

Occupational Fraud:

A Study of the Impact of
an Economic Recession



ACFESM

Association of Certified Fraud Examiners

*Together, Reducing
Fraud Worldwide*

Introduction

With the economy struggling to find its foothold, many businesses and individuals are facing the greatest financial concerns in recent memory. In these tough times, protecting valuable — and increasingly scarce — economic resources has become a monumental task. Losing assets to fraud may be enough to send an already struggling organization to the financial brink.



Unfortunately, many of the situations that abound in a turbulent economy are factors that can lead to an influx of occupational fraud. Employees are under growing financial pressures as their houses decline in value and their retirement funds shrink. Organizations in nearly every sector are cutting expenses and laying off workers. Stock prices have been dropping. Morale is down. Fear is up. The combination of these conditions may create an environment ripe for fraudulent activity.

Although both logic and experience tell us that the threat of fraud could be heightened in the present economy, it is nearly impossible to gauge the true amount of fraud occurring at any given time. The vast majority of fraudsters take action to conceal their misdeeds. Consequently, some frauds may never be caught. Other schemes may be perpetrated for years before they are uncovered. And, even among those that are detected, a large number of cases will never be reported, allowing them to remain hidden from the public eye. Thus, no exact measure of the level of fraud during the current recession can exist.

Nonetheless, examining the association between fraud and a weakened economy is an important endeavor. To get a pulse on how the economy is affecting fraud trends, the ACFE went to the experts who are in the trenches fighting fraud on a daily basis. By surveying anti-fraud professionals about their experiences and observations, we hope to gain some insight into the correlation between economic downturns and fraudulent activity.

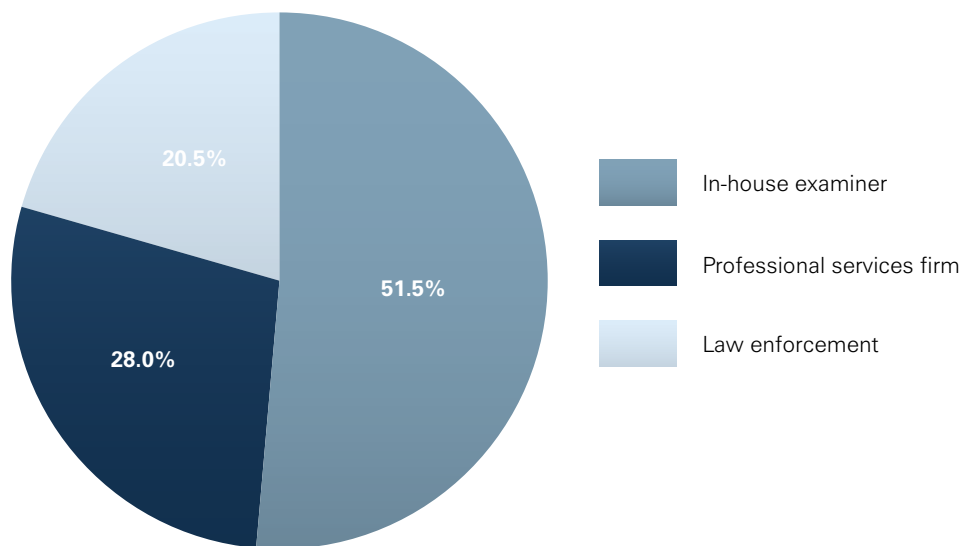
Methodology

During February and March 2009, the ACFE distributed a survey to 6,000 randomly selected Certified Fraud Examiners (CFEs) based in the United States. We received 845 responses, 507 of which were usable for purposes of this report.

The respondents were broken into three categories: those who conduct fraud examinations in-house for a single organization, those who work for a professional services firm that conducts fraud examinations on behalf of other organizations, and those who work for a law enforcement agency.

Based on their identified professional roles, respondents were then presented with a series of seven to 13 questions regarding their observations of and opinions about fraud in a weakened economy. The responses to these questions were compiled, and the resulting findings are presented in this report.

