

# Does Canada Have a Problem with Occupational Fraud?

By the Certified General  
Accountants Association of Canada



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## Foreword

Many of us have at one time or another been curiously drawn to the subject of occupational fraud. Whether observed in our own work environments or exposed through broader media, we often find ourselves perplexed by the apparent ease with which an otherwise responsible organization can be financially violated by its own agents or employees. The simple fact of the matter of it is that we generally have confidence in the folks that work shoulder to shoulder in achieving the wellbeing of a collective venture. And that is received as a positive condition.

As history has shown us, there can however be the occasional breach or abuse of the confidence placed in people. That is not to say that all individuals are necessarily capable or willing to resort to occupational fraud; but rather that businesses need be mindful of the prospect of occupational fraud and of the relative unpredictability of the potential or eventual aggressor.

Recognizing that individual occupational frauds are more often than not dwarfed by larger more discernable frauds and scandals, The Certified General Accountants Association of Canada (CGA-Canada) considers it timely to direct some attention to the inherent opportunity for occupational fraud within the domestic environment. Moreover, it is conceivable that in the current economic landscape of slow growth and deleveraging, the propensity for occupational fraud may in fact intensify.

As the following pages corroborate, we are pleased that there is relatively little alarm with Canada's exposure to occupational fraud. That said we can conservatively estimate that \$3.2 billion is lost to Canadian businesses annually from occupational fraud alone. These findings are based on data compiled from our random national survey sample of 802 companies having fewer than 500 employees; considered to be adequately representative of the sector. And as acknowledged by our survey participants, there is room for improvement within individual companies and within the aggregate SME sector.

While we have undoubtedly all heard the anecdotal tales of occupational fraud, there is little comprehensive and conclusive reference that empirically measures the frequency, intensity, severity, and impact of occupational fraud. As such, this paper intends to contextualize the Canadian experience and to impart some best practice for consideration by those having an active interest in the

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comprehension of fraud, the economic impact of fraud, or in the more technical dimensions of prevention, deterrence, and detection of occupational fraud.

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# Executive Summary

# 1

Small and medium-sized enterprises (SMEs) form a very important segment of the Canadian economy constituting the majority of business establishments and contributing more than half of business-sector GDP. Despite the importance of SMEs as a collective force, the visibility and economic power of small businesses suffer due to their size and frequent turnover. When it comes to the issue of businesses being subject to fraud, the moderate visibility of SMEs only contributes to the challenge of assessing the real scope of the problem. Two other challenges – focusing on a specific type of fraud in SMEs and gathering information about fraudulent activities – further impede our ability to understand whether or not fraud presents an acute threat to SMEs and whether concomitant elevated attention should be accorded.

Given the highly uncertain and unstable economic outlook, our limited knowledge regarding the true scale of fraud victimization of SMEs is particularly worrisome as deterioration in the economic situation may further exacerbate the risk of fraud. Recognizing the outlined challenges and limitations, CGA-Canada saw it timely to investigate the level of vulnerability of Canada’s largest segment of businesses – SMEs – to fraud. For that purpose, CGA-Canada commissioned a survey seeking to examine the prevalence and types of occupational fraud experienced by SMEs and to gather information on prevention and detection methods used by SMEs to safeguard against occupational fraud. Occupational fraud was chosen as the focus of the analysis as the presence and the size of the workforce are the two elements most common to all SMEs. As the following pages reveal, it can be reasonably contended that:

*A substantial number of different types of occupational fraud exist.*

Although occupational fraud is only one among many types of fraud to which SMEs are exposed, the taxonomy of occupational fraud is vast and includes more than 50 distinctive types of deception. However, the notion of occupational fraud should not be confused with the notion of “white-collar crime” as the latter may or may not involve the misuse of the employing organization’s resources. The profile of a typical white-collar perpetrator is also noticeably different from that of a perpetrator committing occupational fraud.

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*The majority of SMEs are not prepared to respond to occupational fraud, and more than half do not undertake periodic assessments of risks of fraud.* Only one fifth (20%) of all surveyed SMEs have a Fraud Response Plan while the overwhelming majority (80%) do not. Some 59% of the surveyed SMEs do not undertake periodic assessments of the risks of occupational fraud, and companies that experienced fraud in the last fiscal year are not more likely to engage in this activity. However, SMEs victimized by fraud tend to make some adjustments as a result of fraud victimization: the majority (57%) of them revise disciplinary actions to be administered in case of fraud while 2 in 5 victim companies modify protocols for hiring and retaining employees, and adjust policies and channels for reporting employees' concerns about fraud.

*A large proportion of SMEs believe the risk of occupational fraud is low; however, 1 in 4 SMEs experienced incidents of occupational fraud in the last fiscal year.* Only 5% of SMEs believe that occupational fraud poses a high risk for them while the majority (74%) believe that their exposure is low. Moreover, one quarter (26%) of surveyed SMEs do not see themselves as susceptible to any particular type of occupational fraud. However, one quarter (26%) of SMEs report to have experienced at least one incident of occupational fraud in the past fiscal year. This translates into an estimated 290,000 Canadian SMEs victimized by occupational fraud in 2010. The most often cited type of occupational fraud experienced by SMEs relates to misappropriation of inventory or assets; followed by misappropriation of cash; and misrepresentation of employment credentials, internal or external documents. Reoccurrence of fraud is common: at least one fifth of SMEs that experienced misappropriation of cash, inventory or assets confirmed that those types of fraud occurred four or more times in their respective companies in the last fiscal year.

*The awareness of risks and implications of occupational fraud improves among SMEs that experienced incidents of fraud.* SMEs that encountered at least one incident of occupational fraud in the last fiscal year are more than twice as likely to gauge the risk of occupational fraud as either high or moderate compared to companies that did not experience fraud incidents. Victimized SMEs are also much more likely to assess their companies as susceptible to any given type of occupational fraud, agree that they need improvements in fraud prevention and detection measures, and have a Fraud Response Plan. However, previous victimization of an SME by way of occupational fraud does not seem to improve the SME's propensity to use fraud prevention and detection measures.

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***Financial losses incurred by individual SMEs due to occupational fraud are not large; however, non-monetary negative consequences of fraud are reported by many.*** For more than half (55%) of the reporting SMEs, financial losses experienced due to occupational fraud do not exceed \$1,000; for another 26% of reporting companies, losses range between \$1,000 and \$5,000. Meanwhile, less than 1% of SMEs report being victimized by an occupational fraud event exceeding \$200,000. In turn, 61% of victim companies gauge that fraudulent activities negatively affect the morale of their employees; at least one fifth agree that a company's business relationships, reputation, value, and public and client trust suffered as a result of fraud.

***Nearly all SMEs utilize occupational fraud prevention measures; in turn, 1 in 10 companies does not have any fraud detection measures in place.*** The two most commonly used techniques of occupational fraud prevention include clear and uniform accounting procedures, and frequent financial reviews and/or reconciliations: 4 in 5 of surveyed SMEs utilize these measures. Reliance on a wide range of measures is common: 49% of SMEs have six or more fraud prevention measures in place. When it comes to fraud detection, 11% of SMEs do not incorporate any particular fraud detection techniques in their business activities. Among SMEs that use at least one fraud detection measure, 69% rely on a system of monitoring and safeguarding assets; whereas 59% and 49% rely on internal and/or external auditors respectively to detect fraud. Unlike prevention measures, the use of multiple fraud detection measures is not very common: 52% of SMEs utilize three or less fraud detection measures at a time. The majority of SMEs (60%) do not think that a significant improvement in occupational fraud prevention and/or detection is needed in their company.

***SMEs' experiences with, and attitude toward occupational fraud varies with company characteristics.*** Larger SMEs (those generating more than \$5 million in annual revenues or employing between 20 and 499 employees) have higher awareness of the risk of occupational fraud, but are also more likely to be victimized by fraud and experience larger financial losses when compared to smaller SMEs. Likewise, larger SMEs show higher propensity to conduct periodic assessment of risks of occupational fraud, use fraud prevention and detection techniques, and be equipped with a Fraud Response Plan. The SME's industry affiliation is also important. Companies operating in service-producing industries for example are less likely to conduct periodic assessment of fraud risks, but tend to experience higher financial losses from occupational fraud when compared to SMEs in goods-producing industries.

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*Noticeable regional differences are likewise observed.* Reporting companies located in Québec are less likely to experience occupational fraud: only 16% of Québec SMEs encountered incidents of occupational fraud in the last fiscal year; in Ontario and British Columbia this proportion is almost twice higher (31% and 37% respectively), whereas Canada averages at 26%. Québec SMEs are also consistently less likely to use fraud prevention and detection measures compared to Canada overall; however they more often agreed that a significant improvement in the area of occupational fraud prevention is needed. A number of other provincial variations also exist; however, with no particular pattern.

*Very few sources provide information on the presence and prevalence of occupational fraud in Canadian business, and none of them are comprehensive.* Statistics Canada's Survey of Fraud against Businesses – the only source of official statistics on business fraud in Canada – is focused on a narrow set of industries and provides very few details regarding occupational fraud. Private sources of information on incidents of occupational fraud are primarily limited to a few studies offered by the Association of Certified Fraud Examiners (ACFE) and PricewaterhouseCoopers. However, these sources are either focused on characteristics of the fraud and its perpetrators without addressing the issue of fraud prevalence, or touch upon it but only briefly. In addition to the scarcity of information on incidences of occupational fraud in Canada, the existing sources do not provide a consistent picture.

Based on these findings, it is reasonable to espouse the following four conclusions. First, SMEs are not highly concerned with issues related to occupational fraud; the lack of first-hand experience with occupational fraud may be a contributing factor. Second, the magnitude of financial losses incurred by SMEs resulting from occupational fraud suggests that this type of fraud does not present a significant problem for the SME sector; however such an inference may benefit from additional consideration. Third, a multi-faceted information gap regarding the presence and impact of occupational fraud on SMEs continues to exist. And lastly, room for improvement on issues of occupational fraud exists for businesses.

Small and medium-sized enterprises (SMEs) form a highly important segment of the Canadian economy. They account for some 1.14 million business entities or 99.7%<sup>1</sup> of all businesses with employees located in Canada. Likewise, SMEs contribute significantly to the Canadian labour force: some 6.8 million Canadians are employed by SMEs accounting for 63.9% of all private sector employees and nearly half (47.3%) of all those employed in Canada.<sup>2</sup> SMEs are particularly important in such industries as construction, accommodation and food, forestry, and non-institutional health care where they provide 4 out of 5 jobs. Not less impressive is the contribution of small business to the economy itself: SMEs produce more than half (54.2%) of Canada's business-sector GDP.<sup>3</sup>

SMEs form a highly important segment of the Canadian economy, but visibility of individual SMEs suffers due to their size and frequent turnover

Beyond the economic statistics, the importance of the SME sector is often linked to its critical role as a backbone of local communities as they have a unique ability to meet special market needs and interests that may be overlooked by larger businesses. Although SMEs enter and exit the market much more frequently than their larger counterparts, such a turnover is often seen as a conduit that introduces new and innovative products and processes into the economy, and as a channel that facilitates greater labour mobility through job creation.

Despite the importance of SMEs as a collective force, the visibility and economic power of individual business establishments suffer due to their size and frequent turnover. It is quite seldom that SMEs can promote their name and brand by engaging in extensive advertising campaigns or sponsoring public events to the same extent as their larger listed counterparts. Very few SMEs are listed on stock exchanges and publicly traded; as such, their wellbeing is not of equal interest to the larger audience of potential investors and financial analysts. Likewise, the relatively small size of a particular SME seldom places it in a position of a newsmaker outside of its local community in terms of recruitment, layoffs, closures, or other hardships that businesses may encounter in their day-to-day dealings. Moreover, one half of SMEs do not survive in the marketplace for more than 5 years.<sup>4</sup>

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1 Industry Canada (2011). *Key Small Business Statistics*, p. 7.

2 Industry Canada (2011). *Key Small Business Statistics*, p. 19, and CANSIM Table 282-0011. The numbers presented exclude the following industries: agriculture, fishing and trapping, private household services, religious organizations and military personnel of defence services.

3 Leung, D. and Rispoli, L. (2011). *The Contribution of Small and Medium-sized Businesses to Gross Domestic Product: A Canada-United States Comparison*, Statistics Canada, Catalogue no. 11F0027M – No. 070.

4 Industry Canada (2011). *Key Small Business Statistics*, p. 14.

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## Subdued visibility of SMEs contributes to the challenge of assessing the real scope of SMEs fraud victimization

When it comes to the issue of businesses being victims of fraud – whether committed by external perpetrators or by employees – the subdued visibility of SMEs only further contributes to the challenge of assessing the real scope of the problem. A fraudulent activity that victimized an SME is rarely a subject of the news headlines unless the scheme affected hundreds of businesses and the monetary value of the damage may be measured in millions of dollars. Two other challenges – focusing on a specific type of fraud and gathering information about fraudulent activities – further impede our ability to understand whether or not fraud presents a meaningful threat to SMEs and thus should be accorded elevated attention.

In broad terms, fraud can be defined as an act whereby an individual or group of individuals by deceit, falsehood or other fraudulent means, defrauds the public or any person or business, of any property, money, valuable security, or service.<sup>5</sup> However, a dozen divergent types of fraud may easily fit under this definition including securities-related frauds such as Ponzi schemes, accounting frauds that overstate the value of company revenues and assets, mass marketing fraud that victimizes consumers, mortgage and real estate fraud, identity fraud, tax fraud and money laundering, fraud in public procurement, health care and immigration fraud, etc.

When speaking about victimization of businesses, fraud is believed to be industry-specific: the business process and the array of products and services vary greatly from one industry to the other and so does the vulnerability to and likelihood of different types of fraud. As SMEs constitute the vast majority of all businesses in the Canadian economy, they are present in all industries and are in all types of business, and thus may be subject to a diverse range of fraudulent activities. It is then impossible to speak about the presence of fraud in SMEs without narrowing the consideration to either a specific industry or a specific type of fraud, or both.

