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# FIGHTING FRAUD IN THE GOVERNMENT

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Association of Certified Fraud Examiners

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## I. INTRODUCTION TO GOVERNMENT FRAUD

### Course Introduction

This workbook is divided into the following chapters:

- Introduction to Government Fraud
- Occupational Fraud by Government Employees
- Public Corruption
- Procurement Fraud
- Fraudulent False Claims and Statements
- Fraud in Government Social Programs
- Other Types of Government Fraud
- Measures to Prevent Government Fraud
- Using Data to Combat Government Fraud
- Protecting Sensitive and Classified Data
- Investigating Government Fraud
- Using the Internet to Improve Investigations

In this course, students will learn how to:

- Relate key information about why people commit fraud.
- Recognize the different ways government employees steal or misuse their employer's cash and noncash assets.
- Relate key information about the different types of public corruption schemes, identify red flags and risk factors of corruption, and compare the various laws and instruments designed to combat public corruption.
- Navigate the procurement process, identify the most common procurement fraud schemes, and deploy techniques to detect and prevent procurement fraud.
- Recognize the characteristics and common schemes of frauds involving material false statements and claims to government agencies.
- Demonstrate knowledge about the various types of frauds that target and challenge the integrity of government social programs designed to aid citizens.
- Identify common types of frauds that target agricultural subsidy programs, grant programs, and student financial aid programs and the preventive controls that might mitigate them.
- Differentiate between tax evasion and tax avoidance, recognize key characteristics of common tax evasion schemes, and assess the ways in which tax evasion can transcend national boundaries.
- Determine appropriate measures for identifying counterfeit and forged documents.
- Identify the basic elements of conspiracy schemes designed to defraud the government.
- Devise measures to prevent and detect the different types of fraud schemes that target government entities.

- Differentiate the various benefits and barriers to using data analytics to prevent and detect government fraud, demonstrate knowledge of the appropriate processes to apply when using data analytics, and identify the appropriate data analysis tools and techniques to use when targeting specific types of government fraud.
- Demonstrate knowledge about why sensitive and confidential information maintained by government entities must be protected, how it can be compromised, and the appropriate controls and actions needed to protect such information.
- Navigate through the stages of a government fraud examination from planning to conclusion.

### Overview of Government Fraud

Fraud costs trillions of dollars in worldwide damages each year, and government entities are among the most common victims. Government entities are victims of every conceivable kind of swindle, and everyone pays for these frauds in direct and indirect ways.

Government entities, however, are not defenseless. Indeed, there are many ways that government agents and members of the public can help prevent government fraud. But prevention starts with being well informed; the more individuals and government agents know about fraud, the less likely they are to be victimized.

### Definition of *Government Fraud*

*Black's Law Dictionary* defines *fraud* as:

*...all multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprise, trick, cunning, or dissembling, and any unfair way by which another is cheated.*

Essentially, all forms of cheating involving money or property are fraud. Although there are many kinds of fraud, this course focuses on fraud committed against the government.

*Government fraud* refers to intentional acts designed to deprive the government of funds by deception or other unfair means. Combating government fraud is an ongoing challenge and an essential component in keeping governments financially strong.

### The Impact and Significance of Government Fraud

Government is necessary for a civilized society, and government organizations provide great value to citizens. Fraud against government organizations, consequently, is harmful not only to the government, but also to taxpayers and beneficiaries of government programs. The cost of government fraud is difficult to measure for various reasons. For one thing, the clandestine nature of fraud makes it difficult

to measure in any situation. For another thing, not all government frauds are detected. Also, defrauded government organizations and programs are spread out among various government levels and agencies, making it difficult to compile and analyze relevant data into a single resource.

Consequently, there is no consensus on the actual extent of government fraud. Nevertheless, government fraud is a big, profitable business. The 2018 *Report to the Nations on Occupational Fraud and Abuse*, which is based on 2,690 cases of occupational fraud, provides that government entities, along with those in banking and financial services, public administration, and manufacturing industries, were the most represented sectors among the fraud cases analyzed.

Moreover, government fraud causes reputational harm. While reputational damage can affect any organization, virtually all government organizations are uniquely exposed to it because they depend on public funds to successfully operate. As a result, the public tends to view government organizations under heightened scrutiny when it comes to the management of assets.

**Video**



In the video clip titled “Chapter I: Importance of Government Fraud,” anti-fraud expert Lisa Duke, CFE, explains, in her own words, why government fraud is important. (Go to [\[redacted\]](#) to view the video.)