Breakdown of Survey Respondents



Findings

1. The level of fraud has increased since the beginning of the economic crisis.

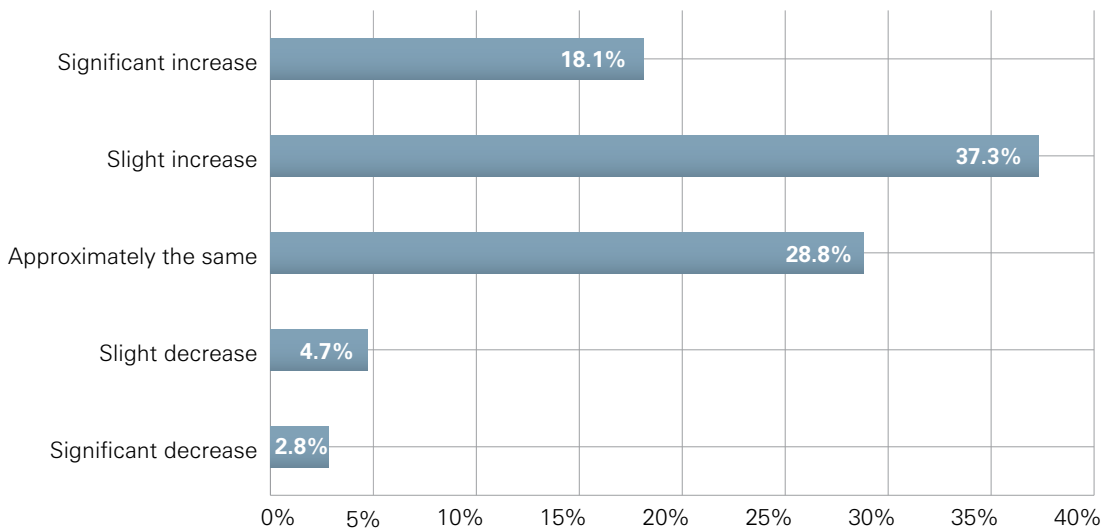
We asked respondents to compare the level of fraud they encountered during the 12 months preceding the survey (from early 2008 through early 2009) to the number of frauds they have seen or experienced in prior years.

By identifying changes in the level of observed fraudulent activity during this period, we can assemble a broad view of the relationship between the current economic downturn and white-collar crime. To help gauge the extent of any observed change, we subdivided the level of fraud into two metrics: number of cases and financial impact.

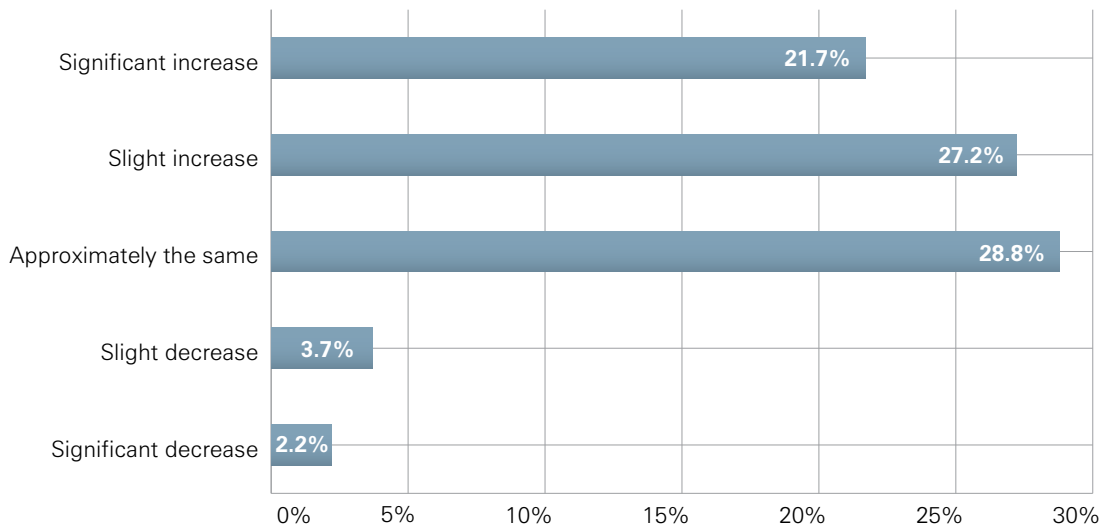
Of the 507 CFEs who responded to our survey, more than half indicated that the number of frauds has increased during the past year. Additionally, 49 percent observed an increase in the dollar amount lost to fraud during the same period.

