Fraud Examination 6e

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Fraud Examination

SIXTH EDITION

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To LeAnn, Jenny, Laurel, and Karen

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About the Authors

W. Steve Albrecht is professor emeritus of Accountancy in the Marriott School of Management at Brigham Young University (BYU). Dr. Albrecht, a certified public accountant (CPA), certified fraud examiner (CFE), and certified internal auditor (CIA), came to BYU in 1977 after teaching at Stanford and at the University of Illinois. He served as both associate dean of the Marriott School and as the director of the School of Accountancy and Information Systems at BYU.

Dr. Albrecht received a bachelor's degree in accounting from Brigham Young University and his MBA and Ph.D. degrees from the University of Wisconsin. He is past president of the American Accounting Association, the Association of Certified Fraud Examiners (ACFE), and Beta Alpha Psi. He was a former member of the Board of Regents of the Institute of Internal Auditors and served on the task force of the AICPA that wrote SAS 82, a fraud auditing standard, and on the FASAC, an advisory committee to the FASB. He was a member of the Committee of Sponsoring Organizations (COSO) from 1997 to 2000 and the AICPA Council from 2000 to 2003 and was chair of the AICPA's Pre-Certification Executive Education Committee from 2002 to 2004. He previously served as a trustee of the Financial Accounting Foundation that oversees the FASB and GASB. Dr. Albrecht has done extensive research on business fraud. His research has resulted in the publication of over 125 articles in professional and academic journals. He is the author or coauthor of over 25 books or monographs, several of which are on fraud. His financial and principles of accounting textbooks are in their 15th editions. In 1997, 2001, 2002, 2003, and 2004 he was chosen as one of the 100 most influential accounting professionals in the United States by *Accounting Today* magazine. Because of his extensive work with the ACFE, one of the headquarters buildings in Austin, Texas, is named after him.

Dr. Albrecht has consulted with numerous organizations, including Fortune 500 companies, major financial institutions, the United Nations, FBI, and other organizations, and has been an expert witness in some of the largest fraud cases in America. He currently chairs the audit committees and serves on the boards of directors of three public companies and two private company. In 2013, he was named one of the top 50 corporate directors in the United States by the National Association of Corporate Directors and in 2017 was named the lifetime outstanding director in the State of Utah.

Chad O. Albrecht is an associate professor and director of the MBA program at the Jon M. Huntsman School of Business at Utah State University. Chad has taught forensic accounting and fraud investigation at various schools both in Europe and the United States.

Chad's research focuses on international fraud and corruption. This research addresses how fraud is perceived and perpetrated across cultures. Chad's research has been published in the *Journal of Business Ethics, Business and Society, Internal Auditing, Corporate Finance Review, Cross Cultural Management: An International Journal*, and the *International Journal of Human Resource Management*, among others. Chad's research has been reporting in various news outlets including the prestigious *Times of London*. Before pursuing doctoral studies, Chad worked as a licensed stockbroker for The Harris, a subsidiary of the Bank of Montreal.

Chad received his bachelor's degree in accounting at Brigham Young University and his Ph.D. from ESADE Business School in Barcelona, Spain. *The Wall Street Journal, Business Week*, and *The Financial Times* consistently rank ESADE as one of the top 20 business schools in the world.

Conan C. Albrecht is a professor of Information Systems at Brigham Young University. He teaches classes in enterprise development, computer-aided fraud detection, and business programming. Dr. Albrecht researches computer-based fraud detection techniques and online group dynamics. He has published articles on fraud detection and information theory in *The Journal of Forensic Accounting, The Journal of Accountancy, The Communications of the ACM, Decision Support Systems, Information and Management,* and other academic and professional outlets.

Mark F. Zimbelman is the Mary and Ellis Professor at Brigham Young University's (BYU) School of Accountancy. He teaches classes on auditing and fraud examination and focuses his research on the detection of financial statement fraud. His research has been published in numerous academic journals including *Journal of Accounting Research, The Accounting Review, Contemporary Accounting Research, Review of Accounting Studies, Organizational Behavior and Human Decision Processes, Auditing: A Journal of Practice and Theory, Journal of Forensic Accounting, Journal of Accounting Literature*, and *Accounting Horizons.*

Dr. Zimbelman received his doctorate in 1996 from the University of Arizona where he completed his dissertation on SAS 82. A paper from his dissertation was honored to be one of six that were presented at the 1997 *Journal of Accounting Research* Conference at the University of Chicago. In 1999, he returned to that conference to present another paper on auditor's detection of fraud. In addition to his academic research on fraud, Dr. Zimbelman has worked with the American Institute of Certified Public Accountants and the Institute of Internal Auditors in writing various publications on fraud.

After graduating from BYU's accounting program in 1984, Dr. Zimbelman received his CPA license and worked for over six years as a financial statement auditor and, later, as a controller in industry. After getting his Ph.D. and working for three years at the University of Oklahoma, he returned to BYU in 1999. In 2005, he took a leave of absence to work with KPMG in their fraud and forensics practice. This opportunity gave him hands on experience investigating violations of the Foreign Corrupt Practices Act, financial statement fraud, vendor fraud and embezzlement.

Foreword

According to the Association of Certified Fraud Examiners' 2016 Report to the Nations on Occupational Fraud and Abuse, certified fraud examiners estimate that organizations lose, on average, about 5 percent of their revenues to dishonesty from within.

If multiplied by the estimated Gross World Product, the cost of occupational fraud and abuse may run a staggering \$2.9 trillion annually. By the breadth of the definition, it covers all corporate dishonesty—from the mailroom to the boardroom. While executives are "cooking" the company's earnings to show better profits, purchasing agents are getting kickbacks from suppliers, and employees are embezzling money to improve their lifestyles.

Knowing how much fraud actually costs is an impossible task. The cases we know about only represent the tip of the iceberg; those discovered tend to be greedy or careless. Executives and employees who are neither may well commit fraud throughout their entire careers and get away with it.

The huge cost of occupational fraud begs an obvious question: Why does it occur? The answers aren't always easy. Although the simple explanation is greed—a natural human trait—even greedy people don't always lie, cheat, and steal. A more complete answer for corporate dishonesty involves three factors: the individual, the workplace, and society.

Individuals likely to commit occupational fraud are often on the financial ropes. This can occur when people spend more money than they make or when there is a personal financial crisis demanding immediate resolution. Although many of us have had such difficult situations, dishonest employees are more likely to salve their consciences with rationalizations that justify fraud. In short, they lack the convictions of their own ethics.

Workplace environments also contribute to occupational fraud. Organizations that are viewed by employees as uncaring, stingy, or dishonest can run a much higher risk of being victimized from within. Many workers—in an attempt to right what they consider to be corporate wrongs—may address these perceived injustices in a variety of ways: goldbricking, excessive absences, pilferage, and dishonesty.

Moreover, some entities unwittingly contribute to the problem. By failing to establish reasonable workplace conditions, safeguards, and controls, companies might make fraud too easy, and thus too tempting. Organizations have a duty to help keep the workforce honest. Societal conditions also influence the rate of occupational fraud. If dishonesty is easily accepted and goes largely unpunished, we can only expect it to thrive.

It was my own search for answers to occupational fraud 20 years ago that led me to W. Steve Albrecht. In the early 1980s, after 10 years with the FBI, I practiced as a fraud examiner. Increasingly, my corporate clients were referring me cases of embezzlement, corruption, and other misdeeds.

One client, certainly on the cutting edge at the time, wanted help in developing an anti-fraud program. That request led me to the vast libraries of the University of Texas at Austin, where I discovered one of Dr. Albrecht's first published works on the subject, *Deterring Fraud: The Internal Auditor's Perspective.*

After reading this seminal research by Steve and his colleagues, I sought him out personally. Even though Steve had never heard my name, he graciously invited me to Brigham Young University, where he was teaching. Dr. Albrecht answered my questions and volunteered his valuable time to aid on the topic of occupational fraud. After that, we've always stayed in touch.

Neither of us then could have imagined the paths our lives would take together. In 1988, Steve was a major influence in encouraging me to start the Association of Certified Fraud Examiners, and he served with distinction as its first president.

