Report to the Nation

The Association of Certified Fraud Examiners published in 1996 an extensive report on the status of fraud and white-collar crime in the U.S. It is called the Report to the Nation on Occupational Fraud and Abuse, and it is the largest known privately-funded study on this subject.

Table of Contents:

Report to the Nation: Section 1 (President's Letter)

Occupational fraud and abuse is a serious problem in the United States.

The Association of Certified Fraud Examiners' Report to the Nation on Occupational Fraud and Abuse represents the largest known privately-funded study on this subject. A total of 2,608 Certified Fraud Examiners contributed details of actual fraud and abuse cases totaling $15 billion. From this data, the Report analyzes four areas: the cost of occupational fraud and abuse, the victims, the perpetrators, and the methodologies.

The Association of Certified Fraud Examiners' Report to the Nation on Occupational Fraud and Abuse is the product of thousands of hours of research by hundreds of people. Dr. Sandra Welch of the University of Texas at San Antonio and Drs. Sarah A. Reed and Robert H. Strawser of Texas A&M University aided significantly in collecting and analyzing the data. But the report's genesis belongs to the Association's founder and Chairman, Joseph T. Wells, CFE, CPA. In his honor, I also am naming this study the Wells Report.

For practitioners, academics, journalists, and citizens interested in the detection and deterrence of occupational fraud, the Wells Report offers a wealth of information.

Gil Geis, PhD, CFE
President
Association of Certified Fraud Examiners

Report to the Nation: Section 2 (Executive Summary)

- The study covers $15 billion in actual cases.
- Fraud and abuse costs employers an average of $9 a day per employee.
- Fraud and abuse costs U.S. organizations more than $400 billion annually.
- Men commit 75% of fraud and abuse cases.
- Small businesses are the most vulnerable.

The Association defines occupational fraud and abuse as: "The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets."

Scope of Report:

The Report summarizes actual cases of fraud and abuse collected from the experience of 2,608 Certified Fraud Examiners (CFEs). The majority of these CFEs work for organizations where they are responsible for resolving allegations of occupational fraud, from inception to disposition. Collectively, they have investigated more than 1 million cases of criminal and civil fraud.

Certified Fraud Examiners gather evidence, take statements, write reports, testify to findings, and assist in the detection and prevention of fraud. The cases described in the Report...

- Occurred principally over the last 10 years
- Total $15 billion in actual fraud and abuse losses
- Range from $22 to $2.5 billion

- Represent 12 different major industry groups, including government

The Cost of Occupational Fraud and Abuse:

The 2-1/2 year study also queried Certified Fraud Examiners on the cost, both direct and indirect, of occupational fraud and abuse. They estimate that...

- The average organization loses more than $9 a day per employee to fraud and abuse.
- The average organization loses about 6% of its total annual revenue to fraud and abuse committed by its own employees.
- Fraud and abuse costs U.S. organizations more than $400 billion annually.
- The median loss per case caused by males is about $185,000; by females, about $48,000.

The Perpetrators:

The Report gathered personal information on employees, managers, and executives who committed occupational fraud and abuse. The findings show that...

- The typical perpetrator was a college-educated white male.
- Men committed nearly 75% of the offenses.
- Median losses caused by men were nearly four times those caused by women.
- Losses caused by managers were four times those caused by employees.
- Median losses caused by executives were 16 times those of their employees.

The Victims:

The victims in the Report are organizations. The findings indicate that...

- The most costly abuses occurred in organizations with less than 100 employees.
- The education industry experienced the lowest median losses.
- The highest median losses occurred in the real estate financing sector.

The Methods:

Occupational fraud and abuses are divided into three main categories...

- Asset misappropriation
- Fraudulent statements
- Bribery and corruption

Report to the Nation: Section 3 (Introduction)

The Association of Certified Fraud Examiners' Report to the Nation on Occupational Fraud and Abuse is the first study of its kind. This is not a random survey - the data presented in this Report is based solely on 2,608 cases. As a general rule, only more serious fraud and abuses are included. The information in this Report is for public consumption. A second Report, primarily for anti-fraud practitioners, will subsequently be released.

A survey, begun in 1993, collected comprehensive fraud case data from 2,608 Certified Fraud Examiners. 1,498 of these cases began after 1985. Fraud and abuse cases totaling $15 billion over the last 10 years are covered in this Report. The largest fraud case in the study involves $2.5 billion; the smallest, $22...

- Case Study #98:
  The 67-year-old owner of a savings and loan association diverted millions of dollars in corporate funds to cover his own bad investments. The final cost of the savings and loan fraud to taxpayers was $2.5 billion.
- Case Study #1073:
  A female bank teller, 24, pilfered $22 from her cash drawer and originally claimed the money was due to "shortages." She later confessed.

Occupational fraud and abuse encompasses a wide variety of conduct by employees, managers, and principals of organizations ranging from pilferage to sophisticated investment swindles. Common violations include asset misappropriation, corruption, false statements, false overtime, petty theft and pilferage, use of company property for personal benefit, and payroll and sick time abuses. The key is that the activity...

- Is clandestine
- Violates the employee's fiduciary duties to the organization
- Is committed for the purpose of direct or indirect financial benefit to the employee
- Costs the employing organization assets, revenues, or reserves

Although this study is not the first to consider abusive and fraudulent employee behavior, it is the first to attempt to estimate its cost by polling experts in the field.

Early related research includes a 1970 study by criminologist Donald Horning, who studied the attitudes of employees at an industrial plant. He discovered an informal system whereby a variety of company property was apt to be viewed as being of "uncertain ownership," particularly small, plentiful, and inexpensive materials, components, and tools. Pilfering such property often was regarded not as stealing, but as "taking things from the plant," and would not arouse feelings of guilt on the part of the employees.