While it is too soon to get a clear picture of exactly how much fraud has commenced since the start of the current economic slump, the data provided by survey respondents (especially when coupled with the consideration of how much fraud has not yet been detected) provides a good indication that fraud is indeed on the rise.

Change in Number of Frauds Observed During Last Year



Change in Dollar Amount of Frauds Observed During Last Year



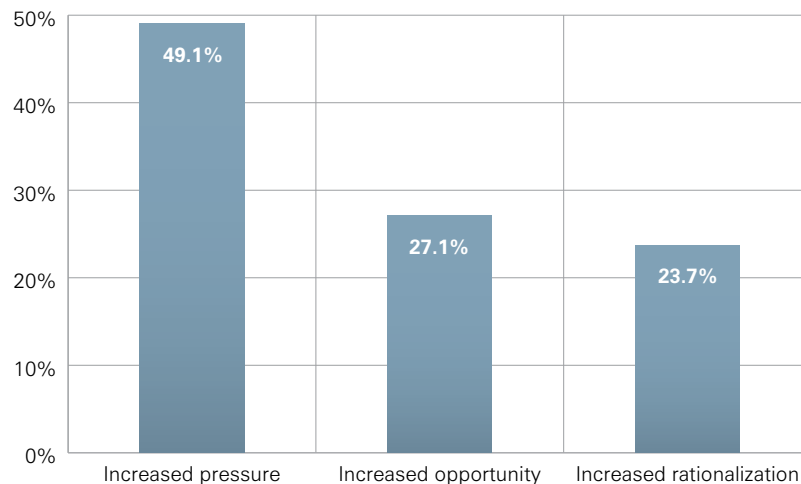
2. The current increase in fraud stems from the intense pressure faced by so many individuals.

Three factors are generally accepted as being necessary for a fraud to occur: pressure, opportunity, and the ability to rationalize illegal behavior. Unfortunately, the presence of each of these factors may rise in periods of economic hardship. Organizations and individuals alike can experience the pressure of increased financial strain. Opportunities for fraud could proliferate as many companies cut their workforces and otherwise reduce expenditures, perhaps leading to reduced internal controls and fewer proactive fraud prevention measures. And bombardments of bad financial news could cause mounting feelings of helplessness, pessimism, and isolation, which may, in turn, allow individuals to rationalize previously unthinkable acts.

We asked survey respondents which of the three elements, if any, they believe has been the biggest contributing factor to the observed increase in fraud. Of the 350 CFEs who identified one of these three factors as key, nearly half stated that it is the increased pressure that has resulted in the amplified level of fraud.

This finding is not surprising, as the pressures that stem from the current economic crisis are being felt widely and deeply. Consequently, understanding the gravity of these pressures on employees is crucial to effective fraud prevention. Employers who proactively support staff members in this time of need — through measures such as employee counseling services, open-door policies, and employee assistance programs — may be able to mitigate the pressures and deter employees from turning to criminal activities.

Biggest Factor Contributing to Increase in Fraud



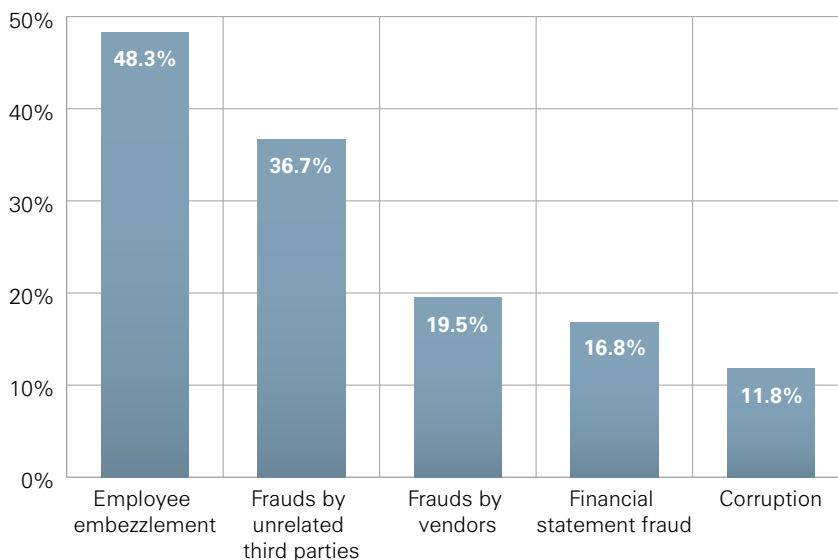
3. Employees pose the greatest threat to organizational resources in the current economy.

