FRAUD

THE PROFESSIONAL SERVICES SECTOR

Examining the ACFE 2022 Report on Occupational Fraud

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Each year the Association of Certified Fraud Examiners (ACFE) releases its Report to The Nations. [1]

The report is an assessment of workplace fraud across all industries.

As always, this report makes interesting if not troubling reading.

Whilst, all sectors should take note of the findings, the Professional Services sector is a regular target of fraud. Both from internal and external sources occupational fraud in the professional services sector costs billions of pounds annually.

As such, the sector should make sure that due diligence against fraud is part of its corporate culture.

Understanding the risk, and all its associated metrics is a crucial step. This guide looks at the key findings of the 2022 ACFE Report to the Nation and discusses what lessons can be learned to help prevent fraud in professional services.

WHAT LESSONS CAN BE LEARNED FROM THE 2022 ACFE REPORT TO THE NATIONS

INTRODUCTION TO THE ACFE REPORT TO THE NATIONS

The twelfth edition of the ACFE Fraud Report is a comprehensive survey of workplace fraud on a global scale. The data within the report is based on 2110 cases of fraud from 133 countries.

The report considers relevant metrics of the cases surveyed. These include the costs, the type of schemes, and the victims & perpetrators of fraud. As a resource, it is incredibly useful as the information detailed in the report is an insight into the prevalence of workplace fraud and more importantly – Why due diligence is essential to prevent occupational fraud.

Understanding the risks of fraud and how it is committed helps to identify potential weaknesses within an organisation at all levels.

Forearmed with this information, potential fraud can be stopped before it begins. Just as importantly, fraudulent behaviour that has slipped through the net is identified earlier.

This last point is important because as the report details, the average duration of a fraud case before it is uncovered is 12 months. This and other key takeaways from the ACFE report on occupational fraud are detailed in the next section.

ACFE FRAUD REPORT – THE KEY TAKEAWAYS

The original report weighs in at a hefty 96 pages. To help understand the findings it is useful to take a condensed look by concentrating on the key takeaways. The report lists in great detail all the relevant facts and figures from several categories, this section discusses each of them.

One note, the original report uses US dollars as the currency. For the sake of relevance, we have converted the figures into Sterling using the exchange rates available at the time of writing.

£104,000

MEDIAN LOSS PER CASE

£6,875

AVERAGE MONTHLY LOSS PER BUSINESS

FRAUD SCHEMES

Understanding the types of fraud commonly perpetrated is a key factor in reducing the risk of becoming a fraud victim.

As noted, the average fraud scheme will take a year to uncover, when you pair this figure with the £104,000 median loss per case for the professional services sector, this equates to an average loss of £8,666 per month.

This figure gives us an idea of the scale of the problem facing the professional services industry. It takes on more relevance when compared to the £6875 figure that represents the average monthly median loss as reported across all the surveyed sectors.

The types of fraud that make up these figures are broken down into three categories in the report, which are then broken down into further sub-categories. Each of these categories has relevance to the professional services sector.

The categories and a summary of the more relevant subcategories are listed below.

Corruption – Bribery, economic extortion, conflicts of interests

Asset Misappropriation – Cash, inventory and other assets

Financial Statement Fraud – Net worth or net income overstatements, net worth or net income understatements

With each subcategory broken down into further categories, the one key fact that can be taken from this is that anti-fraud procedures need to be as varied as they are robust.

DETECTION OF OCCUPATIONAL FRAUD

Understanding which detection methods are successful against workplace fraud is incredibly useful. Armed with this information the appropriate departments can allocate their anti-fraud where they are most needed.

Perhaps surprisingly, the most successful detection method was tip-offs. These constituted 42% of all detections, a figure that is three times higher than the next most successful. This figure varies depending on the region, reaching 58% in the Asia-Pacific region. However, the relevant figure for Western Europe and the UK sits almost bang in the middle at 41%.

The following table shows the details of the detection methods in full.

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%

The Importance of Tips as an Anti-fraud Measure

The above table demonstrates that plain old word of mouth is the most successful anti-fraud measure. For professional services, this one key fact reveals the importance of cultivating a working environment that promotes openness and takes the concerns of employees (and others) seriously.