**The Public’s Perception of Government Organizations**

The public is often highly opinionated about government institutions and can hold perceptions that are not objective or ideal. Professionals at government entities must understand these perceptions and the effects they can have. The following are common public conceptions (for better or worse) that are important to consider when dealing with government fraud:

- Frauds against government organizations are frauds against the public.
- The government sector is rife with frauds.
- Government employees and officers should not be highly reimbursed.

**Factors Leading to Government Fraud**

There are many reasons why government entities are prime targets for fraud, including:

- Large amounts of government spending
- Major employer
- Lack of resources allocated to combat fraud
- Inadequate data sharing

### ***Government Spending***

Government entities deal with large amounts of money and engage in numerous transactions; therefore, their enormous size and complexity makes them prime targets of fraud. Governments spend trillions of dollars each year on a variety of programs. They acquire goods and services to satisfy the needs of their communities and create future benefits, and they make transfer payments without any exchange of goods or services. The U.S. federal government, for example, spends trillions of dollars each year on programs such as national defense and homeland security, Social Security, Medicare and Medicaid, anti-poverty programs, interest on the national debt, education, veterans' spending, unemployment benefits, and farm subsidies.

### ***Major Employer***

Occupational fraud is a universal problem for organizations around the world, and because governments employ millions of workers, they must install anti-fraud controls to reduce the likelihood and potential impact of fraud.

In the United States, for example, the federal government is the nation's largest employer, and approximately 15.6% of the workers in the United States are government workers.<sup>1</sup> The U.S. Department of Defense alone is the world's largest employer.<sup>2</sup>

### ***Lack of Resources Allocated to Combat Fraud***

Often, governments do not have sufficient resources to combat fraud. Government organizations are driven by *public policy*—the body of principles that tie a society together—and often, this approach can result in governments failing to allocate adequate resources for the prevention, detection, and investigation of fraud.

Moreover, in down economic times, governments might look for ways to cut costs, such as layoffs and hiring freezes, and taking such actions can create an environment with high potential for fraud.

According to the 2018 PwC Global Economic Survey, which surveyed 7,228 respondents from 123 territories and across a variety of industries, 54% of the responding organizations reported performing a general fraud risk assessment in the last two years. The numbers were even lower for targeted risk assessments. For example, only 33% of respondents reported conducting an anti-bribery and corruption

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1. Andy Kiersz, "The Percentage of Workers in Government is at a 54-Year Low," *Business Insider*, (Jan. 9, 2015), [www.businessinsider.com/government-worker-percentage-2015-1](http://www.businessinsider.com/government-worker-percentage-2015-1).

2. Ruth Alexander, "Which Is the World's Biggest Employer?" *BBC*, (March 20, 2012), [www.bbc.com/news/magazine-17429786](http://www.bbc.com/news/magazine-17429786).

assessment in the two years preceding the survey. Likewise, only 23% reported performing an anti-money laundering assessment.<sup>3</sup>

### ***Inadequate Data Sharing***

Often, government programs are run by different agencies that lack adequate channels to share information; such inadequacies hinder the identification of fraud and decrease the efficiency in which agents can respond to ongoing frauds.

## **Victims of Government Fraud**

Government fraud has many victims, including government authorities and their employees, taxpayers, and beneficiaries of government funds. Government fraud reduces the public funds that a government entity has available, and therefore, it can affect a government's spending power. Likewise, government fraud can result in a loss of public confidence, and it can cause reputational damage to government officials.

When a government's funds are reduced from fraud, taxpayers might experience a reduction of public services. Also, beneficiaries can lose access to necessary services and support.

## **Why People Commit Fraud**

To prevent fraud, fraud examiners must first understand why it occurs. However, there is no definitive answer as to why people commit fraud. Every human being is unique. Everyone's chemical makeup is different, and everyone has different personal experiences. Accordingly, people act differently in similar situations.

Although there is no clear answer as to why people commit fraud, research and experience have provided some insight into the matter, and the following material describes the most common theories explaining why people commit fraud.

### ***The Fraud Triangle***

The best and most widely accepted model for why people commit fraud is the Fraud Triangle. This is a model developed by Dr. Donald Cressey, a criminologist whose research focused on embezzlers—people he called “trust violators.” According to Cressey, three factors must be present at the same time for an ordinary person to commit fraud:

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3. PricewaterhouseCoopers LLP, “Global Economic Crime and Fraud Survey 2018,” [www.pwc.com/gx/en/forensics/global-economic-crime-and-fraud-survey-2018.pdf/global-economic-crime-and-fraud-survey-2018.pdf](http://www.pwc.com/gx/en/forensics/global-economic-crime-and-fraud-survey-2018.pdf/global-economic-crime-and-fraud-survey-2018.pdf).