To get a sense of which types of frauds may be most affected by periods of economic distress, we asked survey respondents which categories of fraud, if any, have increased during the previous 12 months. More than 48 percent of the CFEs who participated in our survey indicated that employee embezzlement has been on the rise — making this the most commonly cited category. In this economy, employees have seen a surge of incentives and opportunities to defraud their employers, and an increased number have reportedly yielded to temptation.

Additionally, more than one-third of survey respondents stated that frauds by unrelated third parties — such as identity theft, con schemes, and securities fraud — have increased in the past year. This may be partly due to the upswing in mortgage fraud related to the housing market crash, as well as the crimes within many financial institutions that have played a central role in the current economic crunch. As we are seeing, these types of frauds can be devastating to individual and organizational victims as well as to the economy as a whole.

Frauds by vendors, financial statement fraud, and corruption were also indicated to have increased during the present economic slump. With observed fraud in every category showing a significant jump over previous years, organizations must heed the warning that fraud is pervasive in the current economy. To protect company assets from would-be fraudsters, management needs to make a comprehensive system of anti-fraud controls a top strategic priority.

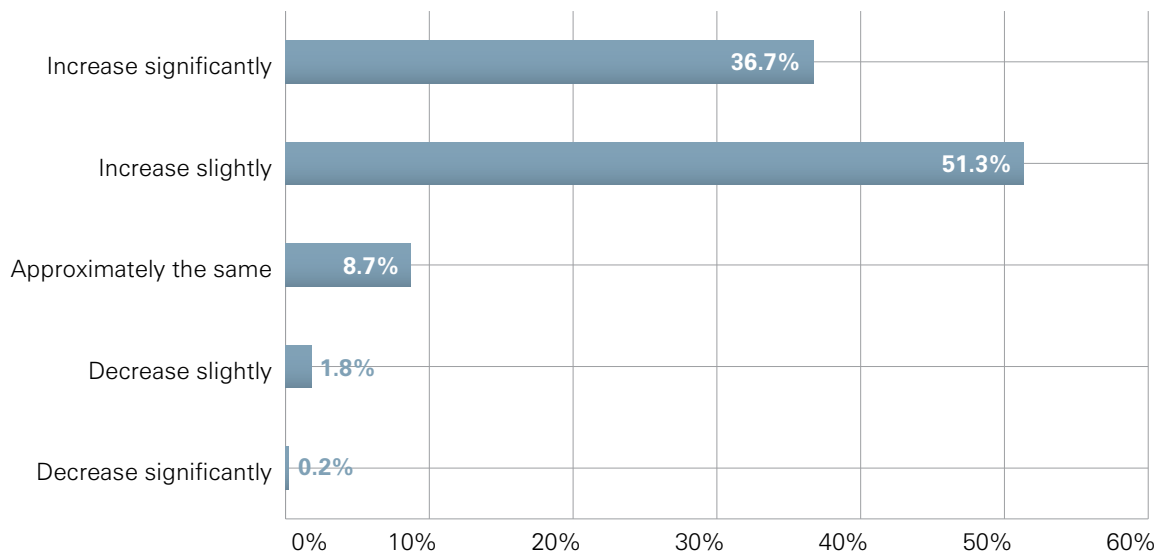
Types of Fraud Observed to Have Increased During Past Year



4. Fraud levels are expected to continue rising.

When asked about the expected level of fraud that will be experienced by all organizations during the next 12 months, 88 percent of the CFEs polled indicated that they anticipate a slight or significant increase in fraudulent activity. Conversely, only 2 percent of respondents expect any decline in the general level of fraud. While no one knows just how long the present economic turmoil will last, the majority of anti-fraud experts who responded to our survey believe that the corresponding increased fraud risk will be with us until at least 2010.

