The Mind Behind The Fraudsters Crime: Key Behavioral and Environmental Elements

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Goal

“To change the way you think and approach fraud…”
Culture
Corporate Governance Framework™

- Board of Directors & Committees
- Legal & Regulatory
- Communication & Trust
- Business Practices & Ethics
- Disclosure & Transparency
- Enterprise Risk Management
- Monitoring
Business Practices & Ethics

It can be argued that Business Practices & Ethics drives the other components of the Governance Framework. It requires a continuous effort, reinforcement, and on-going training. Without it, you could and probably will fail because everyone believes they’re ethical, no matter what they’re doing!
The Fraud Environment
Do We Really Notice What's Going on Around Us?
Just the Facts

70 percent of fraudsters have a profile that combines Pressure with Arrogance or Greed

Source: COSO Study
Behavioral Elements
Lack of a moral compass

As much as you would like to maintain separation between the personal and professional lives of your employees, the two are linked when it comes to actions on the business front.
Troubling friends, family, and relationships

Fraudsters seek out those who share the same social background are gullible and easily manipulated.
Organized Crime

- Big Boss
  - Captain or Lieutenant
    - Soldiers
      - Associates

Typical Organization

- Chairman
  - Senior Management
    - CEO and CFO
      - Middle Management and Staff
        - Third Parties
Deception and Deflection
Excessive arrogance is an attitude of superiority and entitlement and needs to be checked and redirected.
Cleverness and creativity
Environmental Elements
Weak tone from the top
Ethics: What Is It?

The word "ethics" is derived from the Greek word ethos (character), and from the Latin word mores (customs).

In essence, it is what you do or don’t do when no one is watching.
A business traveler checked into a hotel in California after traveling for over 10 hours, he/she was starving, so they ate the $6 box of Oreos from the minibar. Later that day while walking down the street to a convenience store, he/she bought an identical box for $2.50, and replenished the minibar before the hotel had a chance to restock it and charge them the $6.00.

Was this proper? After all no harm no foul right – no one will ever know.

Would it help if I told you the box was fresher. The Oreos eaten were going to expire three months before the box I replaced them with.
Question

What are the benefits of good ethics?

A. Good ethics can improve employee morale, recruitment, and retention.

B. Other companies want to do business with companies that have a reputation for fairness, ethics, and integrity.

C. People are more likely to invest in ethical companies.

D. Good ethics instills a more positive mind-set that fosters creativity and innovation among stakeholders.

E. All of the above
Theory

Unethical

Situational Ethics

Ethical
One Benefit of Good Ethics

Studies have shown a linkage between Companies with good ethics outperform those who ethics policies that are weak or non-existent.
Vulnerable culture
Loose link between ethics and compensation
Components of fraud

Act or actions that can be internal or external (fraud schemes)

Concealment (deception or deflection)

Conversion
Fraud Pentagon™

Focused on middle management

CEO, CFO, larger fraud schemes – “today’s fraudster”
Five elements of the Fraud Pentagon™

✓ Arrogance
Arrogance or lack of conscience is an attitude of superiority and entitlement or greed on the part of a person who believes that internal controls simply do not personally apply.

✓ Competence
Competence is an employee’s ability to override internal controls, develop a sophisticated concealment strategy, and to control the social situation to his or her advantage by selling it to others.

✓ Opportunity
Weak controls provide the opportunity for a person to commit fraud.

✓ Pressure
There is a motive to commit and conceal a fraud.

✓ Rationalization
Not an ex post facto means of justifying a theft or fraud that has already occurred.
Deterrence

- Awareness through ongoing communication and training – understanding “red flags”
- Internal controls – design and effectiveness
- Policies and procedures
What is a Red Flag?

An observable event or action(s) that could be linked to an act or concealment strategy that causes someone to stop, assess the situation, and investigate
Speculate or investigate that is the dilemma
The Use of Red Flags to Detect Fraud

- Does the anomaly have supporting documentation?
- Does the documentation appear to be falsified, altered, or fictitious?
- Does the transaction and its reflection in the financial statements make sense?
- Does the transaction make sense in light of the company’s operations, goals and objectives?
- Does the totality of this and similar transactions make sense analytically when evaluated in comparison to the economy, the industry, key competitors and other related accounting numbers within the organization?
- Does the transaction have proper approval and the proper authority levels?
- Does anything else about the transactions or its nature make it appear suspicious?
Categories of Red Flags

- Data
- Documents
- Lack of Controls
- Behavior
Data

- **Unusual timing of transactions.** This includes the time of day, the day of the week, or the season.

