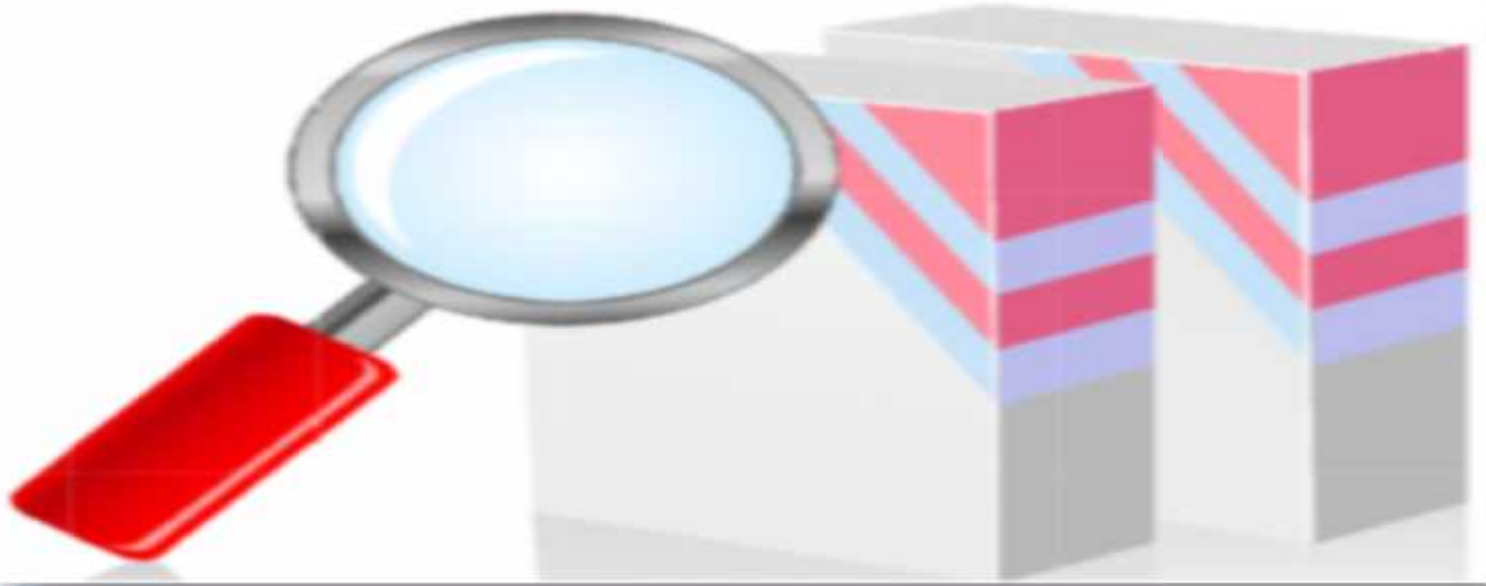




UNIT-2 The Fraudster

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Discuss the Profile of a typical Fraudster.
- ✓ Identify High-Level and Low-Level Thieves

Unit 2

Profile of Fraudsters

One of the most important aspects of fraud detection is to gain an understanding of how the fraudster's mind works. The profile of a perpetrator depends on the type of fraud involved. For example, a blue-collar criminal is different from a white-collar criminal, which makes the job of forensic accountants difficult. In addition, the people involved in asset misappropriations are usually those least suspected of doing so.

Who Commits Fraud?