As will be further discussed in Section 3.2, our knowledge of the extent of fraud victimization of Canadian business is rather limited, particularly when it comes to SMEs. Very few industry associations or other centralized agencies collect data on fraud from businesses while information that is collected is often incomprehensive and incomparable between industries.<sup>6</sup> Police records may be a useful and reliable source of information, but it is assumed that they are not very representative of fraud committed against businesses as the reporting rate is low. Complementing police records with information available in company records may also be problematic as SMEs often do not keep track of incidents

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5 Taylor-Butts, A. and Perreault, S. (2009). *Fraud Against Businesses in Canada: Results from a National Survey*, Statistics Canada, Catalogue no. 85-571-X, p. 6.

6 Statistics Canada (2005). *A Feasibility Report on Improving the Measurement of Fraud in Canada*.

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of fraud in their internal or accessible records.<sup>7</sup> At the same time, it is believed that SMEs are particularly vulnerable to fraud because of the limited financial and human resources dedicated to effective fraud detection and prevention.<sup>8</sup>

Although the Canadian economy experienced a relatively quick recovery after the 2008-2009 recession and financial crisis, the global economic outlook has deteriorated again over the summer and fall of 2011. Ongoing deleveraging by banks and households, increased fiscal austerity and declining business and consumer confidence is expected to restrain growth across advanced economies. Acute fiscal and financial strains in Europe have intensified the fear of severe dislocations in global funding markets. The “R” word is again becoming part of our vernacular in the United States, Europe and even Canada.

Given the highly uncertain and unstable economic outlook, our limited knowledge regarding the true scale of fraud victimization of SMEs is particularly worrisome. Research shows that economic downturn may present a heightened risk of fraud as recession conditions impose increased pressures, present individuals with greater incentives to commit fraud, and may also increase gaps in control systems as fewer resources are deployed to focus on internal controls.

Recognizing the challenges and limitations outlined above, CGA-Canada sees it timely to assess the level of vulnerability of Canada’s largest segment of business establishments – SMEs – to fraud. For that purpose, CGA-Canada commissioned a survey that sought to examine the prevalence and types of occupational fraud experienced by SMEs and to gather information on prevention and detection methods used by SMEs to safeguard against occupational fraud. Occupational fraud (versus other forms of fraud) was chosen as the focus of the examination as the existence and the size of the workforce are the two elements that are common to all SMEs, but also differentiate them from other types of business. Moreover, previous research suggested that small businesses may be disproportionately victimized by occupational fraud when compared to their larger counterparts.<sup>9</sup>

In the following text, we begin with a brief overview of the notion of occupational fraud and our current knowledge on its prevalence in SMEs. We then present the key findings of CGA-Canada’s survey of the presence of occupational fraud in Canadian SMEs and provide additional considerations

Our limited knowledge regarding the true scale of fraud victimization of SMEs is particularly worrisome given the highly uncertain and unstable economic outlook

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7 Statistics Canada (2005). *A Feasibility Report on Improving the Measurement of Fraud in Canada*, p. 12-14

8 Peltier-Rivest, D. (2009). *An Analysis of the Victims of Occupational Fraud: A Canadian Perspective*, *Journal of Financial Crime*, Vol. 16, No. 1, p. 65

9 Association of Certified Fraud Examiners (2010). *Report to the Nations on Occupational Fraud and Abuse*, and Peltier-Rivest, D. (2007). *Detecting Occupational Fraud in Canada: A Study of its Victims and Perpetrators*, Association of Certified Fraud Examiners.

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supplementing selected survey results. We conclude by highlighting the most salient aspects of our findings, along with some practical recommendations. Appendix A describes the survey methodology and replicates the administered survey questionnaire.



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## Occupational Fraud in SMEs – An Overview

Three elements are thought to constitute the core of any fraudulent activity and thus be present in all fraud cases. An act of fraud includes (i) a material false statement or action that has been made with the purposeful intent to deceive, whereas (ii) the victim of fraud relied upon the purposefully false statement or action of the perpetrator, and (iii) incurred damage as a result of false statement or action of the perpetrator.<sup>10</sup> Although the core notion of occupational fraud is also based on these three elements, a number of additional aspects form the definition and distinctive nature of occupational fraud. The paragraphs that follow discuss in more detail the notion of occupational fraud as well as the extent of knowledge regarding the presence of occupational fraud in the Canadian marketplace.

### 3.1. What is Occupational Fraud?

The Association of Certified Fraud Examiners (ACFE) defines occupational fraud as the “use of one’s occupation for personal enrichment through the deliberate misuse or misappropriation of the employing organization’s resources or assets”.<sup>11</sup> It is not uncommon that occupational fraud is colloquially referred to as “employee fraud” or “internal fraud”; the essence, nevertheless, remains the same – it is fraud that is committed by employees, managers and company owners where the victim of fraud is the organization itself. Four key elements are usually present in an occupational fraud scheme: the scheme is clandestine, it violates the perpetrator’s duties to the organization, it is committed for direct or indirect financial gain of the perpetrator, and it costs the organization assets, revenues or reserves.<sup>12</sup>

The ACFE has developed a detailed taxonomy of occupational fraud according to which there are three mutually exclusive categories of fraud: asset misappropriation, corruption, and fraudulent statements. Asset misappropriation is a scheme that involves the theft or misuse of an organization’s assets. Common examples of asset misappropriation include false invoicing, payroll fraud, and skimming. Corruption is a scheme in which a perpetrator uses his or her influence in a business or official transaction to obtain an unauthorized benefit contrary to that person’s duty to his or her employer. Examples of corruption include paying or accepting bribes or illegal gratuities, engaging in self-dealing transactions or engaging in conflicts of interest. Fraudulent statements fraud is a scheme

Occupational fraud is fraud that is committed by employees, managers and company owners where the victim of fraud is the organization itself

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10 Lord, A. T. (2010). *The Prevalence of Fraud: What Should We, as Academics, Be Doing to Address the Problem?* Accounting and Management Information Systems, Vol. 9, No. 1, p. 5

11 ACFE (1996). *Report to the Nation on Occupational Fraud and Abuse*, p. 2.

12 Saksena, P. N. (2010). *Ethical Theories and the Incidence of Occupational Fraud*, Proceedings of the Academy of Accounting and Financial Studies, Vol. 15, No. 2, p. 34

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The notion of occupational fraud should not be confused with the notion of white-collar crime

that involves the deliberate misstatement or falsification of an organization's financial or non-financial statements. In order to meet the definition of occupational fraud, fraudulent statements must bring direct or indirect financial benefit to the perpetrator. Common examples include recording fictitious sales, concealing liabilities or expenses, and falsifying employment credentials.<sup>13</sup> It should be recognized that the detailed taxonomy of occupational fraud further subdivides asset misappropriation, corruption, and fraudulent statements into more than 50 sub-categories.

The notion of white-collar crime often comes to mind when speaking about occupational fraud, particularly so since a number of high-profile white-collar crimes have shaken the world in the past decade including those of Enron, WorldCom, Tyco, ImClone, and cases of Bernard Madoff and Earl Jones. Although white-collar crime often involves fraud, the notion of occupational fraud should not be confused with the notion of white-collar crime. White-collar crime may be a corporate or an occupational crime. The first category includes offenses committed by corporations and their officials for the benefit of the corporation and its principals. The second category of crime is committed in the course of activity in a legitimate occupation and can be committed by employees against employers, employers against employees, or by those who by virtue of their occupation provide services and goods to the public.<sup>14</sup> Occupational fraud, in turn, is a crime committed by an individual against the employing organization and legitimate employment is a condition for occupational fraud.

Similarly, there is a difference between the typical white-collar offender and the offender that commits occupational fraud. The typical white-collar offender is frequently characterized as a highly educated white male, aged forty on average, situated in the upper managerial ranks of his organization, who commits a one-time criminal act.<sup>15</sup> Unlike white-collar perpetrators who share distinct sets of characteristics, characteristics of offenders committing occupational fraud vary based on the specific type of fraud committed. Research shows that individuals who commit asset misappropriation are typically younger and have significantly lower levels of education than those who engage in either corruption or fraudulent statements. Moreover, individuals that commit assets misappropriation and corruption are also less likely to be managers or executives compared to individuals who commit fraudulent statements. In addition, there is a nearly equal likelihood for the occupational fraud offender

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13 ACFE (2008). *Report to the Nation on Occupational Fraud and Abuse*, p. 10, and ACFE (2007). *Detecting Occupational Fraud in Canada: A Study of its Victims and Perpetrators*, p. 8.

14 Green S. P. (2004). *The Concept of White Collar Crime in Law and Legal Theory*, Buffalo Criminal Law Review, Vol. 8, No. 1, p. 109.

15 Holtfreter, K. (2005). *Is Occupational Fraud "Typical" White-collar Crime? A Comparison of Individual and Organizational Characteristics*, Journal of Criminal Justice, Vol. 33, p. 354.

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to be male or female and the majority of these perpetrators are employees rather than managers or executives.<sup>16</sup>

## 3.2. What Do We Know about the Presence of Occupational Fraud in Canada?

Two most common sources of information may be sought out to inform us regarding the prevalence of occupational fraud in Canada, and specifically in SMEs: (i) official statistics collected by government agencies, and (ii) information gathered by other interested groups and stakeholders involved in the matters of fraud analysis and prevention. The paragraphs that follow explore these sources in greater detail.

### 3.2.1. Official Statistics on Incidences of Occupational Fraud

The data from Statistics Canada suggest that 87,695 incidents of fraud substantiated by police took place in 2010; 7% of those cases were related to identity fraud.<sup>17</sup> Although the number of fraud incidents appears to be large, it says very little about the seriousness of the offence, its nature and the nature of the victim, the method by which it was committed, and the monetary value of the damage caused. Similarly, this statistic naturally provides no information or estimates on incidents of fraud that were not reported to the police. In fact, very limited information is available on what is understood by “fraud” in the data provided by Statistics Canada. The total number of incidents of fraud includes cheque and credit card fraud, but also contains the “other” category which may comprise securities-related frauds, insider trading, accounting fraud, mass marketing fraud, mortgage and real estate fraud, and other types of fraud. As such, there is little in the way of official public statistics that can be used to at least somewhat understand the nature of fraud and its victims, leaving aside the issues related to such a specific type of fraud as occupational fraud in SMEs.

There is little in the way of official public statistics that can be used to at least somewhat understand the nature of fraud and its victims

Recognizing the existence of the information gap regarding fraudulent activities in Canada, the Canadian Centre for Justice Statistics (CCJS) undertook a study in 2005 to assess the feasibility of improving the measurement of fraud by collecting data directly from business and business associations. The analysis prompted Statistics Canada to recommend introducing a survey of businesses to gather data that allows measuring the nature and extent of fraud experienced by businesses.<sup>18</sup> This recommendation was implemented in 2008 when Statistics Canada conducted the Survey of Fraud Against Businesses (SFAB) seeking to build a standard, more comprehensive picture of the prevalence and characteristics of business fraud in Canada.

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16 Holtfreter, K. (2005). *Is Occupational Fraud “Typical” White-collar Crime? A Comparison of Individual and Organizational Characteristics*, *Journal of Criminal Justice*, Vol. 33, p. 359-360

17 Based on CANSIM Table 252-0051.

18 Statistics Canada (2005). *A Feasibility Report on Improving the Measurement of Fraud in Canada*, Catalogue no. 85-569-XIE, p. 14.

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Although the introduction of the SFAB was an important step in improving the availability of fraud-related information, both the scope and the regularity of the survey have continued to present the main deficiency of this data collection tool. The survey covered only three industries – retail, banking, and health and property insurance – that together account for a mere 16.5%<sup>19</sup> of all business establishments in Canada. In addition, the survey focused primarily on types of fraud that were specific to those industries. Although the survey collected data on both non-employee and employees (i.e. occupational) fraud,<sup>20</sup> it included an only limited categorization of the types of occupational fraud, namely assets misappropriation and financial misrepresentation. In turn, such forms of occupational fraud as corruption and non-financial fraudulent statements were not included in the survey. Moreover, the survey was conducted only once – in 2008 – and does not allow analysing changes in prevalence of fraudulent activities over time.

As a result of the recognized shortcomings, the SFAB provides only limited information on occupational fraud, and does not attempt to examine the link between occupational fraud and the size of the company. In instances where the SFAB does offer some insights on the differences in fraud-related experience of businesses of different sizes, the information is imparted as it relates to fraud in general and not specifically to occupational fraud. Below, we provide those few extracts from the SFAB results that speak about occupational fraud and the company size differentials:<sup>21</sup>

- Overall, only 15% of businesses experienced occupational fraud; these included 19% of surveyed retail establishments, 3% of insurance establishments and 5% of banks. The prevalence of fraudulent activities did not differ among small (5 to 19 employees), medium (20 to 49 employees) and large (50 or more employees) establishments.
- The use of fraud prevention and detection methods was more common among large and medium-sized businesses than among small ones. More than three-quarters (76%) of large businesses reported using pre-employment screening as a fraud prevention measure while only 45% of small businesses used the same method. Similarly, 87% of large establishments conducted management training to prevent fraud; in small establishments, this method was utilized only in 69% of the cases. To detect fraud, large establishments used internal and external audits in 63% and 28% of the cases respectively; 59% of them deployed detection technology in order to identify fraud.

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19 Based on Industry Canada (2011). *Key Small Business Statistics*, Table 4, p. 11.

20 For the purpose of consistency in terminology used in this report, we refer to employee fraud discussed in the SFAB as “occupational fraud”.

21 As presented in Taylore-Butts, A. and Perreault, S. (2009). *Fraud Against Businesses in Canada: Results from a National Survey*, Catalogue no. 85-571-X.

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For small establishments these proportions stood at a lower level: 52%, 17% and 48% respectively.

### 3.2.2. Private Sources of Information on Incidences of Occupational Fraud

Private sources of information on incidences of occupational fraud in Canada are relatively scarce. One of the best known and more comprehensive private sources is represented by the series of reports made public by the ACFE; however their primary focus is the United States. In 1996, the ACFE published an exploratory study on the status of occupational fraud and abuse in the United States; the study intended to establish baseline measures of the frequency and types of occupational fraud occurring in different kinds of organizations. Since then, the ACFE has subsequently repeated the study in 2002, 2004, 2006, 2008 and 2010 enlarging the scope of the analysis to incorporate some specific regional considerations as well as expanding it to the global scale in 2010 by drawing information from fraud cases throughout the world.

