



FORENSIC

# The fraud triangle - an aid to assessing fraud risks

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ADVISORY

# Categorising fraud and misconduct

## Fraudulent financial reporting

- Improper revenue recognition
- Overstatement of assets
- Understatement of liabilities inc tax
- Customer over-billing
- Fraud by JV partners
- Treasury & Investment related fraud
- Manipulation of apparent performance / KPIs

## Misappropriation of assets

- Payroll & Pensions fraud
- Expenses fraud
- External theft
- Procurement fraud
- Disposals related fraud i.e land, plant, vehicles, scrap
- Theft of IP
- Sales and Marketing fraud

## Other threats

- Bid-rigging and other anti-competitive behaviour
- Falsifying compliance data for regulators
- Money laundering
- Organised crime
- Insider trading
- Recruitment fraud

# The United Kingdom Fraud Act 2006

Effective from 15 Jan 2007

Creates for the first time a specific offence of fraud, split into three categories:

- Fraud by false representation
- Fraud by failure to disclose information, and
- Fraud by abuse of position

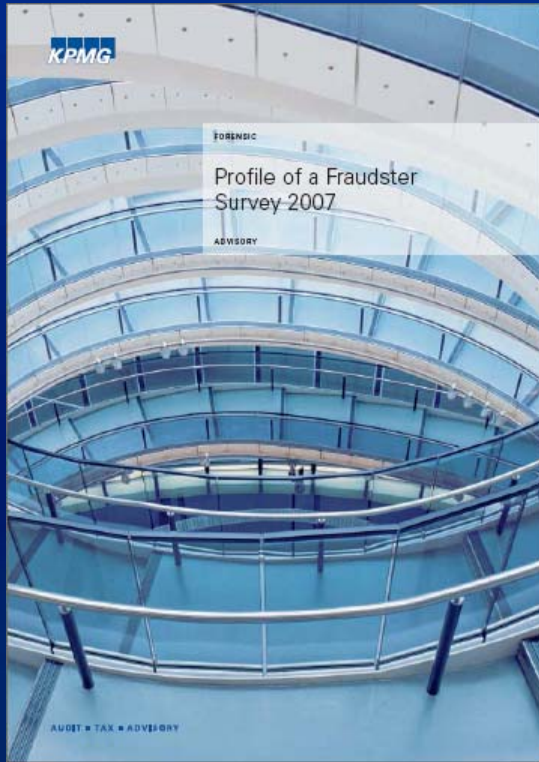
Act also focuses on what the perpetrator intended rather than what necessarily resulted – the mere intention to cause a victim loss through fraud is the crucial point – there does not even need to be an identifiable victim!

The act also includes sections on:

- Possession of articles for use in frauds
- Making or supplying articles for use in fraud
- Obtaining services dishonestly

# Who is committing fraud?

KPMG's 2007 survey "Profile of a Fraudster" looked at 380 investigations performed by our firms in recent years. It found the following:



Board members and members of senior management comprised 60% of fraudsters. A further 26% of fraudsters were members of the management group.

In 68% of the cases surveyed, the fraudster acted independently.

85% of cases involved only men.

70% of the fraudsters were between 36 and 55.

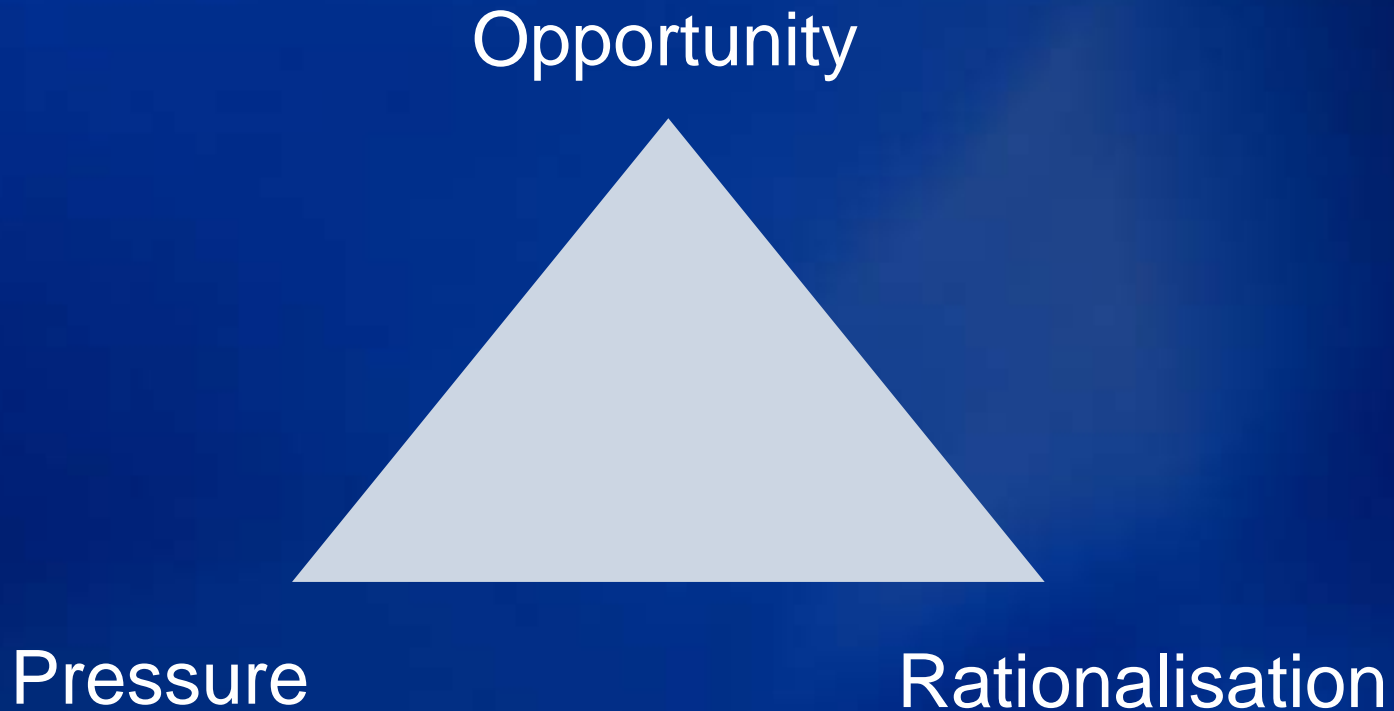
Finance was most likely place in which fraudsters worked followed by sales / operations or the fraudster worked as the CEO.

