Anchin Alert: ACFE Report to the Nations 2018

The Association of Certified Fraud Examiners ("ACFE") recently published the *Report to the Nations 2018 Global Study on Occupational Fraud and Abuse (the 2018 "Report to the Nations" or "2018 Report")*, its tenth publication since 1996. For the past 20 years, the ACFE has reviewed thousands of cases of occupational fraud[1] in which insiders stole billions of dollars from their employers. The organizations included in these studies consisted of private, public, government and not-for-profit entities. The 2018 Report explores 2,690 cases of occupational fraud from January 2016 to October 2017 that were investigated by Certified Fraud Examiners ("CFEs") throughout 125 countries. The goal of the report is to compile detailed information about occupational fraud in five critical areas:

- The methods by which occupational fraud is committed;
- The means by which occupational fraud is detected;
- The characteristics of the organizations that are victimized by occupational fraud;
- The characteristics of the people who commit occupational fraud; and
- The results of the cases after the frauds have been detected and the perpetrators identified.

Some of the key findings of the 2018 Report and past Reports to the Nations are summarized as follows:

1. **<u>Revenue Losses to Occupational Fraud</u>**

The 2018 Report estimates that a typical organization loses 5% of its revenue in a given year due to fraud. From 1996 to 2018, losses as a percent of total revenue has varied from 5% to 7% per annum (See Table 1 below). According to the 2018 Report, 22% of the cases had losses of $1 million or more, with the median loss amounting to $130,000, and combined total identified losses exceeding $7 billion. The 2018 Report noted that the median duration of a fraud scheme was 16 months.

Table 1: Historical Summary of Revenue Lost to Fraud

Estimate of Revenue Lost to Fraud			
Report Year	**% Of Revenue**	**Estimate of Revenue Lost to Fraud**	**Estimate Based On[2]**
1996	6%	$400 Billion	1996 GDP $7 Trillion
2002	6%	$600 Billion	2002 GDP $10 Trillion
2004	6%	$660 Billion	2003 GDP $11.0 Trillion
2006	5%	$652 Billon	2006 GDP $13.0 Trillion
2008	7%	$994 Billion	2008 GDP $14.2 Trillion
2010	5%	$2.9 Trillion	2009 GWP $58.1 Trillion
2012	5%	$3.5 Trillion	2011 GWP $70.3 Trillion
2014	5%	$3.7 Trillion	2013 GWP $73.9 Trillion
2016	5%	$3.8 Trillion	2014 GWP $74.2 Trillion
2018	**5%**	**$4.0 Trillion**	**2017 GWP $79.6 Trillion**

Source: ACFE Reports to the Nation
GDP (U.S. Gross Domestic Product) is the value of all finished U.S. goods and services produced yearly
GWP (Estimated Gross World Product) is the value of all finished world goods and services produced yearly

[1] *Occupational fraud* is defined as "the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets." (2018 Report)
[2] The ACFE Reports prior to 2010 were based on studies of U.S. based organizations. Subsequent to 2010, the study was expanded to include international organizations.

2. Types of Fraud

The ACFE has identified three primary categories of occupational fraud:

a. **Asset Misappropriation** – "A scheme in which an employee steals or misuses the employing organization's resources (e.g., theft of company cash, false billing schemes, or inflated expense reports)."
b. **Corruption** – "A scheme in which an employee misuses his or her influence in a business transaction in a way that violates his or her duty to the employer in order to gain a direct or indirect benefit (e.g., schemes involving bribery or conflicts of interest)."
c. **Financial Statement Fraud** – "A scheme in which an employee intentionally causes a misstatement or omission of material information in the organization's financial reports (e.g., recording fictitious revenues, understating reported expenses, or artificially inflating reported assets)."

As noted in Table 2 below, while asset misappropriation occurs more frequently than the other categories of fraud, it results in the lowest median loss, and while financial statement fraud occurs less frequently, it results in the greatest median loss.