Since that time, the ACFE has grown to the world's largest anti-fraud organization with nearly 60,000 members in over 140 countries. Steve's lifetime of contributions to the field of fraud detection and deterrence simply cannot be overstated. The ACFE recognized the enormity of Dr. Albrecht's body of work in 1998 when it honored him with its most valued prize: the Cressey Award.

However, the many awards Steve has received do not capture the kind of man he is. A devoted father and husband, Steve lives his life by high example. Regardless of his many accomplishments, you won't hear about them from him; humility is one of his most endearing traits. I have had the pleasure of meeting the coauthors, Conan and Chad Albrecht, two of Dr. Albrecht's sons. There is no question that they will carry on his work. I am proud to call Steve my great friend.

Steve and I are of a common mind when it comes to fraud. First, the accounting community, which has the lion's share of responsibility to control occupational fraud, is ill-equipped for the job. Second, education is the cornerstone to preventing fraud. The more we know, the less likely we are to become victims.

The terms "fraud examination" and "forensic accounting" are often used interchangeably. However, they refer to different but overlapping concepts. The latter phrase, although highly popular as a euphemism for fraud investigation, actually refers to any kind of accounting work done for litigation purposes.

According to the *Fraud Examiners Manual*, fraud examination is a methodology for resolving allegations of fraud from inception to disposition. The process involves gathering evidence, taking statements, writing reports, and assisting in the detection and deterrence of fraud. Although many organizations employ fraud examiners, audit professionals and others also conduct fraud examinations on a limited, as-needed basis. The fraud examination field draws its common body of knowledge from four areas: accounting and auditing, fraud investigation techniques, the legal elements of fraud, and criminology and ethics. Steve's work in helping define this field was indispensable.

For accountants, anti-fraud education has been practically nonexistent for decades. One of the main reasons has been the lack of authoritative texts on the subject. Educators and students alike will find *Fraud Examination* to be a solution. Packed full of real examples, thought-provoking discussion issues and questions, this book is ideal for both undergraduate and graduate students.

Moreover, practitioners will find a great deal of guidance in resolving current cases. Managers and executives will benefit from understanding the myriad of issues that can assist them in deterring occupational fraud. And for all of us, *Fraud Examination* is simply a wonderfully engaging read.

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Preface

Fraud examination (sometimes called forensic accounting) is one of the most exciting careers for students studying accounting and business today. Forensic accountants combine their accounting knowledge with investigative skills in various litigation support and investigative accounting settings. Forensic accountants are employed by public accounting firms' forensic accounting divisions; by consulting firms specializing in risk consulting and forensic accounting services; or by lawyers, law enforcement agencies, insurance companies, government organizations, or financial institutions. Due to heightened awareness and growing intolerance of fraudulent activity, demand for forensic accountants is rapidly increasing. Both the size and the number of frauds are increasing, which will result in an even greater demand for fraud-fighting professionals in the future.

You've probably heard about Enron, WorldCom, Madoff, and other major frauds. But, there are many other types of frauds that occur every day. Fraud is an extremely costly business problem. For example, not long ago a Fortune 500 automaker experienced a $436 million fraud. Because the fraud reduced the company's net income by $436 million from what it would have been and because the company had a profit margin (net income divided by net sales) of approximately 10 percent, the company would have to generate an additional $4.36 billion (10 times the amount lost in the fraud) in revenues to restore net income to its prefraud level. If you assume that an average car sells for $30,000, this company would have to make and sell over 145,000 additional cars ($4.36 billion divided by $30,000 sales price) to recover the effect on net income. In other words, this company faced a major business problem: it could either make and sell 145,000 more cars, or it could work hard to prevent these types of frauds from occurring in the future. When faced with the choice of generating that much additional revenue—which would have been difficult if not impossible—the company decided that reducing and eliminating future frauds was the more effective way to spend its money. As a result, it hired additional fraud and control experts and implemented extensive fraud prevention procedures throughout the organization. Eliminating fraud is a problem that every organization faces, and you can help them deal with this growing problem.

Even if you decide not to become a fraud expert, the topics you will study in this book will help you be a better professional in whatever career path you choose. The technology, interviewing, document examination, public records, and other tools and knowledge you will gain will make you a better consultant, auditor, tax professional, or manager, as well as a better and more astute investor.

As you will discover in this book, there is a very active professional organization that deals with fighting fraud called the Association of Certified Fraud Examiners (ACFE), which currently has over 80,000 members and is based in Austin, Texas. This organization, as well as others, can provide future fraud training. In addition, the ACFE will provide its educational materials free of charge to institutions of higher learning that agree to offer a three-hour course entitled "Fraud Examination." These materials include several original videos related to fraud detection and prevention. A complete listing of the ACFE's materials and other information can be found at the association's Web site at www.acfe.com.

New to This Edition

MindTap: Empower Your Students

MindTap is a platform that propels students from memorization to mastery. It gives you complete control of your course so you can provide engaging content, challenge every learner, and build student confidence. Customize interactive syllabi to emphasize priority topics, then add your own material or notes to the e-book as desired. This outcomes-driven application gives you the tools needed to empower students and boost both understanding and performance.

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Featured Topics by Chapter

In this book, we cover seven different topics:

- *Part 1, comprising Chapters 1, 2, and 3, provides an introduction to fraud and an overview of the fraud problem. Chapter 1 discusses the nature of fraud, Chapter 2 describes fraud perpetrators and their motivations for being dishonest, and Chapter 3 provides an overview of the different ways to fight and, hopefully, reduce fraud.*
- *The second and third parts of the book focus on fraud prevention (Chapter 4) and fraud detection (Chapters 5 and 6.) Chapter 5 provides an overview of and discusses traditional fraud detection methods, while Chapter 6 introduces you to the use of technology to proactively detect fraud.*
- *Part 4 covers the various elements of fraud investigation. In Chapter 7, we cover theft act investigation methods; in Chapter 8, we cover concealment investigation methods; in Chapter 9, we discuss conversion investigative methods; and in Chapter 10, we cover various types of interviewing and other query approaches to investigating fraud. The interview techniques you learn in Chapter 10 will make you a more discerning husband or wife, parent, manager, employee, or friend.*

  Parts 5 and 6 discuss the various types of fraud. In Part 5, we include three chapters on management, or financial statement, fraud. In Chapter 11, we provide an overview of financial statement fraud and introduce a proactive model for detecting fraud and errors in the financial statements. In Chapter 12, we discuss both revenue- and inventory-related frauds, the two most common ways to intentionally misstate financial statements. In Chapter 13, we discuss three other types of financial statement frauds: understating liabilities and expenses, overstating assets, and inadequate disclosures. These chapters will help you better understand and critique the financial statements of any organization.
- *In Part 6, we discuss four other types of fraud. Chapter 14 covers fraud committed against organizations by employees, vendors, and customers. Chapter 15 covers consumer fraud, a chapter that will have immediate relevance to you and will alert you to the fraud exposures you face every day. Chapter 16 introduces divorce, tax, and bankruptcy fraud, all of which are very common because people often try to hide assets from those who want to take them away—the government in the case of taxes and others in the cases of divorce and bankruptcy. Chapter 16 also covers money laundering frauds. Chapter 17 discusses e-business frauds, a growing type of fraud problem because of the increasing use of the Internet to conduct business.*
- *The final part in the book—Chapter 18—discusses options that victims have when deciding how to follow-up on frauds they experience. This chapter provides an overview of the criminal and civil statutes governing fraud legal proceedings and helps you understand the various ways organizations have to resolve dishonest acts.*

We realize that there are many other fraud-related topics that we could have included. We have tried to strike a balance between brevity and topics of general interest and detailed investigation and specific knowledge that experienced professional fraud examiners would need. We also realize that, for most of you, this book will be used in the only fraud-related course you will take in your college studies. We are certain, however, that studying fraud will be one of your most exciting courses and will spark an interest that will stimulate career-changing plans for many of you. At a minimum, after studying fraud examination, you should be a much more careful investor and business decision maker. You will never view business transactions or reports the same way, and you will be a much more careful and skeptical observer and participant in future endeavors.

We are excited to share this exciting topic with you. We wish you success and enthusiasm as you study this book, and we welcome suggestions for improvement.

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Mark F. Zimbelman, Ph.D., CPA (inactive)

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CHAPTER 1
The Nature of Fraud

TO THE STUDENT

With this chapter, you are embarking on an exciting journey of the study of fraud. Many of you will find this course more interesting than any other course you have taken before. Chapter 1 will provide an overview of fraud—what is fraud, how serious is the problem, fraud-fighting careers, criminal and civil laws, and other overview topics.