In 1983, Richard Hollinger and John Clark surveyed 9,175 employees in three different industry segments. More than two-thirds of the respondents admitted counterproductive behavior at some level, while approximately one-third admitted they had stolen company property, such as supplies or merchandise on the job.

In a 1992 survey, Employee Theft on the Rise, Judith Edgerton studied more than 1,000 supermarkets and found that the average amount of theft alone, excluding abuse, rose from $44.72 per employee in 1989 to $168.48 in 1992 - an increase of 376%.

In 1992, James Patterson and Peter Kim studied employee "abuses" as a part of a larger research project. They concluded that half of American workers believe that the way to get ahead is through "politics and cheating."

The Ethics Resource Center's 1994 study, Ethics in American Business: Policies, Programs, and Perceptions, concluded that two of the most common types of transgressions observed by employees were lying on reports or falsifying records (41%), and stealing and theft (35%).

The Association of Certified Fraud Examiners' Report to the Nation on Occupational Fraud and Abuse has four goals...

- Summarize the opinion of experts on the percentage and amount of organizational revenue lost to all forms of occupational fraud and abuse
- Examine the characteristics of the employees who commit occupational fraud and abuse
- Determine what kinds of organizations are victims of occupational fraud and abuse
- Categorize the ways in which serious fraud and abuse occurs

Report to the Nation: Section 4 (The Cost of Fraud)

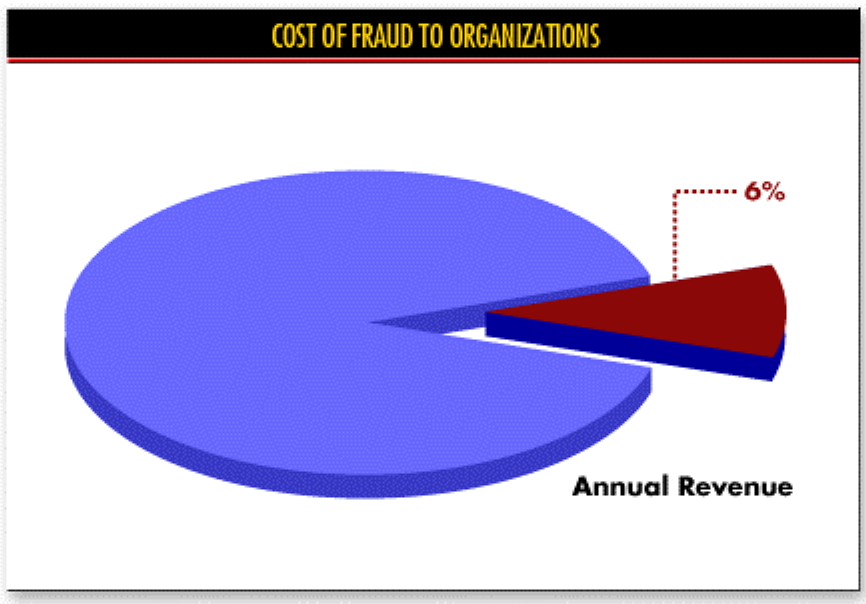
- Organizations lose 6% of annual revenue to fraud and abuse.
- Fraud and abuse costs U.S. organizations more than $400 billion annually.
- The average organization loses more than $9 a day per employee to fraud and abuse.

In the U.S., estimates of the cost of fraud vary widely. No comprehensive national studies have been conducted to empirically measure the economic effects of fraud and abuse. Numerous professionals have opined on the subject. For example, in 1974, the U.S. Chamber of Commerce estimated that the cost of white-collar crime is not less than $40 billion. The U.S. General Accounting Office estimated that, in 1995, fraud and abuse consumed about 10% ($100 billion) of the $1 trillion expenditures for the nation's health care. For years, many experts have placed the approximate cost of fraud alone at $200 billion annually.

The cost of fraud and abuse is so difficult to quantitatively measure because (1) not all fraud and abuse is uncovered; (2) of that uncovered, not all is reported; (3) incomplete information is gathered in some reported fraud cases; (4) that information which is gathered often is not distributed to management or the authorities; and (5) civil or criminal action often is not taken against the perpetrator(s) of fraud.

The Cost of Fraud to Organizations:

Certified Fraud Examiners estimate that, within their own companies, fraud and abuse accounts for about six cents on each dollar of annual revenue. They conclude that other organizations lose a similar amount.



A total of 124.9 million civilians were employed in the U.S. in 1995. For 1996, that number is estimated at 126.6 million. The estimated 1995 and 1996 Gross Domestic Products are estimated at around $7 trillion. Based on these figures, U.S. organizations lose over $400 billion to occupational fraud and abuse. The amount per employee per day attributable to fraud and abuse (based on a 365-day year) is more than $9.

In addition to the direct economic loss to the organization from fraudulent or abusive behavior, there are indirect costs to be considered: the loss of productivity from hiring and firing abusive employees, legal action, increased unemployment, government intervention, and other hidden costs of fraud and abuse. As a result, researchers are left with indirect choices of how to measure the cost of fraud and abuse. In this particular study, the following methodology was adopted...

- CFEs were asked to estimate, based upon their industry knowledge, the percentage of annual revenue lost to fraud and abuse in the average organization.
- They were then asked to estimate the percentage of annual revenue lost to fraud and abuse in their own organizations over the last 12 months.

- The two estimates were compared for statistical differences. In each case, the median was 6% of revenues.

Experts conclude that most U.S. companies suffer similar losses. However, in interpreting these costs, the following observations should be considered...

