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The Fraud Triangle revisited

(according to Thinus Barnard)

The fraud triangle (developed by US criminologist Donald R Cressey) provides us with a great overview of what factors need to be in place for a fraud to occur. For those not familiar with the Fraud Triangle...try Google...there are numerous discussions on this topic!

But here follows a short summary of the fraud triangle's components:

The fraud triangle consists of three components, i.e.:

- **Incentive / pressure:** The person must have a financial pressure such as debts to be paid or even pressure from a syndicate to commit the fraud;
- **Opportunity:** The person must have access to a process or system which he/she can manipulate, such as a process with poor controls or people which he/she can influence or mislead – at the end of the day fraud is an abuse of trust;
- **Rationalisation:** This is the attitude or thinking of the person, such as the amount defrauded is a small loan which he/she will pay back (they never do), the company will not miss the amount (they eventually will), the company owes him/her for all the overtime worked, everyone else is doing it, etc.

The idea with the fraud triangle is that if you can remove one of the components through certain initiatives, it should technically be impossible for a person to commit fraud.

My question is: On which component do almost all organisations spent fortunes every year?

Answer: OPPORTUNITY!

Yes...More often than not fortunes are spent ineffectively on the opportunity component.

Companies incur a lot of expenses in respect of external audits, internal audits, forensic / ad hoc investigations, new improved systems to control fraud, etc.

Go on and make your calculations. You will see that fortunes are spent on this component and still fraud continues. People will find a way around almost anything.

How many times have you heard your external / internal auditors talk to you about the root cause of this and the root cause of that. The root causes they refer to often relates to control issues or training issues, such as the staff do not understand this part of the IT system or the IT system allows for a short cut in respect of certain types of transactions, etc.

Root causes of a problem are sometimes deeper than mere control/training issues. It is probably similar to when you run a fever, i.e. you can manage the symptoms and hope it goes away or you can search for the actual cause of the fever and make it go away permanently.

External / internal auditors have not been trained to focus on the often neglected components of the fraud triangle. For them it is about internal controls, documented procedures, likelihood, significance and audit plans.

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My approach has always been a holistic one, i.e. consider all the components.

War story #1 – How a 10 year old kid in a car spawned a multi million Rand syndicate?

Now that title should have caught your attention. If it didn't...nothing will.

My client suspected syndicate activities within their warehouse and distribution operations. My client had a list of suspects. However, before I start with an investigation of this nature, I first want to understand the relevant processes and systems. Refer to my discussion regarding the "WoYD 3 process" method.

One of the key members of the syndicate – he was not on the original list of suspects – was the senior stock controller. His background: He is a single parent with a 10 year old boy. He has no other family close to where he lives and works. Therefore, he had no one to look after his boy when he finished school in the afternoons. So what did he do? The boy had to wait in his dad's car until his dad finished work, which was mostly 8 or 9 o'clock at night. Often he had to come to work on weekends in situations where export loads were required to be ready first thing on a Monday morning.

The client also required daily stock counts of the warehouse and this usually commenced at 4 or 5 o'clock in the afternoon after all the trucks were loaded and sent off to the 20 or so nationwide depots or harbours.

Thus, he was stretched and the fraud triangle components were just glaringly obvious in his situation.

The success of the syndicate depended on his involvement, because he controlled the quantities to be loaded on each truck and he controlled the forklift drivers and stock pickers.

For him it was easy to take the next step and become involved in the syndicate.

However, if the client was aware of his situation, i.e. his boy is sitting without food and water in the car waiting for his dad, and the client went the extra mile in order to improve his situation, just maybe he might have refused to be part of the syndicate. According to him he would have refused to be part of the syndicate if management assisted him. Now please do not hand out any tissues. I am not getting soft on fraudsters. Fraud is fraud doesn't matter what your circumstances are.

So which components were not managed or looked at? Answer: Rationalisation and Incentive / Pressure.

Based on my recommendations the client launched a human resources (or capital as some companies prefer) initiative in order to assess staff's personal challenges, such as single parenthood and financial difficulties. This resulted in the client establishing an aftercare facility for children of staff and a staff loan scheme for emergency unplanned expenses.

Moral improved dramatically.

The client commented that they could see the difference in the staff's quality of work, as well as their enthusiasm. There were various other initiatives, but the ones above stood out for me.

This story should make it quite clear that small initiatives focusing on the other often neglected components of the fraud triangle could go a long way in helping you to fight fraud.

Based on my experience one of the conclusions I have reached is that a person will not easily steal from another if the latter looks after him/her, i.e. they won't bite the hand that feeds them. But there are always the exceptions to any rule.

Shortly before the abovementioned investigation, this client spent millions of Rands on upgraded security, such as electronic seals on the trucks' containers, UV powder in randomly selected boxes, miniature GPS units in other boxes, hidden cameras – you name it they have tried it! BUT, still the syndicate continued.

War story #1 – Continues...

Another aspect which was not properly managed by my client was the following:

EXCO made the decision to outsource their whole warehousing, distribution and depot operations. Therefore, all the employees within those operations would become employees of another unknown company. Some of these employees have worked for my client in excess of 20 years. They were not happy with this.

EXCO did not involve all the employees in these discussions and therefore had no idea about their unhappiness.

Again the often neglected components of the fraud triangle were left unmanaged.

Based on my recommendations the client launched various initiatives to assess all the affected staff's situations and input. This resulted in great empowerment initiatives, such as setting up a company controlled by some of the senior employees which would have been outsourced. This empowerment company obtained part of the outsourced functions.

The effect on moral and the staff's enthusiasm was unbelievable.

Conclusion

Don't forget the often neglected components of the fraud triangle. Some well timed low-cost initiatives could go a long way in preventing fraud and corruption within your organisation. You can focus on opportunity by tightening the controls to such an extent that not even a fly can move in your warehouse without proper approval, but they will still find a way around it.

Joseph T Wells once said that when a person decides that fraud is the answer to their financial problems, they will steal from the place they know best...their employer...because it is the place where they spend 8 to 10 hours of their day. They don't steal from their family. Therefore, make their place of employment their second family.