Charles Ponzi and Bernie Madoff are among the most infamous fraudsters in United States history. Charles Ponzi’s 1920’s era scheme cost his investors more than $200 million in current dollars and gave name to the “Ponzi scheme” that Bernie Madoff used to commit his $17.5 to $20 billion (yes with a "B") fraud that was exposed in 2008 (still the world’s largest financial fraud).

For most businesses these two names represent good news and bad news. The good news – most companies are very unlikely to face a fraud of these magnitudes. The bad news – the potential for much smaller frauds is very real for most companies and even small frauds can have a significant impact on your business. Based on the most recent study by the Association of Certified Fraud Examiners:

- The typical organization loses 5-6% of its revenues to fraud each year.
- The median loss caused by an occupational fraud was $140,000.
- Occupational fraud is a significant threat to small businesses. The smallest organizations in the study suffered the largest median losses.

So what are the factors that contribute to fraud risk and what can be done to mitigate those risks? A common framework for understanding fraud risk is known as the fraud triangle – three elements that are present in most fraud scenarios:

- Pressure – Financial pressures can result from personal debt, financial losses or living beyond one’s means. Even an otherwise honest and loyal employee may be tempted to use company assets to relieve the pressure.
- Opportunity – The most obvious opportunity is a weak internal control system. Without a strong system of internal controls, the risk of fraud happening and going undetected increases.
- Rationalization – The reason the perpetrator uses to justify their fraud. This rationalization can be influenced by the “tone at the top” (is “cutting corners” a part of the culture?) or, for example, caused by perceived under-compensation leading to a sense that the stolen assets are “owed” to the fraudster.

Eliminating any one of the three elements necessary for fraud will significantly reduce the potential for fraud. The easiest element for a company to control is opportunity. A well-designed and functioning internal control system is the number one defense against fraud.

A key element in a well-designed internal control system is appropriate separation or segregation of duties. If at all possible (and more difficult in small organizations), one individual should not have access to assets and responsibility for control activities, and/or authorization responsibilities and the ability to record financial transactions. When one individual has custody of the entire accounting process in a particular area, they have OPPORTUNITY! Changing accounting processes to create appropriate segregation of duties can significantly reduce the opportunity and decrease the risk of a fraud.