- Pressure
- Perceived opportunity
- Rationalization



### Video



In the video clip titled “Chapter I: Fraud Triangle,” anti-fraud expert Gerry Zack, CFE, CPA, ACFE Fellow, discusses the importance of keeping focus on all three elements of the Fraud Triangle in combating fraud. (Go to [\[REDACTED\]](#) to view the video.)

### **PRESSURE (NON-SHAREABLE FINANCIAL PROBLEMS)**

The first leg of the Fraud Triangle represents *pressure*—what motivates the crime in the first place. The individual has some financial problem that they are unable to solve through legitimate means, so they begin to consider committing an illegal act to solve their problem. The financial problem can be personal (e.g., they are too deep in personal debt) or professional (e.g., their job or business is in jeopardy).

Examples of pressures that commonly lead to fraud include:

- Living beyond one’s means
- High bills or personal debt
- Personal financial losses
- Family or peer pressure
- Unexpected financial needs
- Substance abuse or addictions
- Need to meet earnings to sustain investor confidence
- Need to meet productivity targets at work

### PERCEIVED OPPORTUNITY

The second leg of the Fraud Triangle is *perceived opportunity*, which is the method by which the crime can be committed. The person must see some way they can abuse their position of trust to solve their financial problem with a low perceived risk of getting caught.

According to the Fraud Triangle model, the presence of a non-shareable financial problem by itself will not lead an employee to commit fraud. The non-shareable financial problem creates the motive for the crime to be committed, but the employee must also perceive that they have an opportunity to commit it without being caught. The perceived opportunity can arise from several sources, including:

- Poor internal controls
- Poor training
- Poor supervision
- Lack of prosecution of perpetrators
- Ineffective anti-fraud programs, policies, and procedures
- Weak ethical culture (e.g., poor tone at the top)

Thus, the person must see some way they can abuse their position of trust with a low perceived risk of being caught. For example, if an employee has access to blank checks, he might see an opportunity to write a company check payable to himself. But that check might be spotted during the reconciliation of the bank statement and the employee would be caught. Under such facts, there is an opportunity to steal the funds, but there is no opportunity to steal them without being caught. Conversely, suppose the same employee also reconciles the company's bank statement. Under these revised facts, the employee can write a check to himself, destroy the fraudulent check when the bank statement arrives, and force the balance on the reconciliation. Under such facts, the employee has a perceived opportunity to commit fraud.

### RATIONALIZATION

The third leg of the Fraud Triangle is rationalization. Fraudsters must justify their crime to themselves in a way that makes it an acceptable act, and this is known as *rationalization*. Rationalization must occur before the crime takes place; it is not a means of justifying a fraud after the fact.

Fraudsters rationalize their misconduct in various ways. Here is a list of common excuses fraudsters give to explain their corrupt conduct:

- Everyone else does it.
- We have always done it.
- It was the only way we could compete.
- We had no idea our agent was...
- We thought our anti-corruption programs were sufficient.
- We did not know the conduct would be considered a bribe.

- It was not a bribe; it was part of conducting business.
- Bribery is part of the culture in the country.

### Video



Diann Cattani, a former employee at a small human-resources consulting firm, embezzled \$500,000 in four years through an expense reimbursement fraud scheme. She pleaded guilty to charges of mail fraud for which she spent 18 months in prison. In the video clip titled “Chapter I: How Fraud Starts,” Cattani explains how she initially got involved in fraud. (Go to [\[redacted\]](#) to view the video.)

### ***When Does the Fraud Triangle Not Apply?***

The Fraud Triangle applies to most embezzlers and occupational fraudsters, but it does not apply to *predatory employees*—individuals who take jobs with a premeditated intent of stealing from employers.

Also, while a rationalization is necessary for most people to begin committing fraud, perpetrators often abandon rationalizations after the initial act. Most frauds are not one-time events. They usually start as small thefts or misstatements and gradually increase in size and frequency. As the perpetrator repeats the act, it becomes easier to justify until eventually no justification is needed at all.

