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Using the Fraud Triangle to mitigate escalating compliance risk

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For thousands of years fraud has been a risk that we all face. Never has this been truer than in these challenging business times. So how should we face this risk? One framework that can be explored is the Fraud Triangle, which provides us with defences to not only address fraud risk head on but also broader compliance risks.

The first recorded incident of fraud dates to around 300 BC when a Greek merchant called Hegestratos[1] took out a large insurance policy known as bottomry; that is, he borrowed money and agreed to pay it back with interest when his cargo of corn was delivered, but if he refused to pay back the loan, the lender could claim the cargo and the boat used for its transportation. The facts though were not quite as they seemed: The hold of the ship was empty. Hegestratos planned to sink the vessel, make it back to the shore on a raft, and pocket the value of the boat and the nonexistent corn. This plan failed, however, when he drowned trying to escape his crew and passengers, who had discovered his secret. This is the first recorded incident of fraud, but it's safe to assume that the practice has been around since the dawn of commerce.

Since the first report, corrupt business practices have been prevalent, ebbing and flowing but generally increasing in times of crisis. Following the 2008/2009 financial crisis, both corporate and occupational fraud cases rose significantly. In January 2011, the BBC ran a report[2] covering research completed in 2010 by KPMG that showed that the number of financial fraud cases put before the UK's courts had reached record levels with 314 alleged major fraud cases involving suspected losses of £1.4 billion. The KPMG Fraud Barometer found 42.5% of all cases—higher than those targeting financial services—were leveled at the public purse. They totaled £593 million. This was up nearly 20% from 59 instances in 2009 to 70 in 2010.

So it should be no surprise that many are saying the same phenomenon is happening now. Take an April 2020 article from *The Economist*,[3] for example, that ran the headline: "The economic crisis will expose a decade's worth of corporate fraud." In times of economic crisis, there are always parties who will look to exploit the situation for their own advantage, and a significant increase in fraudulent activity due to COVID-19 is anticipated. This might be through misusing government support packages or misreporting business performance to avoid contract breaches.

When the three points of the Fraud Triangle—Pressure, Opportunity, and Rationalization—come together, the prevalence for fraud increases and the risk of losing trust is heightened. This concept was first put forward in an article[4] by Donald R. Cressey and Edwin Sutherland and later coined by Steve Albrecht. Over history, these drivers have remained the same; though simple and unsurprising, they have prevailed. It is also important to consider the factors from a broader compliance perspective, as the triangle applies to many actions that affect the integrity and trust of an organization. These actions may be by an employee against the company (e.g., benefiting from creating ghost employees on the payroll or skimming cash before it is recorded) or by third parties submitting bogus invoices for personal protective equipment, or it might be an employee wanting to help their company and deliberately misreporting performance so the company can gain a performance bonus.