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- **Understand the seriousness of fraud and how fraud affects individuals, consumers, organizations, and society.**
- **Define fraud.**
- **Understand different types of fraud.**
- **Understand the difference between fraud committed *against an* organization and fraud committed *on behalf* of an organization.**
- **Understand the difference between criminal and civil fraud laws.**
- **Understand the types of fraud-fighting careers available today.**

On December 11, 2008, the Federal Bureau of Investigation (FBI) arrested Bernard "Bernie" Madoff for perpetrating the single largest investment fraud in the history of the world. A day earlier, Madoff's own sons had turned him in, reporting to authorities that Madoff's wealth management business was not a legitimate business but was a shell company for a large scam. On March 12, 2009, Madoff pled guilty to 11 federal crimes and admitted to operating the largest Ponzi scheme in history. On June 29, 2009, he was sentenced to 150 years in prison and ordered to make restitution payments of $17 billion.

Madoff was born in Queens, New York, and later graduated from Hofstra College in 1960. After college, he dedicated himself to building his firm, Bernard L. Madoff Investment Securities, where he remained until his arrest in 2008. Throughout his career, Madoff became one of the most respected and trusted individuals on Wall Street, serving both as chairman of the board of directors and on the board of governors of the NASD (National Association of Securities Dealers). Madoff was also actively engaged in creating the technology that eventually became the NASDAQ stock exchange.

Madoff perpetrated his scheme by consistently providing high returns for his investors. Madoff claimed that he was able to provide such returns by investing in what is known as a split-strike conversion strategy. A split-strike conversion strategy is a complicated investment where investors take a long position in equities together with a short call and a long put on an equity index to lower the volatility of the position.[1,2] Although the entire split-strike conversion strategy may seem very elaborate, the strategy was nothing more than a tool employed by Madoff to attract additional investors to his large Ponzi scheme.

A Ponzi scheme is a type of fraud that lures investment funds from victims and then pays those victims a premium or interest from money that is paid by subsequent investors.[3] Without intervention, Ponzi schemes will continue to grow until new recruits become unavailable, at which time, the scam breaks down and is discovered.

Individuals throughout the world lost money in Madoff's pyramid scheme.[4] Whereas many of the victims were blue-collared workers who came from humble backgrounds, others were extremely wealthy. For example, Prince Michel of Yugoslavia traveled across Europe to raise money for Madoff. Other victims included various royal families and even London's House of Lords. Actor Kevin Bacon and producer Steven Spielberg, as well as various other Hollywood movie stars, had invested with Madoff. Because Madoff had connections with the Jewish community, many Jewish charities and institutions lost a significant amount of money in the scam.[5]

Seriousness of the Fraud Problem

Bernard Madoff is an example of an individual who misrepresented himself and his company to commit fraud. Investment fraud, like the fraud committed by Bernard Madoff, is just one of the many types of frauds that present major problems for businesses and consumers throughout the world.

Although most people and even most researchers believe that fraud is increasing both in size and frequency, it is difficult to know for sure. First, it is impossible to know what percentage of fraud **perpetrators** are caught. Are there perfect frauds that are never detected, or are all frauds eventually discovered? In addition, many frauds that are detected are quietly handled by the victims and never made public. In many cases of employee fraud, for example, companies merely hide the frauds and quietly terminate or transfer perpetrators rather than make the frauds public. Companies and individuals who have been defrauded are often more concerned about the embarrassment of making frauds public and the costs of investigating fraud than they are about seeking justice and punishing fraud perpetrators.

Statistics on how much fraud is occurring, whether it is increasing or decreasing, and how much the average fraud costs come from four basic sources:

1. Government agencies—Agencies such as the FBI, FDIC, IRS, and various other agencies publish fraud statistics from time to time, but these organizations only publish those statistics that are directly related to their **jurisdictions**. As a result, their statistics are not complete and do not provide a total picture of fraud—even in the areas for which they have responsibility.
2. Researchers—Researchers often conduct studies about particular types of fraud within certain

industries. Unfortunately, data on actual frauds are hard to obtain and, as a result, most research only provides small insights into the magnitude of the problem, even in the specific areas being studied. Comprehensive research on the occurrence of fraud is rare and is not always based on sound scientific approaches.

3. Insurance companies—Insurance companies often provide fidelity bonding or other types of coverage against employee and other fraud. When fraud occurs, they undertake investigations and, as a result, collect some fraud statistics. Generally, however, their statistics relate only to actual cases where they provided employee bonding or other insurance. At best, their analysis of the problem is incomplete.
4. Victims of fraud—Sometimes we learn about fraud from those who have been **victims**. In almost all industries, there is no organized way for victims to report fraud and, even if there were, many companies would choose not to make their fraud losses public.

> The **Association of Certified Fraud Examiners (ACFE)**, the world's largest anti-fraud organization with approximately 80,000 members (see www.acfe.com), regularly conducts one of the most comprehensive fraud studies in the United States. First conducted in 1996 and then conducted every two years with the last study in 2016, the ACFE study, also known as the *Report to the Nations on Occupational Fraud & Abuse*, is based on actual fraud cases reported by Certified Fraud Examiners (CFEs) who investigate the frauds.

The 2016 study estimates that organizations lose roughly 5 percent of their annual revenues to fraud. Applied to the 2015 Gross World Product, this 5 percent figure translates to a projected global fraud loss of $6.3 billion. The median loss caused by the occupational fraud cases in their study was $150,000 with more than 23 percent of all cases causing losses of at least $1 million.

Because fraud affects how much we pay for goods and services, each of us pays not only a portion of the fraud bill but also for the detection and investigation of fraud. It is almost impossible to read a newspaper or business magazine without coming across multiple incidents of fraud.

Even more alarming than the increased number of fraud cases is the size of discovered frauds. In earlier times, if a perpetrator wanted to steal from his or her employer, he or she only had to physically remove the assets from the business premise. Because of fear of being caught with the goods, frauds tended to be small. With the advent of computers, the Internet, and complex accounting systems, perpetrators now need only make a telephone call, misdirect purchase invoices, bribe a supplier, manipulate a computer program, or simply push a key on the keyboard to misplace company assets.[6] Because physical possession of stolen property is no longer required and because it is just as easy to program a computer to embezzle $1 million as it is $1,000, the size and number of frauds have increased tremendously.

In addition, as companies have given in to the pressures to meet Wall Street's earnings expectations and as these pressures to "meet the numbers" have intensified, some very large financial statement frauds have been committed. Hundreds of million- and even billion-dollar frauds have occurred and, in some cases, the market value of the company's stock has declined by billions of dollars.

To understand how costly fraud is to organizations, consider what happens when fraud is committed against a company. Losses incurred from fraud reduce a firm's income on a dollar-for-dollar basis. This means that for every $1 of fraud, the **net income** of the firm is reduced by $1. Because fraud reduces net income, it takes significantly more **revenue** to recover the effect of the fraud on net income. To illustrate, consider the $436 million fraud loss that a large U.S. automobile manufacturer experienced a few years ago.[7] If the automobile manufacturer's **profit margin** (net income as a percentage of revenues) at the time was 10 percent, the company would have to generate up to $4.36 billion in additional revenue (or 10 times the amount of the fraud) to restore net income to what it would have been without the fraud. If we assume an average selling price of $30,000 per car, the company must make and sell an additional 145,000 cars to make up for the fraud. Considered this way, fighting fraud is serious business. The automobile company can spend its efforts in manufacturing and marketing additional new cars, or reducing fraud, or a combination of both. One of the authors consulted with the company after this fraud occurred. His advice to the top executives of the company (the management committee) was "You don't have a fraud problem; rather, you have a business problem. You can either stop these types of fraud from occurring or you can make and sell hundreds of thousands of additional cars. The effect on net income is the same." Viewed this way, the executives decided that, indeed, fraud was a serious business problem.

As another example, consider the case of a large financial institution that was the victim of several frauds that totaled approximately $100 million in one year alone. With a profit margin of 5 percent, and assuming that the bank made $100 per account per year, how many new accounts must the financial institution generate to compensate for the fraud losses? The answer, of course, is up to 20 million new accounts ($100 million fraud loss/0.05 = $2 billion in additional revenues; $2 billion/$100 per account = 20 million new accounts).