Private sources of information on incidences of occupational fraud in Canada are relatively scarce

One of the specific regional considerations undertaken by the ACFE was a study aiming to describe how occupational fraud is committed in Canada, identifying the nature of the likely perpetrators, and the main characteristics of the victim entities. The study was based on the survey of Canadian members of the ACFE who were asked to provide detailed information about the largest occupational fraud case investigated since January 2004. Although the study does not contain information on the prevalence of occupational fraud, the following findings of ACFE's analysis may be pertinent to the current discussion:<sup>22</sup>

- Some 42.2% of occupational fraud cases occurred in small businesses (those with less than 100 employees); businesses employing between 100 and 999 employees accounted for 14.5% of fraud cases whereas large businesses with more than 1,000 employees were victims in the remaining 43.4% of the cases.
- Small companies suffer disproportionately large losses from occupational fraud with a median loss of \$150,000 representing 11%<sup>23</sup> of their annual sales. That contrasted noticeably with the \$100,000 in median loss experienced by companies employing between 100 and 999 employees.
- More than one third (35.1%) of occupational fraud cases in small business is detected through tips from employees, vendors, customers or anonymous sources.

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22 Based on Peltier-Rivest, D. (2007). *Detecting Occupational Fraud in Canada: A Study of its Victims and Perpetrators*, Association of Certified Fraud Examiners.

23 Peltier-Rivest, D. (2009). *An Analysis of the Victims of Occupational Fraud: A Canadian Perspective*, Journal of Financial Crime, Vol. 16, No. 1, p. 64-65.

In addition to the scarcity of information on incidences of occupational fraud in Canada, the existing sources do not provide a consistent picture

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Some Canada-specific information on occupational fraud may also be obtained from a PricewaterhouseCoopers publication. In its 2009 global economic crime survey,<sup>24</sup> PricewaterhouseCoopers touched upon the issue of occupational fraud, albeit only briefly. According to that survey, 47%<sup>25</sup> of Canadian companies reported asset misappropriation which was also the most prevalent type of fraud reported.

### 3.2.3. The Lack of Consistency in the Information Available

In addition to the scarcity of information on incidences of occupational fraud in Canada, the existing sources do not provide a consistent picture. Statistics Canada's survey suggests that only 15% of businesses experience occupational fraud; however, this proportion is three times higher (47%) based on the information collected by PricewaterhouseCoopers. At the same time, Statistic Canada's survey shows that the prevalence of fraudulent activities does not differ among establishments of different size. In turn, the ACFE study suggests that small businesses are much more likely to be victims of occupational fraud compared to their larger counterparts and experience disproportionately higher financial losses.

The differences in the methodology and the scope of the studies may be the reason for diverging findings. As was mentioned above, Statistics Canada's survey was focused on only three specific, service-producing industries. Although the ACFE's analysis did not contain industry limitations, it was based on information derived from a relatively small number of fraud cases – a total of 90 occupational fraud cases were examined with 35 of those cases occurring in small businesses that employ less than 100 employees. Given the fact that some 1.12 million Canadian businesses are small,<sup>26</sup> conclusions derived from a sample of 35 fraud cases may not be fully representative of the actual situation prevalent in the marketplace. The PricewaterhouseCoopers survey may likewise have been underrepresented given that the Canadian sample included only 52 companies.<sup>27</sup>

Although the described sources of information on occupational fraud bear some shortcomings and provide somewhat diverging findings, they continue to present the best available reference materials on occupational fraud in Canadian business – our literature analysis yielded no other source that provides

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24 PricewaterhouseCoopers (2009). *Economic Crime in a Downturn – The 2009 Global Economic Crime Survey: The Canadian Perspective*.

25 Derived based on the information that 56% of surveyed Canadian companies experienced incidents of economic crime in the 12 months prior to the survey, whereas 83% of those that experienced economic crime reported victimization through asset misappropriation.

26 Industry Canada (2011). *Key Small Business Statistics*, July 2011, Table 1, p. 7.

27 PricewaterhouseCoopers (2009). *The Global Economic Crime Survey – Economic Crime in a Downturn*, p. 19.

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information on the prevalence of occupational fraud in Canada, leaving aside the discussion of the issue as it pertains to Canadian SMEs.

Summing up the discussion above, the following points are deemed to be important. First, several key elements are typically present in an occupational fraud scheme: the scheme is clandestine, it violates the perpetrator's duties to the organization, it is committed for direct or indirect financial gain of the perpetrator and it costs the organization assets, revenues or reserves. The detailed taxonomy of occupational fraud includes more than 50 distinctive types of fraud. Second, the nowadays popular and often used term of "white-collar crime" should not be bluntly interpreted as occupational fraud as it may or may not involve misuse of the employing organization's resources. The profile of a typical white-collar perpetrator is also noticeably different from that of a perpetrator committing occupational fraud. Third, neither official statistics collected by government agencies nor information gathered by other interested groups and stakeholders provide a comprehensive picture of the degree of victimization of Canadian business by different types of fraud. Similarly, none of the studies conducted to date focus on fraud in SMEs.

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# Findings From CGA-Canada's Survey of Presence of Occupational Fraud in SMEs

# 4

The survey commissioned by CGA-Canada sought to examine the level of vulnerability of Canadian SMEs<sup>28</sup> to occupational fraud and to gather information on the prevalence and types of occupational fraud experienced by SMEs. The survey also aimed to identify prevention and detection methods used by SMEs to safeguard against occupational fraud. For that purpose, the survey asked respondents to reflect on the state of affairs and events that had occurred over the past fiscal year by examining two broad elements: (i) the overall number of occupational fraud incidents experienced by SMEs (with particular attention to characteristics of the single largest incident of occupational fraud), and (ii) measures used by SMEs to prevent and detect incidents of occupational fraud. The findings of the survey are presented in this section under the two main themes identified above. Appendix A, in turn, contains the description of the survey methodology and questionnaire.

For the purpose of the survey, occupational fraud is understood as the use of one's occupation for personal enrichment through the deliberate misuse or misappropriation of the employing organization's resources or assets.<sup>29</sup> Direct theft where no deceit is involved is not considered fraud. An incident of occupational fraud is understood as either a one-time event of occupational fraud, or a set of events repeated over time that originate from the same source, which have come to the attention of the respondent company.

## 4.1. Incidents of Occupational Fraud

Respondents were asked to reflect on the number of incidents of occupational fraud experienced by their companies during the last fiscal year as well as to provide some details regarding the single largest incident of occupational fraud that took place during that year. The types of occupational fraud were categorized into six groups – misappropriation of cash, misappropriation of inventory or assets, theft of proprietary information and intellectual property, assets/revenue overstatement or understatement, misrepresentation of employment credentials or internal and/or external documents, and corruption.<sup>30</sup> Respondents were also offered an option to indicate other types of occupational fraud that were not included in the list of answer options.

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28 For the purpose of this survey, small and medium-sized enterprises (SMEs) are understood as those employing between 5 and 499 employees.

29 Adopted from ACFE (1996). *Report to the Nation on Occupational Fraud and Abuse*, p. 2.

30 For the purpose of the survey, the term "corruption" includes conflict of interest, accepting gifts, gratuities or secret commissions from vendors or other business contacts.

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#### 4.1.1. Prevalence of Occupational Fraud in SMEs

One quarter (26%) of surveyed SMEs reported to have experienced at least one incident of occupational fraud in the past fiscal year; and another 4% of respondents were not sure whether or not occupational fraud had occurred in their companies.<sup>31</sup> These proportions translate into an estimated 290,000 Canadian SMEs that were victims to occupational fraud in 2010 and another 50,000 that do not rule out this possibility.

26% of surveyed SMEs experienced at least one incident of occupational fraud in the past fiscal year

Noticeable regional differences existed in the likelihood of SMEs to report incidents of fraud: only 16% of those surveyed in Québec told us that their companies encountered at least one incident of occupational fraud in the last fiscal year; in Ontario and British Columbia this proportion was almost twice higher and stood at 31% and 37% respectively.<sup>32</sup> The company size was another factor that influenced the likelihood of reporting incidents of occupational fraud. One quarter (26%) of SMEs generating less than \$5 million dollars in annual revenue reported to have experienced incidents of occupational fraud; among larger SMEs (those with annual revenues exceeding \$5 million dollars) this proportion stood at 36%. These results held true when the size of the company was measured by the number of employees.

SMEs with weakening company performance were also somewhat more susceptible to occupational fraud. Some 32% of companies that had experienced a significant decline in their financial performance in the past three years reported to have been subject to occupational fraud. Among those whose performance did not deteriorate, only 25% reported incidents of fraud. Such company characteristics as number of years in business and industry sector did not seem to noticeably influence the odds of reporting occupational fraud.

The most often cited type of occupational fraud experienced by SMEs was misappropriation of inventory or assets: 54% of companies reporting fraud said they encountered at least one incident of misappropriation of inventory or assets in the last fiscal year. At a distant second and third most often named types of occupational fraud were misappropriation of cash and misrepresentation of employment credentials through internal or external documents – some 36% and 25% of SMEs respectively indicated that they experienced those types of fraud (Figure 1).

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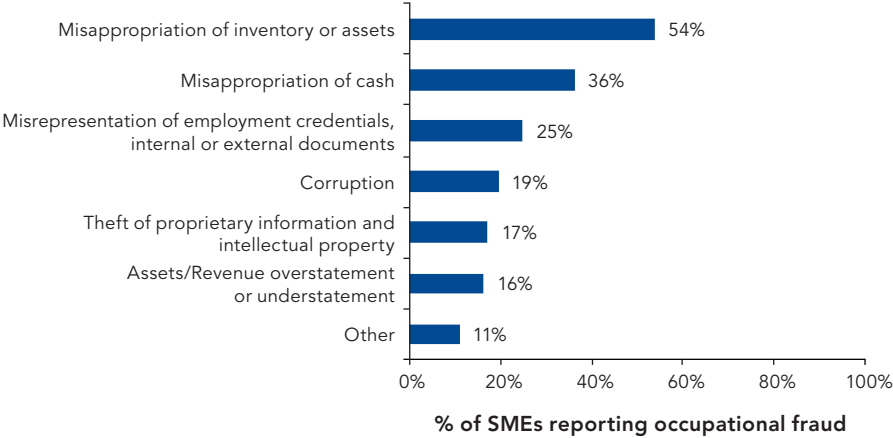
31 The 4% of respondents refer to those who chose the option “don’t know” when asked to reflect on the number of incidents of each types of occupational fraud that have occurred in their companies in the last fiscal year. As the “none” and “refuse” options were also available to respondents, the preference accorded to the “don’t know” option is treated as insufficient knowledge of whether or not incidents of occupational fraud have occurred.

32 Differences also existed among other provinces; however the sample size for those provinces does not allow for a reliable regional comparison.

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Survey respondents were provided with an option to indicate the frequency with which occupational fraud occurred in the last fiscal year. Although “one” was the most often indicated number of incidents for all types of occupational fraud, at least one fifth of respondents that experienced misappropriation of cash, inventory or assets, and corruption said that those types of fraud occurred four or more times in their companies in the last fiscal year.

**Figure 1 – Types of Occupational Fraud Experienced by SMEs**



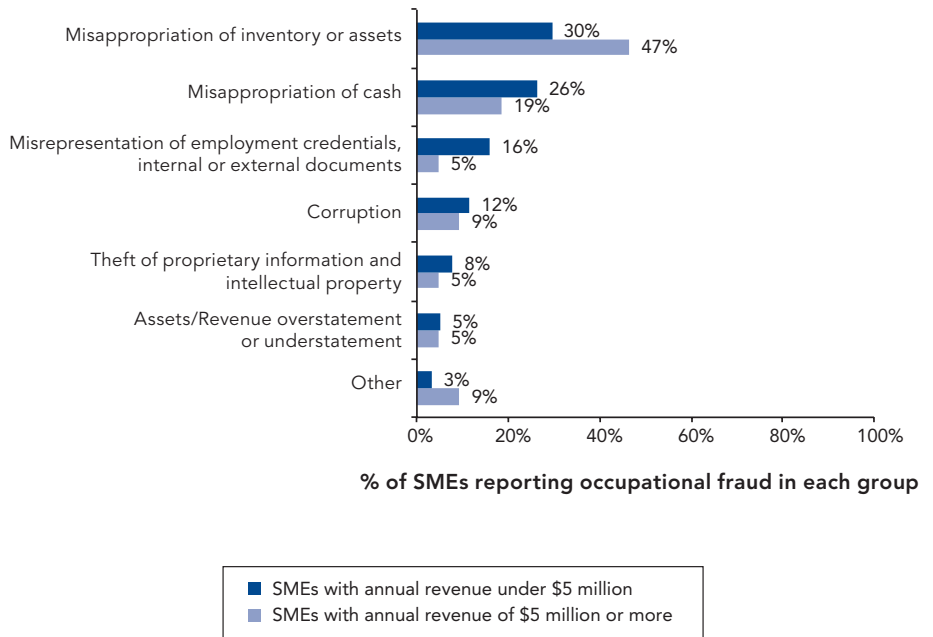
Misappropriation of inventory or assets was most often identified by respondents as the largest case of occupational fraud in their company

**4.1.2. Characteristics of the Single Largest Incident of Occupational Fraud**

To better understand the means of detecting occupational fraud and its consequences for SMEs, survey respondents were asked to reflect on the single largest incident of occupational fraud that occurred in their companies in the last fiscal year. Misappropriation of inventory or assets was most often identified by respondents as the largest case of occupational fraud in their company: 34% of respondents who experienced fraud told us so. For another 26% of SMEs that encountered fraud, misappropriation of cash was the most notable fraud incident.

When surveyed companies were grouped into smaller SMEs (those generating less than \$5 million in annual revenue) and larger SMEs (those generating \$5 million and more in annual revenue), some differences were observed in the type of occupational fraud identified as the single largest incident. For instance, misappropriation of inventory or assets was much more often identified as the most notable fraud episode by larger SMEs than was the case for smaller SMEs. In turn, smaller SMEs were more likely than larger SMEs to report misrepresentation of employment credentials, and internal or external documents as the single largest incident of fraud (Figure 2).

