

Employee Fraud: Perpetrators and their Motivations

Prepared for Eide Bailly, LLP by Thomas A. Buckhoff, Ph.D., CPA, CFE

The Association of Certified Fraud Examiners (ACFE) estimates that employee fraud costs \$600 billion annually or about 6% of an organization's total revenues. KPMG, LLP—one of the “Big Five” accounting firms—conducted a fraud survey of 5,000 leading U.S. companies and organizations from a cross-section of publicly held companies, not-for-profit organizations, and governments. The survey results indicate that the average fraud loss per incident was \$116,000 and 62% of respondents reported that their organizations had suffered losses due to employee fraud during the past year. By whatever measure, employee fraud has become increasingly widespread and is an enormous and intolerable financial drain on our society

To effectively detect and prevent fraud, we must first understand what motivates people to commit fraud. Three essential elements are common to all types of fraud schemes: opportunity, pressure, and rationalization. In combination, these three elements make up what is commonly referred to as the fraud triangle.

The first and most critical element of the fraud triangle is opportunity. Fraudsters typically exploit their employment responsibilities as the means to defraud their employers. Unfortunately, many organizations unwittingly and unwisely provide their employees with a variety of opportunities to commit fraud. The most common opportunity-providing factor is the lack of adequate controls for monitoring employee behavior. For example, a bookkeeper in a clinic was given the responsibility to prepare checks, sign the checks, and record the payments in the cash disbursements journal. Not surprisingly, the bookkeeper soon discovered the opportunity and embezzled about \$1,000,000 of the clinic's cash. Adequate internal controls require—at the very least—that these three responsibilities be segregated among at least two or more employees. Clearly, employees possessing such “incompatible responsibilities” have been provided with an easy opportunity to commit fraud. They can simply make out the checks (to themselves or to pay their own bills), sign the checks, and then “hide” the fraud by charging it to a variety of expense accounts.

Not all employees will exploit opportunities to commit fraud. What is it that induces one employee to commit fraud and the other to remain honest? Pressure is the

second element of the fraud triangle. Financial pressure can come from a variety of sources including:

- Lifestyle—including the perceived need to maintain a high standard of living
- Personal debt—from credit cards, gambling losses, drugs, alcohol, or poor investments
- Business losses—caused by inflation, high interest rates, poor economy, or lack of demand

Employees burdened with financial pressure are desperately searching for ways to relieve that pressure. Consequently, they should not be put in a position that would provide them with an opportunity to commit fraud. Doing so would be analogous to employing an alcoholic as a bartender—an unwise decision with predictable results.

The third and final element of the fraud triangle is rationalization, which means that the fraudster must somehow psychologically justify the fraud. Common rationalizations include:

- “They owe it to me. I deserve to get paid more.”
- “I’m only borrowing the money. I’ll pay it back.”
- “Nobody will miss it. The company can afford it.”
- “Everyone does it. I’m not hurting anyone.”

Those with low integrity generally have little trouble coming up with rationalizations for defrauding their employers.

People rarely commit fraud thinking they will be caught. The purpose of internal controls is to safeguard assets and records, minimize opportunities to commit fraud, and monitor employee behavior. Properly designed internal controls effectively instill in the minds of employees the perception that fraudulent activity will be detected. This “perception of detection” can be very effective in preventing fraud in the workplace. In today’s society of high financial pressure and low integrity, organizations without adequate fraud prevention programs will continue to suffer substantial fraud losses and most will not even realize it.