### ***The Fraud Diamond***

Cressey’s Fraud Triangle demonstrates certain characteristics that increase the likelihood for fraud to occur, but it does not provide perfect guidance. Although the Fraud Triangle helps explain the nature of many occupational offenders, it does not explain the nature of all occupational offenders. Moreover, Cressey’s study is nearly half a century old, and there has been considerable social change in the interim. Now many anti-fraud professionals believe there is a new breed of occupational offender—one who lacks a conscience sufficient to overcome temptation.

Moreover, some experts believe that the fraud triangle could be enhanced by considering a fourth element. In their article “The Fraud Diamond: Considering the Four Elements of Fraud,” David Wolfe and Dana Hermanson incorporated the element of *capability*—personal traits and abilities that play a major role in whether fraud will actually occur—into Cressey’s model, transforming it from a triangle into a diamond. (See the following diagram.)



According to Wolfe and Hermanson, many frauds would not have occurred without the right person with the right ability to carry out the fraud. “Opportunity opens the doorway to fraud, and incentive and rationalization can draw the person toward it. But the person must have the capability to recognize the open doorway as an opportunity and to take advantage of it by walking through, not just once, but time and time again. Accordingly, the critical question is, ‘Who could turn an opportunity for fraud into reality?’”<sup>4</sup>

Wolfe and Hermanson state that there are observable traits for committing fraud, especially those that involve large sums of money or last a long time. These traits are:

- The person’s position or function might provide the ability to create or exploit an opportunity to commit fraud.
- The person has the capacity to exploit control weaknesses.
- The person is confident that they will not be caught or believes that, if they are caught, they can talk their way out of trouble.
- The person is persuasive and can coerce others to commit or conceal fraud.
- The person is a good liar.
- The person is good at dealing with the stress that comes from committing fraudulent acts.

### ***Workplace Conditions***

In 1983, Richard C. Hollinger and John P. Clark published *Theft by Employees*,<sup>5</sup> a study based on federally funded research involving surveys of nearly 10,000 U.S. workers. In their book, Hollinger and Clark reached a different conclusion than Cressey. They concluded that employees steal primarily because of

4. David T. Wolfe and Dana R. Hermanson, “The Fraud Diamond: Considering the Four Elements of Fraud,” *The CPA Journal*, 74, (December 2004).

5. Richard C. Hollinger and John P. Clark, *Theft by Employees*, (LexingtonBooks, 1983).

workplace conditions and job dissatisfaction, and that the true costs of the problem are vastly understated: “In sum, when we take into consideration the incalculable social costs ... the grand total paid for theft in the workplace is no doubt grossly underestimated by the available financial estimates.”

In short, Hollinger and Clark proposed that fraud prevention requires that management pay attention to the following four aspects of workplace conditions:

- Having a clear understanding regarding theft behavior
- Continuously disseminating positive information reflecting the organization’s policies
- Enforcing sanctions
- Publicizing sanctions

Additionally, Dr. Steve Albrecht and two of his colleagues, Keith R. Howe and Marshall B. Romney, conducted research that identified ten environment factors that result in fraud:

- Placing too much trust in key employees
- Lack of proper procedures for authorization of transactions
- Inadequate disclosures of personal investments and incomes
- No separation of authorization of transactions from the custody of related assets
- Lack of independent checks on performance
- Inadequate attention to details
- No separation of custody of assets from the accounting for those assets
- No separation of duties among accounting functions
- Lack of clear lines of authority and responsibility
- Department that is not frequently reviewed by internal auditors

All of the factors in this list affect employees’ opportunities to commit fraud without being caught.

