

FRAUD IN THE HOSPITALITY SECTOR

Examining the ACFE 2022 Report on Occupational Fraud

SEPTEMBER 2022

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This year's report on occupational fraud as compiled by the Association of Certified Fraud Examiners (ACFE)[1] is of particular interest to the hospitality sector. Hospitality has always been a soft target for fraud of all sizes. However, with the soaring cost of living and staffing shortages, fraud is on the increase and this year's report is more relevant than ever.

The nature of the hospitality industry has always left it open to fraudulent behaviour. From small-scale skimming by bar staff working in one of the last bastions of the cash transaction right through to large-scale fraud at an executive level, the hospitality sector is incredibly vulnerable to fraud.

The first step to reducing a business's "fraud risk" is to understand the complexity of the risk they face. This article sets out to explore the risk in detail.

By examining the findings of the ACFE 2022 report on occupational fraud, it is possible to glean an understanding of the risks faced and how to identify potential weaknesses and ultimately prevent occupational fraud.

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ACFE REPORT ON OCCUPATIONAL FRAUD – INTRODUCTION

Occupational fraud costs companies of all sizes and from all sectors billions of pounds per year. It is the world's most costly type of financial crime. The reason that this type of crime is so prevalent can be ascribed to two major reasons:

- Regardless of what anti-fraud measures an organisation has in place, ultimately a level of trust in an employee(s) with control over assets is required.
- While the vast majority of any workforce is honest, globally over 3.3 billion people are employed. Even a tiny percentage of such a large number means that the number of people willing to commit occupational fraud is huge.

While the ACFE is unable to precisely quantify the percentage of the workforce that engage in occupational fraud, it does conclude that the cost to organisations is likely to run to trillions of US dollars annually.

The report is the most comprehensive study of occupational fraud undertaken by any organisation. It is based on information gathered from Certified Fraud Examiners and the frauds represented in the report are gathered from 133 countries.



Whilst the report is representative of frauds committed in all industry categories, the relevance to the hospitality sector cannot be over-emphasised. While the hospitality sector is not the sector that has suffered the greatest median losses, it does have specific vulnerabilities. These will be described in detail later in the article.

OCCUPATIONAL FRAUD REPORT – THE KEY TAKEAWAYS



£2.95 BILLION

TOTAL LOSSES REPORTED

The report's findings are based on a total of 2110 cases covering 133 countries. In total, the losses reported in the cases covered were £2.95 billion. Breaking this figure down equates to an average loss per case of £1,461,000 with a median loss per case of £96,000.

These are staggering figures that are only the tip of the iceberg. It should be remembered that these only represent frauds that have been uncovered. The report goes on to say that Chief Financial Officers estimate that 5% of revenue is lost to occupational fraud each year.



£96,000

MEDIAN LOSS PER CASE

Another relevant piece of information for the UK hospitality market is that the country does not fare well when the fraud cases that form the basis of the report are tallied. For Western Europe, the report used 145 cases, of these 21 were perpetrated in the UK, with only Greece and Germany having higher figures.



14%

OF FRAUD PERPETRATED IN THE UK

Other key findings of the report include:

FRAUD SCHEMES

Overall, a typical fraud case will cause a loss of £6,800 per month and will last a year before it is detected. Asset Misappropriation (theft) was the most common type of fraud with 86% of all cases. However, it was also the least costly with a median loss of £82,000.

But it should be noted that this is a type of fraud that has relevance to the hospitality sector, where there is plenty of opportunity for theft at all scales. The least common was financial statement fraud schemes, but these constituted the highest median loss of £486,00. However, although rare, this type of fraud can do untold damage to a business. This is covered in more detail later in the article when we look at the case of the high street café chain Patisserie Valerie.

DETECTION

How fraud is detected is incredibly relevant. By understanding this aspect businesses can put procedures in place that can maximise the chance of early detection.

The most important fact uncovered by the report is that 42% of all frauds detected were detected by tips. This is 3 times as many cases as the next most common method.

