

# GAO Topic of the Month – May 2024

## OCCUPATIONAL FRAUD



### Background

Fraud is a global issue that affects organizations in every region and in every industry worldwide, including government and the State of Arizona. Those committing fraud may be from the United States or another country. Those who commit fraud continue to invest their time and resources in finding new ways to commit fraud. New technology can assist in helping fraud to be committed, as we have seen with artificial intelligence. When fraud is committed from other countries and through electronic means in an environment where transactions happen almost instantly, it becomes more challenging, if not impossible, to stop the fraud and recover lost funds. The best way to combat fraud is to be aware of how fraud occurs so that **everyone** in **any** role can raise concerns, strengthen internal controls, and prevent fraud and loss from occurring. Fraud **prevention** is **everyone's** responsibility.

Continuing on our topic of fraud, GAO would like to share some recent statistics provided by the Association of Certified Fraud Examiners (ACFE). In their *Occupational Fraud 2024: Report to the Nations*, the ACFE concluded that occupational fraud is the largest and most costly form of financial fraud in the world, with estimated costs in the trillions of dollars. These crimes are a threat to every type of organization in every region throughout the world. The fact that occupational fraud remains so common and so costly is one reminder of why the work that we do as stewards of taxpayer money and the need for good internal controls is so important.

Occupational fraud is divided into three distinct categories; asset misappropriation, corruption, and financial statement fraud. In order to understand occupational fraud, we need to better understand questions such as:

- How much did the fraud cost?
- How was the fraud committed?
- Who committed the fraud?
- How can the fraud be prevented and detected?

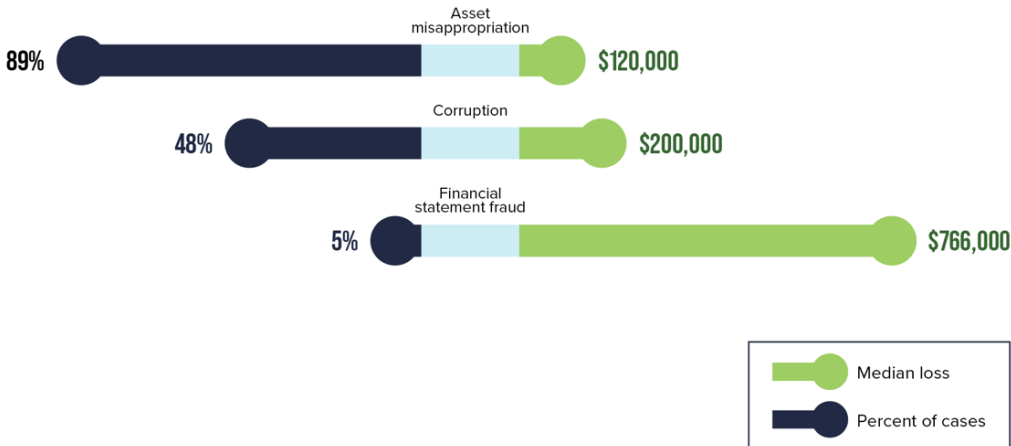
### Types of Occupational Fraud

It is estimated that organizations lose 5% of their revenue every year to fraud. The following chart identifies the three different types of occupational fraud, including the cost and percentage of cases of each. It is important to understand how fraud is committed so that we know where to look and what to watch out for:

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FIG. 2 HOW IS OCCUPATIONAL FRAUD COMMITTED?



### What is Asset Misappropriation?

Asset misappropriation schemes occur when an employee takes or uses an organization's assets for personal gain. Asset misappropriation includes things such as theft of company cash, fraudulent disbursements (submitting false invoices, altering time cards, making personal purchases with company funds, etc.), false billing schemes, misuse of an organizations assets, inflated expense reports, and larceny. Asset misappropriation schemes are the most common type of fraud but the least costly, occurring in 89% of the cases with a median loss of \$120,000.

### What is Corruption?

Corruption is a scheme in which an employee misuses their influence in a business transaction in a way that violates their duty to the employer in order to gain a direct or indirect benefit. Corruption cases include conflicts of interest, bribery, illegal gratuities, and economic extortion. Examples also include purchasing and sales schemes, invoice kickbacks, and bid rigging. Corruption cases make up 48% with a median loss of \$200,000.