**Figure 2 – Type of the Single Largest Incident of Occupational Fraud Experienced by SMEs**



The single largest incident of occupational fraud was most often exposed thanks to employees

Note: Due to the relatively small sample size of the “SMEs with annual revenue of \$5 million and more” category, the percentages presented in the figure above should be viewed as indicative of the relative prevalence of different types of occupational fraud rather than as a precise measurement of the frequency of fraud occurrence.

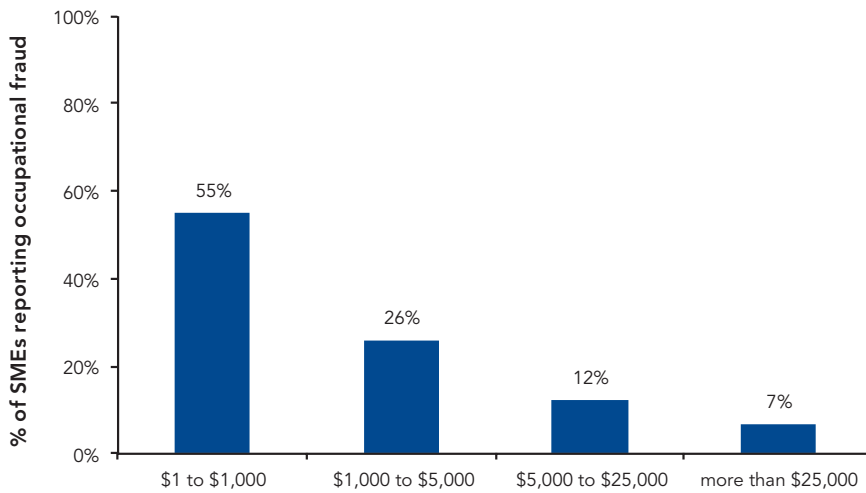
Most often, the single largest incident of occupational fraud was exposed thanks to employees. Some 24% of SMEs that experienced occupational fraud indicated that the single largest case of fraud was uncovered as it was reported by employees. For another 22% of respondents, the single largest fraud incident was identified by internal audit and/or compliance personnel, whereas it was reported by managers, or customers and business contacts respectively in 16% and 10% of the cases. Three other methods of fraud detection – data mining and analysis, surprise controls, and external auditors – were noticeably less frequent in leading to detecting the largest incident of fraud. It may be of interest to note that in 9% of the cases, the largest episode of fraud was uncovered by accident.

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### 4.1.3. Impact of Occupational Fraud on SMEs

Financial losses incurred by SMEs due to incidents of reported occupational fraud over the last fiscal year were not very substantial. For more than half (55%) of SMEs that experienced occupational fraud, financial losses associated with fraud did not exceed \$1,000; another 26% of companies assessed that their losses ranged between \$1,000 and \$5,000. Only 7% of SMEs experiencing occupational fraud said that their financial losses exceeded \$25,000 (Figure 3); and only two companies (or less than 1% of those experiencing fraud) reported an estimated loss of more than \$200,000.

**Figure 3 – Range of Financial Losses Incurred due to Occupational Fraud**



For 55% of SMEs that experienced occupational fraud, financial losses associated with fraud did not exceed \$1,000

The company size and sector of operations were two company characteristics that were somewhat likely to affect the extent of financial losses experienced by SMEs resulting from occupational fraud. For instance, SMEs with annual revenue in excess of \$5 million reported losses greater than \$25,000 twice more often compared with SMEs generating less than \$5 million in annual revenues (12% vs. 6%). These results held true when the size of the company was measured by the number of employees. Similarly, SMEs operating in the service-producing industries were three times more likely to report losses in excess of \$25,000 compared to SMEs affiliated with goods-producing industries. However, these differences did not change the main trend: regardless of the company's characteristics, more than half of respondents that experienced fraud in the last fiscal year assessed their losses as fairly modest – not exceeding \$1,000.

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The negative impact on staff morale was the most often identified aspect of business that was affected by occupational fraud

It is worth noting that the findings of CGA-Canada's survey regarding the scale of financial losses incurred due to occupational fraud differ markedly compared to findings of the Canada-specific study undertaken by the ACFE in 2007. According to the ACFE's data, the median, occupational fraud-related financial loss of a small business with less than 100 employees is \$150,000<sup>33</sup> whereas the average loss suffered by a small business is \$1,188,462.<sup>34</sup> Although the exact cause of the discrepancy cannot be identified, a number of possible explanations may be offered. For instance, information regarding monetary impact of fraud may be seen as sensitive by businesses and thus not fully reflected in the survey that collects data directly from business establishments which was the case of CGA-Canada's survey. The ACFE survey did not face this limitation as the information was provided by fraud examiners who may be seen as a more neutral party than victimized businesses when it comes to assessing the consequences of fraud incidents. On the other hand, the ACFE survey did not seek to collect information from a representative sample of respondents, but rather from fraud examiners who were willing to provide information. As such, certain predispositions of survey participants due to self-selection may have disproportionately transmuted in the size of fraud cases described. Moreover, the ACFE survey assessed financial losses based on the information regarding the *largest* fraud case investigated by respondents. This, naturally, may lead to an overestimation of losses when they are generalized from the level of an individual case to the level of the sector.

In addition to the financial consequences of fraud, survey respondents were also asked to reflect on other negative effects associated with occupational fraud. As seen from the top chart of Figure 4, the negative impact on staff morale was by far the most often identified aspect of business that was affected by occupational fraud – 61% of SMEs that experienced fraud in the last fiscal year agreed. At a noticeable distance, such elements as business relationships, company's reputation, public and client trust and company's value were indicated by at least one fifth of respondents as other non-financial negative consequences of occupational fraud. The majority of respondents that chose the "Other" answer option, noted that occupational fraud experienced by their companies affected management's confidence in staff.

The likelihood of respondents to report certain aspects of business as negatively affected by occupational fraud fluctuated depending on the company's characteristics. The age of business was particularly influential in this regard. As seen from the bottom chart of Figure 4, younger SMEs were at least twice more likely than their older counterparts to feel that occupational fraud

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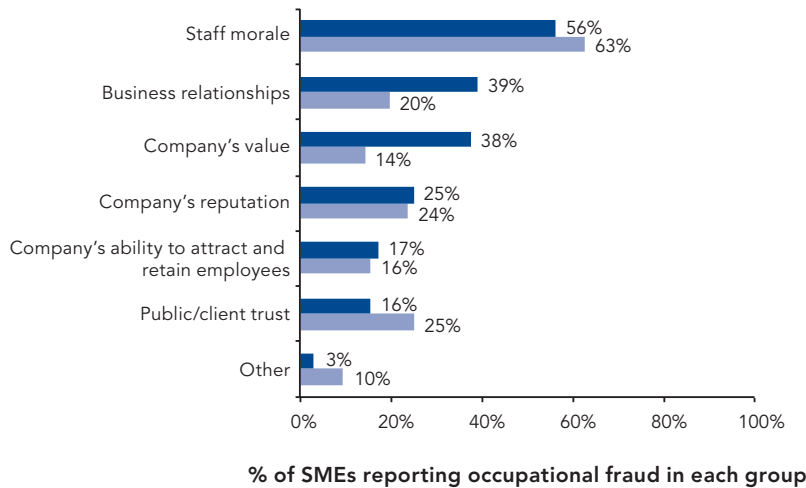
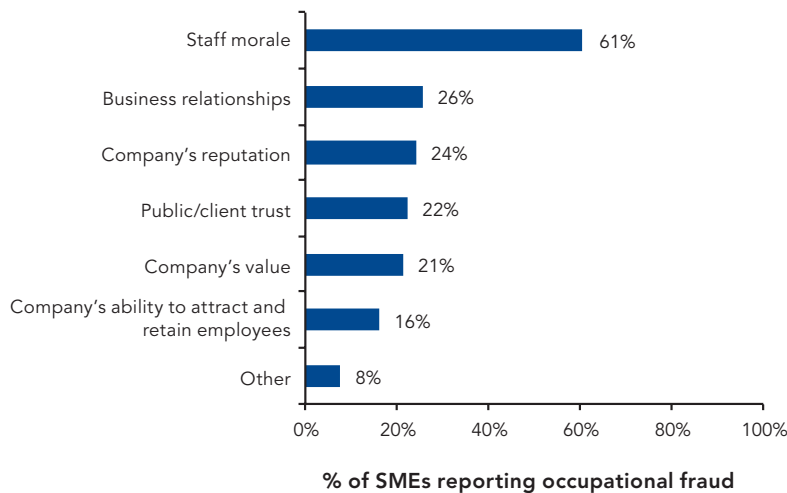
33 Peltier-Rivest, D. (2007). *Detecting Occupational Fraud in Canada: A Study of its Victims and Perpetrators*, ACFE, p. 18.

34 Peltier-Rivest, D. (2009). *An Analysis of the Victims of Occupational Fraud: A Canadian Perspective*, Journal of Financial Crime, Vol. 16, No. 1, p. 65.

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negatively affected business relationships and company value. Larger SMEs (those employing between 20 and 499 employees) felt stronger than smaller SMEs employing 5 to 19 employees that occupational fraud negatively affects staff morale and company reputation: the proportion of respondents indicating those answer options were 67% vs. 58% and 30% vs. 21% respectively. In turn, SMEs operating in goods-producing industries were more likely than their services-producing counterparts to experience a negative impact on company value (29% vs. 20% respectively).

**Figure 4 – Aspects of Business Negatively Affected due to Occupational Fraud**



■ SMEs in business for 15 years or less  
 ■ SMEs in business for more than 15 years

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57% of SMEs that experienced occupational fraud said their companies revised disciplinary actions to be administered in the case of fraud

Once an incident of occupational fraud is uncovered, some adjustments may reasonably be expected to the company’s internal policies and practices aiming at preventing similar incidents in the future. The survey asked SMEs that experienced occupational fraud in the last fiscal year to identify those changes. The majority (57%) of respondents said that their companies revised disciplinary actions to be administered in the case of fraud. The other two most often cited changes related to modifying protocols for hiring and retaining employees, and adjusting policies and channels for reporting employees’ concerns about fraud: 45% and 42% of respondents respectively indicated those changes (top chart of Figure 5). Two additional measures – strengthening the system of internal controls and improving physical safeguards to secure company assets – were most often mentioned by respondents as “other” policies and practices that were adjusted as a result of detected occupational fraud.

When companies were grouped into smaller SMEs (those employing between 5 and 19 employees) and larger SMEs (those with 20 to 499 employees), a number of differences emerged in the type of policies that were adjusted as a result of occupational fraud. For instance, smaller SMEs accorded much greater attention to revising protocols for hiring and retaining employees (58% vs. 32% respectively) when compared to larger SMEs. Similarly, smaller SMEs were much more likely to modify the company’s code of ethics and conduct than was the case with larger SMEs, and to alter the quantity/frequency of fraud awareness and ethics training among employees (bottom chart of Figure 5). The sector of company’s operations somewhat affected the likelihood of revising company’s policies related to segregation of duties: 48% of goods-producing SMEs said that they adjusted these policies as a result of incidents of occupational fraud. Among services-producing SMEs this proportion stood at 37%.



**Figure 5 – Internal Policies and Practices Revised as a Result of Occupational Fraud**



■ SMEs with 5 to 19 employees  
■ SMEs with 20 to 499 employees

Only 5% of SMEs gauged that occupational fraud poses a high risk for them, another 21% thought that the risk is moderate

## 4.2. Occupational Fraud Prevention and Detection

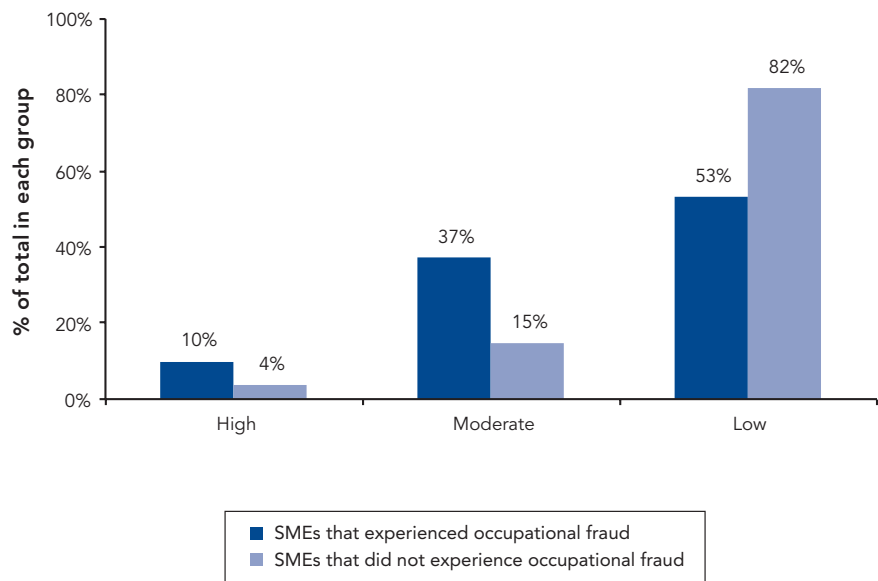
All survey respondents – including those who reported incidents of occupational fraud, but also those who did not – were asked to reflect on the measures that were in place in their companies in the last fiscal year aimed at prevention and detection of incidents of occupational fraud.

### 4.2.1. Level of Risk of Occupational Fraud

Overall, surveyed respondents did not think that occupational fraud presents a significant peril for their companies. Only 5% of SMEs gauged that occupational fraud poses a high risk for them, another 21% thought that the risk is moderate while the majority (74%) of surveyed SMEs believed that their exposure to the risk of occupational fraud is low.

Some difference in respondents’ perception of risk existed depending on company characteristics. The most notable difference appeared when surveyed SMEs were grouped into those that have experienced occupational fraud in the last fiscal year and those which did not. SMEs that encountered at least one incident of occupational fraud were more than twice more likely to gauge the risk of occupational fraud as either high or moderate; however, the majority (53%) still believed that occupational fraud posed a low risk for their businesses (Figure 6).