- Organizations are already paying for the economic losses from fraud and abuse as a part of their total operating costs.
- Because abuse is seen by many employees as an informal employment benefit, some sociologists have even suggested chronic pilferage and certain other abuses might actually have a positive effect on morale, and therefore increase productivity.
- Much abuse is silently condoned in organizations. It is not restricted to the rank and file; indeed, one study reflected that 62% of inventory shrinkage caused by employees was committed by company supervisors.

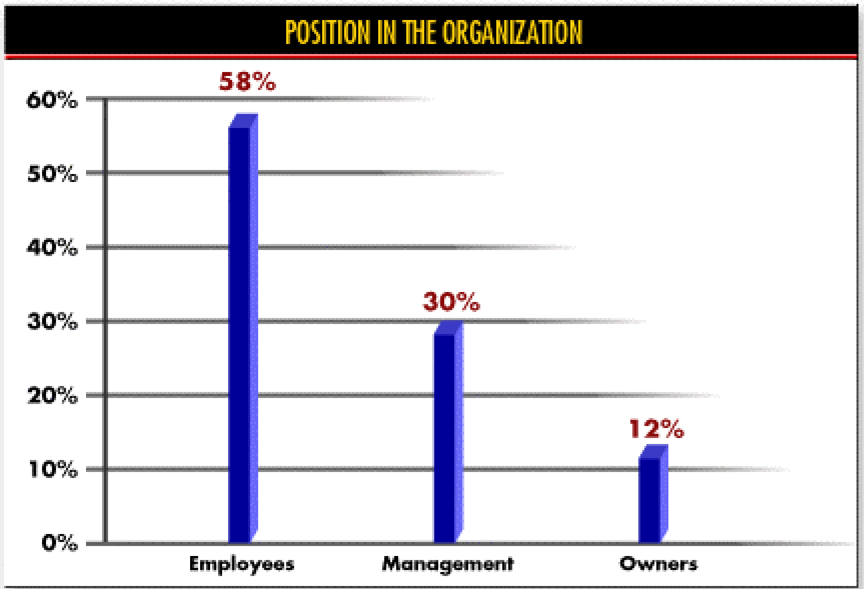
Report to the Nation: Section 5 (The Perpetrators)

- Losses from fraud caused by managers and executives were 16 times greater than those caused by non-managerial employees.
- Losses caused by men were four times those caused by women.
- Losses caused by perpetrators 60 and older were 28 times those caused by perpetrators 25 or younger.
- Losses caused by perpetrators with post-graduate degrees were more than five times greater than those caused by high school graduates.

The Report asked respondents to detail characteristics of occupational fraud perpetrators. The data that follows analyzes the perpetrators by position in the organization, gender, age, marital status, and education.

Position in the Organization:

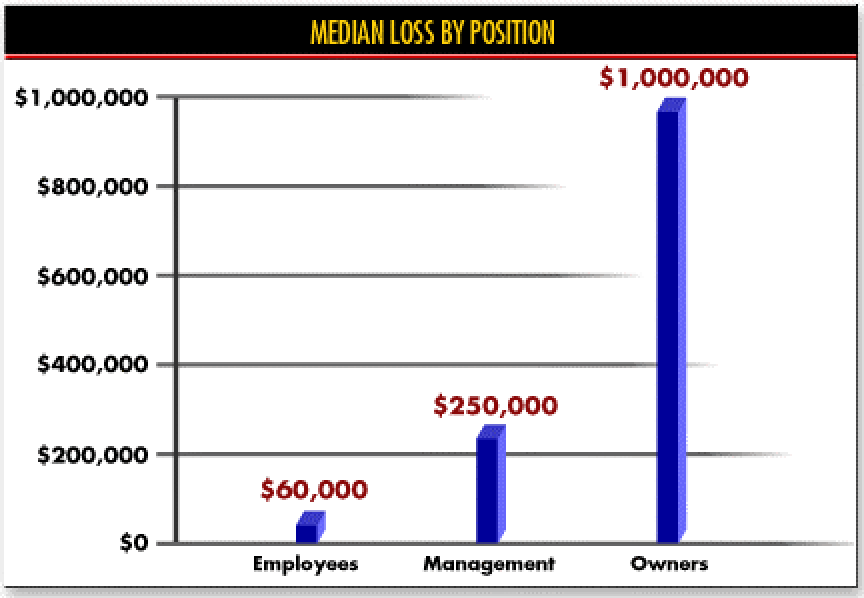
The data indicates that about 58% of the reported fraud and abuse cases were committed by non-managerial employees, 30% by managers, and 12% by owner/executives. However, the median losses caused by non-managerial employees were significantly lower than those caused by managers and executives.



- Case Study #1932:
  Six executives of a family-owned electronics company pocketed more than $100 million by selling overvalued company stock. The company's earnings and profits had been significantly overstated through false financial statements prepared by the family members.

Median Loss by Position:

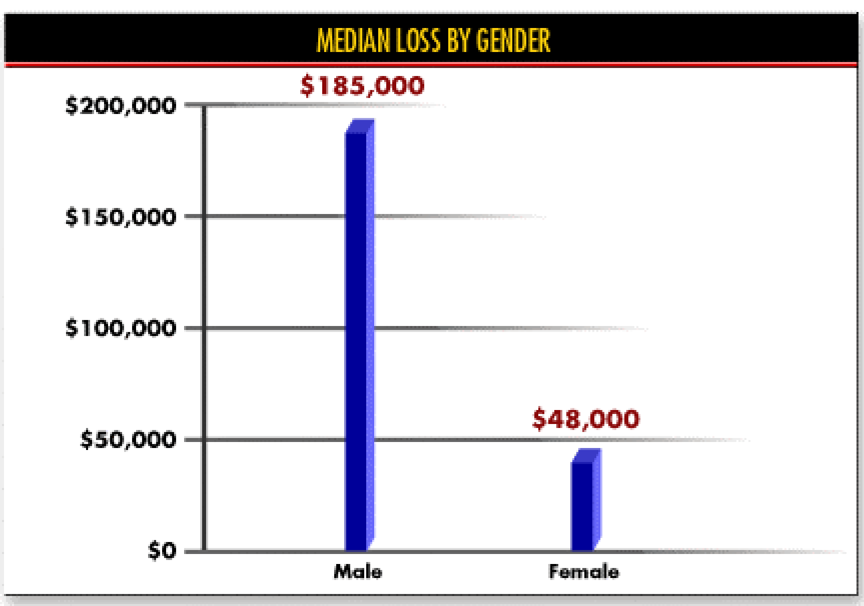
Median losses caused by non-managerial employees were $60,000; by managers, $250,000; and by owner/executives, $1 million. The loss differences are attributable primarily to the amount of financial control exercised in each position; those in the highest positions have the greatest access to company funds and assets.



- Case Study #1711:
  The acting director of admissions for a university knew his job was only temporary. To enhance his resume, he created the necessary fake transcripts to "award" himself a degree.

Median Loss by Gender:

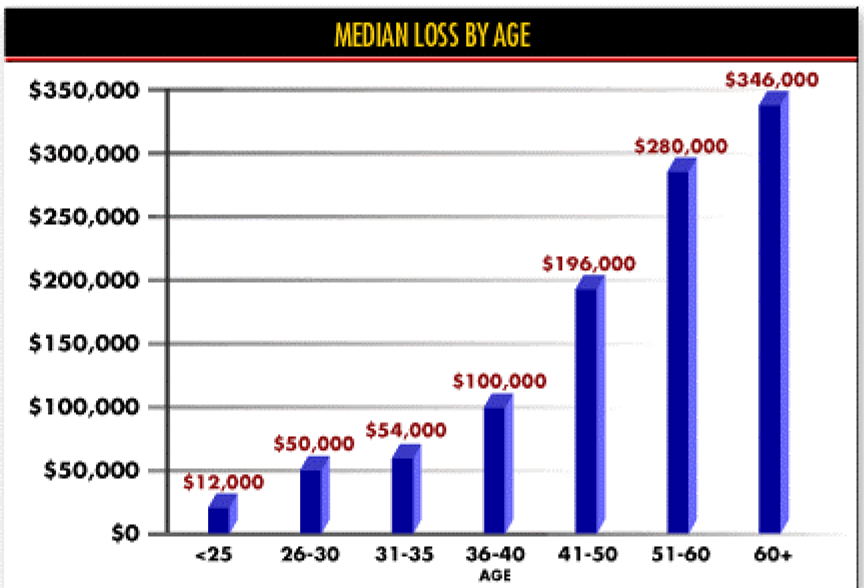
The median loss per case caused by males ($185,000) was nearly four times that caused by females ($48,000).



- Case Study #1401:
  A male bookkeeping employee of one company knew how busy the boss was at certain times. The employee always presented a stack of checks for the boss' signature during one of those busy times. The employee regularly slipped in an extra check for himself, which the boss would sign in haste. This oversight cost the company $150,000.

Median Loss by Age:

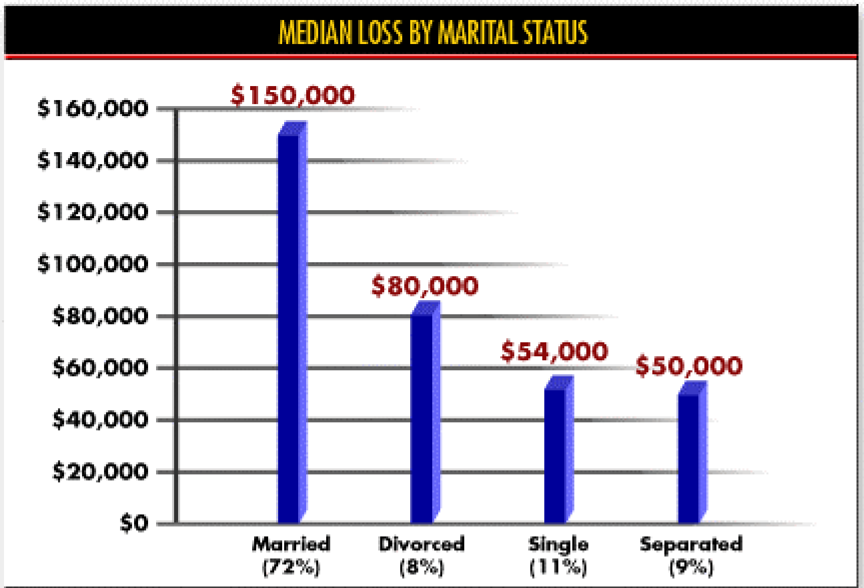
Perpetrators younger than 25 cause median losses of about $12,000, while those caused by employees 60 and older are 28 times greater, or about $346,000. Older employees tend to occupy higher-ranking positions and therefore generally have greater access to company assets.



- Case Study #1440:
  A 48-year-old manager was very partial to one of his company's outside consultants. The manager ultimately suggested that the consultant, in addition to his regular billing, submit occasional fictitious bills to the company. The manager would then approve them for payment. Together the twosome split $300,000 of the company's money.
- Case Study #2418:
  A 78-year-old real estate financier was in default on several multimillion-dollar bank loans. To forestall bankruptcy, the financier stole $1.3 million from his partners in several other real estate projects and used the money to catch up on his past-due payments.