While other anti-fraud measures are ignored at an organisation's peril, the report makes it clear that tips are a major area where the right resources will produce significant results. Understanding how to allocate these resources is helped by taking a deeper look at the “tip-off” statistics compiled in the report.

DETECTION OF OCCUPATIONAL FRAUD (CONT.)

The first area that the report covers is the method used to tip off fraud victims.

Reporting Method	Percentage
Email	40%
Online form or Internet	33%
Telephone Hotline	27%

Interestingly, although telephone hotlines were the least used reporting method, companies that operated them had significantly less losses and a shorter average fraud duration than companies without them:

· Organisations with Hotlines – Median loss £86,000 – Average duration 12 months

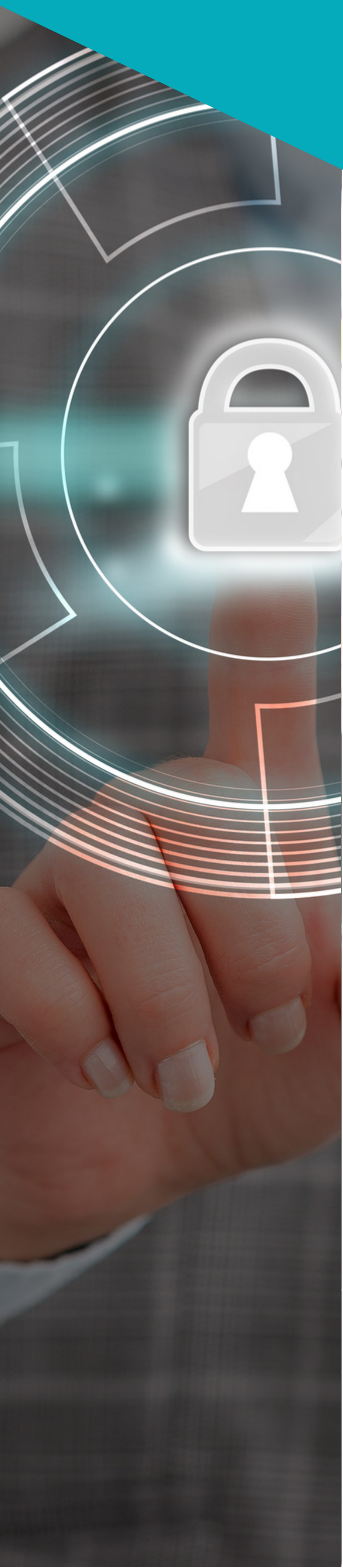
· Organisations without Hotlines – Median loss £192,000 – Average duration 18 months

Understanding how tips are reported is useful. It illustrates the importance that companies need to place on maintaining multiple communication channels for fraud reporting.

Another metric that is essential to understand is the source of the tip-off. This is detailed in the following table:

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

Tips cannot be ignored and companies need to build a culture in the workplace that takes reports and claims seriously. However, it needs to be noted that many tips come as a result of findings of other anti-fraud procedures such as audits. Therefore, the implementation of policies to improve fraud reporting should be part of an overall and integrated anti-fraud policy.



PERPETRATORS OF ORGANISATIONAL FRAUD

It is fair to assume that the vast majority of every workforce are hardworking and honest individuals.

But this is a game of numbers, and with a global workforce that numbers over 3 billion, even a fraction of a percent equates to a huge number of individuals willing to partake in occupational fraud.

Identifying potential fraudsters in a workforce is never easy. But the ACFE report looked in detail at the type of person that perpetrated the fraud. Amongst the factors covered were:

· Job Details

· Prior Records of Misconduct

· Basic Demographics

· Behavioural Warning Signs

This information can be used by professional service companies to make assessments of potential fraud risks within their own company.

One other point of note before we take a deep dive into the statistics – Over 86% of committed fraudsters showed at least one red behavioural flag prior to the fraud being uncovered.

Perpetrators Position

Unsurprisingly, the report concluded that the higher up an organisation's hierarchy the perpetrator was, the higher the median loss the company suffered as a result of the fraud.

Frauds committed by such individuals also took longer to detect. However, frauds committed by higher-ranked individuals were also rarer.