### What is Financial Statement Fraud?

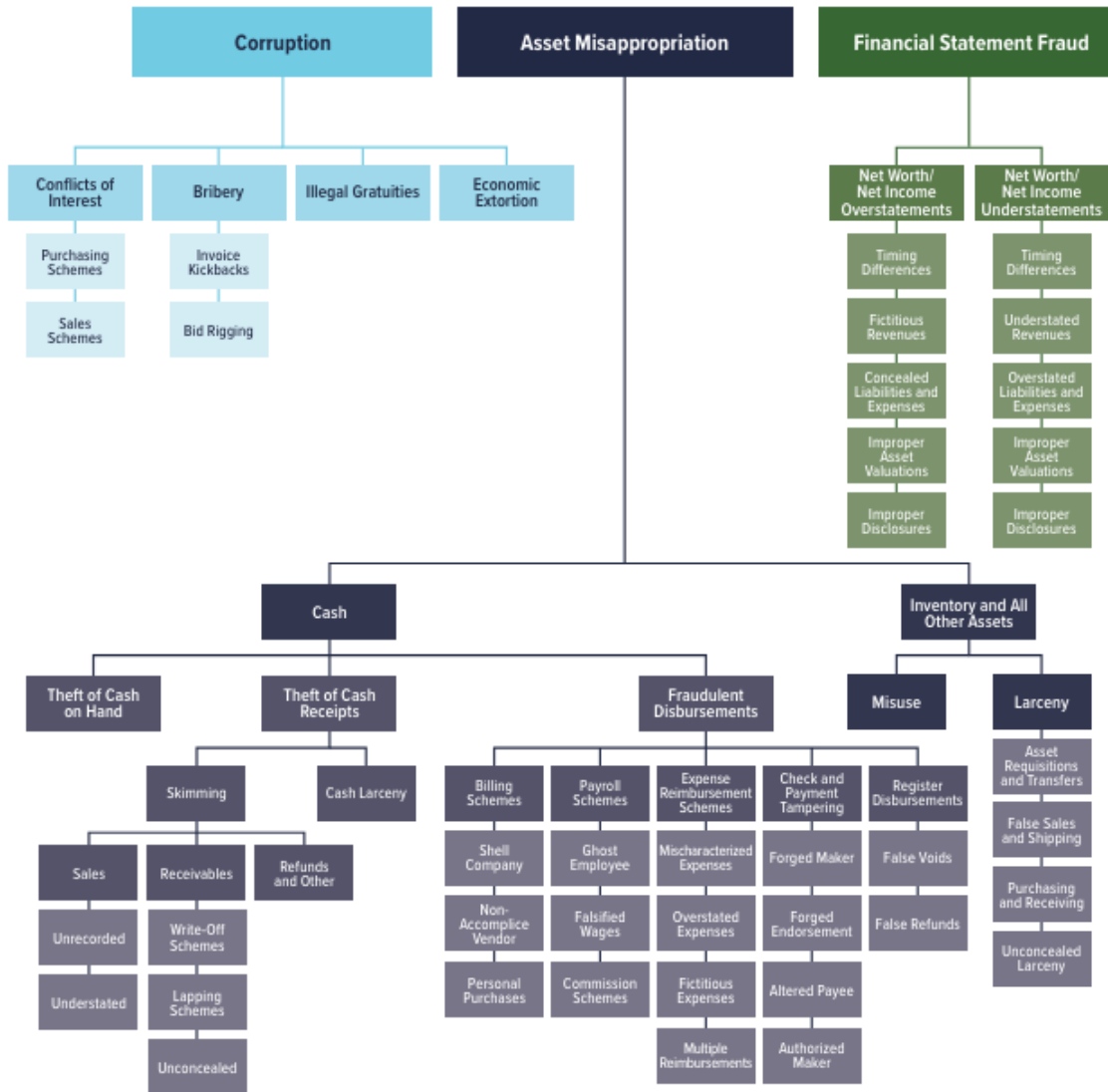
Financial statement fraud is a scheme in which an employee occurs when intentionally causes a misstatement or omission of material information in the organization's financial statements. This may include recording fictitious revenues, understating expenses, artificially inflating reported assets, improper asset valuations, or even improper disclosures. Financial statement fraud schemes are the least common, but the most costly, accounting for 5% of fraud cases with a median loss of \$766,000.

Figure 3 below provides a taxonomy of occupation fraud schemes. Understanding how these frauds are committed, in turn can help organizations focus on prevention and detection efforts to address the greatest risks.

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FIG. 3 OCCUPATIONAL FRAUD AND ABUSE CLASSIFICATION SYSTEM (THE FRAUD TREE)<sup>3</sup>



<sup>3</sup> The definitions for many of the categories of fraud schemes in the Fraud Tree are found in the Glossary of Terminology on page 104.