Usually, it is assumed that there are external motivating factors driving people to commit fraud, such as economic situation, socio-political factors, competitive factors, poor internal control mechanism etc. However, it is crucial to acknowledge the personality traits and internal motivators of those who commit fraud. It is important to ask whether certain people are more likely to commit fraud than others. Are there other factors more powerful than environmental factors? According to studies in criminology and sociology, certain kinds of people are, in fact, more prone to committing fraud. First, certain generalizations can be made about people:



According to research conducted to find out whether employees are honest at work or not, forty per cent of the employees said they would not steal, thirty per cent said they might steal, and thirty per cent

said that they would steal. Gwynn Nettler, in *Lying, Cheating and Stealing*, makes the following assessment of cheaters:

- If people have experienced failure in their lives, they are more likely to cheat.
- People who have a low opinion of themselves and are disliked by others have a higher tendency to deceive.
- Impulsive, easily distractible, impatient and selfish people are more likely to be deceitful.
- People who are afraid of being caught and of suffering punishment, i.e. those who have a higher perception of detection, are less likely to be tempted to cheat or deceive.
- Middle/upper-class people are less likely to cheat than lower-class people, and intelligent people are more honest than ignorant people.
- People will steal and cheat more the easier it is to do so.
- The level of motivation for an individual to commit fraud, lie or cheat depends on his/her needs.
- Greater stress and pressure to achieve objectives leads to more deceit and cheating.
- The motivation to deceive increases with the struggle and determination to survive.
- A variety of personal and organizational situations lead to people lying and deceiving.

The following are a few personal, organizational and external variables that affect a person's likelihood of cheating:

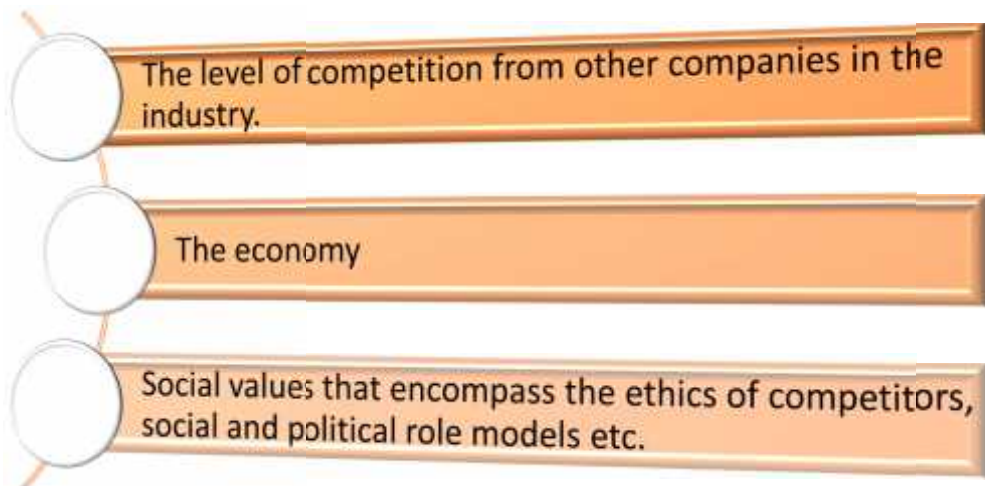
1. Personal variables



2. Organizational variables

- Nature of the job and its scope, i.e. how meaningful is the job?
- The training and tools provided to the employees.
- The organization's reward system.
- The level and quality of supervision and management on the job.
- Roles and responsibilities associated with the job and how clearly they are defined.
- Objectives of the job.
- Interpersonal relations and the level of trust.
- Organizational values and ethics of co-workers.
- Motivational environment of the organization

3. External variables



Why Do Employees Lie, Cheat and Steal on the Job?

According to criminologists, psychologists, sociologists, risk managers, auditors and police, there are twenty-five main reasons for white-collar crimes, which are listed below.