Firms are not the only victims of fraud. In the aggregate, national economies also suffer from large-scale fraud and corruption. If we use the logic described in the case of the automobile manufacturer described earlier, we can better understand how, from a macrolevel, countries suffer from fraud. Take, for example, three different economies. If Economy A, whose collective profit margin is 10 percent, loses $500 million to fraud, it must generate $5 billion of additional revenue to offset the loss to net income. If Economy B, whose collective profit margin is also 10 percent, loses $200 million to fraud, it must generate an additional $2 billion. Finally, if Economy C, whose collective profit margin is 5 percent, loses $100 million to fraud, it must also generate an extra $2 billion. The strain fraud imposes on economies throughout the world is tremendous. If just one fraud is prevented, billions of dollars can be saved—resources that can be reinvested in building the economy. Given this analysis, it is easy to see how difficult it is for countries with high amounts of corruption to ever compete with countries with low rates of corruption. High-corruption countries are constantly trying to overcome corruption losses, whereas low-corruption countries are growing and moving ahead. As a result, many honest economists, politicians, and regulators spend a considerable amount of time and resources trying to reduce fraud and corruption.

In addition to the actual reduction of a country's total GDP, the amount of fraud an economy suffers has a big impact on how willing investors are to invest in a given economy. When fraud and corruption levels are high in a country, for example, investors lose confidence in the integrity of the country and become more hesitant to invest resources. The same is true with organizations. After the revelations of corporate wrongdoing in the early 2000s in the United States, for example, foreign investors' purchases of U.S. stocks dropped to $49.5 billion, the lowest level since 1996. Whether these foreign investors' funds moved to stocks in other economies that were deemed safer or whether investors decided to stand on the sidelines and wait out the corporate scandals is not clear. What is clear is that the U.S. economy was significantly hurt by the fraudulent acts at Enron, WorldCom, and others.

Because of different cost/revenue structures, the amount of additional revenues a firm must generate to recover fraud losses varies from firm to firm, from industry to industry, and from country to country. However, it is easy to see that in order to maximize profits, eliminating fraud should be a key goal of every organization or country. The best way to minimize fraud is to prevent it from occurring. In this book, we will cover fraud prevention, as well as fraud detection and investigation.

Remember this …

Statistics about how much fraud is occurring are difficult to get. However, all signs indicate that fraud is increasing both in frequency and amount. Fraud is very costly to organizations and to economies. Because fraud reduces net income on a dollar-for-dollar basis, the amount of additional revenue needed to restore the stolen funds is many multiples of the amount of the fraud.

What Is Fraud?

There are two principal methods of getting something from others illegally. Either you physically force someone to give you what you want (using a gun, knife, or other weapon), or you trick them out of their assets. We call the first type of theft robbery or armed robbery, and the second type **fraud**. Robbery is generally more violent and more traumatic than fraud and usually attracts much more media attention, but losses from fraud far exceed losses from robbery.

Although there are many formal definitions of fraud, probably the most common is the following:

> *Fraud is a generic term, and embraces all the multifarious means which human ingenuity can devise, which are resorted to by one individual, to get an advantage over another by false representations. No definite and invariable rule can be laid down as a general proposition in defining fraud, as it includes surprise, trickery, cunning and unfair ways by which another is cheated. The only boundaries defining it are those which limit human knavery.*[8]

Fraud is deception that includes the following elements:

1. A *representation*
2. About a *material* point
3. Which is *false*
4. And *intentionally or recklessly* so
5. Which is *believed*
6. And *acted upon* by the victim
7. To the victim's *damage*

CAUTION *Who is in the best position to "con" you right now? Who is in the best position to "con" your parents? Remember, it is always those you "trust most" who are in the best position to con you or commit fraud.*

Fraud is different from unintentional errors. If, for example, someone mistakenly enters incorrect numbers on a **financial statement**, is this fraud? No, it is not fraud because it was not done with *intent* or for the purpose of gaining advantage over another through false pretense. But, if in the same situation, someone purposely enters incorrect numbers on a financial statement to trick investors, then it *is* fraud!

As was discussed in the beginning of this chapter, one of the most common types of fraud today is a scam that lures investment funds from victims and then pays those victims a premium or interest from money that is paid by subsequent investors. This popular fraud scheme, also known as a Ponzi scheme, was named after Charles Ponzi who perpetrated a large scam in the early 1900s. To better understand fraud in general, let's take a closer look at Charles Ponzi.

Charles Ponzi and the Famous Ponzi Scheme

Carlo "Charles" Ponzi was born in Parma, Italy, in 1882 and then emigrated to the United States in November 1903. Over the next 14 years, Ponzi wandered from city to city and from job to job. He worked as a dishwasher, waiter, store clerk, and even as an Italian interpreter. In 1917, he settled in Boston where he took a job of typing and answering foreign mail. It was in Boston in 1919 that Ponzi discovered the mechanism that he thought would make both him and his investors very wealthy.[9]

At the time, Ponzi was considering publishing an export magazine. He had written a letter about the proposed publication to a gentleman in Spain, and when Ponzi received his reply, the man had included an international postal reply coupon. The idea behind this enclosure was quite simple. Ponzi was to take the coupon to his local post office and exchange it for American postage stamps. He would then use those American stamps to send magazines to Spain.

Ponzi noticed that the postal coupon had been purchased in Spain for about one cent in American funds. Yet, when he cashed it in, he was able to get six American one-cent stamps. Immediately, Ponzi started to consider the many possibilities to invest. Assuming this was possible, he could buy $100 worth of stamps or coupons in Spain and he could then cash in or sell the stamps to a third party. In the early 1900s, just like today, it was impossible to get this kind of interest in a bank.[10]

Ponzi's mind quickly went into overdrive, and he devised a clever scheme to capitalize on his idea. He was determined to be a rich man. His first step was to convert his American money into Italian lire (or any other currency where the exchange rate was favorable). Ponzi's foreign agents would then use these funds to purchase international postal coupons in countries with weak economies. The stamp coupons were then exchanged back into a favorable foreign currency and finally back into American funds. He claimed that his net profit on all these transactions was in excess of 400 percent.

Was he really able to do this? The answer is "no." The red tape of dealing with the various postal organizations, coupled with the long delays in transferring currency, ate away at all of Ponzi's imagined profits.

However, a failed scheme couldn't keep Ponzi from bragging about his great idea. As a result, friends and family members understood what he was saying, and they wanted in on the investment.

On December 26, 1919, Ponzi filed an application with the city clerk establishing his business as The Security Exchange Company. He promised 50 percent interest in 90 days, and the world wanted in. However, personally he claimed to be able to deliver on his promise in just 45 days. This, of course, translates into doubling investors' money in just 90 days.

Word spread very quickly about Ponzi's great idea, and within a few short months, the lines outside the door of his School Street office began to grow. Thousands of people purchased Ponzi promissory notes at values ranging from $10 to $50,000. The average investment was estimated to be about $300, a large sum of money in the 1920s.

Why would so many people invest in a scheme that didn't work? The real reason was that the early investors did see the promised returns on their money. Ponzi used the money from later investors to pay off his earlier obligations. It was a new twist on the age-old pyramid scheme.

With an estimated income of $1,000,000 per week at the height of his scheme, his newly hired staff couldn't take in the money fast enough. They were literally filling all of the desk drawers, wastepaper baskets, and closets in the office with investors' cash. Branch offices opened, and copycat schemes popped up across New England.

By the summer of 1920, Ponzi had taken in millions and started living the life of a very rich man. Ponzi dressed in the finest suits, had dozens of gold-handled canes, showered his wife in fine jewelry, and purchased a 20-room Lexington mansion.

Any get-rich scheme is certain to attract the attention of the law, and Ponzi's was no exception. From the start, federal, state, and local authorities investigated him. Yet no one could pin Ponzi with a single charge of wrongdoing. Ponzi had managed to pay off all of his notes in the promised 45 days and, because everyone was happy to get their earnings, not a single complaint had ever been filed.