The following table shows these figures in full:

Level of Authority	Percentage of Frauds	Median Loss	Average Duration
Owner/Executive	23%	£276,000	18 months
Manager	39%	£102,000	16 months
Employee	37%	£41,000	8 months
Other	2%	£133,000	Not available

The report noted that the challenges in dealing with high-level fraud are hampered by the individual's ability to evade or override an organisation's anti-fraud procedures. Another conclusion was that the bullying or intimidation of employees below them can help to conceal the fraud and prolong its duration.

Tenure of Perpetrator

Another factor that has a bearing on occupational fraud is the length of tenure of the perpetrator. The report throws up some interesting facts that can those operating in the professional service sector more accurately tailor their anti-fraud procedures.

As you can see from the table below, employees with greater than ten years of service are likely to perpetrate the most costly fraud schemes. However, those with 1 – 5 years of service are the likeliest to undertake in fraudulent behaviour.

Length of Tenure	Percentage of Cases	Median Loss
Less than a year	9%	£41,000
1 – 5 years	47%	£86,000
6 – 10 years	25%	£113,000
10 years and over	20%	£205,000

Perpetrators Department

The last metric to consider when discussing perpetrators of fraud is the department they worked in. This is another useful takeaway from the report that can help the professional service sector create a highly-tailored anti-fraud policy.

The report covers a huge range of departments, many of which are not relevant to the sector. For the sake of brevity and relevance, the information below covers only relevant departments.

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

One final aspect that is worthy of note is the gender of the perpetrator.

Fraud perpetrators are overwhelmingly male, as the figures below show:

- Male – Male employees were responsible for 73% of frauds with a median value of £113,000
- Female – Women accounted for 23% of fraud cases with a median value of £83,000

Information regarding the perpetrators of fraud is crucial for organisations implementing or improving anti-fraud procedures. Understanding the nature of potential perpetrators and the areas of the organisation they are likely to work in should always be considered when constructing a robust anti-fraud policy.

THE RESPONSE TO FRAUD – ACTIONS TAKEN AND RECOVERY OF LOSSES

Looking at the response that organisations take against perpetrators of fraud might seem like "shutting the barn door after the horse has bolted". However, it is still a useful exercise as it has relevance when considering the recovery of losses due to fraud.

The data does not paint a pretty picture for fraud victims, as is noted below. The vast majority of fraud cases will result in major losses that are in many instances, unrecoverable. For the professional services sector, the following figures highlight the importance of ongoing due diligence and an active and comprehensive anti-fraud policy.

Actions Taken

An organisation's response to fraud and the actions taken against the perpetrator is highly variable. Once again though certain patterns emerge that display wide discrepancies in the treatment, dependent on the seniority of the perpetrator.

- Owners/Executives – 40% had their association with the organisation terminated, while 15% received no punishment
- Managers – 62% had their employment terminated and 6% faced no action
- Employees – 73% were fired and only 3% had no action taken

These are the figures for the internal course of action taken by the affected organisations. However, 58% of cases resulted in criminal referral. The relevant stats for cases that resulted in a criminal prosecution are listed below.

Outcome	Percentage
Pleaded guilty/No contest	44%
Convicted at trial	22%
Prosecution Declined	17%
Acquitted	10%

As the table shows, two-thirds (66%) of all cases that result in criminal referral result in successful convictions.

Proceeds of Fraud – Recovery

The chances of recovering all or some of the losses in a fraud case vary depending on the region the fraud was carried out in. The following table shows the losses from fraud recovery figures for Western Europe.

- 54% of cases resulted in no recovery
- 32% resulted in partial recovery
- 14% resulted in a full recovery of losses

The obvious highlight of this set of stats is the fact that 54% of fraud victims recovered none of their defrauded assets.

This one fact underscores the importance of tackling fraud proactively, with the focus on prevention and early detection.

ANTI-FRAUD PROCEDURES

The above sections are incredibly useful in understanding the nature of occupational fraud. It gives a thorough oversight of the relevant factors that contribute to workplace fraud. As such, it can help organisations put in place effective and tailored anti-fraud procedures.

The ACFE report covers anti-fraud procedures in great detail, including the effectiveness of each. The following table shows the prevalence of anti-fraud procedures of companies in the Western Europe region.