The full findings of detection are listed in the following table:

Detection Method	Percentage of Cases
Tip	42%
Internal Audit	16%
Management Review	12%
Document Examination	6%
Accidentally	5%
Account Reconciliation	5%
Automatic Transaction/Data Monitoring	4%
External Auditing	4%
Surveillance Monitoring	3%
Law Enforcement Notification	2%
Confession and Others	2%

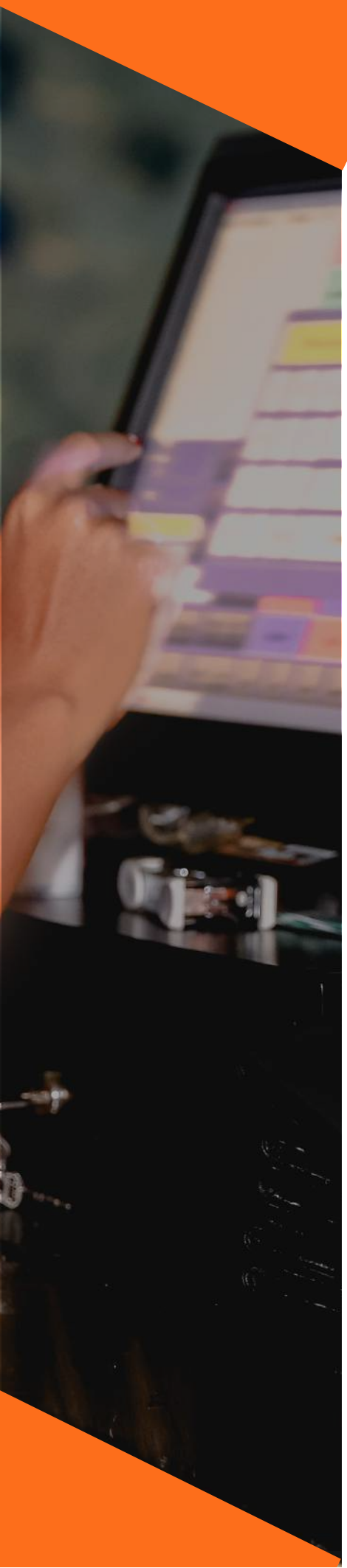
Given the margin of tips as the preeminent fraud detection method, this should be an area where businesses implement effective processes that encourage and thoroughly evaluate tipping. As such, it is worth examining in greater detail.

One area that merits further attention is the methods the tipsters used to report fraud. Perhaps surprisingly, telephone hotlines were the least common method, accounting for 27%. Top of the list was email with 40% of all tips received this way, with online forms or web-based tips making up the remaining 33%. However, the report adds that organisations with hotlines will detect frauds quicker and suffer lower losses than those without.

The other area of interest is the source of the tips. Details of where the tips originate are described in the table below.

Who reports occupational fraud	Percentage
Employee	55%
Customer	18%
Anonymous	16%
Vendor	10%
Other	5%
Owner/Shareholder	3%
Competitor	3%

For the employer, these stats reinforce the importance of anti-fraud measures that include strong reporting mechanisms. These should include processes that target both internal and external parties.



PERPETRATORS

The perpetrators of occupational fraud are found at every level of an organisation. What is apparent in the figures from the ACFE data is an inverse correlation between the low percentage of owner executive/frauds and the higher losses that these frauds incurred:

- Owners/Executives committed 23% of fraud costing an average of £276,000
- Managers were responsible for 39% of frauds with an average cost of £102,000 per case
- Employees committed 37% of the sampled fraud cases costing an average of £41,000

Amongst the other correlations that the report noted when considering the perpetrators was the duration of the fraud. The median duration varied depending on the level of authority of the perpetrator. Frauds committed by employees had a median duration of 8 months, with managers it was 16 months, this figure rises to 18 months for executive/owner frauds.

Another direct correlation that the report uncovered was a link between the length of service of the fraudster and the size of the losses. Fraudsters with at least ten years of service with an organisation carried out frauds with a median loss of £205,000.

By comparison, perpetrators with less than a year of tenure were responsible for fraud with a median value of around £41,000.

The largest percentage of fraud (47%) was carried out by fraudsters with a tenure of between 1 and 5 years.