1. The perception of being able to get away with fraud.
2. The desperate belief of an employee that he/she needs the stolen money or articles.
3. Frustration or dissatisfaction with the job, or with aspects of the job.
4. Frustration or dissatisfaction with personal life or with some aspect of personal life that is not related to the job.
5. An employee's need to take revenge for being abused by the employer.
6. Failure of an employee to think about the consequences of being caught committing the crime.
7. The employee thinks that it is acceptable to cheat because everyone else is doing it as well.
8. The employee thinks that stealing will go unnoticed because the organization is too big to be affected by it.
9. The employee is having financial difficulties and feels compelled to steal.
10. The employee steals because he/she wants to beat the organization.
11. The employee was deprived of social or economic welfare during childhood.
12. Stealing/cheating is a mechanism to fill the absence of love, trust or affection in the employee's personal life.
13. The employee is a compulsive thief.
14. The employee wants to harm the organization on behalf of a friend whom he/she feels has been treated unfairly, humiliated or abused.
15. The employee is lazy and does not want to work in order to fulfil his/her needs.
16. The internal controls put in place by the organization to prevent cheating or stealing are so weak that everyone thinks that it is easy to steal.
17. The organization has never punished or prosecuted anyone for stealing.
18. There is an absence of the fear of being caught because most thieves are caught by accident and not by audit.
19. Lack of counselling from the management regarding employees' personal or financial problems.
20. Not all employees steal for the same reasons. They face different situations, and have different preceding conditions and motives.
21. There is a wide variety of reasons behind an employee's stealing or cheating.
22. Employees rarely face long prison sentences for committing fraud, stealing and embezzling from their employers.
23. Human nature is weak and vulnerable to criminal temptations.
24. In today's world, employees have weak morals and ethics.
25. Corrupt bosses set a bad example for employees, making them more likely to steal or cheat.

Like general criminal laws, a company's laws that deal with fraud, cheating, stealing, etc., must be rational, fair, easily comprehensible, efficient, easily enforced and applied uniformly in order that employees might respect and comply with them. These laws should work in the company's best interest. A company's laws and fraud policy will only be considered rational if punishments are applicable in real situations and if their enforcement is swift and legally effective.

Exactly which acts are serious enough to be prohibited or punished?

Any act that causes substantial damage or loss to the company's assets must be prohibited and punished. However, what is considered substantial differs from one organization to another. In any case, these prohibitions must be defined clearly, communicated across the workforce, respected by the upper management as well as the rest of the workforce, and enforced uniformly.

Certainty of punishment, impartial and speedy trials, swift and uniform dispensation of justice, and punishments befitting the crime are the biggest deterrents to criminal behaviour.

However, why do crimes occur even in the presence of strong deterrents?

One reason for this is that the rewards of indulging in criminal behaviour may exceed the risk of detection and of being apprehended. This is very common in white-collar fraud cases where the perpetrators tend to receive lenient punishments for their crimes and some even go unpunished. Therefore, even though criminals know that they are quite likely to be caught, they also know that the punishment will not exceed the gains made from fraud.

High-Level and Low-Level Thieves

It is easier for high-level managers and employees to steal because they are able to override and bypass internal controls easily and get away with stealing large sums of money, as opposed to lower-level employees who usually steal small sums. According to the Association of Certified Fraud Examiners (ACFE)'s Report to the Nations (RTTN), in 2008, executives stole an average estimated sum of £834,000 per fraud, managers stole about £150,000, and employees stole about £70,000. Although the sums of money are greater at the higher levels, the incidents of fraud are more numerous at lower levels because of the larger number of employees at those levels.

The ACFE RTTN also compiled a profile of perpetrators of fraud with the help of information collected from Certified Fraud Examiners (CFEs). Frauds involving large sums of money are particularly committed by the following: (i) long-term employees of the organization, (ii) high-income earners, (iii) males, (iv) people aged over 60, (v) people with good educational backgrounds, i.e. the higher the level of education, the bigger the fraud, (vi) people working in collusion with other perpetrators, and (vii) people who have never been subject to criminal charges.

On the other hand, the most frequent frauds are committed by people who fit the following profile: (i) long-term employees of the organization (about the same length of service as high-level fraudsters), (ii) low-income earners, (iii) males or females (gender is not a factor), (iv) those aged 41 - 50, (v) those with

high school education, (vi) those working alone rather than in groups, (vii) those who have not been subject to any criminal charges.

According to Hall and Singleton's general profile of fraudsters, they are: (i) important position holders in the organization, (ii) mostly male, (iii) more than 50 years of age, (iv) married, and (v) highly educated.

