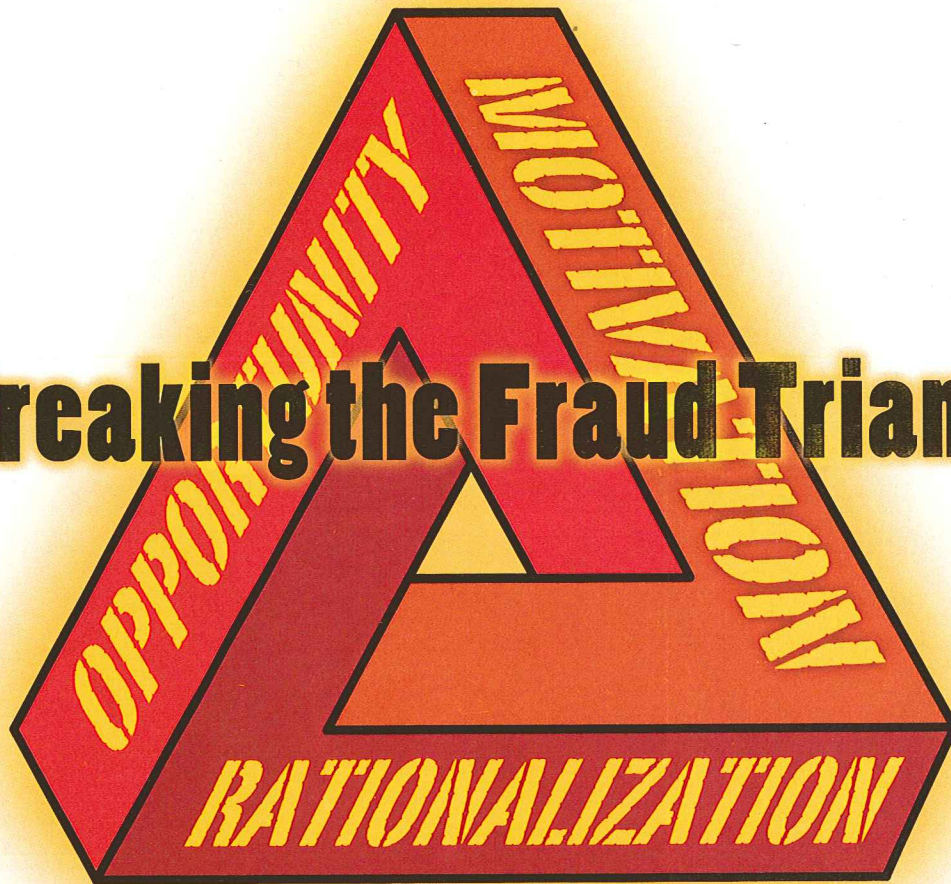


# Breaking the Fraud Triangle



By James A. Lindsey, Jr., CPA

**M**ake no mistake about it, all businesses, organizations, and government agencies are subject to fraud risks!

The dictionary defines fraud as any intentional act or omission designed to deceive others, resulting in the perpetrator achieving a gain or the victim suffering a loss. Quoting a study by the Association of Certified Fraud Examiners, a recent article in *Business Week* noted that U.S. employers lost an estimated \$994 billion to fraud last year.

Who are these marauding fraudsters? First, most are in their 40s, with men outnumbering females two to one. Second, they have worked for more than five years at the company where they

did their pilfering. Finally, of the nearly one thousand fraud cases recently analyzed, more than half were discovered by accident.

Over half a century ago the noted criminologist Donald R. Cressey interviewed over 200 embezzlers who had stolen from their companies. From his research in occupational fraud Cressey devised the theory of the "fraud triangle." The three elements making up the fraud triangle are opportunity, motivation and rationalization.

## **The Catch-22 of Fraud Detection**

Because of a need to control costs, every organization is constantly looking for ways to reduce headcount or com-

bine jobs. The result is that managers become responsible for a wider range of functions, which in turn gives them more access and control over related transactional areas.

This can pave the way for increased fraud because the opportunity to commit fraud grows as fewer employees have greater access to assets or information that permits the commission and concealment of fraudulent activities.

## **Don't Let Opportunity Knock**

Opportunity is the element over which management has the most control, so don't let a fraud opportunity knock. Opportunities arise when internal controls are weak

or non-existent, or when an employee is trusted too much.

Some immediate steps to take include: [1] Incorporating background checks on all new accounting and financial hires into your policy and procedures manual. [2] When interviewing candidates, look for, and when possible hire, people with fraud training or experience. They can help close the door before cash and valuable assets walk away. [3] Communicate and enforce your ethics policy.

Additional steps would be to conduct surprise audits, insist on mandatory vacations, and when feasible rotate responsibilities between the various accounting and bookkeeping functions. Finally, restrict access to the systems, information, and assets that are necessary for employees to complete their jobs.

### **Motivation Isn't Always a Good Thing**

Motivation is the second side of the fraud triangle. In this case motivation means a need felt by an individual to commit fraud.

The "need" could be a genuine financial need resulting from

high medical bills, debts or a perceived need such as a desire for material goods, but not the resources to obtain them. Motivators also fall into the category of non-financial, such as gambling addiction or substance abuse.

The best way to address the motivation for fraud is head-on with on-going training for all employees.

### **There is no Rational Rationalization**

The final part of the fraud triangle is the conscious or unconscious ability of a perpetrator to rationalize his or her behavior and action. For those who are dishonest by nature, rationalization comes quite easily. "What's mine is mine, and what's yours is mine." Those with a higher sense of ethics must convince themselves that fraud is tolerable with "excuses" or "rationalizations" for their behavior.

Some common rationalizations include "I'm underpaid or didn't get a bonus." Or an embezzler may say they were only "borrowing" the money and they will replace it one day. Some fraudsters tell themselves that the company doesn't need the

money, won't miss the assets or insurance will cover the theft.

While an ethics policy is no substitute for hiring employees with strong moral codes, a properly communicated and enforced policy is a key step in fraud deterrence.

### **For the Long Haul...**

The responsibility for accomplishing an organization's mission and objectives ultimately resides with its leadership. To reduce the risk of fraud in local government, it's critical that leaders focus on the individual components of the fraud triangle, build and constantly update effective safeguards and systems, and select internal staff and external auditors who are dedicated to breaking the fraud triangle.



## **Lindsey + Associates**

Jim Lindsey graduated magna cum laude from the University of Maryland and earned an MBA from The Wharton School. He is a member of the Association of Certified Fraud Examiners (ACFE) and has conducted over 200 audits and engagements for Maryland governmental entities.