

SAPID AND THE FRAUD TRIANGLE

Conceptual Models for Reliable Financial Statements



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INTRODUCTION

Fraud remains an ongoing issue among businesses. No matter the size or significance of a fraudulent scheme, perpetrators often find cause to work around controls. Accounting fraud, in particular, remains a concern in business, as management continually seek effective ways to prevent such activities. A recent study by the Association of Certified Fraud Examiners indicates that financial statement fraud remains the costliest type of fraud per incident faced by organizations in 2022 to 2023 ([Association of Certified Fraud Examiners \(ACFE\), 2024](#)).

For investors, financial statements free of fraud remain the foundation of financial due diligence for fair valuation and investment risk analysis. Investors need to be secure in management's ability to provide trustworthy information for decision making. These decisions lead directly to activities such as stock selection and portfolio construction.

REAL-WORLD EXAMPLE

To better understand the causes of fraud in business and how to prevent it, we will examine a recent real-world incident. In late 2024, Macy's disclosed that their financial records misrepresented their delivery expenses, a component of cost of sales in one of its accrual accounts. According to Macy's accompanying Form 8-K, a single employee was responsible for hiding nearly \$150 million for three years ([U.S. Securities and Exchange Commission, 2024](#)). Although the company released a statement alluding to a cause ([Macy's, Inc., 2024](#)), there are several factors that may have contributed to the misconduct, including perceived repercussions for an initial bookkeeping error, weak internal controls and motive rationalization. These accounting irregularities forced the company to delay its quarterly earnings report and triggered a forensic investigation. The company later revealed that an overstatement of \$81 million of an earnings metric in 2023 led to erroneous cash bonuses of approximately \$600,000 to executives ([U.S. Securities and Exchange Commission, 2025](#)).

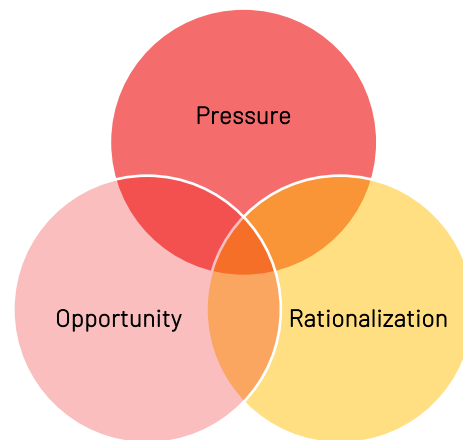
Overall, this case revealed failures in financial oversight, emphasizing the need for stronger understanding of conceptual models and tighter internal controls to prevent future accounting fraud.

CONCEPTUAL MODELS: FRAUD TRIANGLE & SAPID FRAMEWORK

To prevent fraudulent activities, organizations must first recognize and detect them before prevention can be effective. The tool that is widely used to understand and identify the factors leading to fraud is the fraud triangle, while the SAPID framework helps assess risks and implement controls to prevent such misconduct.

Fraud Triangle

The fraud triangle is a tool utilized by management to understand, explain, and help prevent fraud in organizations. It is a widely recognized model that has become a standard in auditing and fraud prevention. The three key elements are **pressure**, **opportunity**, and **rationalization**, and all are typically present when an individual commits fraud.



Pressure	Opportunity	Rationalization
The individual feels they have financial or personal pressure.	There is a loophole or a weakness in internal controls allowing the individual to commit fraud believing they will not get caught.	The individual rationalizes their actions firmly believing that it is okay to commit wrongdoing.
Examples <ul style="list-style-type: none">- Debt- Drug/gamble addiction- Job insecurity- Performance targets	Examples <ul style="list-style-type: none">- Lack of supervision- Poor segregation of duties- Weak auditing	Examples <ul style="list-style-type: none">- "Nobody is getting hurt."- "I'm just borrowing, I will pay back later."

The incident at Macy's may have been driven by elements of the fraud triangle and encourages scrutiny of the underlying circumstances. The company's press release indicated that the single employee perpetuated a scheme that initially stemmed from a small bookkeeping error, but the lengthy nature of the scheme may indicate that there may have been personal pressure to conceal the activity for fear of reprisal or financial pressure to meet earnings or performance targets. Additionally, the prolonged undetected nature of the fraudulent activity suggests a significant lack of oversight and weak segregation of duties. This lack of controls likely created the opportunity for misconduct to occur and persist.

