THE PERPETRATORS AND THE VICTIMS

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"HMO to Settle Billing Claims for $12 Million."[1] "Air Force Worker Accused of Bilking the US."[2] These recent Washington Post headlines suggest that even the federal government is not immune to victimization by criminal activities of a financial nature. Indeed, fraud uncovered within the federal sector has proven to be extremely costly. Though relatively small in terms of the percentage of the budget impacted (median dollar losses as a percentage of median budgets ranged from a low of 0.03 percent to a high of only 0.4 percent), the specific illegal acts reported in this article affected numerous agencies and resulted in losses in excess of $157 million. Even beyond the sheer magnitude of the dollar losses incurred, fraud has also proven to be extremely costly in other ways. Illegal activities divert budgeted resources from their intended uses. In addition, fraud undermines an agency's attempts at reform by deflecting the focus of its leaders. These well-publicized events also erode the public's confidence in the integrity of our federal system.

All would agree that fraud must be uncovered and eliminated whenever and wherever it is practical to do so. Fraud can never be justified or condoned. The complete eradication of fraud, however, is simply not feasible. In the book, "Other People's Money," D. R. Cressey specified that a fraudulent act is committed when three conditions co-exist. "Trusted persons become trust violators when they conceive of themselves as having a financial problem which is non-sharable, are aware that this problem can be secretly resolved by violation of the position of financial trust and are able to apply to their own conduct in that situation verbalizations which enable them to adjust their conceptions of themselves as trusted persons with their conception of themselves as users of the entrusted funds or property."[3]

Organizations typically lack both the skills and the tools necessary to identify those individuals who may harbor non-sharable financial problems and who may subsequently rationalize a trust-violation as either noncriminal, justified or a part of a general irresponsibility for which the individual feels no personal accountability. Realistically, organizations can alter only one of Cressey's three conditions that culminate in the criminal violation of a financial trust—the likelihood that individuals will perceive that a violation of their financial trust would provide a means of resolving their non-sharable problem. The presence of controls, both internal and external to the organization, certainly can reduce (but not eliminate) the opportunities to perpetrate fraud available within an individual's ordinary work routine. Nevertheless, a balance must be maintained. An organization must guard against the costs of over-controlling an environment without sacrificing the benefits of justifiable levels of asset protection.

Greater knowledge of the details of specific incidents of fraud that have been perpetrated and subsequently uncovered at the federal level offers insight into the need for the constant vigilance of agency personnel. Specifically, by identifying characteristics of the organizations victimized by fraud, as well as traits of the perpetrators, agency managers and auditors, both internal and external, can be alerted to the likelihood that their areas of responsibility may be particularly vulnerable to fraud. Further, by identifying the patterns of fraud schemes associated with various types of perpetrators, control systems can be designed and implemented that effectively balance costs and benefits. Concerned individuals can be sensitized to the possible presence of fraud or, at a minimum, to its potential danger.