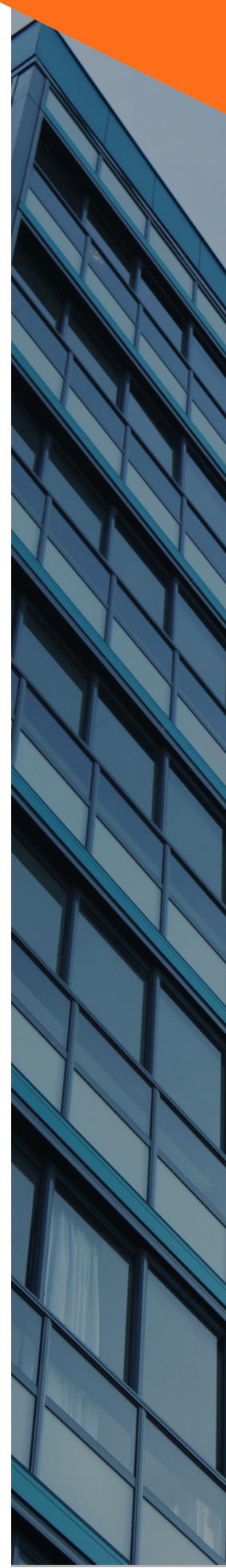
PERPETRATORS DEPARTMENTS

To help allocate anti-fraud procedures most effectively, it is useful to understand the departments that are more prone to fraudulent behaviour. To keep it relevant to the hospitality sector, this section will only look at the statistics for departments that are common in the industry.

The following information is a snapshot of the departments that should be of the greatest interest to those implementing anti-fraud procedures in the hospitality sector:

Department	% of Fraud Cases	Median Loss
Board of directors	3%	£401,000
Upper Management- Executives	11%	£401,000
Finance	5%	£131,000
Sales	11%	£82,000
Purchasing	7%	£115,000
Administrative Support	7%	£82,000
Facilities and Maintenance	3%	£41,000
Information Technology	3%	£123,000
Marketing and PR	2%	£82,000

FROM THIS INFORMATION, IT IS POSSIBLE FOR THE RELEVANT DEPARTMENTS TO MORE PRECISELY TARGET AND MONITOR POTENTIAL FRAUD RISKS.



RESPONSE TO FRAUD – THE ACTION TAKEN AGAINST THE PERPETRATORS

The last Metric to look at from the report is the actions taken against the perpetrators in the aftermath of a fraud case being uncovered. This is useful to understand as it gives an insight into how organisations respond to fraud – this has a bearing on the chances of recovering some or all of the misappropriated funds.

The outcome of fraud cases is greatly affected by several factors:

- The role of the perpetrator
- The size of the fraud
- The fraud scheme
- Organisational response