Median Loss by Marital Status:

Married employees commit the greatest number of fraud and abuse cases and cause the highest median losses.

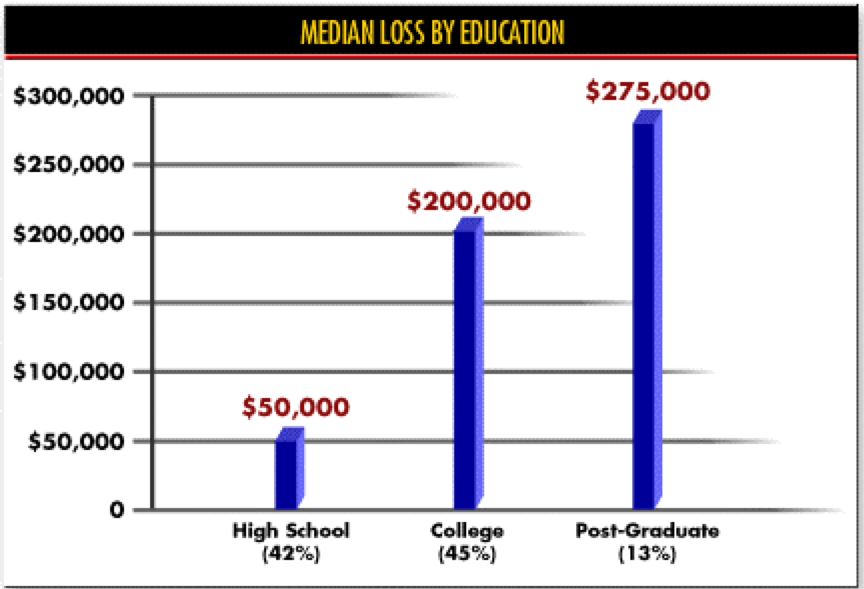


- Case Study #2019:
  A married buyer for one company convinced his superiors that business supplies purchased from three particular vendors were better than anything on the market. But the buyer's judgment was clouded by the fact that these vendors together had paid him

  $250,000 in kickbacks to buy their goods.

Median Loss by Education:

There is a linear relationship between education and median losses due to fraud and abuse. Generally, those with more education occupy higher positions in their organizations and therefore have more access to company funds and assets.



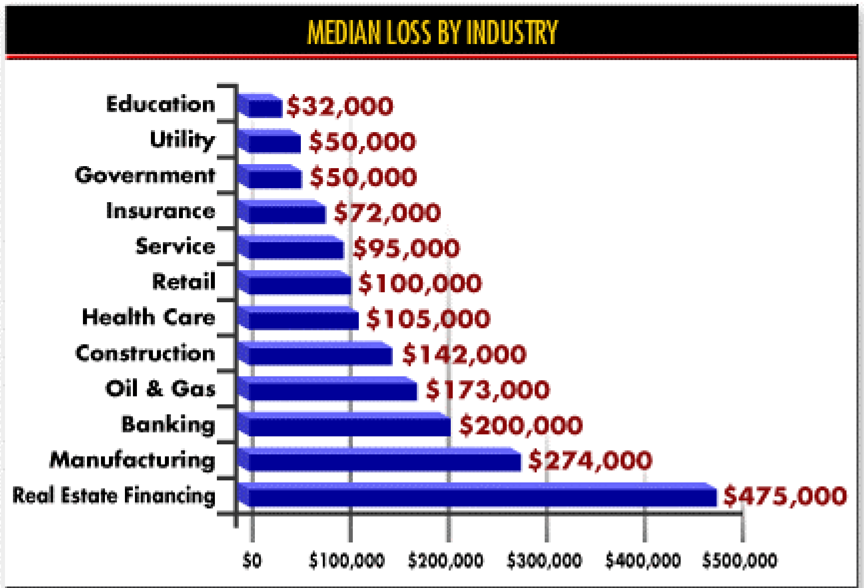
- Case Study #2389:
  A high school graduate and government employee once used her government credit card for personal purchases in an emergency. When no one detected her action, the employee charged another $4,500 in personal items to Uncle Sam.
- Case Study #1842:
  The director of taxation for a large company, who had a post-graduate degree, conspired with a partner of one of the company's "Big Six" auditors. Together, the two set up a shell corporation controlled by the director's wife. They paid the shell $1 million in bogus billings over three years.

Report to the Nation: Section 6 (The Victims)

- Companies with 100 or fewer employees were the most vulnerable to fraud and abuse.
- The real estate financing industry suffered the largest losses.
- The education industry suffered the smallest losses.

Median Loss by Industry:

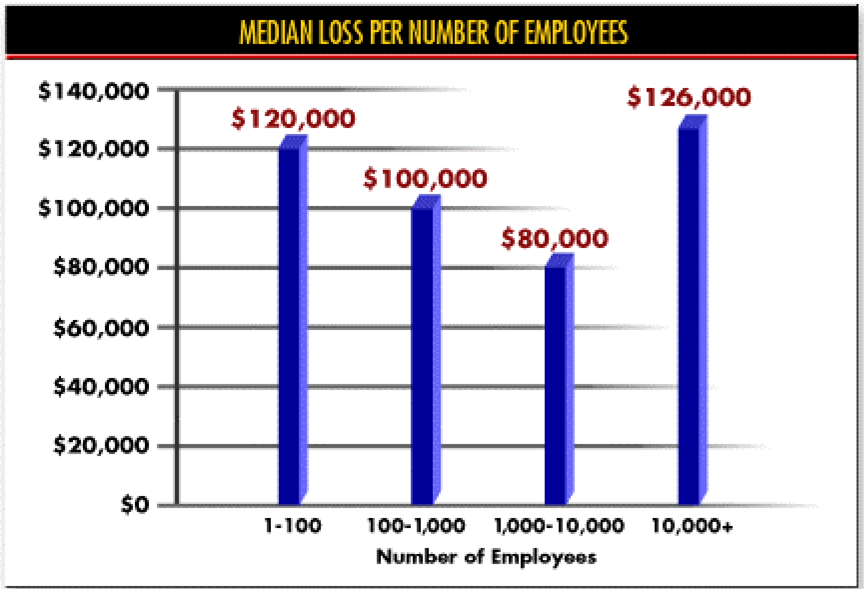
Respondents were asked to provide descriptive data on the organizations which were victims of occupational fraud and abuse. These organizations were divided into 12 different industries. The large median losses in the real estate financing segment are due primarily to the savings and loan problems of the late 1980s.