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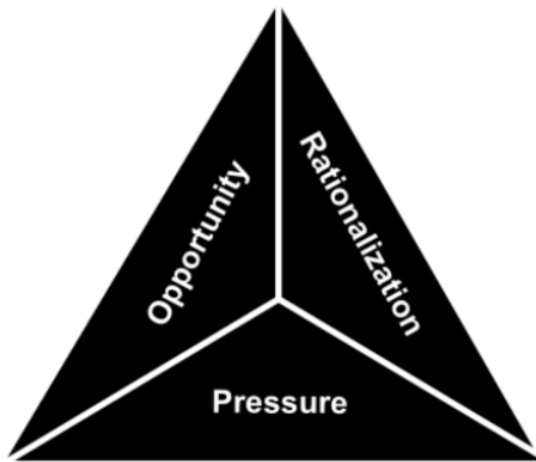
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While occupational fraud is divided into three distinct categories, perpetrators do not always limit their schemes to just one category. In this study, 38% involved two or more types. Those committing financial statement fraud are very likely to have committed other types of fraud as well. Generally, the longer the fraud continues, the greater the overall loss.

The ACFE report details asset misappropriation sub-schemes which are categorized as noncash, billing, expense reimbursements, check and payment tampering, cash on hand, skimming, cash larceny, payroll, and register disbursements. The ACFE report also provides statistics on the number of cases, the median losses, and which have the greatest risk.

### Fraud Triangle

Although we don't know what causes employees to commit fraud, one prominent theory known as the "fraud triangle" identifies three factors: pressure, opportunity, and rationalization.



**Pressure** may be a crucial element in many aspects of life. The need to be financially stable or some non-sharable problem such as high medical bills, gambling debts, or excessive lifestyles can motivate an employee to commit fraud. Pressure can also come from an organization itself, put on employees by forcing an employee to perform better or cover up negative results to look good.

**Opportunity** is another factor explaining fraud and is usually more obvious than pressure. For any organization to function, a certain level of trust must be placed in employees. This factor arises when an entrusted employee violates that trust by taking advantage of their position to commit fraud.

**Rationalization**, the third factor, is typically a person's excuse for committing the fraud. In many cases, perpetrators tell themselves that they are only temporarily borrowing from the organization. In other cases, perpetrators might rationalize their actions with thoughts like, "they won't miss the money," or "the organization deserves what it is getting."

### Common Red Flags

What are some common red flags? According to the data, 84% of fraudsters displayed at least one behavioral red flag. It is critical that you and others are able to identify these red flags when identifying and reporting suspected fraud, theft, waste or abuse.

#### Lavish Lifestyles

Employees who suddenly begin living luxurious lifestyles that seem beyond their means could indicate illicit income from fraud. Look for things like expensive new cars, jewelry, designer clothes, lavish vacations, new homes, and country club memberships. Compare their lifestyle to their salary level - if it

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doesn't add up, it's a red flag. Reporting concerns to the appropriate resources can lead to an investigation of employees exhibiting this behavior.

### *Difficulty Reviewing Records*

Fraudsters will often try to deny auditors access to certain records or claim records are "missing." They may send auditors on wild goose chases trying to locate paperwork or receipts. If key financial documents are suddenly difficult to access or review, it could point to an employee trying to conceal fraudulent activity. Auditors should persist in obtaining full documentation.

### *Overrides of Controls*

One of the most common fraud schemes involves managers overriding their internal controls and policies around things like spending limits, inventory counts, and access to systems. If certain employees seem able to bypass controls that others must follow, it enables fraud and warrants a closer look. Organizations should monitor compliance with financial controls.

### *Lack of Support for Oversight*

Employees who openly resent or hinder oversight activities like audits should raise suspicions. Fraudsters are anxious about getting caught, so they may try to avoid audits, provide pushback, or refuse to cooperate fully. Their resistance to transparency shows discomfort with closer scrutiny that could reveal illicit activity.

### *Inconsistencies*

Multiple financial documents should be reconciled, including inventory records, bank statements, invoices, delivery receipts, and general ledgers. If numbers don't match up or there are discrepancies, it could point to fraudulent books being kept. Trace inconsistencies to their source to check for fraud.

Through upcoming Topics of the Month, we plan to provide additional information regarding how fraud is detected, reported, and what can be done to help prevent fraud from occurring.

## Resources

- [2024 Report to the Nations](#), Occupational Fraud 2024: A Report to the Nations. Copyright 2024 by the Association of Certified Fraud Examiners, Inc.
- SAAM Topic 05, *Internal Controls*
- SAAM 0530 - *Fraud, Theft, Waste, and Abuse*
- [GAO Topics of the Month](#) (January 2024 - *Reporting Fraud*, October 2023 - *Internal Controls*)
- ["Occupation Fraud." Florida Atlantic University College of Business,   
https://business.fau.edu/centers/center-for-forensic-accounting/public-resources-on-fraud/fraud-in-businesses-and-non-profits/occupation-fraud/](#). Accessed 14 May 2024."
- ["What is Occupational Fraud and How to Prevent it?", NSKT Global, March 4, 2024,   
https://www.nsktglobal.com/usa/blog/what-is-occupational-fraud-and-how-to-prevent-it](#)