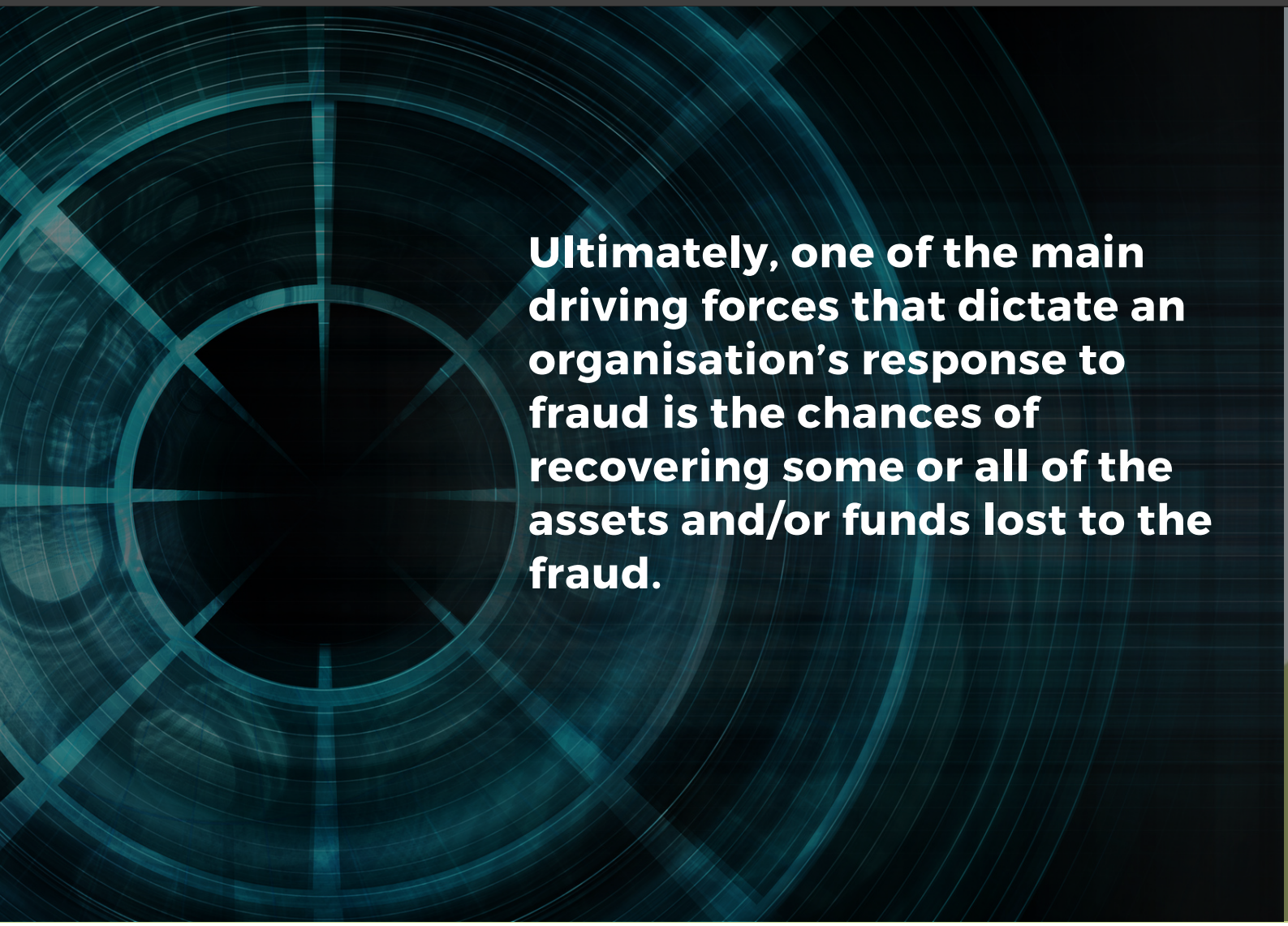
Perhaps unsurprisingly, the report concluded that owners/executives were least likely to be punished for internal fraud. In these cases, 15% received no punishment and only 40% had their association/employment with the company terminated.

By contrast, 3% of lower-level employees escaped punishment and 78% had their employment terminated. The figure for managers splits the extremes with 6% receiving no punishment and 62% having their employment terminated.

The figures for the overall picture are listed below:

- Termination – 61%
- Perpetrator had already left the organisation – 12%
- Suspension or probation – 12%
- Required or permitted to resign – 11%
- Settlement agreement – 10%
- No punishment – 7%
- Other – 5%

Sufficient internal discipline and bad publicity cover 80% of the reasoning for not pursuing external punishment for fraud perpetrators.



Ultimately, one of the main driving forces that dictate an organisation's response to fraud is the chances of recovering some or all of the assets and/or funds lost to the fraud.

FRAUD LOSS RECOVERY

Unfortunately, the figures make grim reading for organisations hoping to recoup their losses. The report breaks the figures down into regions, with slight variances in the percentages recovered across the regions.

The overriding statistic though is the fact that regardless of region, at least 40% of organisations recovered none of their funds.

The figures below show the recovery statistics for Western Europe:

- **Recovered all losses – 11%**
- **Partial recovery of losses – 32%**
- **No losses Recovered – 54%**

ANTI-FRAUD PROCEDURES

With such low recovery rates, the best way to prevent fraud losses is to have robust anti-fraud procedures in place. These should encompass internal and external auditing as a root, but the report considers 18 common anti-fraud procedures and their effectiveness.