On July 26, 1920, Ponzi's house of cards began to collapse. The *Boston Post* headlined a story on the front page questioning the legitimacy of Ponzi's scheme. Later that day, the district somehow convinced Ponzi to suspend taking in new investments until an auditor examined his books. Within hours, crowds of people lined up outside Ponzi's door demanding that they get their investment back. Ponzi obliged and assured the public that his organization was financially stable and that he could meet all obligations. He returned the money to those who requested it. By the end of the first day, he had settled nearly 1,000 claims with the panicked crowd.

By continuing to meet all of his obligations, the angry masses began to dwindle and public support swelled. Crowds followed Ponzi's every move. He was urged by many to enter politics and was hailed as a hero. Loud cheers and applause were coupled with people eager to touch his hand and assure him of their confidence.

Because of the additional attention, Ponzi dreamed of opening more investments. For example, Ponzi began to make plans to establish a new type of bank where the profits would be split equally between shareholders and depositors. Ponzi also planned to reopen his company under a new name, the Charles Ponzi Company, whose main purpose was to invest in industries throughout the world.

The public continued to support Ponzi until August 10, 1920. On this date, the auditors, banks, and newspapers declared that Ponzi was indeed bankrupt. Two days later, Ponzi confessed to serving 20 months in a Canadian prison in 1908 on forgery charges related to a similar high-interest scheme followed by an additional two-year sentence in Atlanta, Georgia, for smuggling five Italians over the Canadian border into the United States.

On August 13, Ponzi was finally arrested by federal authorities and released on $25,000 bond. Just moments later, he was rearrested by Massachusetts authorities and re-released on an additional $25,000 bond.

Following his arrest, there were federal and state civil and criminal trials, bankruptcy hearings, suits against Ponzi, suits filed by Ponzi, and the ultimate closing of five different banks. An estimated 40,000 people had entrusted an estimated $15 million (about $140 million in U.S. funds today) in Ponzi's scheme. A final audit of his books concluded that he had taken in enough funds to buy approximately 180 million postal coupons, of which authorities could only actually confirm the purchase of 2.

Ponzi's only legitimate source of income was $45 that he received as a dividend of five shares of telephone stock. His total assets came to $1,593,834.12, which didn't come close to paying off the outstanding debt. It took about eight years, but noteholders were able to receive an estimated 37 percent of their investment returned in installments.

Ultimately, Ponzi was sentenced to five years in federal prison. After three years in prison, Ponzi was sentenced to an additional seven to nine years by Massachusetts' authorities. However, Ponzi was released on $14,000 bond pending an appeal and disappeared the following month.

Ponzi turned up a short time later in Florida under the assumed name of Charles Borelli. Again, Ponzi was involved in a pyramid land scheme by purchasing land at $16 an acre, subdividing it into 23 lots, and selling each lot for $10 a piece. He promised all investors that their initial $10 investment would translate into $5.3 million in just two years. Unfortunately, much of the land was under water and worthless.

Ponzi was again indicted for fraud and sentenced to one year in a Florida prison. Once again, Ponzi jumped bail and was later found in Texas. Ponzi hopped a freighter headed for Italy but was captured on June 28 in a New Orleans port. On June 30, he sent a telegram to President Calvin Coolidge asking to be deported. Ponzi's request was denied, and he was sent back to Boston to complete his jail term. After seven years, Ponzi was released on good behavior and deported to Italy on October 7, 1934. Back in Rome, Ponzi became an English translator. Mussolini then offered Ponzi a position with Italy's new airline, and he served as the Rio de Janeiro branch manager from 1939 to 1942. Ponzi discovered that several airline officials were using the carrier to smuggle currency, and Ponzi wanted a cut. When they refused to include him, he tipped off the Brazilian government. World War II brought about the airline's failure, and Ponzi found himself unemployed.

Ponzi died in January 1949 in the charity ward of a Rio de Janeiro hospital. He left behind an unfinished manuscript appropriately titled *The Fall of Mister Ponzi*.

Fraud, Greed, Deception, and Confidence

Ponzi's scam is extremely helpful in understanding fraud. Certainly, the scheme involved deception. It also involved greed by the *perpetrator* and—this is important—greed by the *investors*, who wanted higher-than-sensible returns. Finally, Ponzi's scheme involved the element of *confidence*. If he had not paid returns to original investors, no one would have invested additional money. By paying early "returns," Ponzi gained investors' confidence and convinced them that he had a legitimate business. In fact, confidence is the single most critical element for fraud to be successful. (The word "con," which means to deceive, comes from the word "confidence.") It is difficult to con anyone out of anything unless the deceived has confidence in the deceiver. We cannot be conned unless we trust the person trying to deceive us. Similarly, employers cannot con employees if they do not have their employees' trust and confidence. And, without investor confidence, fraudulent companies cannot con unsuspecting investors.

The following scenario illustrates the role that confidence plays in committing fraud:

> *Two men enter a bank. One is dressed in a business suit and is well groomed. The second has scraggly hair, has tattoos up and down both arms, is wearing tattered jeans, and is carrying a motorcycle helmet under his arm. Based on the probably unfounded categorization of the appearance of these two individuals by most people in society, which one do you think is in the best position to successfully con a teller?*

Most of us would agree that the man in the business suit is in a better position to defraud the bank. His appearance is, simply put, much more likely to be trusted, stereotypes being what they are. Most people would argue that the scraggly fellow is unlikely to pull off a successful fraud because the bank employees would be less likely to trust him, at least initially.

One common response of fraud victims is disbelief: "I can't believe she would do this. She was my most trusted employee … Or my best customer … Or my best friend." Someone who understands fraud will sadly tell you, "What else could they be? They wouldn't have succeeded *without* your trust!" Indeed, fraud perpetrators are often the least suspected and the most trusted of all the people with whom victims associate.

One company's research revealed that its largest group of fraud perpetrators is composed of people between the ages of 36 and 45.[11] The statistics don't tell us *why* this is the case, but we assume that this age group includes managers who have worked themselves into positions of trust. In addition, they are probably the group with the highest financial pressures. When young people graduate from college, they look ahead and think, "By the time I'm 40, I'll have my house and cars paid off and have savings to pay for my children's college." But, when many people reach 40, their houses and cars are mortgaged to the hilt and they have no savings to pay for their children's college. During this same time frame (36–45), people are also better positioned in their careers to commit fraud. As we will discuss in future chapters, any time opportunity and pressures are present, the probability of fraud increases.

> **Remember this …**
>
> *Fraud involves all deceptive ways in which one individual obtains an advantage over another by false representations. Fraud always involves confidence and trickery. Fraud is different from robbery where force is almost always used.*

STOP & THINK *Why is it more difficult to tell if someone can be trusted on the Internet than in person?*

Types of Fraud

Although there are many ways to classify the various types of fraud, the most common way is to simply divide frauds into those that are committed *against* organizations and those that are committed *on behalf* of organizations.

In employee fraud, for example—fraud committed against an organization—the victim of the fraud is the employee's employer.[12] On the other hand, with financial statement fraud, for example, executives usually commit fraud "on behalf" of an organization,[13] usually to make the company's reported financial results look better than they actually are. In this case, the executives of the company benefit because a company's stock price increases or remains artificially high and the victims are investors in the company's stock. Sometimes, executives misstate earnings in order to ensure a larger year-end bonus. Financial statement fraud often occurs in companies that are experiencing net losses or have profits much less than expected.

Another way to classify frauds is to use the ACFE's definition of "occupational fraud." The ACFE defines this type of fraud as, "The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets."[14] Occupational fraud results from the misconduct of employees, managers, or executives. Occupational fraud can be anything from lunch break abuses to high-tech schemes. The key to fraud is that the activity is always done in secret (is clandestine), is committed to gain direct or indirect benefits to the perpetrator and costs the victim organization assets, lost time and often lost reputation.[15]

The ACFE includes three major categories of occupational fraud: (1) asset misappropriations, which involve the theft or misuse of an organization's assets;

(2) corruption, in which fraudsters wrongfully use their influence in a business transaction in order to procure some benefit for themselves or another person, contrary to their duty to their employer or the rights of another; and (3) fraudulent financial statements, which generally involve falsification of an organization's financial statements.

