survive fraud incidences.

By reducing vulnerabilities and limiting impact, companies can go a long way to eliminate the rate of occurrence, and the cost of fraud should it occur. The key to combating fraud is in identifying risks and vulnerabilities pre-emptively, and having a plan in place to respond when it happens. Those that adapt to the economic conditions and the risks and challenges they bring about have the opportunity to adopt appropriate, effective and sensible solutions. Ultimately, they will have a better chance at recovery, securing their future and ensuring that the Middle East is a paradigm of transparency and good governance.

By **Simon Charlton**, Managing Director, Forensic & Dispute Services, Deloitte Corporate Finance Limited