Therefore, based on all these theories and profiles we might conclude that a white-collar criminal does not look like a typical criminal.

Victims of Fraud

In order to detect and prevent fraud, the control mechanisms of organizations, suppliers and contractors have a basic goal: feasible and cost-effective protection of the organization's assets against losses, damage or destruction. Cost-feasibility implies incurring minimal expenditure to ensure the maximum possible gains. The objective should be to strike a balance and not seek to enforce controls excessively. This balance is achieved after conducting a cost-benefit analysis of the introduction of new controls. While blind trust in the employees and lack of accountability may make it lucrative to commit fraud, a total lack of trust also breeds disloyalty and dishonesty.

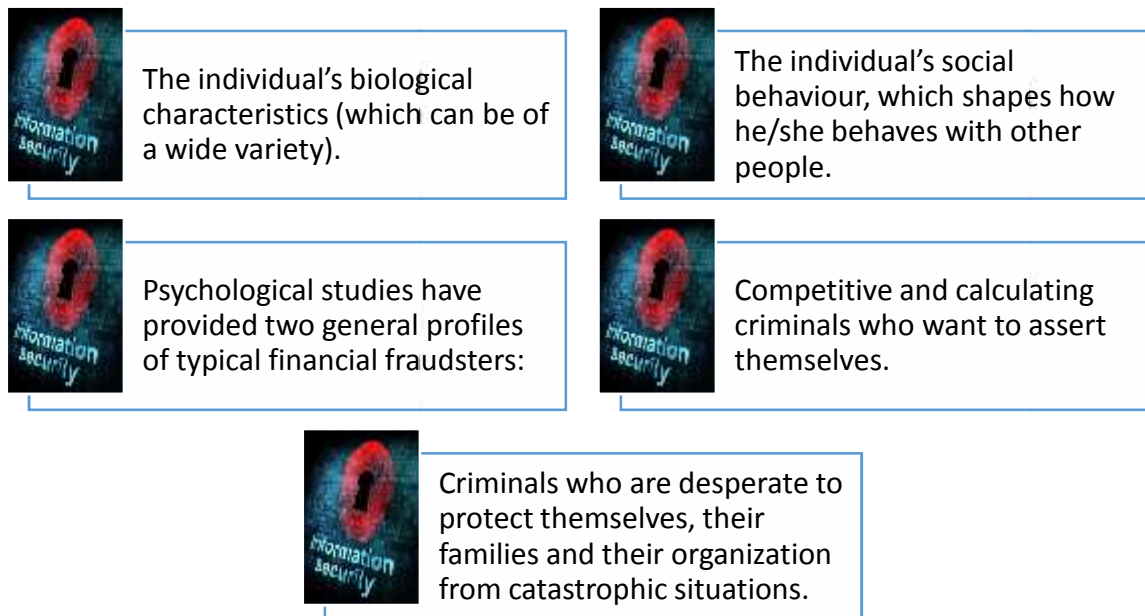
Empirical evidence suggests that one of the most frequently observed factors in all frauds is the inability of the management to segregate duties and weak controls. These factors are very common in small businesses, which face a higher risk of fraud than larger organizations. This is because they usually have only one accountant who is responsible for all financial tasks; there is no division of duties, and no control mechanism. Moreover, fraud is more common in organizations that have no trust or ethics, poor management, negligible profits, if any, and no future prospect of prospering.

In our childhoods, we were taught that "honesty is the best policy", but in the real world that hardly ever holds true. History, statistics and human nature all point towards people's tendency to be dishonest and to cheat. Sometimes, even our society does not look down upon fraud in the same way as it discourages violence and bodily harm. Take, for example, Charles Ponzi of the infamous Ponzi scheme. Although he committed a fraud costing millions of dollars in losses, he is still celebrated as a folk hero among some people. Similarly, wealthy executives in the finance industry 'get away' with committing frauds worth millions of dollars and disrupting the lives of thousands of people when they receive light sentences in relatively comfortable prisons. According to some scholars, this tolerance of white-collar crime can be described as "a perversion of our general societal admiration for intelligence."