Change in Level of Fraud Expected During Next Year

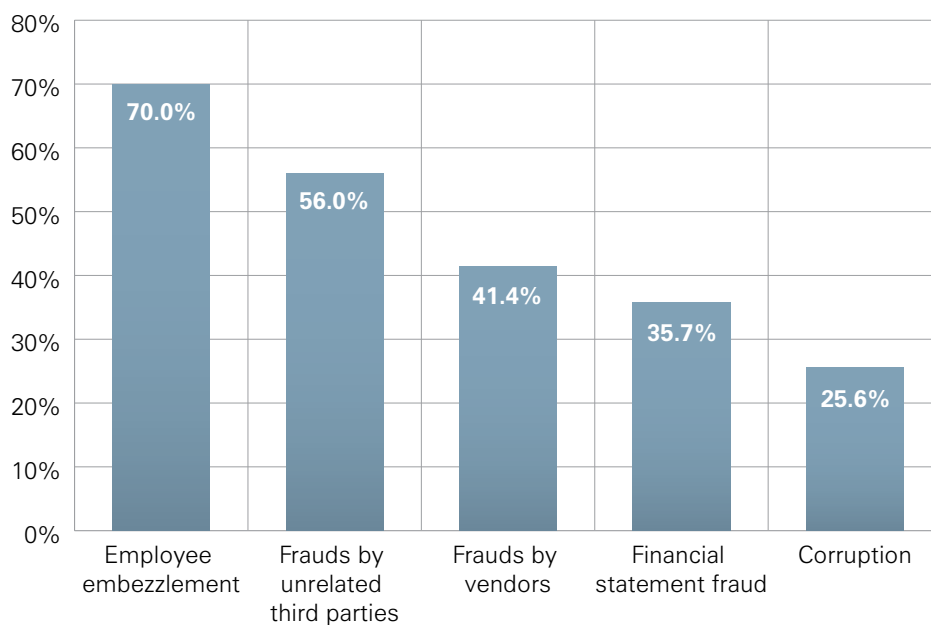


5. Organizations need to take seriously the threat posed by employees.

Of the 507 CFEs who took part in our survey, 70 percent believe the incidence of employee theft will rise in the coming year. This finding highlights an unfortunate, though somewhat expected, consequence of an endemic economic struggle. With so many individuals under mounting financial pressure, situations of professional trust may now provide unbearable temptation to employees.

More than half of respondents also think fraud by unrelated third parties will increase, and 41 percent believe vendor fraud will be on the rise. The number of financial statement frauds and corruption schemes is also expected to grow during the next year, according to the CFEs we polled. These findings further underscore the need for employers to engage in comprehensive, proactive fraud prevention programs.

Types of Frauds Expected to Increase During Next Year

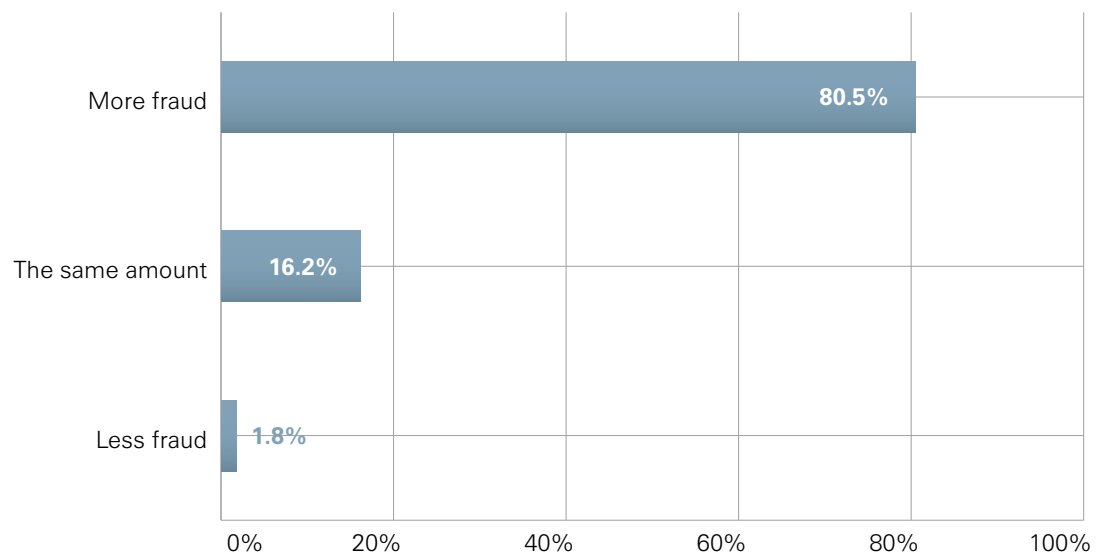


6. Fraud thrives in times of economic turmoil.

For the reasons previously discussed, it seems logical that the rate of fraud increases when the economy weakens. This view is shared by the vast majority of the CFEs who participated in our study. When asked how the overall amount of fraud during economic downturns compares to the amount of fraud during times of stable or improving economic conditions, more than 80 percent of respondents stated that they believe there is more fraud during times of economic distress.