A third classification scheme divides fraud according to victims:

1. Frauds where a company or organization is the victim.
   a. Employee embezzlement—perpetrator is an employee of the organization.
   b. Vendor fraud—perpetrator is a vendor of the organization.
   c. Customer fraud—perpetrator is a customer of the organization.
2. Management fraud—victims are shareholders or debt-holders of the organization.
3. Investment scams and other consumer frauds—victims are unwary individuals.
4. Miscellaneous frauds—any other type of fraud. Fraud that doesn't fall into one of the first three types of fraud and may have been committed for reasons other than financial gain is simply labeled **miscellaneous fraud**. The various types of fraud are summarized in Table 1.1 and are discussed in the paragraphs that follow.

Employee Embezzlement

Employee embezzlement is the most common type of occupational fraud. As stated previously, in this type of fraud, employees deceive their employers by taking company assets.[16] Embezzlement can be either direct or indirect. Direct fraud occurs when an employee steals company cash, inventory, tools, supplies, or other assets. It also occurs when employees establish dummy companies and have their employers pay for goods that are not actually delivered. With direct fraud, company assets go directly into the perpetrator's pockets without the involvement of third parties. Indirect employee fraud, on the other hand, occurs when employees take bribes or kickbacks from vendors, customers, or others outside the company to allow for lower sales prices, higher purchase prices, nondelivery of goods, or the delivery of inferior goods. In these cases, payment to employees is usually made by organizations that deal with the perpetrator's employer, not the employer itself.

The case of CVC Construction provides an example of direct employee fraud:

CVC Construction specializes in building new homes as well as remodeling older homes. Although CVC Construction has a large market share, they, unfortunately, have a hard time making a profit. An investigation into the matter revealed that several of CVC's employees were using company supplies and equipment to do their own remodeling jobs on the side and

TABLE 1.1 TYPES OF FRAUD

TYPE OF FRAUD	PERPETRATOR	VICTIM	EXPLANATION
Employee embezzlement	Employees of an organization	The employer	Employees use their positions to take or divert assets belonging to their employer. This is the most common type of fraud.
Vendor fraud	Vendors of an organization	The organization to which the vendors sell goods or services	Vendors either overbill or provide lower-quality or fewer goods than agreed.
Customer fraud	Customers of an organization	The organization which sells to the customers	Customers don't pay, pay too little, or get too much from the organization through deception.
Management fraud (financial statement fraud)	Management of a company	Shareholders and/or debt-holders and regulators (taxing authorities, etc.)	Management manipulates the financial statements to make the company look better (or worse in the case of tax fraud) than it is. This is the most expensive type of fraud.
Investment scams and other consumer frauds	Fraud perpetrators—all kinds	Unwary investors	These types of frauds are committed on the Internet and in person and obtain the confidence of individuals to get them to invest money in worthless schemes.
Other (miscellaneous) types of fraud	All kinds—depends on the situation	All kinds—depends on the situation	Anytime anyone takes advantage of the confidence of another person to deceive him or her.

pocketing the profits. One employee alone had stolen more than $25,000 worth of company assets.

To highlight indirect fraud, consider the case of Mark who committed fraud against his employer "Big D" Advertising:

In his role as a purchase agent, Mark paid a company in New York City nearly $100,000 for contracted work that should have cost about $50,000. The contractor then paid Mark a kickback of nearly $30,000. Only after someone noticed that the quality of work performed by the New York contractor decreased substantially was the fraud suspected and eventually detected.

Vendor Fraud

Vendor fraud has been in the news time and again over the years because of significant overcharges by major vendors on defense and other government contracts. Vendor fraud, which is extremely common in the United States, comes in two common forms: (1) fraud perpetrated by vendors acting alone and (2) fraud perpetrated through collusion between buyers and vendors. Vendor fraud usually results in either an overcharge for purchased goods, the shipment of inferior goods, or the nonshipment of goods even though payment is made.[17]

A recent Department of Defense case highlights the typical vendor fraud. As a result of a joint FBI/Department of Defense investigation, an Illinois-based corporation pleaded guilty to false claims and conspiracy charges pertaining to cost overruns and executive personnel expenses charged to the Department of Defense. The corporation agreed to make restitution of $115 million to the government. The corporation later agreed to an additional payment of $71.3 million to resolve pending administrative and noncriminal issues and to dismiss certain officers proven criminally culpable through investigation.[18]

Customer Fraud

When **customer fraud** takes place, customers do not pay for goods purchased, they pay too little, or they get something for nothing.[19] For example, consider the bank customer who walked into a branch of a large bank one Saturday morning and convinced the branch manager to give her a $525,000 cashier's check, even though she had only $13,000 in her bank account. The manager believed she was a very wealthy customer and didn't want to lose her business. Unfortunately for the bank, she was a white-collar thief, and she proceeded to defraud the bank of over $500,000. In another customer fraud, six individuals sitting in a downtown Chicago hotel room pretended to be representatives of large corporate customers, made three calls to a Chicago bank, and had the bank transfer nearly $70 million to their accounts in another financial institution in New Jersey. Once the money was transferred to New Jersey, it was quickly transferred to Switzerland, withdrawn, and used to purchase Russian diamonds.

Management Fraud

As stated previously, **management fraud**, often called *financial statement fraud*, is distinguished from other types of fraud both by the nature of the perpetrators and by the method of deception. In its most common form, management fraud involves top management's deceptive manipulation of financial statements.[20] Well-known examples of alleged management fraud include WorldCom, Enron, Waste Management, Sunbeam, Rite-Aid, Phar-Mor, Parmalat, Adelphia, ESM Government Securities, Regina Vacuum Company, Tesco, Olympus Corporation, Penn West, and the Vatican Bank, among others.

To illustrate management fraud, consider John Blue, the CEO for a fast-growing music store chain. The company was opening new stores almost monthly. The company had loyal customers and was famous for its low prices. When the company went public, the price of the stock soared. Unfortunately, the new shareholders didn't know that the chain was selling the music below cost and was actually losing money on each item it sold. John and the other executives hid the losses by inflating inventories and recording fictitious revenues. The scam eventually unraveled when a top accountant reported the fraud. When word leaked out, shares of the company's stock became worthless overnight.

STOP & THINK *Why do you think it is easier for top management to manipulate financial statements than for other individuals in an organization?*

Investment Scams and Other Consumer Frauds

Closely related to management fraud are **investment scams**. In these scams, fraudulent and usually worthless investments are sold to unsuspecting investors.[21] Telemarketing fraud falls into this category, as does the selling of worthless partnership interests and other investment opportunities. As discussed earlier, Charles Ponzi is regarded as the father of investment scams. Unfortunately, he has not lacked imitators. His form of deception is extremely common today. In fact, research suggests that one of every three Americans will fall prey to this type of fraud during his or her lifetime.

The FBI has suggested that the following are some of the most common consumer fraud schemes[22]:

1. **Ponzi schemes**. As discussed earlier in the chapter, these schemes are named after Charles Ponzi and are quite simple: Lure investment funds from victims and then pay those victims a premium or interest from money that is paid by subsequent investors.
2. **Pyramid schemes**. These are similar to Ponzi schemes except the participants believe they are earning money by recruiting other participants, not from their investments.
3. **Telemarketing fraud**. When telemarketing fraud takes place, victims send money to people they do not know personally or give personal financial information to unknown callers. Typically, these callers put pressure on potential victims to "act now because the offer won't last" or somehow convince the victim that he or she has won a free gift such as a cruise, trip, or vacation. In order to redeem the prize, the victim must pay for postage and/or handling by providing their credit card number and personal information to the perpetrator.
4. **Nigerian letter or money scams**. This type of fraud typically occurs when a potential victim receives an e-mail or other form of communication promising the victim a large financial payout in exchange for help in transporting large sums of money from one country to another. The author of the letter usually states that an up-front payment is needed in order to pay taxes, bribe government officials, or pay other legal fees.
5. **Identity theft**. Identity theft occurs when someone assumes the identity of another person to purchase goods, engage in criminal activity, or perpetrate fraud. Perpetrators steal a person's identity by accessing personal financial information such as information that is found on creditor statements, credit cards, bank statements, Social Security, and other personal documents such as driver's license. Perpetrators sometimes also gain this information by going through a victim's mailbox or trash can.
6. **Advance fee scams**. An advance fee scam occurs when a victim pays an up-front cost for a good or service that is never delivered. In the scam, the victim pays an up-front cost to secure a payment, loan, contract, investment, or gift. In the end, once the perpetrator receives the money, the victim will be unable to contact the perpetrator and the victim loses the original payment that was made.
7. **Redemption/strawman/bond fraud**. In this scam, perpetrators claim that the U.S. government controls certain bank accounts that can be accessed by submitting paperwork with government officials. In order to gain access to this paperwork, victims must buy expensive training kits that teach individuals how to access the funds. When the victim is unable to access the government funds, the perpetrator will indicate that the paperwork was not filled out correctly and will often charge additional fees for more training.
8. **Letter of credit fraud**. A letter of credit is a legitimate document that is issued by banks to guarantee payment for goods that are shipped in international trade. In order to scam victims, fraud perpetrators will often create bogus letters of credit and then sell them to unsuspecting victims. The victims are told that they can use these letters as investments that will pay unrealistic returns. In order to avoid this type of scam, consumers should be aware that legitimate letters of credit are never sold or offered as investments.
9. **Internet fraud**. According to the North American Securities Administrators Association (NASAA), Internet fraud has become a booming business. Recently, federal, state, local, and foreign law enforcement officials targeted Internet fraudsters during Operation Cyber Sweep. In the raid, law enforcement identified more than 125,000 victims with estimated losses of more than $100 million and made 125 arrests. Many of the online scams that are perpetrated today are simply new versions of schemes that have been perpetrated offline for years.