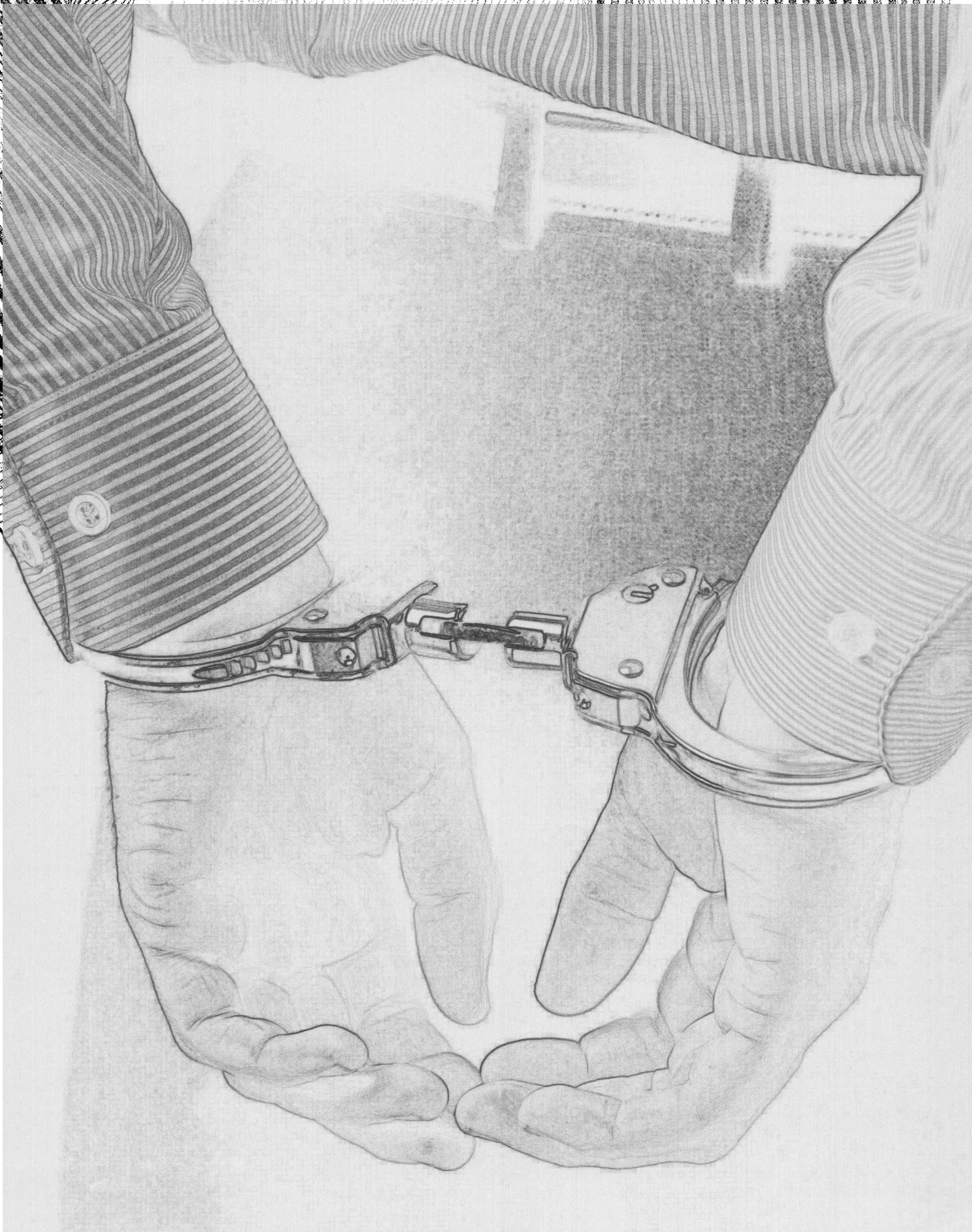

TABLE 1
Characteristics of Perpetrators

	Type of Perpetrator			
	Employee			
	Management	Other	Vendor	Collusion
Number of Cases	31	76	46	55
Percentage of Total	14.9	36.5	22.1	26.5
$ Amount of Loss (Median in 000's) *	97.2	45.0	400.0	500.0
Demographics (% of Details Provided):				
Gender*				
Male	72.4	52.8	90.0	91.1
Female	27.6	47.2	10.0	8.9
Marital Status*				
Married	88.9	57.4	92.3	80.5
Unmarried	11.1	42.6	7.7	19.5
Level of Education*				
High School	34.8	58.8	0.0	44.7
College	65.2	41.2	100.0	55.3
Perpetrator Age (mean) *	41.6	36.0	48.4	41.7

* significant at < .01

This is the first of two articles on fraud in the federal government. Part I provides a profile of the perpetrators and examines the victims of fraud to identify those characteristics that made them vulnerable to defalcations. Part II, which will run in the Summer issue of the Journal, describes, analyzes and summarizes data pertaining to the instances of fraud perpetrated against the federal government. Also in Part II, characteristics of the schemes are investigated and the methods used to detect and confirm the fraud are described and discussed. Finally, the outcomes of and reactions to the fraud investigations are examined.

The data reported in this two-part article were obtained from a mail survey distributed to the 8,000 active members of the Association of Certified Fraud Examiners. Each member was asked to describe in detail an instance of fraud with which (s)he was personally familiar. A total of 2,475 usable responses (30.9 percent response rate) was obtained.[4] Of these, 208 (8.4 percent) reported and described defalcations against agencies of the federal government, committed by employees and vendors, working alone and in concert with others.[5] Specific responses were sorted by the type of perpetrator and then analyzed using frequency statistics and averages.[6]

The Results

The Perpetrators

While certain groups of individuals, based on their gender,[7] age[8] and marital status,[9] have been found to display a greater propensity to commit defalcations than others, successful instigators of fraudulent acts must have both opportunity and motive. Specifically, crimes of a financial nature are typically committed in areas in which the instigators possess knowledge obtained from their occupations. Thus, individuals holding jobs that encompass a wider range of organizational activities may be in a position to perpetrate more complicated (and costly) irregularities.[10]

Of the cases of fraud reported in this study, individuals occupying management positions within federal agencies initiated 14.9 percent (31 cases), other (nonmanagement) employees perpetrated 36.5 percent (76 cases), vendors instigated 22.1 percent (46 cases) and persons in collusion with one another were responsible for 26.5 percent (55 cases). Certain demographic characteristics emerged as significant when the classes of perpetrators were examined. These results are summarized in *Table 1*.