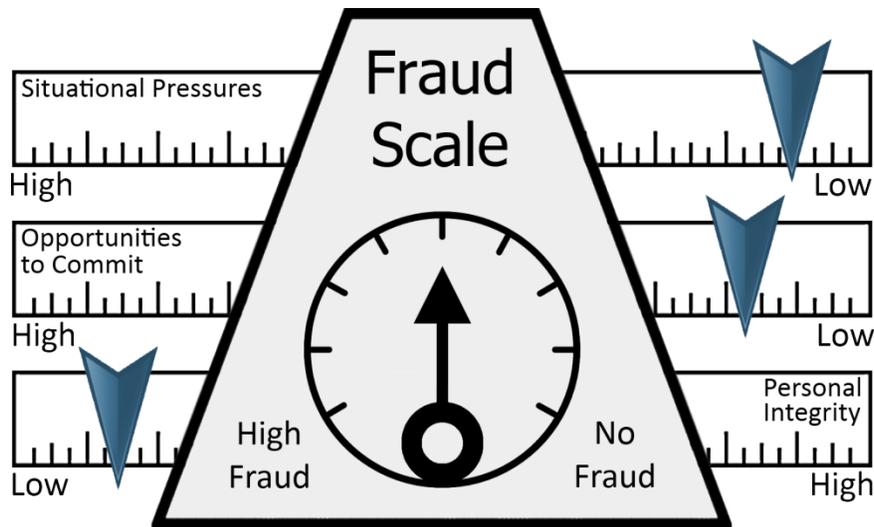
### ***The Fraud Scale***

To help predict the likelihood of a fraudulent act, Albrecht, Howe, and Romney created the Fraud Scale to be a tool to assess the likelihood of a fraudulent act through the evaluation of the relative forces of pressure, opportunity, and personal integrity.

The Fraud Scale suggests that when pressure, opportunity, and integrity are considered at the same time, one can determine whether a situation possesses a higher probability of fraud.

In addition, the Fraud Scale provides that when situational pressures and perceived opportunities are high and personal integrity is low, occupational fraud is much more likely to occur than when the opposite is true. Albrecht describes situational pressures as “the immediate problems individuals

experience within their environments, the most overwhelming of which are probably high personal debts or financial losses.”<sup>6</sup>



**Government and Public Administration Fraud Cases by Type**

The following table shows the most frequent types of fraud schemes within government and public administration.

SCHEME	PERCENT OF CASES*
Corruption	50%
Billing	15%
Expense reimbursements	11%
Noncash	22%
Skimming	11%
Payroll	7%
Cash on hand	11%
Check and payment tampering	9%
Cash larceny	11%
Financial statement fraud	5%
Register disbursements	2%

SOURCE: Report to the Nations on Occupational Fraud and Abuse: 2018 Global Fraud Study by the Association of Certified Fraud Examiners.  
 \* The sum of percentages in this table exceeds 100% because several cases involved schemes from more than one category.

6. Ibid, p. 5.

### Who Commits Government Fraud?

It helps to break down and understand the categories of government fraudsters as a foundation for delving deeper into their respective motivations. This discussion divides the perpetrators of government fraud into the following categories:

- Executive officers
- Managers
- Employees
- Contractors
- Beneficiaries
- External perpetrators

#### *Executive Officers*

For the purposes of this course, the term *executive officers* refers to individuals who manage a government agency or departments of government agencies; they can be elected or appointed. For example, in a typical city government in the United States, the mayor and city controller are executive officers. The mayor serves as the city's executive officer, and the city controller serves as the city's chief financial officer (CFO).

According to the ACFE's 2018 *Report to the Nations on Occupational Fraud and Abuse*, owners and executives are responsible for 19% of all reported fraud cases. Additionally, because these high-level individuals are generally better equipped to circumvent anti-fraud controls, their schemes result in the highest median losses and tend to be the most difficult to detect.

Executives might commit fraud for several reasons, such as to improve the appearance of their entities. Typically, executives have the ultimate responsibility for the success or failure of their agency or department, and they often serve as role models and authority figures. They face significant pressure to ensure organizational success, meet budgets and targets, and keep their jobs. Accordingly, they want to see their agencies or departments succeed, and such desires might drive them to commit fraud to conceal losses or poor performance. Some executives commit fraud because they consider it to be the only way out of a bad situation.

Moreover, to become an executive, an individual generally must be ambitious and dedicated. Thus, individuals in these roles are driven and often seek respect, social status, accomplishment, and even power. Sometimes, however, the drive to obtain such benefits can overshadow a person's ethics and cloud their ability to make sound moral decisions.

Additionally, executives have authority over systems that they can exploit for fraudulent purposes. If an executive who is responsible for ensuring that a government organization meets its budgets and targets

also has the authority and ability to influence lower-level staff, as well as access to the organization's information systems and records, the executive has the ability and motivation to commit fraud.

Executives in a government organization might also use their influence over lower-level staff to perpetrate fraud. They might pressure employees with threats of being fired, provide an environment that encourages unethical practices, or offer financial incentives to employees to engage in fraud.

EXAMPLE

*A government organization experienced a multimillion-dollar fraud when five executive-level employees colluded to form a shell company. Each month, the organization's chief information officer (CIO) prepared and hand-delivered an invoice for consulting services to the accounts payable clerk and told her that it should be paid immediately. The CIO had signed the invoice himself as an approver, and because it was greater than \$100,000, he obtained the signature of the chief operating officer (COO) as well. The accounts payable clerk paid the invoices without asking any questions because she did not want to be disrespectful toward her superiors.*

Schemes such as the one in the example might occur if executives develop a feeling of entitlement due to the nature and status of their roles. Such feelings can also serve as a rationalization for committing fraud.