- Case Study #15:
  The purchasing manager and another employee cost a manufacturing company $2.8 million. They conspired with one of the company's suppliers to send bills to the company for products never delivered. The manager and his employee would approve the fake invoices for payment. The trio then split the money evenly.

Median Loss Per Number of Employees:

The study gathered information on the size of the defrauded organization by number of employees. The median loss for organizations with 100 or fewer employees ($120,000) was nearly the same as that for organizations with more than 10,000 employees ($126,000). On a per capita basis, however, small organizations suffered the largest losses.



- Case Study #1515:
  A bookkeeper in a four-person legal office wrote 22 checks to herself and forged a partner's signature, eventually stealing $186,000. Her fraud was discovered shortly after she resigned. The law partner later learned that she had two prior embezzlement convictions and had served four years in prison before coming to work for him. After she resigned from the law office, she went on to steal from two more employers.
- Case Study #1090:
  The accounts payable supervisor for a 5,000-employee oil and gas refining company embezzled $639,000. He established his own outside company and approved fake invoices for his phony operation.
- Case Study #2541:
  One college athletic director believed he was underpaid, so he made up the difference elsewhere. Since total attendance at the college's athletic events was one measure of his compensation, the athletic director generously "padded" those figures to show a much higher attendance. He got an extra $120,000.
- Case Study #1969:
  One company was in the home repair business. They didn't know it, but so was one of their employees. He used $10,000 of the company's supplies and equipment to do his own remodeling jobs, pocketing the profits himself.
- Case Study #1819:
  A degreed male, 32, started a software company using his employer's time, equipment, and facilities. His employer, also a software company owner, discovered that the employee even demonstrated his own products to the company's customers. Ultimately, the employee diverted $500,000 in business away from his employer.

Report to the Nation: Section 7 (The Methods)

- Asset misappropriation accounted for more than four out of five offenses.

- Bribery and corruption constituted about 10% of offenses.

- Fraudulent statements were the smallest category of offense.

The Report classifies the numerous methodologies used by employees to commit occupational fraud and abuse. Occupational fraud and abuse can be divided into three broad categories: asset misappropriation, corruption, and fraudulent statements.

Asset Misappropriation:

Asset misappropriation was by far the most common form of occupational fraud, constituting more than four out of five reported offenses. Assets are misappropriated either directly or indirectly for the employee's benefit.

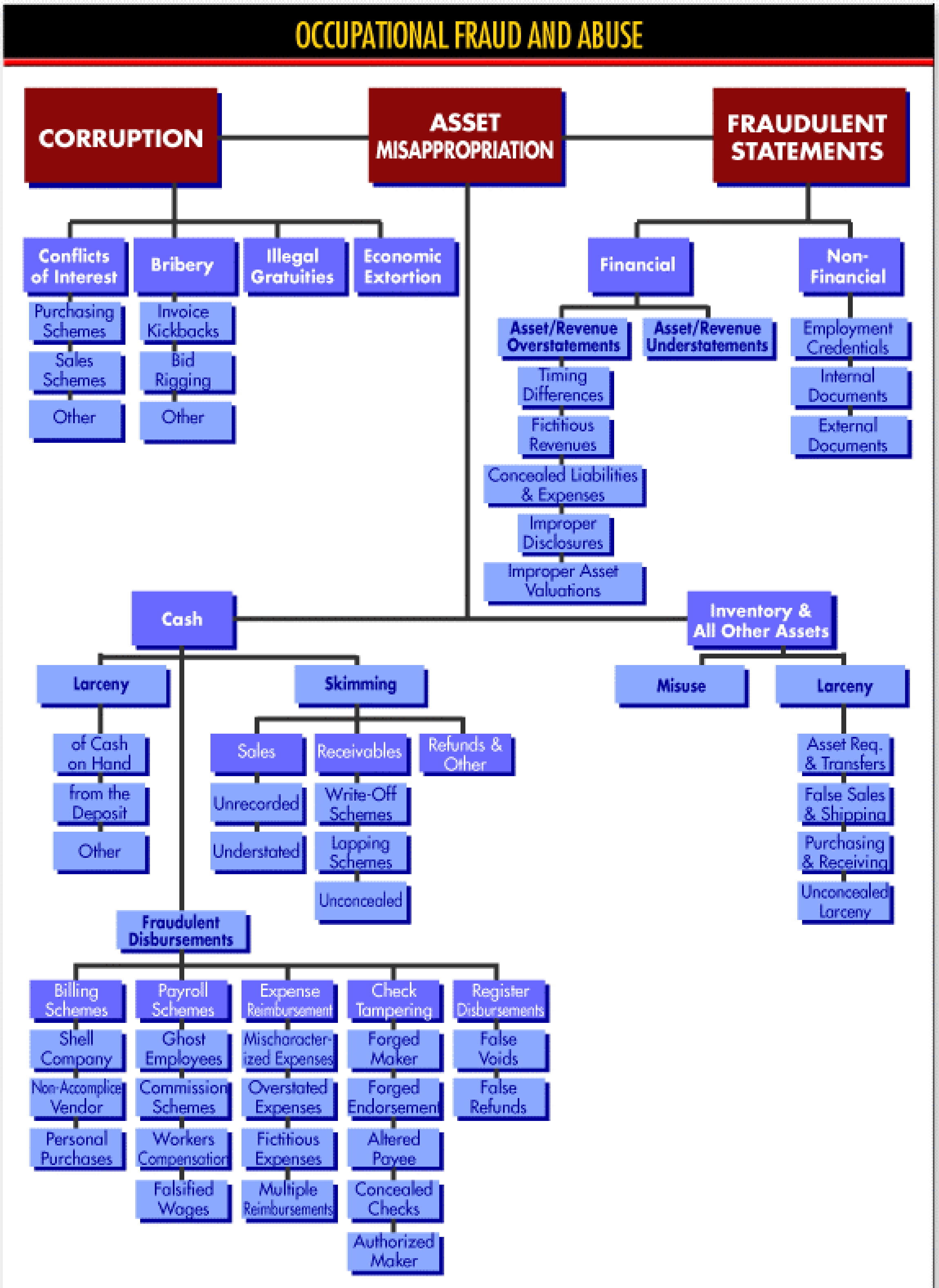
Although any tangible asset can be misappropriated, certain assets are more susceptible than others. Transactions involving the organization's cash and checking accounts were far more common than all other asset misappropriations combined. Other susceptible assets include inventory, supplies, equipment, and information.