As an example of how consumer frauds can occur, consider Brian, a hard-working college student, who was victimized by an investment scam.

During the day, Brian attended school, and at night, to support himself, he worked as a server at a downtown diner. On a good night, Brian brought home about $100 in tips. During a period of three years, Brian saved almost $1,200. One day at lunch, Brian's friend, Lance, told him about a startup company in Canada. "If you get in now," Lance said, "you'll be in on the bottom. You'll make at least three times your money in only a couple of weeks." That same night, Brian accompanied Lance to a meeting describing the *investment opportunity. The following day, they each invested $1,000. Lance and Brian had never been so excited. They thought the opportunity was almost too good to be true—and unfortunately, they were right. The investment was a scam, and Brian and Lance never saw their $1,000 again, let alone any of the exorbitant earnings they were promised.*

CAUTION *You recently received the following e-mail:* Please be so kind as to contact me at your earliest convenience for a possible business deal involving a money transfer of about $22,000,000.

In conducting an audit of a financial institution, I discovered a dormant account with a balance of $22,000,000, which has not been accessed for the past three years. From my investigations and confirmations, the owner of this account is a foreigner by the name of John Doe who died without a will. I am presently in London working as an investment consultant with the above bank at their London office, and I am poised to work this deal out if we can do business. At the moment, I am constrained to issue more details about this business until your response is received. As we have not met before, I will give you every detail you need to know regarding the business and about me as we progress with the business.

At the conclusion of this business, you will be given 35 percent of the total amount, 60 percent will be for me, and 5 percent will be for expenses.

You should send me your bank account information as indicated below where you would like the money to be transferred so that I can send an application for the release of the funds immediately with your account information.

Beneficiary Name ________________
Bank Name ________________
Bank Address ________________
Account Number________________
Swift Code ________________
Routing Number ________________
State & Country ________________
Your Mobile Telephone Number/Fax Number ________

I look forward to hearing from you as soon as possible.

Obviously, this e-mail, which was actually received by one of the authors, is an attempt to fraudulently steal money from your bank account. What in this e-mail suggests that you should never participate in this scheme?

Remember this …

Frauds can be classified in several ways: by victim, by perpetrator, or by scheme. Frauds against organizations are most common, but financial statement frauds are usually most expensive.

Sometimes fraudulent behavior is so pervasive by an entire industry that it affects the entire economy. That was certainly true with the Great Depression of the 1930s, which was caused by fraudulent speculation on Wall Street and a subsequent run on banks. It was also true with the Savings and Loan crisis of the 1980s and early 1990s. Many have argued that it was also widespread industry fraud that resulted in the subprime (loans to low-creditworthy buyers) mortgage crisis of 2008, which led to the recession in the United States. The subprime mortgage crisis was characterized by a rise in subprime mortgage delinquencies and foreclosures and the resulting decline of securities backed by those mortgages. These mortgage-backed securities (MBS) and collateralized debt obligations (CDO) initially offered attractive rates of return because of the higher interest rates on the mortgages; however, the lower credit quality of the borrowers and these securities ultimately caused massive defaults. Several major financial institutions collapsed in 2008, with significant disruption in the flow of credit to businesses and consumers and the onset of a severe global recession.

There were many causes of the subprime mortgage crisis, including the rise in subprime lending or mortgages made to people who weren't very creditworthy. Another cause was that home prices declined steeply after peaking in mid-2006, making it more difficult for borrowers to refinance their home loans. This led to a huge rise in mortgage delinquencies. The securities backed with mortgages, which were widely held by financial firms globally, lost most of their value. As loans made to borrowers began to fail at a surprisingly rapid rate, widespread fraud helped support the entire mortgage system—from borrowers who lied on their loans, to brokers who encouraged lying, to lenders who misled some low-income borrowers, to the many lenders, investors, and ratings agencies that conveniently and deliberately looked the other way as profits rolled in.

The crisis had severe, long-lasting consequences for the U.S. and European economies. The United States entered a deep recession, with nearly 9 million jobs lost during 2008 and 2009, roughly 6 percent of the workforce. U.S. housing prices fell nearly 30 percent on average, and the U.S. stock market fell approximately 50 percent by early 2009. As of early 2013, the U.S. stock market had recovered to its pre-crisis peak, but housing prices remained near their low point and unemployment remained elevated. Economic growth remained below pre-crisis levels. The fraud that helped fuel this crisis was indeed very costly to American citizens.

Criminal and Civil Prosecution of Fraud

When people commit fraud, they can be prosecuted criminally and/or civilly. To succeed in a criminal or civil prosecution, it is usually necessary to show that the perpetrator acted with *intent* to defraud the victim. This is best accomplished by gathering evidential matter. **Evidential matter** consists of the underlying data and all corroborating information available. In Chapter 7, we will discuss different types of evidence and the role evidence plays in successful prosecution and/or litigation of fraud.

Criminal Law

Criminal law is that branch of law that deals with offenses of a public nature. Criminal laws generally deal with offenses against society as a whole. They are prosecuted either federally or by a state for violating a **statute** that prohibits some type of activity. Every state and the federal government have statutes prohibiting a wide variety of fraudulent and corrupt practices. Some of the principal federal statutes are listed in Table 1.2.

A variety of statutes cover fraudulent activity. Usually, when perpetrators are convicted, they serve jail sentences and/or pay fines. Before perpetrators are convicted, they must be proven guilty "beyond a reasonable doubt." Juries must rule unanimously on guilt for the perpetrator to be convicted. Recent cases of people who were prosecuted criminally include Bernard Madoff; Ken Lay of Enron; Jeff Skilling of Enron; the CEO of Financial News Network (FNN), who was sentenced to five years in prison for spinning companies he controlled into a plot that inflated FNN's sales; the CEO of Towers Financial,[23] who was sentenced to 20 years for a Ponzi-like scheme that defrauded investors of $450 million; and Raj Rajaratnam, who was convicted of insider trading, sentenced to an 11-year prison sentence, and ordered to pay a $92.8 million fine.[24]

Sometimes fraud perpetrators and other criminals plead guilty without being tried in order to seek more lenient sentences. These guilty pleas are usually accompanied by a willingness to help prosecutors in their investigations of other perpetrators. For example, in the Enron case, former Enron executive Michael Kopper pleaded guilty to charges of money laundering and wire fraud. The guilty pleas were the first criminal charges brought against a former Enron employee and represented significant progress in the U.S. government investigation into the scandal. As part of the plea deal, Mr. Kopper agreed to cooperate with prosecutors and paid back $12 million of assets.