There have been attempts, during the last century, by psychologists and sociologists to understand the workings of the white-collar criminal's mind. In 1939, Edwin Sutherland's *White Collar Crime* claimed that an individual's personality did not make him/her more or less likely to commit fraud. He said that, rather than biological and psychological characteristics, an individual's social circumstances and his/her social bond with the organization lead to economic crimes.

Sutherland disputed the observation that crime was linked to one's social class and said that financial fraud was more likely to be committed by socially well-adjusted people belonging to the upper class than by lower-class social misfits.

In the decades since *White Collar Crime* was published, studies have suggested that two major factors must be taken into account when analyzing the psychology of a fraudster:



There is also a third type of criminal who emerges from business failures and embarrassments, and he/she is called the **power broker**.

Calculating Criminals

Calculating criminals tend to possess above-average intelligence, are well educated and tend to be repeat offenders. They are the kind of criminals who are generally known as predators. These types of criminals are risk-takers and lack empathy or anxiety. They usually start their criminal activities later in life than other types of criminals. According to a 1993 study on Wall Street insider trading scandals, conducted by a team of psychologists, the willingness of such criminals to commit crimes derives from "an external locus of control", which means that they lack self-esteem and confidence, and simply want to fit in with others. Their perception of success is determined by outsiders' opinions rather than their own.

Situation-Dependent Criminals

Most literature and media coverage of white-collar crime focuses on the highly publicized, outrageous variety while the more common kind does not receive much attention. However, the majority of

corporate crime is committed not by people who want to harm others intentionally but by those who are driven by their situations.

Power Brokers

Nowadays, powerful corporate criminals, who hold high positions in the organization, possess the traits belonging to the previous two categories explained above, but they still form a separate category called the “power broker”. Although their characteristics might coincide with those of the situation-dependent and calculating criminals, their methods and motives are different. It is hard to believe that these business leaders, who are often heading highly successful enterprises, thought that they could obtain illegal benefits and make even more money at the expense of their organization’s finances and its human resources. Certainly, not all of them started their careers with the intention to deceive investors, stakeholders, and their own employees and to steal from the organization. Not all of them are predators. However, their financial crimes are generated by a dangerous combination of predatory traits and their positions in the organization, which they are able to exploit.

Fraudsters do not Intend to Harm

In 1961, a high-ranking official of Westinghouse Electric Co., who was accused of price-fixing, was asked whether he considered his behaviour criminal. He replied, “Illegal, yes, but not criminal. Criminal action means hurting someone and we did not do that.”

Situation-dependent criminals usually intend no harm to people. These criminals also convince themselves that what they are doing is not wrong because they do not mean any harm to anyone. They even convince themselves that they deserve whatever they get from deception and fraud because their crimes are innocent and immaterial. Initially, the fraud may be insignificant and small but it eventually grows in magnitude as more money and schemes are involved.

Let us say that an investigation begins with a forensic accountant sitting with a client and familiarizing him/herself with the organizational structure of the company. The accountant and client discuss each employee and the likelihood of them committing the fraud. The forensic accountant asks the client about an employee, Brad. The client says that Brad could not have been involved in the fraud because he has been with the company for decades and is a hard-working employee who is pleasant and gets along with everyone. The client informs the accountant that his and Brad’s children attend the same school and that he knows Brad’s family personally. Therefore, according to the client, Brad’s character and lifestyle eliminate him from the list of probable fraudsters. However, an experienced forensic accountant knows better than to eliminate him from the list because he fits the profile of a white-collar criminal. White-collar criminals are usually, though not always, pleasant people whom no one suspects of being criminals.

Typical White-Collar Criminal

Is at least 30 years of age, or older.

Is more likely to be male (55%) than female (45%).

Maintains the appearance of having a stable family.

Has above-average education.

Is less likely to possess a criminal record.

Is psychologically healthy.