The ACFE report surveyed the forms of anti-fraud controls common in Western Europe. They concluded that the most common are as follows:

- External Audit of Financial Statements – 90%
- Code of conduct – 84%
- Management certification of financial statements – 78%
- External audit of internal controls over financial reporting – 77%
- Internal audit department – 74%
- Management Review – 72%
- Hotline – 68%
- Independent audit committee – 65%
- Employee fraud training – 59%
- Fraud training for executives and management – 58%
- Anti-fraud policy – 56%
- Formal fraud risk assessments – 52%
- Employee support programs – 51%
- Proactive data analysis/monitoring – 48%
- Dedicated fraud department or team – 47%
- Surprise audits – 40%
- Mandatory vacation / job rotation – 25%
- Whistleblower reward schemes – 7%

These represent the figures across organisations as a whole. What is surprising is that when the figures are compared against organisations that are victims of fraud, there isn't a large discrepancy.

For example, while an overall 90% of companies had external audit procedures in place, so did 82% of victimised organisations. It is a similar story when comparing other metrics:

Fraud Control	Overall %	Fraud Victim %
Code of conduct	84%	82%
Internal Audit Department	74%	77%
Management certification of financial statements	78%	74%
Hotline	68%	70%
Independent Audit Committee	65%	67%

The above stats are a sample of the overall findings. At first glance, these figures would suggest that most of the victimised organisations fell foul of fraud despite having robust procedures in place. However, it is worth noting that these are the organisations that reported fraudulent behaviour. It shouldn't be a surprise then that organisations with robust anti-fraud procedures are the very organisations that will uncover fraudulent behaviour.

This point is also corroborated by the ACFE report as described in the next section.



ANTI-FRAUD CONTROLS – THEIR EFFECTIVENESS

The ACFE report evaluated the 18 main anti-fraud procedures listed above to measure their effectiveness. Unsurprisingly, they concluded that organisations with robust anti-fraud controls in place had a far smaller median loss than those without them. There is the odd curveball thrown in for good measure, perhaps most surprising is the success of mandatory vacation/job rotation as an anti-fraud procedure.

The table below is a summary of the findings:

Anti-fraud control	Percentage of cases	Median loss - Control in Place	Median loss – No Control	Percentage Reduction
Mandatory vacation/job rotation	25%	£52,000	£115,000	54%
Hotline	70%	£82,000	£164,000	50%
Surprise Audits	42%	£61,000	£123,000	50%
Proactive data analysis	45%	£66,000	£123,000	47%
Anti-fraud policy	60%	£82,000	£150,000	45%
Fraud training for employees	61%	£79,000	£145,000	45%
Formal fraud risk assessments	46%	£67,000	£123,000	45%
External audit of internal controls over financial reporting	82%	£82,000	£123.000	33%

These figures are not a comprehensive list of the report's findings but nevertheless, they illustrate the importance of strong anti-fraud procedures. It is a similar picture when the duration of fraud is considered, although the effectiveness of individual controls varies.

Anti-fraud control	Percentage of cases	Time – Control in place	Time – No Control	Percentage reduction
Proactive data monitoring	45%	8 months	18 months	56%
Surprise audits	42%	9 months	18 months	50%
Mandatory vacation/job rotation	25%	8 months	16 months	50%
Formal fraud risk assessments	46%	10 months	18 months	44%
Internal fraud department	48%	10 months	18 months	44%
Code of conduct	82%	12 months	18 months	33%
External audit of internal controls over financial reporting	71%	12 months	18 months	33%
Independent audit committee	67%	12 months	18 months	33%

The main takeaway from these figures is that anti-fraud procedures should be a coordinated and layered approach. No one procedure is robust enough on its own to detect fraud timeously. However, with a suite of procedures and an organisation that promotes openness with its staff, then the chances of being a victim of fraud are hugely reduced.