Figure 6 – Perceived Level of Risk of Occupational Fraud



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A number of other divergences in respondents' perceptions of the level of fraud risk also existed. For instance, size of the company was of some influence: while 25% of larger SMEs (those with 20 to 499 employees) assessed the level of risk of occupational fraud as moderate rather than low, only 19% of smaller SMEs (those with 5 to 19 employees) did so. Younger companies (those that have been in business for 1 to 15 years) were twice more likely to gauge the risk of occupational fraud as high compared to more established SMEs that have been in operation for more than 15 years. Companies with weakening performance were also more alert to the risk of occupational fraud: some 10% of SMEs that had experienced a significant decline in their financial performance in the past three years gauged the risk of occupational fraud as high, whereas only 4% of companies with stable or improving performance told us so. Such other company characteristics as industry sector, revenue size, province of operations, and rapid expansion of business did not noticeably influence respondents' perceptions regarding the level of risk posed by occupational fraud.

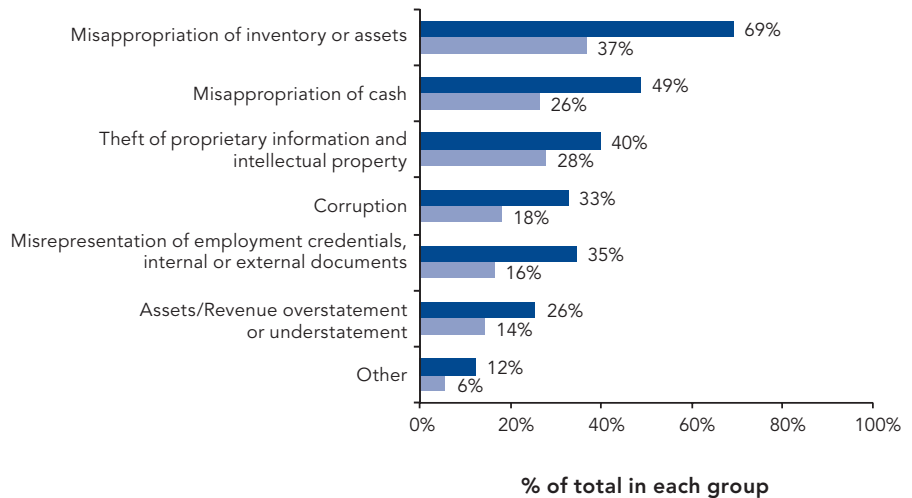
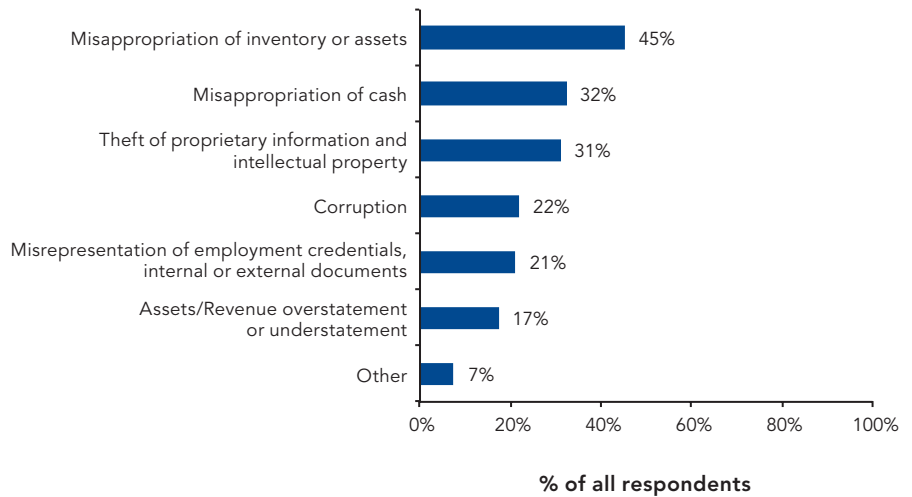
26% of surveyed SMEs do not think they are vulnerable to any type of occupational fraud

The survey asked respondents to reflect on the types of occupational fraud that their companies may potentially be susceptible to. One quarter (26%) of surveyed SMEs do not think they are vulnerable to any of the indicated types of occupational fraud. Respondents that deemed their companies as susceptible to occupational fraud, most often indicated misappropriation of inventory or assets as the point of vulnerability: 45% of respondents said so. Some 32% of surveyed thought that their company was susceptible to misappropriation of cash while 31% of respondents felt that theft of proprietary information and intellectual property may be a threat to their business (top chart of Figure 7). Misuse of company time was most often identified by survey respondents as the "other" type of occupational fraud to which their business may be susceptible. These perceptions of the relative vulnerability to different types of occupational fraud are well aligned with the types of fraud actually experienced by some of the surveyed companies (as discussed in Figure 1).

Grouping surveyed SMEs into two categories – those that have experienced occupational fraud in the last fiscal year, and those that have not – reveals an interesting facet of the perceived vulnerability. Although ranking of the types of occupational fraud to which the company may be susceptible did not vary considerably from one group to the other, the proportion of respondents gauging their company as vulnerable to a given type of fraud was much higher among SMEs that have experienced occupational fraud than among those that did not (bottom chart of Figure 7). That speaks to the increased awareness of risks and vulnerability to fraudulent actions in SMEs that have happened to experience occupational fraud first hand.

**Figure 7 – Types of Occupational Fraud to which Companies Are Perceived to Be Susceptible**

59% of surveyed SMEs did not undertake periodic assessments of risks of occupational fraud



■ SMEs that experienced occupational fraud  
 ■ SMEs that did not experience occupational fraud

Survey respondents were asked whether or not their company undertakes periodic (e.g. monthly, quarterly, annual) assessments of risks of occupational fraud. Less than half (41%) of the surveyed SMEs engage in such an exercise while the majority (59%) do not. The likelihood of undertaking a periodic assessment of risks was somewhat influenced by the company’s perception of the level of its exposure to occupational fraud. For instance, 57% of those believing that occupational fraud poses high risk to their business said that

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they carry out periodic risk assessment. Among companies that gauge the risk of occupational fraud as low, that proportion stood at only 39%.

The size and the sector affiliation were two other factors that also played a role in companies' propensity to conduct periodic assessment of risk of occupational fraud. Some 38% of smaller SMEs (those with annual revenue under \$5 million) agreed that undertaking a periodic risk assessment is part of their company's practice. This proportion was as high as 57% among companies generating more than \$5 million in annual revenue. Similarly, companies with larger numbers of employees and those operating in goods-producing industries were more likely to conduct periodic assessment of risks of occupational fraud than their smaller counterparts or those operating in services-producing industries. Whether or not the respondent's company has experienced incidents of occupational fraud in the last fiscal year did not seem to affect the likelihood of SMEs to engage in periodic risk assessment activity.

80% of surveyed SMEs do not have a Fraud Response Plan

Results of the survey revealed that SMEs preparedness to respond to occupational fraud is even lower than their involvement in periodic assessment of the fraud risk: only one fifth (20%) of all surveyed SMEs had a Fraud Response Plan while the overwhelming majority (80%) did not. Two factors – size of the company and past experience with occupational fraud – affected the company's attitude in this matter. Larger SMEs, as well as those that encountered fraud, were more likely to have a Fraud Response Plan. More specifically, 29% of larger SMEs (those with more than \$5 million in annual revenues) and 26% of SMEs that experienced fraud had a Fraud Response Plan in their organizations. This proportion was noticeably lower (18% and 19% respectively) for those companies generating less than \$5 million in annual revenues and those that did not report an occupational fraud in the last fiscal year.

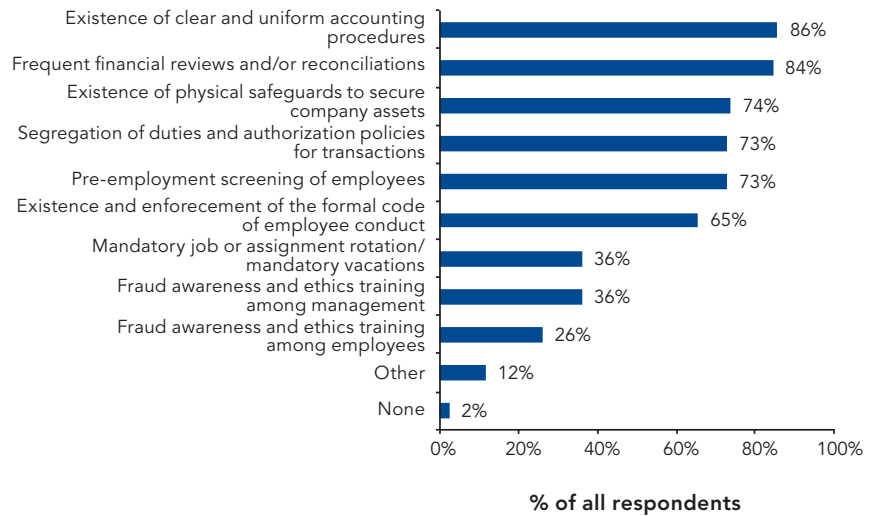
#### 4.2.2. Fraud Prevention Measures

Survey respondents were offered a list of nine possible methods and techniques used to prevent occupational fraud and were asked to identify those that were in place in their companies in the last fiscal year. Although three quarters of the surveyed companies believed that occupational fraud poses an only low risk to their business, all but 2% of respondents said their company employed at least one method of occupational fraud prevention. As seen from the top chart of Figure 8, the two most often utilized techniques of occupational fraud prevention are ensuring that accounting procedures are clear and uniform, and using frequent financial reviews and/or reconciliations. Four in 5 surveyed SMEs relied on these fraud prevention measures. Some three quarters of surveyed companies used such fraud prevention measures as physical safeguards to secure company assets, segregation of duties and authorization policies for transactions, and pre-employment screening of employees.

As was mentioned, only very few of the surveyed SMEs did not use any fraud prevention measures. Those that did were also highly likely to have more than one measure in place. Some 7% of respondents said that their companies rely on all nine fraud prevention measures that were offered as answer options; nearly half (48%) revealed that their companies use a mix of six to eight fraud prevention measures; and only in 15% of the cases, SMEs had three or less measures in place.

SMEs are highly likely to have more than one occupational fraud prevention measure in place

**Figure 8 – Occupational Fraud Prevention Measures and Techniques Used by SMEs**



■ SMEs with 5 to 19 employees  
 ■ SMEs with 20 to 499 employees

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The size of the company is particularly influential when it comes to whether or not the company uses certain fraud prevention measures. When surveyed companies were divided into two categories – larger SMEs (those with 20 to 499 employees) and smaller SMEs (those with 5 to 19 employees), larger SMEs were more likely to have any given fraud prevention measure in place. The difference was particularly noticeable regarding having and enforcing the formal code of employee conduct, segregating duties, undertaking mandatory job or assignment rotation, and having in place physical safeguards to secure company assets (bottom chart of Figure 8). These differences remained constant when companies were grouped into smaller and larger SMEs based on the levels of their annual revenues.

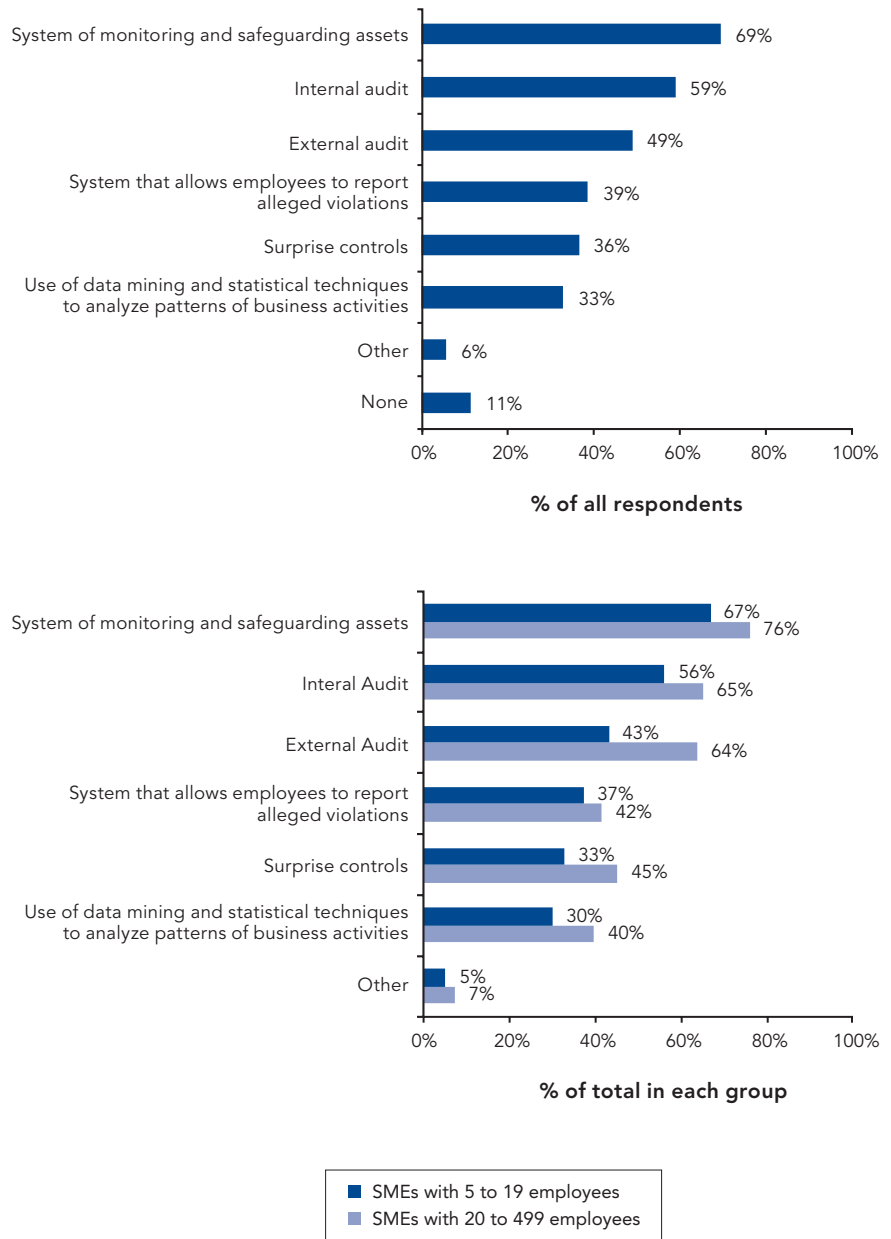
Whether or not SMEs experienced incidents of occupational fraud in the last fiscal year did not noticeably affect the likelihood of the company to utilize fraud prevention measures. One exception though, is worth mentioning: some 72% of companies that have experienced occupational fraud said they had in place and enforced a formal code of employee conduct, whereas a somewhat lower proportion (63%) of companies that did not experience fraud reported using this fraud prevention measure. Some regional differences also existed. For instance, Québec respondents were consistently less likely to report using any of the identified fraud prevention measures compared to Canada overall. A number of other provincial variations were also observed; however, with no particular pattern. In turn, such company characteristics as the number of years in business and industry sector did not influence company's likelihood of having fraud prevention measures in place.