Additionally, there is a strong correlation between the perpetrator's position and the losses caused by fraud. According to the 2018 *Report to the Nations on Occupational Fraud and Abuse*, occupational fraud schemes committed by executives caused losses greater than those caused by managers, and schemes committed by managers caused losses greater than those caused by employees.

### ***Managers***

In this course, the term *managers* refers to employees who both supervise employees and report to other employees within a government organization. These individuals are expected to follow and lead at the same time. Like executives, managers often face pressure to meet budgets and targets, which might prompt them to use unethical means to achieve their goals.

According to the ACFE's 2018 *Report to the Nations*, managers are responsible for 34% of all reported fraud cases. Their frauds result in the second highest median loss amount.

The types of frauds perpetrated by managers depend largely on which departments they work in. For example, accounting managers might be able to perpetrate accounting-related frauds, such as manipulating journal entries or perpetrating shell company schemes. Accounting managers also might have the ability to submit falsified expense reports, falsify timesheets, or influence supplier or contract decisions in exchange for bribes or kickbacks.

### EXAMPLE

*A mid-level manager in the Defense Department, Antonio Decker, pleaded guilty to accepting kickbacks totaling more than \$1 million from six government suppliers. Decker used his position to obtain confidential information that he transmitted to the suppliers, which enabled them to negotiate favorable contracts with the government. In return, the suppliers and manufacturers paid Decker kickbacks.*

Similarly, managers in procurement might exploit their position for financial gain.

### EXAMPLE

*In 2014, the self-proclaimed “Godfather of Camp Pendleton,” a U.S. Department of Defense employee who supervised the base’s construction and service contracts, pleaded guilty to charges involving bribery related to the awarding of construction and service contracts.*

*Natividad Cervantes used his position to solicit bribes from construction companies seeking to do business on the base, according to government documents. Cervantes asked for and accepted bribes in exchange for favorable treatment in awarding contracts to government contractors.*

### **Employees**

For this course, *employees* refer to individuals within an organization who do not have management authority. There are various reasons why employees might commit fraud, but because employees do not have the same access to financial records as management and executives, the types of fraud and the magnitude of the losses that employees can cause are limited.

According to CFEs surveyed for the *Report to the Nations*, occupational frauds are most often committed by individuals at the employee or managerial level. There are likely many factors behind this: It might be a function of probability and organizational structure—in general, there are more workers at those levels—or it might indicate that lower-level employees and managers face greater risk factors, such as financial stress or job dissatisfaction, than owners and executives.

### **Contractors**

All government entities rely on third-party contractors to deliver goods and services, and such entities can commit government fraud. Because government entities are some of the largest buyers of goods and services, they engage in vast numbers of contracts with third parties, which exposes them to fraud risks. Government fraud related to contracting often involves bribery or kickbacks, shell company schemes, bid rigging, market division schemes, and bid tailoring.

### ***Beneficiaries***

Government beneficiaries—entities that receive government benefits—can also commit government fraud. Beneficiaries might use fraudulent means to acquire benefits that they do not deserve. Often, opportunity and need motivate beneficiaries to commit fraud.

### ***External Perpetrators***

External perpetrators are parties who commit fraud against an organization that does not employ them and does not provide them with benefits. As with other types of perpetrators, external perpetrators have an array of reasons for committing fraud. Many external perpetrators make a career out of defrauding others, such as fraudsters who are part of organized crime rings. Others are motivated by the same pressures as internal fraudsters.

#### EXAMPLE

*Alissa, Mary, and Robert are siblings who work for competing software-implementation consulting firms. Their firms received requests for proposals (RFPs)—solicitation documents used to obtain proposals from prospective contractors and price quotes for implementing their proposed solutions—to provide services for three local government agencies. The siblings agreed to allow each of their firms to be the lowest bidder for one of the RFPs.*

### **Types of Government Fraud**

Although fraud against the government can take many forms, it is beyond the scope of this course to address every type. Instead, this workbook focuses on the most significant types of government fraud, including:

- Occupational fraud by government employees
- Public corruption
- Procurement fraud
- False claims and statements
- Fraud in government social programs
- Agricultural subsidies fraud
- Tax evasion
- Counterfeit and forged documents
- Conspiracy to defraud the government
- Grant fraud
- Student financial aid fraud