

Fraud Triangle Part 3: Rationalization

FRAUD PREVENTION ALERT

WHY ARE WE ISSUING THIS ALERT?

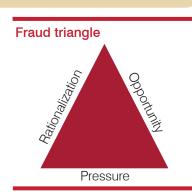
As discussed in the prior Fraud Prevention Alerts— Fraud Triangle Part I: Opportunity and Fraud Triangle Part II: Pressure, there are three elements that are present when an individual commits fraud: opportunity, pressure, and rationalization.1 Public officials can help prevent fraud by diminishing any one of the triangle's three elements and, ideally, taking steps to diminish all three elements. This alert, the last in a three-part series, will focus on the rationalization element and outline how public officials can minimize an employee's rationalization to commit fraud by establishing a strong ethical climate.

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Using the fraud triangle model to help prevent fraud

In understanding the fraud triangle's rationalization element, it is important to first understand that individuals who commit fraud must justify the act to themselves in a way that makes it acceptable or defensible. These individuals may justify a theft as, "I was only borrowing these monies, and I intended to pay them back later." In addition, individuals may believe they deserved the monies and justify it as, "I was underpaid and I deserved this additional money as compensation for my work." Others may justify a theft as a good deed to help themselves, a family



member, or loved one through a difficult situation. Rationalization can take on many forms and can evolve throughout the individual's fraud scheme.

Public officials, including an entity's management, have little control over the fraud triangle's rationalization element because it is reliant on the individual's mindset. However, there are ways that public officials can minimize an individual's justification to commit fraud by establishing a strong ethical climate that holds employees accountable, communicating what is expected from them, and enforcing integrity standards.

Public officials can minimize an employee's rationalization to commit fraud

Public officials can establish a strong ethical climate to minimize an employee's rationalization to commit fraud by:

- Creating a code of ethics that communicates to employees what is expected of them, including a statement that public monies cannot be taken, borrowed, or loaned. Additionally, this code of ethics should relay a zero tolerance for fraud, wherein an entity outlines its intent to report all fraudulent activity to the appropriate authorities, including our Office.
- Requiring employees to acknowledge their roles as stewards of public monies, including their fiduciary responsibility to protect public monies by only expending them for public purposes.
- Setting a tone at the top where an entity's management leads by example and follows established ethical and integrity standards.
- Establishing policies that promote good internal controls and ensuring these policies are continually followed.
- Cultivating a strong whistleblower system where employees feel safe to report policy, ethical, and legal violations.
- Performing adequate background checks and hiring competent employees.

See Office of the Auditor General, Fraud Prevention Alerts: Fraud Triangle Part I: Opportunity, May 2015, Report No. 15-403; and Fraud Triangle Part II: Pressure, November 2015, Report No. 15-405.



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The Auditor General's fraud prevention alerts are available at:

www.azauditor.gov

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