11% of SMEs do not use any fraud detection measures

#### 4.2.3. Fraud Detection Measures

Survey respondents were offered a list of six possible methods and techniques of detecting occupational fraud and asked to identify those that were in place in their companies in the last fiscal year. Some 11% of SMEs said they did not use any fraud detection measures. Among those who had at least one detection measure in place, the majority (69%) said they relied on the system of monitoring and safeguarding assets as part of their fraud detection strategy. The second and third most often used techniques were internal and external auditors with 59% and 49% of SMEs choosing those answer options (top chart of Figure 9). The surveyed companies that used fraud detection techniques were somewhat equally divided (52% vs. 48%) into those using only few techniques (i.e. between one and three) and those which used a full range of detection methods (i.e. more than four).

**Figure 9 – Occupational Fraud Detection Measures and Techniques Used by SMEs**



The likelihood of SMEs having fraud detection measures in place is notably influenced by the size of the company

Similar to fraud prevention measures, the likelihood of companies having fraud detection measures in place was notably influenced by the size of the company. Although the ranking of measures was similar for larger and smaller SMEs (those with 5 to 19 and 20 to 499 employees respectively), the frequency with which those measures were imbedded into companies’ business strategies was evidently higher among larger SMEs when compared to their smaller



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counterparts (bottom chart of Figure 9). These differences remained constant when companies were grouped into smaller and larger SMEs based on the levels of their annual revenues.

Occupational fraud detection measures utilized by companies that have experienced fraud in the last fiscal year did not seem to differ significantly compared to companies that did not report fraud – the hierarchy of the most often used measures was similar for both groups. However, the frequency with which certain measures were incorporated in companies’ operations somewhat varied as SMEs that experienced fraud were more likely to have internal audit and surprise controls as measures applied to detect occupational fraud.

A certain disconnect may be observed between fraud detection methods that were most often used by SMEs and those that have most often led to uncovering actual incidents of fraud. For instance, only 39% of surveyed SMEs had in place systems that allow employees to report alleged violations (e.g. fraud hotline or whistleblowing provisions). At the same time, when companies were asked to reflect on the method of the single largest incident of fraud that was uncovered, the most often indicated option was ‘reported by employees’ – 24% of respondents that experienced fraud agreed. SMEs may also be somewhat over-relying on external audit as a fraud detection measure. Nearly half (49%) of the surveyed SMEs indicated external audit as part of their fraud detection strategy; however, only 3% of companies that experienced occupational fraud in the last fiscal year uncovered the single largest fraud case through external auditor’s examination.

#### **4.2.4. Need for Improvement of Fraud Prevention and Detection Measures**

Although only 5% of surveyed SMEs thought of occupational fraud as posing a high risk for their businesses, nearly one third (31%) of respondents agreed that their company needed a significant improvement in the area of occupational fraud prevention and/or detection. Nevertheless, the majority of respondents (60%) did not think that a significant improvement is needed, whereas another 9% neither agreed nor disagreed with this proposition. Not all survey respondents who thought that their company needs to strengthen fraud prevention measures also thought that a similar need exists in the area of fraud detection. Overall, some 75% of those who agreed that improvements are needed thought the changes are necessary in both areas.

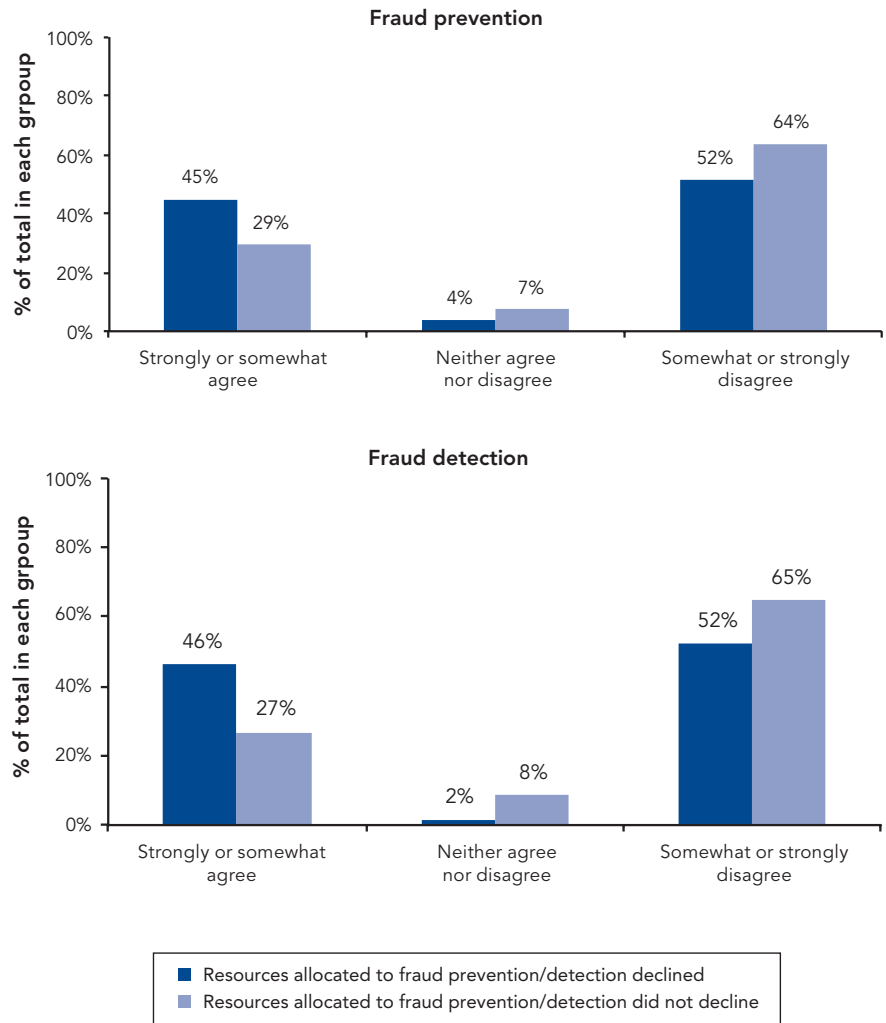
Some 18% of surveyed SMEs told us that resources they allocate to prevention and detection of occupational fraud have noticeably declined in the past 3 years. Respondents’ perceptions of whether or not improvements are needed to their fraud prevention and detection measures were noticeably influenced by the decline in resources allocated to those measures. As seen from

31% of respondents agreed that their company needed a significant improvement in the area of occupational fraud prevention and/or detection

SMEs that have experienced a reduction in resources allocated to fraud prevention and detection were much more likely to report the need of significant improvement in those areas

Figure 10, SMEs that have experienced a reduction in resources allocated to fraud prevention and detection were much more likely to report the need of significant improvement in those areas. Similarly, SMEs that have experienced incidents of occupational fraud in the last fiscal year were also markedly more likely to agree that they need improvements in fraud prevention and detection.

**Figure 10 – Need for a Significant Improvement in Occupational Fraud Prevention and Detection Measures**



Another factor that influenced SMEs perception regarding the need for improvement in fraud prevention and detection policies was the pace of the company's growth. Some 43% of surveyed respondents suggested that their company had been rapidly expanding and diversifying in the past three year. The rapidly growing SMEs assessed more often their fraud prevention and

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retention policies as needing improvement. Specifically, 40% of rapidly expanding SMEs agreed with the idea that their company needs a significant improvement in the area of occupational fraud detection compared to only 21% of SMEs that did not see a rapid expansion of their businesses. A similar divergence in opinion was observed regarding the need for improvement in fraud prevention measures.

Some regional differences were observed in respondents' perceptions regarding the need for improvement in fraud prevention/detection measures. As little as 24% of surveyed SMEs in Ontario, but as many as 44% of Québec SMEs agreed that they need a significant improvement in the area of occupational fraud prevention compared to the Canadian average of 31%. The differences in views were very similar regarding the need of improvement in fraud detection measures. Such company characteristics as the size and industry sector did not noticeably influence the likelihood of assessing company's prevention and detection measures as being in need of significant revamping.

Summing up the discussion above, the following points are deemed most important. First, the majority of SMEs believe that their exposure to the risk of occupational fraud is low; however, more than one quarter of SMEs experienced incidents of occupational fraud in the last fiscal year. Second, financial losses incurred by SMEs due to incidents of occupational fraud are not excessively large with the majority of cases not exceeding \$1,000; however, for a large number of victims, fraud incidents also negatively affect staff morale, business relationships, company reputation and public / client trust. Third, less than half of SMEs undertake periodic assessments of risks of occupational fraud; SMEs preparedness to respond to occupational fraud is even lower as the overwhelming majority do not have a Fraud Response Plan. Fourth, nearly all SMEs use some method of occupational fraud prevention; however 1 in 10 companies does not have any fraud detection measures in place. Moreover, certain disconnects may be observed between fraud detection methods that are most often used by SMEs and those that most often lead to uncovering actual incidents of fraud. Fifth, quite often, noticeable differences in SMEs experience with occupational fraud exist depending on the company size, industry affiliation, geographic location, and the number of years of being in business.

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## Should the Modest Level of Financial Losses From Occupational Fraud Be Comforting?

As discussed in Section 4, the overwhelming majority (81%) of surveyed SMEs that experienced incidents of occupational fraud in the last fiscal year reported that the financial losses incurred in that year due to fraud did not exceed \$5,000. This translates into an average annual loss of approximately \$10,900<sup>35</sup> per each victimized SME. For the Canadian economy as a whole, such level of losses may represent a substantial amount – some \$3.2 billion or approximately the amount the federal government spends annually on the GST credit for lower-income families.<sup>36</sup> However, for an individual SME this level of losses could probably be seen as tolerable (although undesirable). As the business performance and the business bottom line continues to be assessed in monetary terms, the low level of financial losses caused by the occupational fraud may lead some observers to conclude that occupational fraud does not represent a significant problem for the SME sector. In paragraphs that follow, we bring up additional considerations to critically examine this line of thinking.

The Canadian economy as a whole loses an estimated \$3.2 billion annually due to occupational fraud in SMEs

### 5.1. Is the Level of Financial Losses Truly Low?

The existence of such factors as undetected and underreported cases of fraud, high turnover of SMEs and certain limitations of the data collection design may suggest that the estimates of financial losses provided by the CGA-Canada's survey respondents may be below the levels of losses actually sustained. These factors are further considered below.

The length of time that the fraud scheme can last before being detected may be quite substantial. The ACFE estimates that the median time period from the moment occupational fraud first occurs to the moment it is uncovered is 18 months. In cases when fraud involves fraudulent statements, the median duration of the perpetration is even longer – 27 months.<sup>37</sup> As fraud remains undetected until the moment it is uncovered, the losses associated with undetected fraud are also not known to the organization until the moment the fraud is exposed. Moreover, the longer an occupational fraud goes undetected, the larger is the amount lost or stolen. In cases when undetected fraud becomes

35 The estimate was made by converting the categories of financial losses indicated by survey respondents into a continuous variable. The continuous variable was obtained by taking the category mid-point; for the "More than \$200,000" category, the assumption was made that the maximum loss from occupational fraud is \$400,000.

36 Some \$3.7 billion were spent by the federal government on assistance to low- and modest-income families through the GST credit in the fiscal year that ended March 31, 2010. Source: Department of Finance Canada (2011), *Your Tax Dollars*, an electronic resource, available at: <http://www.fin.gc.ca/tax-impot/2010/html-eng.asp>.

37 ACFE (2010). *Report to the Nations on Occupational Fraud and Abuse*, p. 14.

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a successful fraud (i.e. undetected fraud), the likelihood of exposing this fraud sometime in the future is very low as most fraud detection methods focus on current, rather than past, fraudulent activity.<sup>38</sup> As such, the presence of undetected cases of occupational fraud would lead to an underestimation of financial losses experienced by the victimized organization.

As was seen in Section 4, some 11% of surveyed SMEs do not have any fraud detection measures in place. Moreover, the detection measures that are in place may not always be the most efficient ones as certain discrepancy is observed between fraud detection methods that are most often used by SMEs and those that most often lead to uncovering actual incidents of fraud. It is then highly possible that at least some proportion of occupational fraud that victimizes SMEs remains undetected and thus unaccounted for in terms of financial losses estimated by businesses.

## SMEs financial losses due to occupational fraud may be underestimated due to undetected and underreported cases of fraud, and high turnover of SMEs

Another factor that may lead to an underestimation of the scale of financial losses experienced by SMEs due to occupational fraud is underreporting of fraud. Consultations conducted by Statistics Canada with representatives of law enforcement, government and the private sector regarding data collection on fraud showed that the ability of businesses to share fraud-related information may be somewhat diminished as incidents of fraud are not always tracked in the company records. The fear of jeopardizing the company's reputation, or the perceived insignificance of benefits of recording/reporting fraud relative to the size of the losses are two other reasons that may negatively affect businesses response rate regarding the financial consequences of fraud experienced.<sup>39</sup> Moreover, some businesses are believed to accept occasional occupational fraud as a natural part of doing business<sup>40</sup> and thus would not be reporting those expenses as losses.

