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Abstract: Family businesses make up a large percentage of companies in the United States and produce much of the country's gross domestic product. Often defined as companies that are majority owned by a single family with two or more members involved in their management, family businesses can be a significant source of wealth. They may also face higher fraud risks. This article explains why that is true and how family businesses can reduce the risks.

Family businesses aren't immune to fraud

A large percentage of companies in the United States are family businesses, and they produce much of the country's gross domestic product. Many are majority owned by a single family, with multiple family members involved in management. These businesses can be a significant source of wealth. They may also potentially face higher fraud risks. Here's why, and how you can reduce those risks.

Key factors that may lead to problems

While many business owners admit the need for fraud prevention, it can be hard for them to believe that a family member is engaging in or ignoring unethical activity. Loyalty is valuable, but it may make a family business more vulnerable to fraud.

Just like any other company, family businesses need internal controls that make fraud difficult to carry out undetected. Awkward or not, someone must exercise authority, address issues, and keep the business moving forward.

Seek independent advice

Even trusted leaders can commit fraud, so independent auditors and legal advisors are essential. Avoid relying solely on relatives or friends. Instead, engage objective professionals.

Independent audits safeguard stakeholders. If you have a board, include at least one strong outsider.

Dealing with the offender

Fraud prevention is harder in family businesses because of how incidents are handled. Even when legal action is possible, families rarely pursue it. Many protect the offender from scandal rather than maintain ethical standards, and fraudsters know this.

If you uncover fraud by a family member, consult a trusted attorney or accountant. Advisors can explain the consequences to the perpetrator, but if that fails, you may have no choice but to seek prosecution.

Avoid blind trust

Working with family members can be advantageous, but be aware of the pitfalls. To make it easier to maintain high ethical standards and prevent fraud, rely on professional advisors and nonfamily officers for perspective and objective advice. Contact us for help with internal controls.