Holds a position of trust in the organization.

Has detailed knowledge of accounting systems and the loopholes in them.

Has prior accounting experience

Source: ACFE

Kinds of Rationalization

During interview confessions, many white-collar criminals provide rationalizations for their crimes rather than simply stating that they stole money. These rationalizations typically include the following:

- “It was a loan, which I fully intended to pay back. I kept track of all my loans because I wanted to pay them back.”
- “Accounting rules are confusing and open to interpretations. My financial transactions were completely acceptable according to accounting rules.”
- “Why am I the only one being held accountable when my superiors have been doing it for years?”
- “It is common practice for people in this industry to take kickbacks. This is the reason I am not paid well by my bosses because they expect me to accept money and gifts on the side.”
- “I deserve a raise in my salary because I am the hardest worker in the company. My boss would give me a raise, but then other employees would ask for it as well, so I am taking only a little bit.”
- “What else should I do to provide for my wife and children? I do not get health insurance and my salary does not cover our expenses.”
- “I did it to save the jobs of people in my whole division. If I had not made up a few accounting entries, the bosses would have known that we were not making budgeted profits and our whole division would have been fired.”

Rationalization is the criminal’s final step in completing his/her crime.

Motivations for Fraud

According to an article “The Psychology of Fraud” published in 2001, fraud “like other crime, can best be explained by three factors: a supply of motivated offenders, the availability of suitable targets and the absence of capable guardians-control systems or someone to mind the store.” Moreover, the financial aspect of a financial crime should not be ignored. These financial motivations vary, ranging from an employee who cannot pay his/her bills to a senior executive who is under financial strain because the market has taken a turn for the worse and the company will struggle to survive. In the latter case, the

strain is not limited to the financial downturn but includes the prospect of losing social status and reputation.

For example, the US government indicted Sanjay Kumar, the CEO of Computer Associates, and two of the company's executives for stating revenues and profits prematurely. The government's exact indictment read, "Computer Associates prematurely recognized \$2.2 billion in revenue in FY 2000 and FY 2001 and more than \$1.1 billion in premature revenue in prior quarters." The Securities and Exchange Commission (SEC) also alleged that the company kept recording revenue from 1998 to 2000 from contracts that were executed after the quarter had ended simply to enable them to keep up with Wall Street's quarterly earning estimates. Computer Associates reached a \$225 million settlement with the Justice Department and SEC and agreed to undertake financial accounting reforms.

Some theories propose that white-collar crime is a direct and an unavoidable result of competitive capitalism. Recklessness and even deception are given a free hand in the name of competition and to satisfy the egos of powerful executives.

The repetitive message for the masses is that, in the struggle not just to survive, but to thrive and succeed in a competitive society, one must be wealthy. The ever-widening class gap between "winners" and "losers" is motivation enough to be on the winning end of inequality. It is this fear of failing, and of being unable to keep up with those who are making more money than us, that motivates people to commit financial crime and to consider themselves justified in doing so.

We have already established that a situation facing a corporate offender is instrumental in determining whether or not he/she will commit a crime. Corporate culture is another important aspect and determinant of white-collar crime. Sometimes, the norms and values of an organization and peer pressure lead an employee to commit financial fraud. This is true in many cases involving price-fixing, bribery and the manufacturing of dangerous products. Loyalty is transformed into collusion and team-playing becomes conspiracy. Where corporate culture encourages and dictates fraud, many people are forced to follow the norms of this culture for fear of losing their jobs and becoming outcasts. Therefore, according to Sutherland, deceptive and criminal behaviour becomes internalized in people as a result of them associating with people who encourage this kind of behaviour.

White-collar crime is not defined by a personal history of violence and instability. On the contrary, conformity and the appearance of being normal and stable are key factors that help mask such crimes. The fact that these criminals lead conventional lives and have normal personalities gains them the trust of their superiors and colleagues and enables them to commit fraud. The most amazing aspect of a white-collar criminal's personality is his/her ability to rationalize and justify his/her acts. They strike a balance between normalcy and deviance without even feeling conflicted. They can only do so by "neutralizing".