The high turnover of SMEs may also affect the accuracy of the estimates of occupational fraud related financial losses. Unlike large businesses that are characterized by a relative stability and longer life span, thousands of SMEs enter and exit the marketplace every year. The turnover among small business is roughly 10% annually; some 15% of SMEs do not survive one full year of operation whereas another 23% will typically leave the marketplace within three years of their establishment.<sup>41</sup> High turnover, the stress of maintaining the business and the struggle for the niche in the marketplace makes "younger" SMEs less likely to participate in voluntary data collection initiatives. At the

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38 Barnes, P. and Webb, J. (2005). *Reducing an Organization's Susceptibility to Occupational Fraud: Factors Affecting its Likelihood and Size*, BDE Global, p. 7.

39 Statistics Canada (2005). *A Feasibility Report on Improving the Measurement of Fraud in Canada*, Catalogue no. 85-569-XIE, p. 20-22

40 Russell, S. G. (1999). *Organisations as Victims of Fraud, and How They Deal with It*, Trends and Issues in Crime and Criminal Justice. No. 127.

41 Industry Canada (2011). *Key Small Business Statistics*, p. 12-14.

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same time, it is probably the younger companies that are more vulnerable and susceptible to occupational fraud as the development and introduction of fraud prevention and detection measures in such companies takes place simultaneously with the company and staff growth and may or may not be effective in the early stages of company's development.

When data is collected by the means of a survey, underreporting of financial losses may also be caused by the survey design. Often, the answer options regarding financial losses encountered due to fraud are presented to respondents as a range of two values. As such, the actual amount of respondent's losses within that range remains unknown, whereas assuming a mid-point answer for all respondents may ignore the possibility that the distribution of losses is tilted towards the upper limit of the suggested range.

Given the reasons presented above, additional losses sustained by SMEs victimized by occupational fraud may in fact be present in the economy; however, not accounted for in the data and information available. The danger of this information gap goes beyond the simple limitations of the data. It may divert the attention of business owners, the government and law enforcement agencies towards recognizable and often more anticipated external fraud and/or highly visible cases of white-collar crime leaving the issues pertinent to occupational fraud in SMEs largely overshadowed.

Diminished staff morale may create a fertile environment for reoccurrence of fraud and impede the prospects of a company's growth

## **5.2. Importance of Non-financial Consequences of Occupational Fraud**

As was seen in Section 4, the majority (61%) of SMEs that experienced occupational fraud in the last fiscal year said that the fraudulent activity negatively affected staff morale. Two subsequent consequences may be associated with this effect. Diminished ethical principles due to the decline in staff morale may (i) create a fertile environment for reoccurrence of fraud, and (ii) impede the prospects of a company's growth through improving sophistication of operations and strategy.

It is assumed that perceived punitive action influences personal behaviour. In the case of occupational fraud, this implies that the magnitude of employee misconduct relates to both the perceived certainty and severity of organizational sanctions.<sup>42</sup> Businesses are known to have low rates of reporting fraud incidents to police. For instance, nearly half of retail and insurance establishments never or only rarely notify law enforcement in cases of fraud; among small businesses, this proportion is three times lower. Likewise, civil courts are not frequently used to resolve incidents of fraud and recover losses. The magnitude of fraud which is often seen as too minor is the most commonly cited reason

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<sup>42</sup> Strand, C.A. et al (2000). *Corporate Training Assessment Technique: Risk Factors Associated with Misappropriation of Assets*, Journal of Forensic Accounting, Vol. 1 (2000), p. 196.

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Such non-financial consequences of fraud as diminished company value, eroded reputation, damaged business relationships, and undermined public and client trust may likewise impede SMEs growth

for not involving law enforcement in the fraud investigation and punishment.<sup>43</sup> Although this line of business behaviour may well be understandable, the relative softness of punishment actions may affect employees' perceptions regarding the risk of sanctions and thus may increase the likelihood of their engagement in fraudulent activities. This, subsequently, increases the SMEs' risk of additional financial losses and further erode ethical stand of the organization.

Creating an efficient and sophisticated production process allows SMEs to embark growth opportunity and greater productivity. The most frequent method of improving efficiency and increasing the sophistication of the production processes is through greater reliance on employees, improved infrastructure, better suppliers, and stronger competitive pressure. However, the success of the growth strategy of an SME is often dependent on the ability of the owner to delegate authority to other employees within the firm, or to hire new personnel who can assume additional positions and responsibilities. Overall, the reluctance of owner-managers to relinquish their personal control over the firm is fairly common.<sup>44</sup> In cases when a business becomes victimized by incidents of occupational fraud, diminished staff morale may aggravate even further the owner's unwillingness to dilute the power and to delegate. As such, important growth opportunities may be foregone as an indirect consequence of occupational fraud.

The other non-financial consequences of occupational fraud – diminished company value, eroded company reputation, damaged business relationships, and undermined public and client trust – may likewise create strong impediments to SMEs growth and alter the trajectory of business development which could have taken place in the absence of incidents of occupational fraud.

Summing up the discussion above, the following points are deemed to be important. First, the average level of reported financial losses incurred due to occupational fraud by an individual SME is not large by any standard. As such, the likely inference may be that occupational fraud does not represent a significant problem for the SME sector. Second, a number of additional considerations may be of value when assessing the seriousness of the issue of occupational fraud for the SME sector. Those considerations are prompted by the likely underestimation of the level of financial losses sustained by SMEs due to occupational fraud, and by the importance of the indirect impact of non-financial consequences of fraud inflicted on the company's growth and development. Third, a more thorough analysis may be warranted prior to solidifying the conclusion that occupational fraud does not represent a significant problem for the SMEs sector.

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43 Taylor-Butts, A. and Perreault, S. (2009). *Fraud Against Businesses in Canada: Results from a National Survey*, Statistics Canada, Catalogue no. 85-571-X, p. 12-14, 16.

44 Papadaki, E. and Cham, B. (2002). *Growth Determinants of Micro-Businesses in Canada*, Industry Canada, p. 29.

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The analysis in the preceding sections has intended to provide valuable insights into the level of vulnerability of Canadian SMEs to occupational fraud, types of occupational fraud experienced by SMEs and the extent to which fraud prevention and detection methods are used by SMEs to safeguard against occupational fraud. During this examination, a number of contentions have been exposed.

**Overall, SMEs are not highly concerned with issues related to occupational fraud; the lack of first-hand experience with occupational fraud may be the largest contributing factor**

Only a portion of SMEs incorporate regular assessment of risks of occupational fraud into their business strategies and thus are well positioned to gauge the likelihood of occurring of this type of fraud in their organizations. Despite the limited engagement in risk assessment, the majority of SMEs tend to think that their exposure to risk of fraud is low; likewise, many do not gauge their organization as being predisposed to any particular type of occupational fraud. Given this attitude, it is not surprising that SMEs tend to accord little attention to developing and updating a Fraud Response Plan which would guide staff and management in cases when fraud has been detected or is suspected. A visible proportion of SMEs also accord rather little consideration to fraud detection measures – in fact, some SMEs have no such measures in place.

The awareness of risks and implications of occupational fraud improves among SMEs that recently have acknowledged incidents of fraud. Previously victimized SMEs are more likely to understand their vulnerabilities to occupational fraud, and formalize the response policies into a Fraud Response Plan. The recognition of the need for improvements in fraud prevention and detection measures is also more prominent among recently victimized SMEs. As such, the overall low level of concern regarding occupational fraud exhibited by SMEs may, at least partially, be caused by the lack of first-hand experience with this type of fraud.

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**The level of financial losses incurred by SMEs due to occupational fraud suggests that this type of fraud does not present a significant problem for the SME sector; however such an inference may benefit from additional considerations**

One quarter of SMEs are victimized by occupational fraud annually. Whether this proportion should be seen as high or low is a rather judgemental call. In turn, the level of financial losses incurred due to occupational fraud may be a more objective indicator when weighing the seriousness of this issue for the SMEs sector. The analysis shows that losses incurred by individual SMEs are rather low and on average should not be detrimental to their business. This line of thinking strongly suggests that occupational fraud does not represent a significant problem for the SME sector.

A number of additional considerations, however, may also be of value. The estimates of financial losses derived in this report may be below the levels of losses actually sustained: undetected and underreported cases of fraud, high turnover of SMEs, particularly in newer firms, and certain limitations of the data collection design are all contributing factors. Moreover, such non-financial negative consequences of occupational fraud as eroded staff morale, diminished company value, blemished company reputation, damaged business relationships, and undermined public and client trust are not quantified and not included in the estimate of financial losses incurred due to occupational fraud. However, the impact of these non-financial implications may be substantial, particularly in terms of a company's ability to expand and to develop its business.

**A multi-faceted information gap regarding the presence and impact of occupational fraud on SMEs continues to exist**

Little official statistics exist that can be used to fully understand the nature of business fraud and its victims, leaving aside such a rather narrow issue as victimization of Canadian SMEs by occupational fraud. Publicly available information collected by private stakeholders is valuable, but carries certain limitations and may or may not accurately depict the prevalence and seriousness of occupational fraud. In addition to the scarcity of information on incidences of occupational fraud, the existing sources do not provide a consistent picture. The findings regarding the scale of financial losses incurred due to occupational fraud also differ markedly depending on the source. At the same time, the importance of non-financial consequences of occupational fraud is often overlooked and seldom measured in material terms even though such consequences may be as important for business practices as financial losses sustained. Last but not least, noticeable regional differences are observed but not well explained or examined.

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## **Room for improvement on issues of occupational fraud exists for both businesses and the government**

SMEs fare fairly well when it comes to the use of fraud prevention measures. Fraud detection, though, remains somewhat overlooked. Incorporating fraud prevention measures in the business strategy is a constructive approach to safeguarding against the risks of occupational fraud. However, insufficient attention to fraud detection techniques may be dodgy particularly in the environment when fraudulent activities are constantly modified and redefined. Greater use and diversification of fraud detection measures may accord SMEs a better protection from the risks of occupational fraud. A critical assessment of fraud detection techniques that are the most suitable for the structure and the nature of a particular business may also be important.

Another area of improvement may be found in re-balancing efforts between prevention/detection of occupational fraud, and company's ability to respond to fraud. As highlighted in this paper, only some companies have policies in place to guide staff and management actions once fraud is detected.

As the real scope and seriousness of occupational fraud in SMEs is not fully known, the ability of public policy to address the problem (if and when needed) is diminished. As such, a further analysis may be useful to better understand whether the low level of SMEs concern with issues of occupational fraud is warranted and may be seen as a right attitude, or it is rather a product of unawareness whereas the true seriousness of the problem is greater than the current knowledge inferences. Government may be best positioned to undertake such an analysis due to cost implications which are likely to discourage the private sector from undertaking such or similar initiative.

For the time being, all businesses are encouraged to deliberately explore their own exposure to risk and to conduct some sensitivity analysis; both around the entity's current response to occupational fraud and to organizational tolerances. Driven by relative cost and marginal utility, the merit of alternate and complementary techniques, and the recognized principle of diminishing returns, the entity is best served to have a deliberate discussion. In so doing, the entity's prospects are improved for evolving a comprehensive and well-resourced, but responsible, occupational fraud program that is clear and supported from the top.

Importantly, existing techniques, processes and controls should not simply be abandoned on the premise of designing a 'newer' program as many of the existing procedures may in fact be serving as highly effective occupational fraud deterrents. While the existence of an internal audit program for example

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is most often seen as a fraud detection technique, a reasonable argument could be made that knowledge of its existence serves as a deterrent (preventative) to occupational fraud. To conclude that such a strategy does not serve the occupational fraud agenda because it may seldom detect or expose a fraud would be ill concluded as the mere presence of it serves to alter behaviour and inhibit wilful fraudulent acts.

# Appendix A: Survey Methodology and Questionnaire

# 7

## Survey Methodology

The survey was administered by Synovate from August 15 to September 16, 2011. The interview questionnaire was designed by CGA-Canada in collaboration with senior staff of Synovate and pre-tested. The sampling methodology was designed to accommodate telephone interview process with businesses making a representative sample of SMEs across ten Canadian provinces.

For the purpose of this survey, an SME was defined as a company employing between 5 and 499 employees. Quotas were determined by province, as well as by size and industry type of company within each province. Size of company was measured as a number of employees in all establishments, whereas industry type of company was grouped into goods-producing and service-producing categories. Quotas were structured so that the final sample resembles the composition of SMEs by region, size and industry as rendered by the *Canadian Business Patterns – 2010* published by Statistics Canada. The profile of companies surveyed is presented in Table 1.

**Table 1 – Profile of Companies-participants in the CGA-Canada’s Survey**

Characteristics	% of total sample	Characteristics	% of total sample
<b>Number of employees</b>		<b>Province</b>	
5 to 9 employees	45.1%	British Columbia	15.0%
10 to 19 employees	27.3%	Alberta	12.7%
20 to 49 employees	18.3%	Saskatchewan	3.2%
50 to 99 employees	5.9%	Manitoba	3.6%
100 to 199 employees	2.4%	Ontario	34.7%
200 to 499 employees	1.0%	Quebec	23.7%
<b>Gross annual revenue</b>		New Brunswick	2.2%
Under \$5 million	74.1%	Nova Scotia	2.7%
\$5 to \$15 million	10.3%	Prince Edward Island	0.7%
\$15 to \$75 million	3.2%	Newfoundland and Labrador	1.2%
More than \$75 million	1.4%	<b>Industry</b>	
Don't know / Refuse	11.0%	Accommodation and food services	7.5%
<b>Type of organization</b>		Agriculture, forestry, fishing and hunting	3.6%
For-profit – privately owned	70.2%	Construction	8.6%
For-profit – publicly-traded	4.1%	Finance and insurance	4.2%
Not-for-profit / voluntary	12.5%	Health care and social assistance	8.4%
Government	3.2%	Manufacturing	8.6%
Other	8.4%	Professional, scientific and technical services	8.5%
Don't know	1.6%	Real estate and rental and leasing	2.1%
<b>Years in operation</b>		Retail trade and consumer services	21.3%
1 to 3 years	2.0%	Transportation and warehousing	4.0%
4 to 7 years	7.9%	Other	23.2%
8 to 15 years	20.6%	<b>Sector</b>	
More than 15 years	69.6%	Goods-producing	21.6%
		Services-producing	78.4%

Note: Goods-producing sector includes industries that fall under NAICS 11, 21-23 and 31-33; services-producing sector includes industries that fall under NAICS 41, 44-45, 48-49, 51-56, 61-62, 71-72, 81 and 91.