- **Frequency of transactions.** Transactions that are occurring too frequently or not frequently enough are suspicious. Each organization has its own operating patterns, and the transactions should be booked accordingly.

- **Unusual amounts recorded.** Take notice of whether an account has many entries that are large, round numbers. Consider whether some of the transactions in the account are far too large or far too small.

- **Questionable parties involved.** Should the organization be paying an outside party? Is a payment being made to a related party? Is the company paying large sums to a vendor whose name is not easily recognizable?
Documents

- Missing or altered documents
- Evidence of backdating documents
- No original documents available
- Documents that conflict with one another
- Questionable or missing signatures on documents
Lack of Controls

- Lack of controls in general
  - Unwillingness to remediate gaps
  - Poor tone from the top
- Segregation of duties (excuse!)
- Management with no clear position about conflicts of interest
- Lax rules regarding authorization of transactions
- Untimely reconciliation of or failure to reconcile accounts
Behavior

- Rationalization, changes in behavior, contradictory behavior, or recurring negative behavior patterns
- Lack of stability
- Inadequate income for lifestyle
- Resentment of superiors and frustration with job
- Emotional trauma in home or work life
- Undue expectations from family, company, or community
Question

Profiling and stereotyping are the same thing.

A. True
B. False
Profiling in the Fight Against Fraud

Comprehensive Profile

Type

Element or Trait

Element or Trait

Element or Trait

Element or Trait

Actions

Source Dan Korem

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Profile: Tiger Woods

WALK (PERFORMANCE TYPE)

INNOVATOR
Predictable – Unpredictable
Confident – Fearful

• Risk taker
• Creative
• Challenge seeker
• Innovative

TALK (COMMUNICATION TYPE)

SALESPEOPLE
Control – Express
Ask – Tell

• Passionate
• Outgoing
• Friendly
Profile: Me – and Probably You?

INNOVATOR/MANAGER

Predictable – Unpredictable
Confident – Fearful

- Risk taker
- Dependable
- Creative
- Problem solver
- Assumes responsibility

SALESPEOPLE

Control – Express
Ask – Tell

- Passionate
- Outgoing
- Friendly
Profile: White-collar criminal

**RANDOM ACTOR**
Predictable – Unpredictable
Confident – Fearful

- Hot-tempered
- Egocentric
- Deceptive
- Secretive
- Moody
- Without a conscience
- Anxious

**SALESPEerson**
Control – Express
Ask – Tell

- Passionate
- Outgoing
- Friendly
Fraud Pentagon™

Competence is an employee’s ability to override internal controls, develop a sophisticated concealment strategy, and to control the social situation to his or her advantage by **selling it to others**.
Many Times Behavior & Environmental Issues are Hidden in Plain Sight
Focus on “Gatekeepers” and “Random actors” and their associates
Link People to Controls or Actions
When identifying fraud schemes, consider the company's strategic plan. Why? Management might do whatever it takes to achieve the desired results!
Be alert to crisis mode or constant fire drills

It might be very difficult to understand what is normal. Sometimes this is intentional!
Let them know you’re watching!
Anti-fraud framework

Culture of the Organization and “Tone From the Top”

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Anti-Fraud Program

Training and Communication
- Training Programs
  - Ethics
  - Code of Conduct
  - Policies and Procedures
  - Fraud Awareness
- Tools & Promotion
  - Website
  - Email / Memos
  - Handbooks and Acknowledgments

Enterprise-wide Assessments
- Fraud Risk Assessments
- FCPA/Anti-Bribery and Corruption Risk Assessments
- Risk Culture Surveys
- Privacy & Data Security Assessments

Fraud Deterrence and Detection
- Internal Controls
  - Job Rotation
  - Mandatory Vacations
  - Segregation of Duties
- Key Word Searches
  - Surprise Audits
  - Employee Support Programs
  - Disciplinary Actions

Fraud Response Management
- Response Plan and Policies
- Investigation Guidelines
- External Investigation Team
- Computer Forensics and e-Discovery
- Data Security Breaches

Monitoring
- Data Analytics
- Internal Reporting
- External Reporting
- Audit Committee
- Internal Audit
- External Audit of ICOFR
- Legal and Compliance Systems Monitoring
Continuously strive to enhance your fraud or vulnerability risk management program.
If you need love, get a puppy!

“Trust is a professional hazard – verify, verify, verify, and verify!”™
Closing thoughts

…books and records don’t commit fraud, people do!

*Joseph T. Wells*
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ACFE
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Dan Korem – “Art of Profiling”
The Profession
“If you don't know where you are going, you might wind up someplace else.”

Yogi Berra
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