Table 2: Frequency and Median Loss Effect

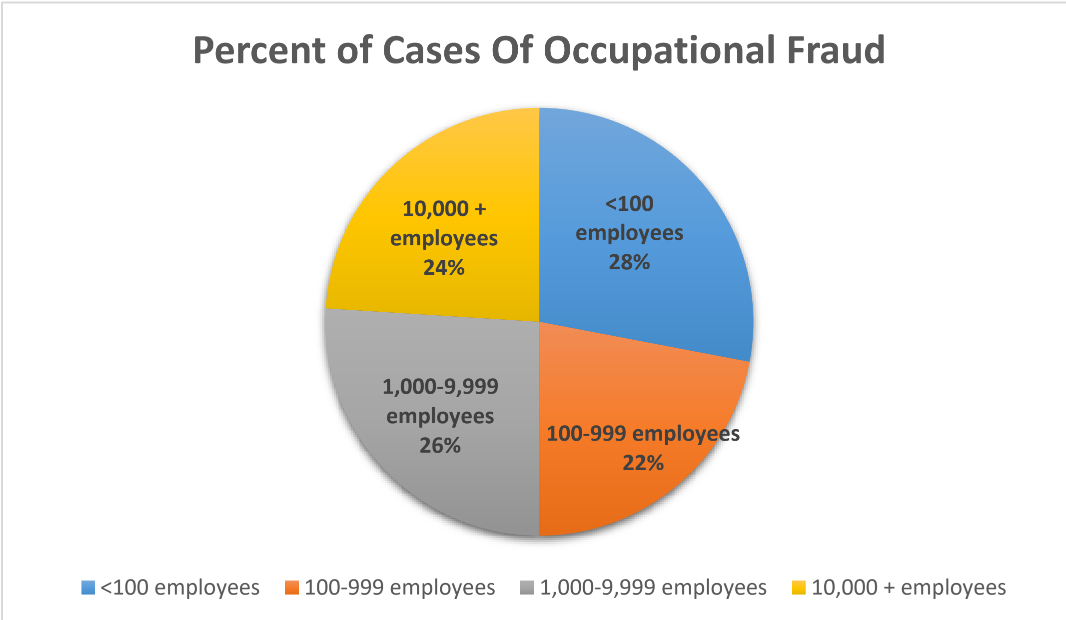
Occupational Fraud by Category		
Category	**Occurrence in cases (%)[3]**	**Median Loss**
Asset Misappropriation	89%	$114,000
Corruption	38%	$250,000
Financial Statement Fraud	10%	$800,000

*Source: ACFE 2018 Report

3. Types and Sizes of Organizations' Risks of Fraud

a. Different size organizations tend to bear different fraud risks. The 2018 Report includes organizations with varied numbers of employees, as demonstrated in the chart below:

[3] The total occurrences exceed 100% because many of the cases in this report involved multiple frauds.



b. The 2018 Report found that cases of **corruption** had the highest level of occurrence for both small organizations (<100 employees) at 32% and large organizations (100+ employees) at 43%.
c. Risks of billing, check and payment tampering, expense reimbursement and skimming (among other **asset misappropriation** schemes) were more common in smaller organizations than in larger organizations.
d. Median losses were almost twice the amount for small organizations ($200,000) than for large organizations ($104,000). Smaller businesses typically have fewer anti-fraud controls than larger organizations, leaving them more vulnerable to fraud.
e. In the 2018 Report, private companies suffered the greatest median loss and not-for-profit organizations suffered the smallest median loss. See Table 3 below.

Table 3: Median Loss by Organization Type

Type of Organization	% of Cases	Median Loss
Private company	42%	$164,000
Public company	29%	$117,000
Government	16%	$118,000
Not-for-Profit	9%	$75,000
Other	4%	$120,000

f. The 2018 Report broke out the organizations into 24 distinct industries. The greatest number of cases examined were in banking and financial services (366 cases), manufacturing (212 cases), government and public administration (201cases), and healthcare (158 cases). The lowest number of cases were mining (27 cases), wholesale trade (24 cases), and communications and publishing (24 cases). The highest reported median losses were suffered by organizations in the following industries: communications and publishing at $525,000, energy at $300,000, and services (professional) at $258,000.