The profile of the typical perpetrator of fraud against federal agencies was that of a middle-aged, married, well-educated male. This profile was found to be overwhelmingly true in the cases of management, vendor and collusive fraud. Only nonmanagement perpetrators did not necessarily fit this mold. Though still a minority, females were most likely to be involved in lower-level employee schemes (47.2 percent were female versus 27.6 percent in management, 10 percent of the vendors and 8.9 percent of the collusive schemes). Greater numbers of the nonmanagement perpetrators also were unmarried, younger and less educated. These findings are probably congruent with the position each held in the victimized agency.

The ability of various perpetrators to conceal their irregularities is graphically demonstrated by disparity among dollar losses attributed to the four classes of perpetrators. Overall, schemes enacted by outside parties working alone or by groups operating in collusion with one another were four times more costly than fraud perpetrated by insiders acting alone (vendor median loss of $400,000 and collusion median loss of $500,000 versus management median loss of $97,200 and nonmanagement median loss of $45,000). Individuals who are outside the scope of organizational mechanisms designed to detect the presence of fraud, or who have the ability to manipulate such mechanisms, will be in a better position to conceal their fraudulent activities.

The Victims

By its very nature, fraud is deceptive. The perpetrator instigates his or her fraud when (s)he perceives that an opportunity exists to do so without negative repercussions. Thus, the victim of the fraud may exhibit characteristics that offer the perpetrator the ability not only to commit fraudulent activity, but also to conceal it.

Table 2 provides summary statistics pertaining to the federal organizations victimized by fraud. Several characteristics were identified: size, as evidenced by median budget and median number of employees; agency affiliation; and organizational climate, as captured by the presence of an internal audit department and the extent to which the victims displayed weaknesses in internal controls.

Irrespective of perpetrator, more of fraud occurred in the Department of Defense (DoD) than in any other agency (management 54.9 percent, nonmanagement 43.4 percent, vendor 52.2 percent and collusion 50.9 percent). Other than DoD, the agencies victimized varied. Management also targeted the State Department and the executive and congressional agencies (both 9.7 percent). Nonmanagement employees were more active in health/housing/human services (13.2 percent), the Internal Revenue Service (13.2 percent) and enforcement/justice (9.9 percent). Vendors additionally victimized health/housing/human services (8.7 percent). Collusive activities occurred in finance/banking (9.1 percent) and the IRS (7.3 percent). No agency, however, is immune to defalcations.

That the DoD appears to be the most frequent victim of fraud in the federal sector does not necessarily indicate a lack of effective control on the part of this particular agency. Rather, it may only reflect the relative size of this department, as well as the volume and nature of the business it undertakes. DoD is subject to monitoring and investigation from numerous sources, not only by its own internal auditors, but also by external entities, such as the Defense Contract Audit Agency (DCAA).

Median budgets of the victim agencies ranged from a low of $80 million when management instituted the schemes, to a high of $300 million when vendors were involved. The number of personnel employed by the victim agencies also varied widely. Victims of management fraud, with 500 employees, and vendor fraud, with 725 employees, were much less labor-intensive when compared to agencies victimized either by nonmanagement personnel or perpetrators working in collusion (2,000 and 3,350 employees, respectively).

Most agency victims maintained an on-site internal audit function. Nevertheless, such control measures were less likely to be present in those agencies where management or vendor defalcations occurred. Percentages ranged from lows of 64.5 percent (management fraud) and 69.6 percent (vendor frauds) to 80.3 percent (nonmanagement fraud) and 81.8 percent (collusion).

Although many federal agency victims maintained internal audit departments, practically all of the victims (ranging from 82.6 percent of the vendor frauds to 89.1 percent of collusion) were perceived, in hindsight, to exhibit internal control weaknesses. A wide variety of these weaknesses contributed to the successful perpetration of fraud. However, one played a particularly important role. When weaknesses were ranked on a scale of 1 (most important) to 7 (least important), lack of proper separation of duties was ranked as quite important in many irregularities instigated by management or nonmanagement employees working alone (2.59 and 2.81, respectively), and by individuals working in collusion to defraud the agency (2.94). Two additional weaknesses were prominent factors in certain frauds. The failure to require proper authorization for activities proved to be important in both management (2.68) and vendor frauds (2.27), while improper documentation led to numerous vendor irregularities (2.40).