While this does not provide a scientific measure of the correlation between fraud and economic swings, the solidarity of the opinions of 507 Certified Fraud Examiners — experts who participate daily in the fight against fraud — bestows additional credence upon the notion that fraud and economic strength are inversely related.

Fraud During Downturns Compared to Stable Times



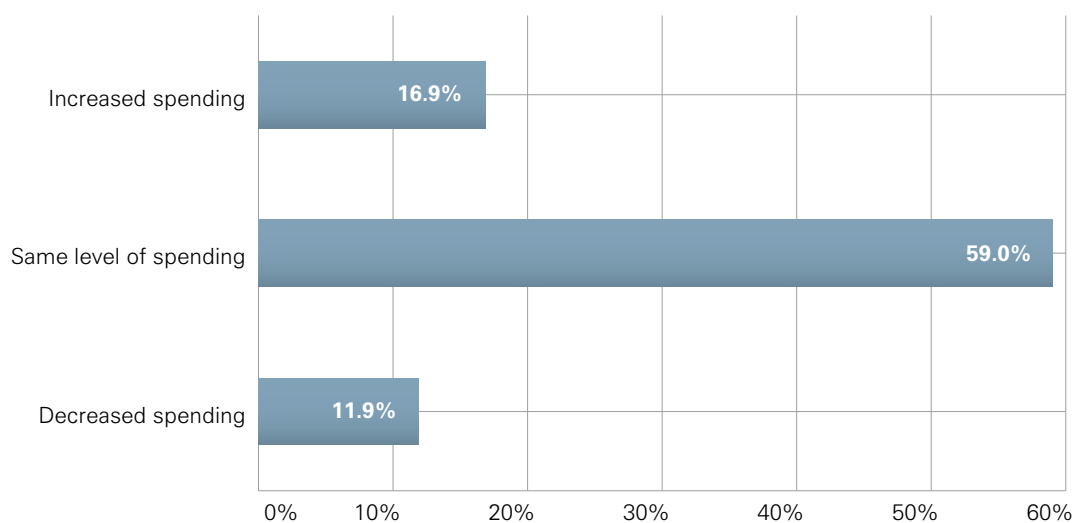
7. Even while facing budget reductions, companies have not cut spending on fraud-related internal controls.

To learn about what organizations are doing — and not doing — to combat fraud in the current economic environment, we presented several additional questions to those CFEs who indicated that they worked as in-house fraud examiners for a single company. Of the 507 CFEs who responded to our survey, 261 (51.5 percent) fell into this category.