FRAUD IN THE HOSPITALITY SECTOR – SPECIFIC VULNERABILITIES

The hospitality sector is not immune to higher-end frauds that are committed at an executive level. But it also has the additional vulnerabilities of being a sector where cash is still common in bars and restaurants. Additionally, staff that work for lower pay rates and are often transient also leaves operators vulnerable to fraud at the lower end of the scale.

To give a better idea of the types of fraud that the hospitality sector faces, it is a useful exercise to look at some specific case studies.

CASE STUDY 1 – PATISSERIE VALERIE

To emphasise the point that fraud in the hospitality sector can occur at any level, the case of Patisserie Valerie can be used as a prime example.

The case came to light in October 2018 when the company announced that instead of being £28 million in the black as the chairman believed, they were £9.8 million in debt.

Although much of the finer details of the case are still to be uncovered, at its heart it is a tale of unreliable accounts, missed chances and corruption at an executive level. As a result of the fraud the company closed 90 stores and laid off over 900 workers.

It is worth remembering that this fraud took place under the nose of an experienced chairman with decades of success in the hospitality sector.



CASE STUDY 2 – BAR FIDDLING

All bar operators that are honest with themselves accept that bar fiddling is part and parcel of the trade. This is a sad but true indictment of the public house and bar industry.

Exact figures are hard to come by, but one study carried out by the University of Leicester took an in-depth look. As reported by The Caterer,[2] the report team was given access to four hotels all part of a major hotel chain. The chain allowed the researchers access on the condition of anonymity.

The report concluded that "skimming" was endemic across the four hotels. Amongst the common scams they uncovered were:

- Overcharging customers and pocketing the difference
- Under ringing a customers bill or not ringing it up at all
- Presenting the wrong bill
- Overpadding bills with additional items

These are just a few of the common scams that the report team uncovered. But the team also discovered that many of the common scams were conducted by bar and restaurant staff in conjunction with management.

The Caterer article also cites the case of Hotel, bar, and restaurant chain Catering South West (CSW). This case gives more of an insight into the scale of the problem. CSW had previously announced that from a turnover of £100 million, it was estimated that staff scams were costing it £3 million per year.

Few sectors face the range of challenges that the hospitality industry has to cope with. With bar fiddling considered part of the culture of the hotel and bar industry, fraud is almost considered an overhead. But businesses can still do much to protect themselves against fraud at all levels.



IN SUMMARY

As the ACFE report demonstrates, strong and divergent anti-fraud procedures will drastically increase the chances of fraud being uncovered before any serious damage is done.

A structured approach to fraud prevention is required. It needs to address the basics at the ground level, but also has controls in place to quickly detect signs of fraudulent behaviour at management and corporate level.

The ACFE report might be grim reading, but the biggest takeaway that businesses can draw from it is that a robust and inclusive approach to anti-fraud procedures will shield them from becoming the next case study.



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During the course of his career, Ken has worked on hundreds of investigations in the corporate world including many for FTSE 100 companies, as well as major international organisations.

He is one of the most experienced investigators in the UK and this expertise has been the foundation of two public listings, including the U.K.'s first fully listed Risk Management and Investigatory business.

Typical cases include, theft, fraud, conspiracy, extortion, blackmail, kidnap and ransom, patent theft, parallel trading, computer hacking, bribery and corruption. Although few went to court, all were of high material value to the client.



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Marcus worked in the hotel and leisure industry for over 15 years before joining Capcon in 1998.

His hotel operation expertise underpins the insightful approaches he brings to clients' audit and due diligence challenges.

Marcus regularly provides training and consultations with senior operational management teams, reviewing and improving their business controls.

He has also provided an independent view of Company risk to a number of Audit Committees.

ABOUT CAPCON

Based in the United Kingdom, Capcon operates globally, offering a range of due diligence, investigations, high level employee screening, brand protection and training services to a broad range of businesses. Together with their specialised compliance related services tailored for the hospitality sector, Capcon helps businesses gain real-time visibility to improve strategic risk, make informed decisions, and increase profits.

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SOURCE:
1. https://legacy.acfe.com/report-to-the-nations/2022/
2. https://www.thecaterer.com/archive/theft-behind-bars

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