TABLE 2

Characteristics of Victims

	Type of Perpetrator			
	Employee			
	Management	Other	Vendor	Collusion
Number of Cases	31	76	46	55
Type of Agency (% of cases):				
Aerospace/Defense	54.9	43.4	52.2	50.9
Financial/Banking	6.5	6.6	6.5	9.1
Health/Housing/Human Services	3.2	13.2	8.7	12.7
IRS	3.2	13.2	0.0	7.3
Enforcement/Justice	0.0	9.2	2.2	1.8
State Department	9.7	0.0	2.2	1.8
General Services	0.0	0.0	4.3	3.7
Transportation	3.2	0.0	0.0	1.8
Executive/Congress	9.7	0.0	0.0	0.0
Energy/Environment/Agriculture	3.2	5.2	2.2	0.0
Unknown	6.4	9.2	4.3	10.9
$ Budget (median, in millions)	80.0	135.6	300.0	125.0
# Employees (median)	500	2,000	725	3,350
Internal Audit Department (% of cases)	64.5	80.3	69.6	81.8
Internal Control Weaknesses (% of cases)	87.1	85.5	82.6	89.1
Ranking of Internal Control Weaknesses (1 = most important, 7 = least important)				
Proper Separation of Duties	2.59	2.81	2.50	2.94
Proper Authorization	2.68	3.13	2.27	3.36
Competent Personnel	4.17	4.52	3.25	3.92
Assets Safeguarded	3.60	4.32	5.00	5.36
Proper Documentation ***	3.94	3.33	2.40	4.30
Periodic Checks *	4.71	3.36	2.79	3.78
Lax Organizational Attitudes **	2.62	2.82	1.93	2.82

* significant at < .10   ** significant at < .05   *** significant at < .01

The problem of weak internal controls was often compounded because many organizations also exhibited a lax attitude toward the control structure that was in place. This was evaluated as very important in every perpetrator category. Some have suggested that this "tone at the top" may have inadvertently communicated to perpetrators of fraud that not only could existing internal controls be successfully circumvented, but also that weaknesses in the control structure could be exploited with low probabilities of raising serious organizational concerns. Lax attitudes toward rules and policies create an atmosphere that is conducive to all forms of defalcations.

Conclusions

This study describes the characteristics of 208 cases of fraud reported in agencies of the federal government along several dimensions, including the victim of the fraud, characteristics of its perpetrator, the fraud scheme, the investigation of the fraudulent activities and the outcome of the investigation. It is evident from Part I of this article that perpetrators were afforded different opportunities to defraud depending upon the relationship that each had with the victim organization. Regardless of the specific role played, however, poor organizational attitudes toward existing controls were found to strongly abet every type of fraud noted. When a proper separation of duties was lacking, organization personnel and outsiders were able to assume unintended authority. Part II will describe the manner in which the perpetrators took advantage of control weaknesses and poor organizational attitudes to successfully implement, conceal and sustain their acts of frauds. Details pertaining to the successful detection of ongoing fraud and subsequent resolution will also be provided.[11]

Watch for Fraud in the Federal Government: Part II—Characteristics of the Schemes, Their Detection and the Resolution of the Cases in the Summer 1997 issue of The Government Accountants Journal.

End Notes

1 *The Washington Post*, October 11, 1996, p. A23.

2 *The Washington Post*, June 6, 1996, p. B6.

3 Cressey, D R., *Other People's Money*, The Free Press, Glencoe, IL, 1953, p. 30.

4 A total of 2,673 instruments were completed and returned. After eliminating duplicates, incomplete questionnaires and non-defalcation frauds, a total of 2,475 independent observations remained.

5 Reported defalcations within the federal sector are representative both in terms of the national workforce and national resources. In 1994, 4.9 percent of the nation's workforce and 12.9 percent of the gross domestic product were associated with public administration.

6 When reported numbers were skewed, median rather than average statistics were used.

7 Hollinger, R. and J. Clark,"Deterrence in the Workplace: Perceived Certainty, Perceived Severity, and Employee Theft," *Social Forces*, December 1983, pp. 398-418; Daly, K.,"Gender and Varieties of White-Collar Crime," *Criminology*, 1989, pp. 769-793; Seidman, J.,"A Case Study of Employee Fraud" (Reprint of 1939 article.) *CPA Journal*, January 1990, pp. 28-35; Collins, J., and F. Schmidt,"Personality, Integrity, and White-Collar Crime: A Construct Validity Study," *Personnel Psychology*, 1993, pp. 295-311.

8 Weisburd, D., E. Waring, and S. Wheeler,"Class, Status, and the Punishment of White-Collar Criminals," *Law and Social Inquiry*, 1990, pp. 223-243; Collins and Schmidt 1993.

9 Seidman 1990; Weisburd, D., S. Wheeler, E. Waring, and N. Bode, *Crimes of the Middle Classes: White-Collar Offenders in the Federal Courts*, New Haven: Yale University Press, 1991.

10 Cohen, L., M. Felson, and K. Land,"Property Crime Rates in the United States: A Macrodynamic Analysis, 1947-1977: With Ex Ante Forecasts for the Mid-1980s," *American Journal of Sociology*, 1980, pp. 90-118; Maxfield, M.,"Lifestyle and Routine Activities of Crime," Journal of Quantitative Criminology, 1987, pp. 275-282.

11 The authors wish to thank the Association of Certified Fraud Examiners for its support of this study.