# The impact of fraud on your business?

Some or all of the following:

- Financial loss
- Reputational damage
- Diversion of senior management time
- Damage to morale
- Loss of confidence by stakeholders
- Concerns about job losses
- Unwelcome press interest
- Increased scrutiny and regulation by government
- Investigation costs

# The concept of the fraud triangle



# Fraud Triangle - Pressure



# Fraud Triangle - Opportunity

Poor controls

Fraud can be hidden in complex transactions

Exploiting errors

Abuse of authority

Lack of segregation of duties

Lack of effective oversight



Poor corporate governance

# Fraud Triangle - Rationalisation

“They do not pay me enough!”

“Rules are made to be broken”

“Everyone else does it”

“Who cares?”

“Its only small amount”

“I’m the boss!”

“It’s a victimless crime”

“They can afford it”

“I’ll never get caught!”

“It’s a cost of doing business”



# Warning signs - some corporate behaviours

Lack of trust / poor internal or external auditor relationships	Dominance / lifestyle issues	Undue secrecy	Illegal unethical practices	Significant director bonus
High analyst or other pressures	Declining industry / earnings	High hope value	Aggressive forecasts	Highly-leveraged rewards
Aggressive accounting policies	Unique products – unique risks	Cash / funding gap	Results exceed market trend	High management turnover
Profit warnings / credit warnings	Complex corporate structures	Related party arrangements / unusual payment methods	Multiple banking arrangements	Remote operations

# Warning signs - some people related behaviours

Lifestyle / Income mismatch	Overextended personal finances	Addictive behaviour	Relationship "issues"	Rarely takes holidays
Refuses or does not seek promotion	Resists or refuses new positions	Poor motivation or unhappy	Stressed, pressurised	Unreliable, prone to mistakes, poor performance
Shifts blame for errors, denies responsibility	Inappropriate acceptance of hospitality	Egotistic	Bullies or intimidates colleagues	Ability and performance not in tune with CV
Has favourites or is surrounded by "yes men / women	Personal pay and reward could be manipulated	Does not, or cannot produce books or records	Vendors and suppliers will not speak to anyone but this person	Cuts corners or Bends the rules!

# Managing fraud risk – some suggestions (1)

- Are your internal controls effective and designed so as to respond to identified fraud risks?
- Is there effective scrutiny in place? Are business decisions subject to regular challenge and review – could a fraudster easily avoid such scrutiny by predicting where and when it will occur?
- If you have a whistle blowing hotline, does it generate an expected level of reporting? If not – why not? Is it available for use by third parties such as customers, suppliers or other stakeholders?
- Have managers been required to identify specific fraud risks? Have internal controls been developed in response to these fraud risks?

# Managing fraud risk – some suggestions (2)

- What deters fraudsters in your business?
- If a fraud was to occur – do you have a fraud response plan or mechanism in place to secure evidence, to protect your business, to maximise the chances of recovering stolen assets?
- Fraud education and awareness –do you educate your employees and managers on the risks posed by fraud? Are appropriate anti-fraud policies in place? Are they accessible to all staff – in local languages, available on the corporate Intranet and regularly reviewed to reflect the business in its current form?
- Could you use data analytical techniques on your business data to detect fraud or other misconduct?

# Presenter



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