Corruption:

Black's Law Dictionary defines corruption as "the act of an official or fiduciary person who unlawfully and wrongfully uses his station or character to procure some benefit for himself or for another person, contrary to duty and the rights of others." Corruption, in the sense of occupational fraud, usually involves an executive, manager, or employee of the organization in collusion with an outsider. There are four principal types of corruption: bribery, illegal gratuities, conflicts of interest, and economic extortion. Corruption accounted for about 10% of occupational fraud cases.

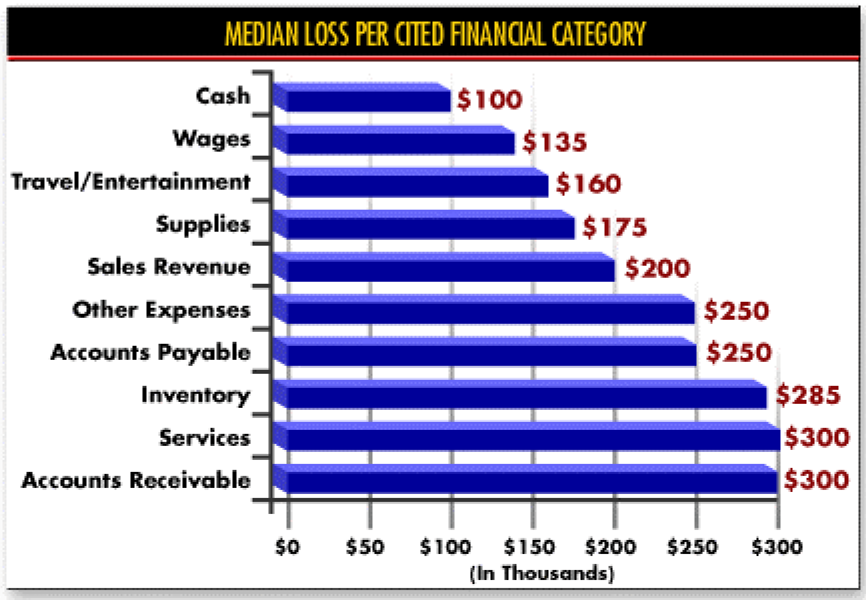
Fraudulent Statements:

Fraudulent statements is the third broad category of occupational fraud. These statements, in order to meet the definition of occupational fraud, must bring direct or indirect financial benefit to the employee. Although all fraud involves "fraudulent statements," this category is limited to two sub-categories: fraudulent financial statements and all others. Fraudulent statements accounted for about 5% of all occupational fraud cases.



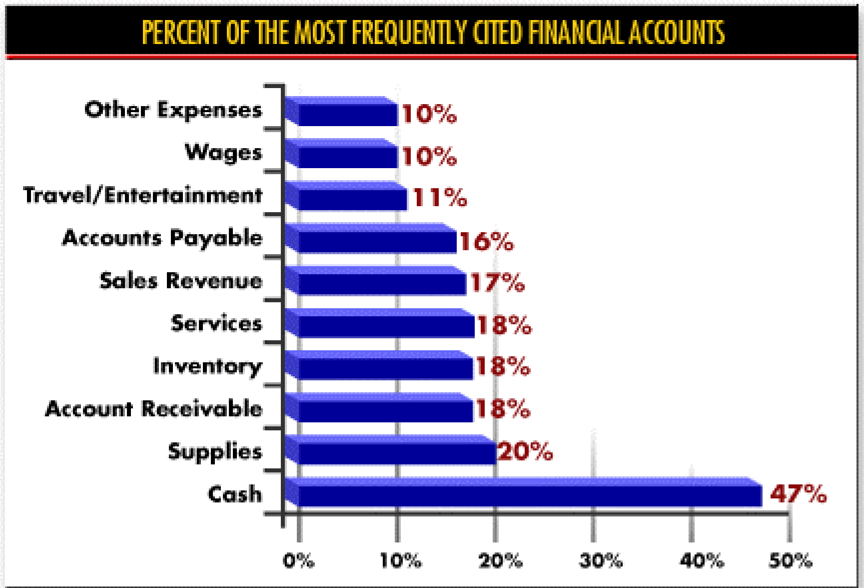
Median Loss Per Cited Financial Category:

As a part of the study of methodologies, each respondent was asked to provide information on how fraud and abuse affected different financial accounts within the organization. Fraud in the cash account resulted in median losses of $100,000. Fraud in accounts receivable and services resulted in the highest median losses of about $300,000 in each category.