The fraud triangle is a valuable tool in both detection and prevention of fraud. By understanding the three key elements – pressure, opportunity, rationalization – organizations can recognize the conditions that lead to behaviors causing fraudulent activities. This awareness supports companies to implement stronger internal controls, such as strict supervision, clear segregation of duties, and improved ethical training, all of which help reduce the risk of fraud.

In addition, the fraud triangle plays a crucial role in assessing risk and analyzing behavior. Auditors and managers use it to find areas within the organization where fraud is most likely to happen, allowing them to focus on those weak areas and spend time, money, and staff more wisely on them. It also helps explain why even trustworthy employees may engage in fraud, particularly when facing financial or personal stress. With this understanding, organizations can design stronger internal controls that address system vulnerabilities and reduce the chances of fraudulent behaviors.






SAPID Framework

While the fraud triangle offers management a standardized model to understand the conditions for fraud and analyze its risk, industry has developed several actionable frameworks that stem from this model. One of these frameworks is the SAPID framework.

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The SAPID framework, which stands for **segregation of duties, authority controls, physical controls, independent checks, and documentation**, is used in organizations to help detect and prevent fraud by establishing strong internal controls across key areas of operations. Each component of the framework describes the common vulnerabilities that perpetrators often exploit, and together they create a layered defense system that makes fraudulent activities more difficult to carry out undetected.

	Segregation of Duties	Segregation of duties reduces the risk of fraud by ensuring that no single individual has control over all parts of a financial transaction. By dividing responsibilities, such as recording, and custody, organizations make it difficult for one person to manipulate the records without being noticed or to simply avoid mistakes that can happen.
	Authority Controls	Authority controls ensure that only authorized individuals can approve transactions on the organization's behalf, or access sensitive systems. This limits unauthorized activities and ensures accountability.
	Physical Controls	Physical controls protect assets such as cash, inventory, or equipment from theft or misuse by limiting access and safely secure physical resources.
	Independent Checks	Independent checks provide regular oversight through audits or reconciliations performed by people who are not involved in day-to-day activities. This allows for objective reviews that can catch errors or fraud attempts.
	Documentation	Documentation creates a clear audit trail, providing evidence that transactions were properly authorized and recorded. Good documentation makes it easier to trace and verify activities, discouraging fraud and supporting investigations if issues arise.

Ultimately, the SAPID framework helps organizations strengthen their internal controls, reducing the risk of fraudulent activities and ensuring that any issues are detected right away.

Applying the SAPID framework to a real case like Macy's reveals several opportunities to strengthen fraud detection and prevention. Instead of assigning one employee sole responsibility over a specific expense account, rotating duties and sharing responsibilities can help enforce segregation of duties, reducing the risk of manipulation. When multiple individuals are involved, irregularities in financial transactions and records are more likely to be noticed quickly. In addition, requiring an authoritative figure to approve transactions and regularly review employees' work enhances oversight. With active involvement from those in positions of authority, it becomes significantly more difficult to conceal accounting anomalies. Independent auditors, removed from day-to-day operations, can objectively assess financial records, while proper documentation offers a reliable audit trail that shows how and when transactions were authorized. Together, these preventive measures not only verify the legitimacy of financial activities but also support investigations if fraudulent behavior is suspected.

CONCLUSION

The fallout from Macy's disclosure was significant internally. The correction of their financial records lowered net income in the third quarter of 2024 and executives were required to pay back part of their lucrative bonuses. More importantly, in repairing its reputational damage, the company restructured its finance leadership and focused on internal controls and accountability at the executive level. A lot of that focus drew from the fraud triangle and key aspects of the SAPID framework, such as reevaluating the risk of employee circumvention of controls, redesigning process level control activities, and investing in technology to ensure quality documentation of those control activities.

The importance of this for investors is also significant. Reliable, fraud-free financial statements ensure that investment analysis is grounded in accurate, comparable, and assessable information, allowing markets to function smoothly and investors to perform beneficial economic activity such as contributing to the fair valuation of companies, allocating capital flows efficiently, and constructing investment portfolios that clients depend upon.