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A total of 802 interviews were completed. In each company, a senior manager was interviewed who would be knowledgeable of fraud related issues in the company. With this sample size, sampling error of plus or minus 3.46% is produced at a 95% confidence level (19 times in 20).

## Survey Questionnaire

*Hello. My name is \_\_\_\_\_, from Synovate, a Canadian marketing research firm. I am calling on behalf of the Certified General Accountants Association of Canada (CGA-Canada). I would like to speak to the Senior Manager who is most knowledgeable of fraud related issues in your organization. This could be the CEO or the Managing Director.*

**(INTERVIEWER: IF CEO OR MANAGING DIRECTOR IS NOT AVAILABLE ASK FOR HEAD OF FINANCE OR HEAD OF HR: May I please speak with Head of Finance or Head of HR?)**

*I am calling on behalf of the Certified General Accountants Association of Canada (CGA-Canada). CGA-Canada is interested in conducting a survey to collect information on prevention and detection methods used by Canadian small and medium-sized enterprises to safeguard against occupational fraud. The survey also seeks to gather information on the prevalence and types of occupational fraud experienced by small and medium-sized enterprises.*

*We're hoping you can help by taking time to answer some questions. The survey will take no more than 10 minutes, depending on what you have to say. As a token of appreciation, everyone who completes this survey will qualify to win one of several cash prizes to be awarded by random draw to survey participants. The first prize is worth \$1,000, the second is worth \$500 and finally there are 15 prizes worth \$100 each.*

*Also, to thank you for your participation, you will receive a summary report of the results of this study.*

*The data reported in this survey will be treated with strict confidence and reported in aggregate form only.*

*Throughout the survey, occupational fraud is understood as the use of one's occupation for personal enrichment through the deliberate misuse or misappropriation of the employing organization's resources or assets. Direct theft where no deceit is involved is not considered fraud. An incident of occupational fraud is understood as either a one-time event, or a set of events*

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repeated over time that originate from the same source, which have come to the attention of your company.

(INTERVIEWER: REPEAT OCCUPATIONAL FRAUD DEFINITION AS NEEDED)

**Q. S1. How informed do you feel you are about occupational fraud related issues in your entire organization? Would you say you are...?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

- |                          |   |
|--------------------------|---|
| 1. Very informed         | <i>[skip to Q. S3]</i>                                |
| 2. Somewhat informed     | <i>[skip to Q. S3]</i>                                |
| 3. Somewhat not informed | <i>[ask Q. T and then terminate]</i>                  |
| 4. Not at all informed   | <i>[ask Q. T and then terminate]</i>                  |
| Refused/Don't know       | (DO NOT READ)<br><i>[ask Q. T and then terminate]</i> |

*[prog: if "somewhat not informed" or "not at all informed" or "don't know", ask Q. T and then terminate. otherwise skip to Q. S3]*

**Q. T. Is there someone else you recommend who is more informed about occupational fraud related issues in your organization?**

(INTERVIEWER: IF "YES", PROBE FULLY, RECORD FULL NAME AND CONTACT INFORMATION)

1. Yes: Please specify the name and telephone number:

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2. No

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**Q. S3. In how many locations does your company operate in Canada?  
Would you say...?**

(INTERVIEWER: DO NOT READ LIST. ACCEPT ONE  
RESPONSE ONLY)

- 1. 1 location
- 2. 2 to 4 locations
- 3. 5 to 8 locations
- 4. More than 8 locations
- Don't Know (DO NOT READ)
- Refused (DO NOT READ)

**Q. S4. How many employees (full time and part time) does your  
company currently employ at all locations in Canada?  
Would you say...?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

- 1. Less than 5 employees *[prog: terminate]*
- 2. 5 to 9 employees
- 3. 10 to 19 employees
- 4. 20 to 49 employees
- 5. 50 to 99 employees
- 6. 100 to 199 employees
- 7. 200 to 499 employees
- 8. 500 or more employees *[prog: terminate]*
- Don't Know (DO NOT READ)  
*[prog: terminate]*
- Refused (DO NOT READ)  
*[prog: terminate]*

*[prog: all answering "less than 5", "500 or more" or "don't know/  
refused" at Q. S4, terminate; otherwise continue]*



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**Q. S5. For how many years has your company been in operation?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

1. Less than 1 year *[prog: terminate]*
2. 1 to 3 years
3. 4 to 7 years
4. 8 to 15 years
5. More than 15 years

**Q. S6. What is your position in the company?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

1. CEO / President / Managing Director
2. CFO / Treasurer / Head of Finance
3. Head of HR Department
4. Owner
5. Other

*[prog: ask Q. S7 only if answer at Q. S6 is “other” and answer at Q. S3 is “2 or more”; otherwise skip to Q. 1]*

**Q. S7. Do you have overall responsibility for the entire company in Canada?**

1. Yes *[prog: continue]*
2. No *[prog: terminate]*

END OF SCREENING BLOCK

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## Section 1: Measures Aiming at Preventing and Detecting Incidents of Occupational Fraud

**Q. 1. In your view, what level of risk does occupational fraud poses for your company?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

1. High
2. Moderate
3. Low

**Q. 2. In your view, to which of the following types of occupational fraud may your company be susceptible?**

(INTERVIEWER: READ LIST. ACCEPT ALL THAT APPLY)

1. Misappropriation of cash
2. Misappropriation of inventory or assets
3. Theft of proprietary information and intellectual property
4. Assets/Revenue overstatement or understatement
5. Misrepresentation of employment credentials, internal or external documents
6. Corruption (i.e. conflict of interest, accepting gifts, gratuities or secret commissions from vendors or other business contacts)
7. Other, please specify: *[prog: specify]*

**Q. 3. Does your company undertake periodic (e.g. monthly, quarterly, annual) assessments of risks of occupational fraud?**

1. Yes
2. No

---

**Q. 4. During the last fiscal year, which, if any, of the following measures and techniques were used by your company to prevent occupational fraud?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE TO EACH MEASURE)

*[prog]*

1. Yes
2. No

*[prog: randomize list]*

1. Pre-employment screening of employees
2. Fraud awareness and ethics training among employees
3. Fraud awareness and ethics training among management
4. Existence and enforcement of the formal code of employee conduct
5. Segregation of duties and authorisation policies for transactions
6. Mandatory job or assignment rotation / mandatory vacations
7. Existence of physical safeguards to secure company assets
8. Existence of clear and uniform accounting procedures
9. Frequent financial reviews and/or reconciliations
10. Other, please specify: *[prog: specify]*
11. none *[prog: autopunch if "no" to all of other options]*

---

**Q. 5. During the last fiscal year, which, if any, of the following methods and techniques were used by your company to detect occupational fraud?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE TO EACH METHOD)

*[prog]*

1. Yes
2. No

*[prog: randomize list]*

1. Internal audit
2. External audit
3. Surprise controls
4. Use of data mining and statistical techniques to analyze patterns of business activities
5. System of monitoring and safeguarding assets
6. System that allows employees to report alleged violations (e.g. fraud hotline, whistleblowing provisions)
7. Other, please specify: *[prog: specify]*
8. None *[prog: autopunch if "no" to all of other options]*

**Q. 6. Does your company have a Fraud Response Plan for incidents of occupational fraud?**

1. Yes
2. No

---

**Q. 7. For each of the next statements, please tell me whether you strongly agree, somewhat agree, neither agree nor disagree, somewhat disagree or strongly disagree with each statement**

*[prog: grid]*

1. Strongly agree
2. Somewhat agree
3. Neither agree nor disagree
4. Somewhat disagree
5. Strongly disagree

*[prog: randomize list]*

1. Your company has experienced a significant decline in financial performance in the past 3 years
2. Your company has been rapidly expanding and diversifying in the past 3 years
3. The amount of resources allocated by your company to prevention and/or detection of occupational fraud have noticeably decreased in the past 3 years
4. Your company needs a significant improvement in the area of occupational fraud prevention
5. Your company needs a significant improvement in the area of occupational fraud detection

END OF SECTION 1

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## Section 2: Occupational Fraud Incidents Experienced During the Last Fiscal Year

**Q. 8. How many incidents of the following types of occupational fraud did your company experience during the last fiscal year?**

(INTERVIEWER: DO NOT READ LIST. IF RESPONDENT IS UNSURE, ASK FOR ESTIMATE)

*[prog]*

1. None
2. One
3. Two
4. Three
5. Four or more
6. Don't know

*[prog: randomize list]*

1. Misappropriation of cash
2. Misappropriation of inventory or assets
3. Theft of proprietary information and intellectual property
4. Assets/Revenue overstatement or understatement
5. Misrepresentation of employment credentials, internal or external documents
6. Corruption (i.e. conflict of interest, accepting gifts, gratuities or secret commissions from vendors or other business contacts)
7. Other types of occupational fraud

*[prog: skip to Q. 14 if "none" to all list items in Q. 8]*

*[prog: show list items selected as one or more incident in Q. 8]*

---

**Q. 9. Thinking about the single largest incident of occupational fraud your company experienced in the last fiscal year, what type of fraud was that?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

1. Misappropriation of cash
2. Misappropriation of inventory or assets
3. Theft of proprietary information or intellectual property
4. Assets/Revenue overstatement or understatement
5. Misrepresentation of employment credentials, internal or external documents
6. Corruption (i.e. conflict of interest, accepting gifts, gratuities or secret commissions from vendors or other business contacts)
7. Other, please specify: *[prog: specify]*

**Q. 10. Thinking about the single largest incident of occupational fraud your company experienced in the last fiscal year, how was it uncovered?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

1. Reported by employees
2. Reported by managers
3. Identified by internal audit and/or compliance personnel
4. Identified by external auditors
5. Reported by customers / business contacts
6. Uncovered through data mining and data analysis
7. Uncovered during surprise controls
8. Uncovered by accident
9. Other, please specify: *[prog: specify]*

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**Q. 11. What is the range of financial losses incurred by your company due to incidents of occupational fraud experienced during the last fiscal year?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

1. \$1 to \$1,000
2. \$1,000 to \$5,000
3. \$5,000 to \$25,000
4. \$25,000 to \$75,000
5. \$75,000 to \$200,000
6. More than \$200,000
7. Don't know (DO NOT READ)
- Refused (DO NOT READ)

**Q. 12. Which of the following aspects of your business were negatively affected by the incidents of occupational fraud experienced in the last fiscal year?**

(INTERVIEWER: READ LIST. ACCEPT ALL THAT APPLY)

1. Business relationships
2. Public/client trust
3. Company's value
4. Company's reputation
5. Company's ability to attract and retain employees
6. Staff morale
7. Other, please specify: *[prog: specify]*
8. None *[prog: autopunch if "no" to all of other options]*



---

**Q. 13. Which of the following internal policies and practices were revised by your company as a result of occupational fraud experienced in the last fiscal year?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE TO EACH POLICY)

[PROG: GRID]

1. Yes
2. No

*[prog: randomize list]*

1. Disciplinary actions to be administered in the case of fraud
2. Protocol establishing investigation procedures
3. Protocol establishing segregation of duties
4. Policies and channels for reporting employees' concerns about fraud
5. Protocols for hiring and retaining employees
6. Company's code of ethics and conduct
7. Quantity / frequency of fraud awareness and ethics training among employee
8. Quantity / frequency of fraud awareness and ethics training among management
9. Policy regarding financial review / reconciliation
10. Fraud Response Plan
11. Other, please specify: *[prog: specify]*
12. None *[prog: autopunch if "no" to all of other options]*

END OF SECTION 2

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### Section 3: General Information

#### Q. 14. In which province is your company headquartered?

(INTERVIEWER: DO NOT READ LIST. ACCEPT ONE RESPONSE ONLY)

1. British Columbia
2. Alberta
3. Saskatchewan
4. Manitoba
5. Ontario
6. Quebec
7. New Brunswick
8. Nova Scotia
9. Prince Edward Island
10. Newfoundland and Labrador

#### Q. 15. In which industry is your company's main business or service?

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

1. Accommodation and food services
2. Agriculture, forestry, fishing and hunting
3. Construction
4. Finance and insurance
5. Health care and social assistance
6. Manufacturing
7. Professional, scientific and technical services
8. Real estate and rental and leasing
9. Retail trade and consumer services
10. Transportation and warehousing
11. Other

---

**Q. 16. Which of the following best describes your company?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

1. For-profit – privately owned
2. For-profit – publicly-traded
3. Not-for-profit / voluntary
4. Government
5. Other

**Q. 17. What was the level of gross annual revenue of your company in the last fiscal year (measured in Canadian dollars)?**

(INTERVIEWER: READ LIST. ACCEPT ONE RESPONSE ONLY)

1. Under \$5 million
2. \$5 to \$15 million
3. \$15 to \$75 million
4. More than \$75 million

END OF SECTION 3

**Q. 18. This concludes the survey, but I just have one more question. Would you like to be informed when the final report containing the survey results is available on the CGA-Canada website ([www.cga.org/canada](http://www.cga.org/canada))?**

1. Yes
2. No

*[prog: ask Q. 19 if “yes” in Q. 18]*

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**Q. 19. Would you prefer to be informed by phone or email?**

1. Phone
2. Email

(INTERVIEWER: IF “EMAIL” IN Q. 19, OBTAIN EMAIL ADDRESS,  
READ BACK ADDRESS TO THE RESPONDENT)

*[prog: if prefer email ask email address]*

---

**Q. 20. We need to call you for notification, should you win the draw.  
Please provide the best phone number to reach you:**

First Name  
Last Name  
Phone Number

*[prog: show address]*

**Q. 21. Finally, we need to confirm the address for sending the  
summary report:**

(INTERVIEWER: READ ADDRESS TO THE RESPONDENT)

First Name  
Last Name  
Mailing address

*Those are all the questions we have  
Thank you for your participation*

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