Percent of the Most Frequently Cited Financial Accounts:

The most common account affected by occupational fraud and abuse is cash, representing 47% of the incidents. The account least affected was other expenses, which was cited in about 10% of all cases.



- Case Study #1747:
  A 55-year-old MBA recipient was an avid biker. So avid, in fact, that he charged a $5,000 mountain bike to his company as "construction equipment." He was caught when he tried to claim reimbursement for an out-of-state biking convention. The executive had falsely described his trip as a "management seminar."
- Case Study #1555:
  A male employee made $7,000 in international long distance personal telephone calls and charged them to his company as "other expenses."

Report to the Nation: Section 8 (Conclusions)

1. Certified Fraud Examiners consider the problem of occupational fraud and abuse to be a serious one. CFEs generally occupy positions within organizations where they investigate a wide range of abusive and fraudulent behavior. They are aware not only of the direct costs of the behavior, but also of the indirect costs: loss of productivity, pilferage, and related expenses.

2. There is a direct correlation between the employee's age, sex, position, and the median loss due to fraud and abuse. The data revealed that the most predictive variable concerning the amount lost was the perpetrator's position in the organization. As a general rule, men and older employees occupy higher positions and therefore have greater access to assets.

3. Smaller organizations are the most vulnerable to occupational fraud and abuse. Organizations with 100 or fewer employees suffered the largest median losses per capita. Generally, this is because sophisticated internal controls, designed to deter occupational fraud, are less prevalent in smaller organizations.

4. A lack of understanding of the nature of occupational fraud and abuse adds to its cost. Certified Fraud Examiners frequently comment that executives often are reluctant to believe fraud and abuse occurs within their organizations. Because of their clandestine nature, many of these offenses go undetected until significant losses are incurred.

5. Relatively few occupational fraud and abuse offenses are discovered through routine audits. Most fraud is uncovered as a result of tips and complaints from other employees. To deter and detect fraud and abuse, many experts believe an employee hotline is the single most cost-effective measure. Some organizations install their own hot lines, while others use a subscription service such as the EthicsLine, maintained by the Association of Certified Fraud Examiners.

6. The expansion of computers in organizations likely will increase losses due to occupational fraud and abuse. The use of computers in business has drastically changed the speed with which financial transactions can be accomplished. In addition, computers often do not create the documents necessary to easily detect fraud and abuse. Many experts see increasing reliance on computers as a likely cause of additional offenses. However, computers are also being employed to detect fraud and abuse.

7. The rate of occupational fraud and abuse likely will rise. It is caused by many complex sociological factors. Individual and corporate morality are difficult to quantify. Among other things, increasing demands on the criminal justice system by violent criminals may make fraud and abuse prosecutions more difficult. Additional proactive vigilance and education, however, as well as consumer action, could stem future increases in occupational fraud and abuse.

Report to the Nation: Section 9 (Minimizing the Costs of Occupational Fraud and Abuse)

Occupational fraud and abuse cannot be eliminated in the workforce, but its costs can be reduced. Doing so requires preventative action, starting with a basic understanding of the nature of these offenses.

Generally, occupational fraud and abuse starts small and continues to grow, sometimes threatening the very existence of the organization. Because of fraud's clandestine nature, employers often are reluctant to believe it exists. This is especially true in small organizations.

It is equally true, however, that trust is the cornerstone of occupational fraud and abuse. As a result, the organization must seek a balance between trusting its employees too much and too little. While some occupational fraud is well hidden, most is not. And most can be prevented and detected with common sense and inexpensive solutions.

Consult a Certified Fraud Examiner:

Certified Fraud Examiners (CFEs) have special knowledge concerning fraud detection and deterrence. Regular audits are not designed specifically for fraud and abuse. A CFE can assess your organization's unique fraud risks and design programs to cost-effectively reduce exposures. Of course, CFEs can also help resolve suspected fraud and abuse matters.

Set the Tone at the Top:

Employees who view their leaders as honest people are more inclined to emulate that behavior. The opposite is also true. Don't give employees an excuse to be dishonest.

Have a Written Code of Ethics:

A written code of ethics sets forth what the organization expects from its employees. Although many larger organizations are implementing written codes, the same cannot be said of smaller ones. And that's where the risk to occupational fraud and abuse is highest.

Check Employee References:

Some occupational offenders chronically abuse their positions and are simply discharged. These persons usually go on to other organizations where they continue their patterns of fraud and abuse. They often purposely select organizations where they know pre-screening is nonexistent.

Examine the Bank Statements:

The organization's unopened bank statement should be reviewed at the highest possible level. Since most occupational fraud involves skimming cash and false disbursements, a responsible person unconnected to the bank reconciliations should look for unusual patterns, dual endorsements, unfamiliar vendors, and unfamiliar financial trends.

Utilize a Hotline:

In this study, the majority of occupational fraud and abuse cases were discovered through tips and complaints by fellow employees. Employees are often in a position to observe improper conduct but frequently have no way to report it without fear of retribution. Some companies use a subscriber service while others maintain an internal hotline.

Create a Positive Work Environment:

Employees frequently commit occupational fraud and abuse as a way of "getting back" at the organization for perceived workplace injustices. By creating a positive and open work environment, the employing organization can often reduce the motivation for its employees to commit fraud and abuse.

(End of Report)