Anti-Fraud Procedure	Percentage
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%
Executive and management level fraud training	58%
Anti-fraud policy	56%
Formal fraud risk assessments	52%
Employee support programs	51%
Proactive data monitoring/analysis	48%
Dedicated fraud team or department	47%
Surprise audits	40%
Mandatory vacation / Job rotation	25%
Whistleblower reward schemes	7%

When we take a deeper dive into anti-fraud procedure stats, some interesting patterns emerge – The following table samples the effectiveness of some of the main anti-fraud controls. It also contains a wildcard in the form of "Mandatory vacation/job rotation." The reason for this inclusion is the fact that despite only 25% of the sampled companies employing this as an anti-fraud procedure, it was the most successful of all detection methods.

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%

Another metric that the report analysed when considering anti-fraud measures, was the duration of the fraud. In this section, the ACFE report compared the average length of fraud schemes and the effectiveness of anti-fraud controls in reducing the length of time that the fraud was active.

The following table is a summary of the report's analysis.

Anti-fraud control	Percentage of cases	Duration with Control in place	Duration Without 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%

What the above data confirms is that if fraud does occur, a comprehensive suite of anti-fraud controls and policies will dramatically reduce the timescale of the fraud.

FRAUD IN THE PROFESSIONAL SECTOR SERVICES – THE RISKS

The professional services sector has some unique challenges that need to be understood to fully assess the risk they face. Some of the more prominent risks are detailed below:

- Expense reimbursement schemes
- Theft of client's funds
- Billing fraud (over billing, billing of fictitious entities)
- Financial Statement manipulation
- Data theft

One way of acquiring a deeper understanding of the inherent risks facing the sector is to look at some case studies. The following are based on real-life examples although the names of the parties have been withheld.

CASE STUDY 1 – THEFT OF CLIENT FUNDS

The case involves a manager at a professional services firm. In this case, an employee raised concerns about potential fraudulent behaviour and based on this report senior management recruited the services of an external auditor.

The audit firm discovered that the manager had stolen funds from two of the firm's bank accounts that were used for holding their client's money. The scale of the fraud was around £1 million, although the true figure was difficult to quantify due to various mechanisms used by the fraudster.
During the audit, it was established that the fraud had gone undetected because the fraudster had manipulated the bank statements to ensure they agreed with internal records.

The audit concluded that various risk factors had contributed to the fraud:

·The firm did not use online banking depriving the firm's accountant of access to real-time and unmanipulated financial data

·The fraudster had access to internal records and was authorised to liaise with the company bank

·The use of a single account to hold client funds meant the theft was easier to hide as new deposits hid much of the shortfall

After the audit, new controls were put in place to prevent the reoccurrence of such a fraud. These included -segregation of duties, regular reconciliation of client funds, dual authority required for bank transfers, and online access to bank records.

CASE STUDY 2 – FALSE EXPENSE CLAIMS

It is easy to dismiss the problem of false expense claims as being at the lower end of the "fraud scale." However, although it is certainly true that many cases deal with smaller amounts, expense claim fraud is often large-scale.

The case in question involves a manager in a professional services firm. In this instance, the manager set up a complex system aimed at claiming reimbursement for large expense claims. The manager set up fake companies that generated fake invoices. He then generated expense reports that claimed reimbursement for payments he'd made on behalf of the firm.

Before the manager was uncovered (and jailed) he had been paid £993,000 in false expenses. The fraud was only uncovered after the manager had set up poorly named companies with suspicious mailing addresses.

As a result of the investigation, the firm added extra anti-fraud policies to ensure it couldn't happen again. These included surprise audits, the establishment of an anti-fraud department, and the employment of an external risk management company tasked with identifying any more potential "fraud blindspots."

FINAL THOUGHTS

The ACFE Report to the Nations is an incredibly useful source of information. The data within the report can be used by professional services firms to identify potential weak spots and strengthen their anti-fraud policies.

The one key takeaway that the report offers is the importance of spreading a wide net when considering a firm's anti-fraud strategy. It is apparent from the data that companies need to employ a range of procedures. These should include strong financial controls and audit procedures. But they need to consider the human factor too.

With 42% of frauds being uncovered as a result of tip-offs, this last point can't be overlooked.

The statistics in the report might make uncomfortable reading, but they present an opportunity for companies to avoid becoming the next big victim.

REPORT PRODUCED BY CAPCON LTD

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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