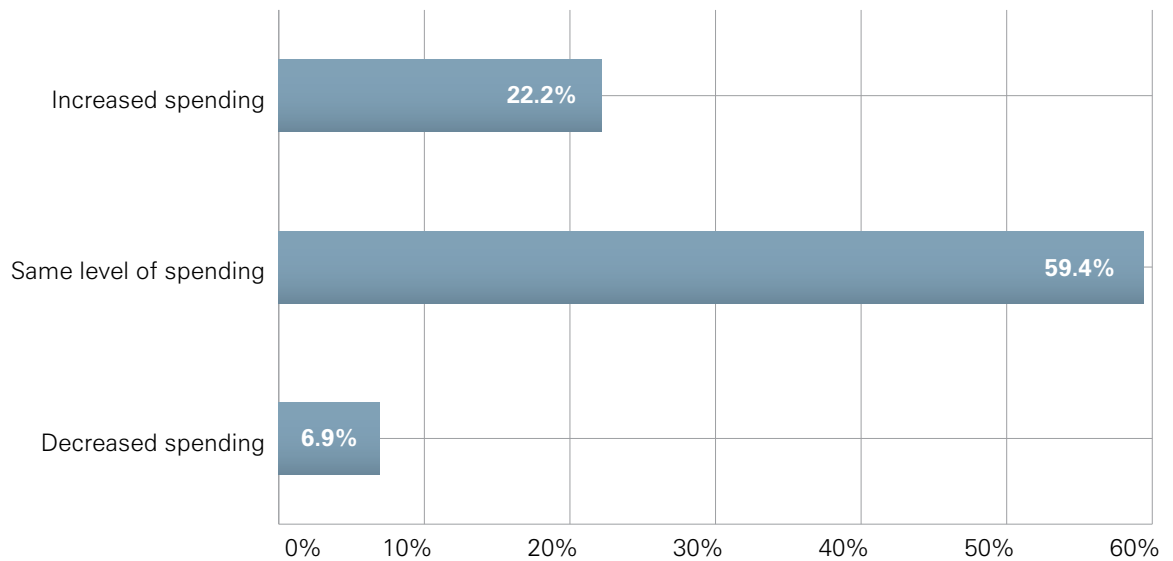
Since organizations generally are cutting budgets and tightening the purse strings, how does this fiscal restriction affect fraud-related internal controls? We asked the in-house CFEs about their employers' level of spending for two categories of anti-fraud controls during the past year: preventive controls, such as employee support programs, fraud training for employees and managers, and segregation of duties; and detective controls, including fraud hotlines, internal audit departments, and independent audits.

For both categories of controls, 59 percent of respondents indicated that their organizations have maintained their current level of spending. Another 17 percent have increased their spending on preventive controls, and 22 percent have increased their spending on detective controls. These results are quite encouraging and signify that organizations may, in fact, realize that devoting resources to anti-fraud controls is essential during periods of financial distress.