4. Organizational Weakness and Internal Controls

a. The most common controls in place at a victim organization were external audits (80% of cases), implemented codes of conduct (80% of cases), and Internal Audit Departments (73%). As noted in the chart below, the presence of every control correlated with lower fraud losses. See Table 4 below.

Table 4: The Relationship of Anti-Fraud Controls and Median Losses

Control	% of Cases	Control in Place	Control Not in Place	Percent Reduction
Code of Conduct	80%	$110,000	$250,000	56%
Proactive data monitoring/analysis	37%	$80,000	$165,000	52%
Surprise audits	37%	$75,000	$152,000	51%
External audit of internal controls over financial statements	67%	$100,000	$200,000	50%
Management Review	66%	$100,000	$200,000	50%
Hotline	63%	$100,000	$200,000	50%
Anti-fraud policy	54%	$100,000	$190,000	47%
Internal audit department	73%	$108,000	$200,000	46%
Fraud Training for employees	53%	$100,000	$169,000	41%
Formal fraud risk assessments	41%	$100,000	$162,000	38%
Fraud training for managers/executives	52%	$100,000	$153,000	35%
External audit of financial statements	80%	$120,000	$170,000	29%

b. Smaller organizations were found to have fewer anti-fraud controls implemented, and as a result, were found to be more vulnerable.

c. Companies with anti-fraud controls in place experienced 12% to 56% less fraud losses, and a 33% to 58% quicker detection of fraud.

d. The most cited organizational weakness was a lack of internal controls (30% of cases), while override of existing internal controls (19%) was found to be the second most common weakness.

e. The perpetrator’s level of authority had a strong correlation to the size of the fraud. See Table 5 below.

Table 5: Perpetrator's Level of Authority Related to Occupational Fraud

Level of Authority	Median Losses
Owner/executive	$850,000
Manager	$150,000
Employee	$50,000

5. Warning Signs and Detection

a. Most perpetrators were first time offenders (89% had never been charged or convicted) and tended to display erratic behavior while engaged in their schemes.[4] At least one behavioral red flag as noted below existed in 85% of cases:

- Living beyond means
- Financial difficulties
- Unusually close association with a vendor or customer
- Control issues, unwillingness to share duties
- Divorce/family problems
- "Wheeler-dealer" attitude

b. The highest percentage of detection (40%) resulted from tips. 63% of victim organizations had anonymous fraud reporting hotlines. Fraud losses were 50% **smaller** at organizations with hotlines than those without. Organizations without hotlines were more than twice as likely to detect fraud by accident or by external audit. See Table 6 below for other methods of detection.

[4] Pursuant to the 2018 Report, the data regarding first time offenders may be understated since 28% of fraudsters in the ACFE study either received no punishment from their employers, were permitted to resign or entered into private settlement agreements. (2018 Report, 43)

Table 6: How Occupational Fraud is Initially Detected

Method of Detection	Method as a %
Tips	40%
Internal Audit	15%
Management Review	13%
By accident	7%
Other	6%
Account Reconciliation	5%
Document Examination	4%
External Audit	4%

c. The second most common forms of detection were from internal audit (15%), while only 4% of cases were discovered by external audits.
d. Companies with active methods of detection such as management review, surveillance/monitoring, IT controls, and account reconciliation experienced both lower median losses and quicker detection.

Conclusion

Regardless of the size or type of the company, as the ACFE's Report to the Nations consistently demonstrates year after year, a *significant portion* of an organization's revenue is vulnerable to occupational fraud schemes and theft. Through the diligent use of appropriate, proactive fraud detection mechanisms such as internal controls and policies that include thorough management review, account reconciliations, and surveillance/monitoring, the risk and potential for damages from fraudulent schemes can be reduced and/or mitigated. Contact your Anchin advisor for more information on how to improve your organization's anti-fraud controls or for assistance in the investigation of known or suspected fraud.

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