This act of neutralizing and rationalizing allows criminals to commit the crime while ridding themselves of all blame. We mentioned the kind of justifications invoked by fraudsters, the most common among them being: "Our acts are benign and were not meant to harm anyone." Other rationalizations include

the inability of employees to pay their bills and provide for their families, which compelled them to steal. Some embezzlers satisfy their consciences by stating that they were merely borrowing some money and intending to return it later, or that if everyone else is doing it, why should they be left behind? Corporate criminals disregard government financial laws and regulations because they feel that the government is using such laws to interfere in and influence free market forces.

Moral justifications of crime include the following:

- The employer owed them money, so they were only taking what was theirs.
- They felt abused, exploited and underappreciated by their employers; therefore, they resorted to stealing.
- They deserved to be promoted more than the employee who was promoted in their place, because they were better qualified and more hard-working.
- The employers reprimanded them unfairly.

While the majority of fraud cases involve people who are driven by egotism, by the need to prove that they are smart, and by anti-capitalist ideologies, some of them may commit crime due to mental illness and a wish to harm the company.

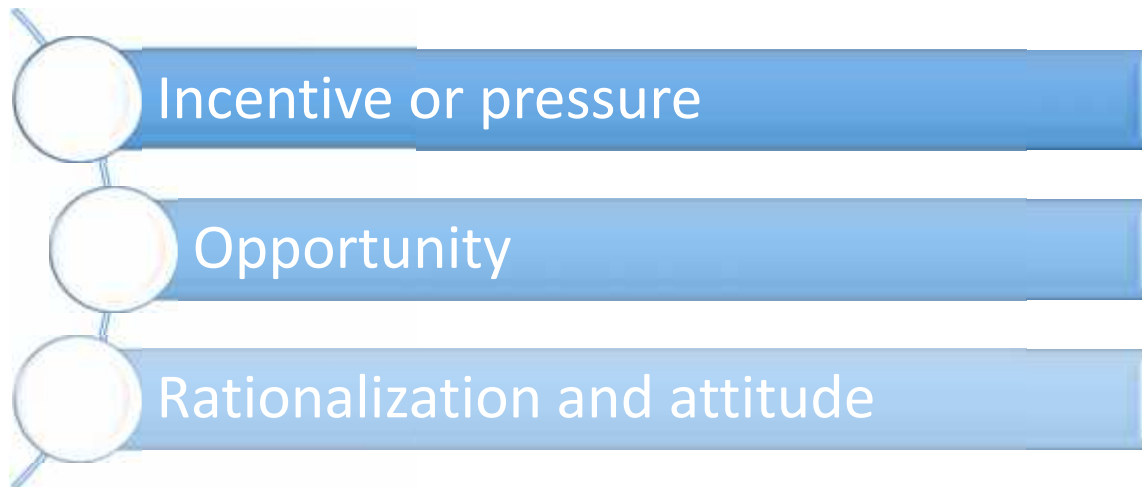
Auditors' Need to Understand the Mind of the Fraudster

Mortimer Feinberg and John J. Tarrant begin their book *Why Smart People Do Dumb Things* with the following words:

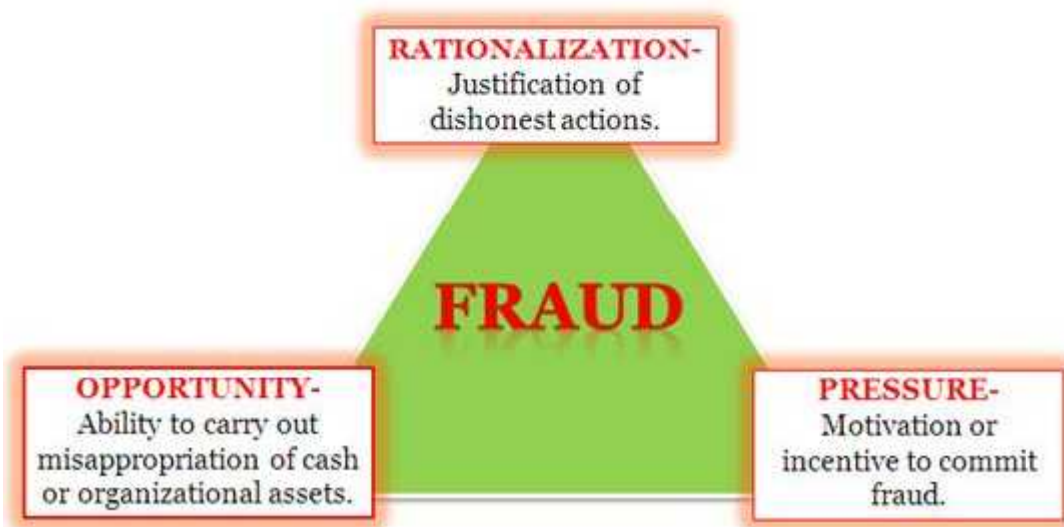
“If you are of above average intelligence—and if you have mastered the use of high intelligence to solve problems and achieve goals—it is the premise of this book that you are at risk [of perpetrating a fraud] because of the strength of your cognitive equipment.”

This book may help auditors to understand how the mind of a white-collar criminal works. It provides an insight into the minds of successful professionals and politicians who ended up doing something foolish. It is impossible for auditors to investigate every single transaction, given time constraints; therefore, they have to make insightful guesses and assumptions based on the evidence they have gathered. As an auditor gains more insight into and understanding of a criminal's mind, he/she will be better able to prepare and plan for the extent and scope of the audit. They make these audit decisions based on the evidence they have gathered and the risks they have identified. The auditor must rely on his/her good judgement and scepticism to investigate and minimize the uncertainty associated with the investigation.

Mindful of the fact that clever people are capable of doing foolish things, and having understood the conditions surrounding the fraud, auditors choose specific transactions for further expansion and investigation. These transactions are the ones they believe will help them find the culprit and discover the manner in which the fraud was conducted. According to the fraud triangle, the following three conditions are present when a fraud is conducted:



THE FRAUD TRIANGLE



Conclusion

Among the various people encountered by auditors during an audit, only a few have the motive and opportunity to commit crime and the ability to rationalize their acts to themselves and others. Their motive and opportunity are undisclosed and a carefully camouflaged secret. This makes the auditors' job difficult.

As mentioned earlier, perpetrators of fraud are usually able to circumvent the controls that are put in place to prevent fraud. Fraud deterrence mechanisms and controls will never be foolproof ways of foiling fraudsters because people who have the intention, motive and opportunity to commit crime will find ways of exploiting the loopholes present in the organization's control system. Sometimes, collusion or human error leads to the fraud going unnoticed.

Perceptions and expectations go a long way to creating deterrence of fraud. If the employees expect to be held accountable and punished for committing a crime, they will fear being apprehended. It is important to send a clear signal to everyone that punishment is guaranteed. There are various ways in which an organisation might create awareness among its employees about financial crime. These include:

- Training and education regarding ethics and the code of conduct
- Thorough background checks before hiring employees
- Regular audits and forensic investigations
- A strong internal control system

Employees must be aware that they are being monitored, and those who have access to the organization's financial assets and transactions should be left in no doubt about the control mechanism's strength and efficiency. The certainty of getting caught will prevent employees from acting on their motivations and exploiting opportunities for wrongdoing.

Further Reading:

- ✓ *Wells, J. T. (2006) Principles of Fraud Examination*
- ✓ *Brown, A., Doig, A., Summers, G., Dobbs, L. (2004) Practically Fraud*
- ✓ *Silverstone, H., Sheetz, M. (2006) Forensic Accounting and Fraud Investigation for Non-Experts, 2nd ed.*
- ✓ *Albrecht, C.C., Albrecht, W. (2005) Fraud Examination*