Managing Fraud, Interest Rate & Investment Risks

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Los Angeles and Southern California business leaders face many different kinds of risk when it comes to running their companies. Of course, the very idea of owning and managing a business entails assuming a certain degree of risk.

While the risks involved in running a business can't be completely eliminated, there are steps executives can take to minimize and manage risk responsibly. Following is a look at three specific kinds of business risk that are common to most companies and some ways they can be mitigated.

1. Fraud and Embezzlement Risk
According to the Association of Certified Fraud Examiners (ACFE) 2012 Report to the Nations, the median business loss due to occupational fraud is $140,000. Almost half of all businesses victimized by fraud do not recover any losses, and the smallest organizations in the ACFE study suffered the largest median losses.

For internal fraud to occur, there must be three separate elements in place: pressure, rationalization and opportunity. While there's little you can do about your employees' financial or other pressures or their ability to rationalize theft, you can limit their opportunities to commit fraud by implementing sound internal controls. These typically include:

Ensuring proper financial oversight
Make sure there is an adequate level of management oversight of your company's finances. As the owner or CEO, you should maintain at least a minimum level of personal oversight of the business' finances. This could be as simple as looking at the bank statements each month and personally signing all checks, instead of letting accounting staff use a check stamp.

Segregating financial duties among the accounting staff
In other words, different employees should be responsible for different financial and accounting tasks. This will make it harder for one employee to cover his or her fraud tracks. For example, at least two different employees should fill out deposit slips and enter cash receipts.

Using bank fraud prevention services
Positive Pay is a common bank service that helps guard against check fraud by comparing checks presented to the bank for payment with a check-issued list supplied by your company. The bank only pays exact matches, sending all suspect items to you to make a pay/no-pay decision.

2. Interest Rate Risk
Changes in interest rates inevitably expose companies with variable rate debt to interest rate risk. Since most senior corporate debt today is variable rate, it's wise to plan now for how you can minimize interest rate risk — especially when you consider that it's not a matter of *if*, but *when*, interest rates start to rise.

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Hedging tools (also known as derivatives) are usually the best way to mitigate interest rate risk. These are contractual agreements between companies and banks in which each party agrees to exchange different forms of interest payments through a maturity date. The three main types of derivatives are:

Swaps
These allow variable rate borrowers concerned about rising rates to lower their future interest costs — and in turn, preserve their margins — by converting from a variable to a fixed rate in the future.

Caps
These limit a company's variable rate exposure by setting a maximum level (or cap) above which rates cannot rise during a specified period of time.

Collars
These establish a floating range within which variable rates can move, either up or down.

3. Investment Risk

When deciding how to invest excess corporate funds, CEOs and CFOs must balance the competing goals of maximizing return and liquidity while minimizing risk. Tactics for achieving this delicate balancing act should be spelled out in a corporate investment policy statement. Such a statement will provide an overarching vision and direction to guide how corporate investments will be managed, including the level of risk that's acceptable, the level of liquidity that's needed, and the level of return that's desired. Investment policy statements usually include the following components:

- Statement of purpose
- Investment objectives
- Roles and responsibilities of key individuals
- A definition of investment "prudence"
- Concentration limits, approved investment types and portfolio maturity guidelines
- Portfolio review and benchmarking guidelines

Concluding Thoughts

Completely eliminating all of the risks involved in running a business is impossible, but Los Angeles and Southern California business owners and executives can take steps to mitigate and manage risk responsibly. This is especially true in the three main categories into which most risks fall: fraud and embezzlement, interest rates and investments. An outsourced CFO services firm can help you formulate a comprehensive risk mitigation strategy that minimizes key business risks, which can in turn maximize profits over the long term.

About CFO Edge

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