Spending on Preventive Controls During Past Year



Spending on Detective Controls During Past Year

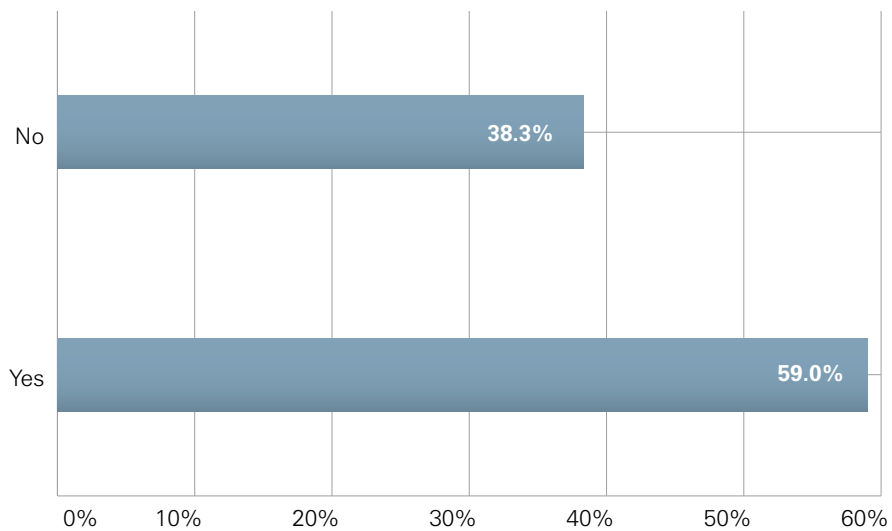


8. Layoffs are pervasive and are leaving holes in organizations' internal control systems.

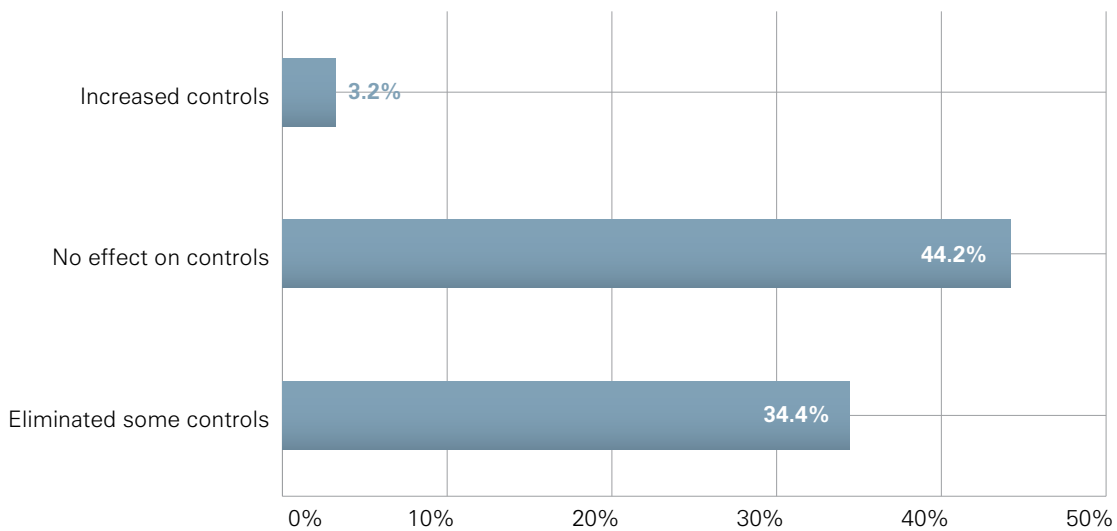
We also asked those CFEs who work as in-house fraud examiners about the impact of layoffs. Of the 261 respondents who work as internal fraud examiners, 59 percent stated that their employing organization has experienced layoffs or similar staffing restrictions in the past year. However, 44 percent of those who have encountered recent layoffs indicated that the workforce reduction has had no effect on the companies' internal controls. Another 3 percent responded that their companies have actually increased internal controls in the wake of the layoffs.

But more than one-third of these organizations have had some controls eliminated as a consequence of the staff reduction. Paradoxically, it is these organizations — those that are trimming costs and struggling to stay afloat — that most likely need a strong system of anti-fraud controls. Employees who remain after a round of layoffs often experience decreased morale, which — when combined with the added job responsibilities of former colleagues, fewer formal controls, and an increased pressure to perform — can lead to the perfect storm for fraud.

Companies Experiencing Layoffs During Past Year



Effect of Layoffs on Internal Controls



Conclusion

All signs indicate that the economy will take a while to recover. Unfortunately, this means many individuals and organizations will continue to face financial hardships for some time to come — hardships that can materialize as pressure, opportunity, and rationalization to commit fraud. The responses to our survey show that, in this weakened economy, the threat of fraud is on the rise. To protect valuable resources from a growing number of potential white-collar criminals, we must work together, remain vigilant, and take a proactive stance in the fight against fraud.

“The message to Corporate America is simple: Desperate people do desperate things,” said ACFE President James D. Ratley, CFE. “Loyal employees have bills to pay and families to feed. In a good economy, they would never think of committing fraud against their employers. But especially now, organizations must be vigilant during these turbulent times by ensuring proper fraud prevention procedures are in place.”

About the ACFE

The ACFE is the world's largest anti-fraud organization and premier provider of anti-fraud training and education. Together with nearly 50,000 members, the ACFE is reducing business fraud world-wide and inspiring public confidence in the integrity and objectivity within the profession. Founded in 1988 by Joseph T. Wells, CFE, CPA, the ACFE proudly celebrates its 20th anniversary as the leader in the global fight against fraud.

The ACFE provides educational tools and practical solutions for anti-fraud professionals through initiatives including:

- Global conferences and seminars led by anti-fraud experts
- Instructor-led, interactive professional training
- Comprehensive resources for fighting fraud, including books, self-study courses and articles
- Leading anti-fraud periodicals including *Fraud Magazine*®, *The Fraud Examiner* and *FraudInfo*
- Local networking and support through ACFE chapters worldwide
- Anti-fraud curriculum and educational tools for colleges and universities

Certified Fraud Examiners

CFEs are anti-fraud experts who have demonstrated knowledge in four critical areas: Fraudulent financial transactions, fraud investigation, legal elements of fraud, and criminology and ethics. In support of CFEs and the CFE credential, the ACFE:



- Provides bona fide qualifications for CFEs through administration of the CFE Examination
- Requires CFEs to adhere to a strict code of professional conduct and ethics
- Serves as the global representative for CFEs to business, government, and academic institutions
- Provides leadership to inspire public confidence in the integrity, objectivity and professionalism of CFEs

For more information about the ACFE, visit www.ACFE.com.



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