Civil Law

Civil law is the body of law that provides remedies for violations of private rights. Civil law deals with rights of individuals. Civil claims begin when one party files a complaint against another, usually for the purpose of gaining financial restitution. The purpose of a civil lawsuit is to gain compensation for harm an individual or organization believes has been done to him or her (it). Unlike criminal cases, juries in civil cases need not consist of 12 jurors but may have as few as 6 jurors. The verdict of the jury need not be unanimous. Civil cases are often heard by judges instead of juries. To be successful, plaintiffs in civil cases must only prove their case by the "preponderance of the evidence." In other words, there need only be slightly more evidence supporting the plaintiff than supporting the defendant. In both civil and criminal proceedings, the parties often call expert witnesses to give their opinion on matters thought to be too technical for the jurors or judge to understand. Fraud examiners and accountants are often used as experts in fraud cases to compute and testify to the amount of damages and to the nature of the fraud. When fraud is committed, criminal prosecution usually proceeds first.

STOP & THINK *O. J. Simpson was tried for murder both criminally and civilly. He was found innocent in the criminal trial but guilty in the civil trial. Why do you think that was the case?*

Table 1.3 identifies the major differences between a civil and a criminal case.

As an example of civil litigation, consider the case of WorldCom. After the WorldCom fraud was discovered, investors sued various organizations that the investors claimed helped perpetrate the fraud. In 2004, one of those organizations, Citigroup, agreed to settle investors' civil claims by agreeing to pay $2.65 billion to investors. These kind of out-of-court settlements often occur before civil cases actually go to trial.

Remember this …

The purpose of a criminal case is to right a wrong, whereas the purpose of a civil case is to obtain a remedy. Criminal cases usually result in jail and/or fines, whereas civil cases result in restitution and damage payments. Juries must reach unanimous verdicts in criminal cases; only a majority is necessary to convict someone in a civil case.

TABLE 1.2 PRINCIPAL FEDERAL FRAUD STATUTES

STATUTE	TITLE AND CODE	DESCRIPTION
Bribery of Public Officials and Witnesses	Title 18, U.S. Code §201	Bribery is punishable by up to 15 years in prison, a fine of up to three times the thing of value given or received, and disqualification of officer.
Anti-Kickback Act of 1986	Title 41, U.S. Code §51 to 58	This act outlaws the giving or receiving of any thing of value by a subcontractor to a prime contractor in U.S. government contracts. Willful violations are punished by a fine and up to 10 years in prison.
Mail Fraud	Title 18, U.S. Code §1341	"Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, … shall be fined under this title … or imprisoned."
Bank Fraud	Title 18, U.S. Code §1344	Any scheme to defraud federally insured financial institutions by customers, officers, employees, and owners. Covers banks, savings and loans, credit unions, and other financial institutions insured by government agencies.
Racketeer Influenced and Corrupt Organizations (RICO) Statute	Title 18, U.S. Code §1961	This statute makes it an offense for any person associated with an "enterprise" engaged in interstate commerce to conduct the affairs of the enterprise through a "pattern of racketeering activity." A pattern is defined as two or more enumerated criminal violations.
Computer Fraud	Title 18, U.S. Code §1030	Section 1030 punishes any intentional, unauthorized access to a "protected computer" for the purpose of obtaining restricted data regarding national security, obtaining confidential financial information, using a computer that is intended for use by the U.S. government, committing a fraud, or damaging or destroying information contained in the computer.
Securities Fraud	Rule 10(b)5 Securities Act of 1934, $17(a)	It is unlawful for an insider who has material inside information to purchase or sell the company's securities, irrespective of whether the insider deals directly or through an exchange. The anti-fraud provisions impose civil liability on those who perpetrate or who aid and abet any fraud in connection with any offer and sale of securities.
Foreign Corrupt Practices Act (FCPA)	Title 15, U.S. Code §78m, 78a(b), 78dd-1, 78dd-2, 78ff	This law outlaws bribery of foreign officials by U.S. companies for business purposes. The FCPA also requires that SEC-regulated companies keep accurate books and records and have sufficient internal controls to assure that "access to assets is permitted only in accordance with management's … authorization," to prevent slush funds and bribe payments.
Tax Evasion	Title 26, U.S. Code §7201	Failure to report income from fraud or bribes may be prosecuted as tax evasion, or for filing a false return. Also, bribes may not lawfully be deducted as business expenses.

How to Prepare to Be a Fraud-Fighting Professional

At most universities, there is not a major called "Fraud Prevention, Detection, and Investigation," although a few such programs have been created in recent years. Rather, students who want to prepare for fraud-fighting careers must usually choose majors and courses that will provide the skills that will make them a successful fraud-fighter. The following are some of the most important skills for a fraud-fighting professional to have:

- **Analytical skills:** Fraud detection and investigation are analytical processes where investigators identify the kinds of fraud that could occur, the kinds of

TABLE 1.3 DISTINCTIONS BETWEEN CIVIL AND CRIMINAL CASES

	CRIMINAL CASE	CIVIL CASE
Purpose	To right a wrong	To obtain a remedy
Consequences	Jail and/or fines	Restitution and damage payments
Burden of proof	"Beyond a reasonable doubt"	"Preponderance of evidence"
Jury	Jury must have 12 people	May consist of fewer than 12 persons
Initiation	Determination by a grand jury that sufficient evidence exists to indict	Filing of a claim by a plaintiff
Verdict	Unanimous verdict	Parties may stipulate to a less-than-unanimous verdict
Claims	Only one claim at a time	Various claims may be joined in one action

symptoms and indicators those frauds would generate, and ways in which to examine and follow up on symptoms that are discovered. Being a fraud investigator is very much like being a physician: It requires significant amounts of diagnostic and exploratory work to discover what is really happening. It is impossible to be a good fraud examiner without having great analytical skills.

- **Communication skills:** Fraud examiners spend considerable amounts of time interviewing witnesses and suspects and communicating those findings to witnesses, courts, and others. A good communicator will know how to push for evidence and confessions, how to structure questions and interviews, and how to write reports that are valued by courts, lawyers, and others. It is impossible to be a good fraud examiner without refined oral and written communication skills.
- **Technological skills:** In the past, detecting fraud involved more luck than anything else. However, with the technological advances of the last two decades, we can now proactively search for fraud symptoms and fraud perpetrators and build both fraud-free and fraudulent profiles. Technology allows fraud examiners to analyze huge databases very efficiently to both detect and investigate fraud.

  Computers and other forms of technology provide some of the best evidence to determine if someone is guilty of fraud. Real-time and even post-hoc fraud detection and investigation in the future will involve the use of technology.

Although the three skills addressed here are critical and most important, other skills that will be extremely useful for future fraud examiners are as follows:

- **Some understanding of accounting and business**. One of the major differences between fraud and other types of crime is the always present concealment attempts to hide the fraud. Usually, concealment attempts involve altering accounting records and documents. Fraud examiners who understand accounting and business will be highly valued in the future. For example, the FBI has a large number of agents who are CPAs. The expertise of these agents is highly valued by the FBI.
- **A knowledge of civil and criminal laws, criminology, privacy issues, employee rights, fraud statutes, and other legal fraud-related issues**. Investigating and resolving frauds always involves legal questions such as "should this case be pursued in the criminal or civil courts, are certain evidence-gathering techniques legal, and when should law enforcement be involved?"
- **The ability to speak and write in a foreign language**. With developments in travel, communication, and technology, many frauds today involve individuals in multiple countries. Cross-border investigations are not uncommon, and the ability to speak and write a foreign language, such as Spanish or Chinese, will be highly valued.
- **A knowledge of human behavior, including why and how people rationalize dishonesty, how they react when caught, and what is the most effective way(s) to deter individuals from committing fraud**. These kinds of skills are usually learned in behavioral courses such as psychology, social psychology, or sociology.

Many readers are probably wondering which major on campus will provide them with all of these skills. The answer is probably none.[25] But majors such as information systems, accounting, and law can provide a basic understanding that is extremely helpful. Regardless of the major one chooses, it would be beneficial to fulfill elective requirements with courses in the previously mentioned topics. For example, if you are an accounting major, you should probably take as many technology and behavioral type classes as you can. Although no candidate will possess all of the skills identified earlier, the more of these skills an individual possesses, the better qualified he or she will be to find success as a fraud examiner.

Certified Fraud Examiners

The Association of Certified Examiners (ACFE) provides the opportunity for an individual to become a Certified Fraud Examiner (CFE). CFEs are considered to be leaders in the anti-fraud community and have recognition as such throughout the world. They represent the highest standards held by the ACFE and possess expertise in all aspects of the anti-fraud profession. The CFE designation is acknowledged globally and preferred by many employers. The ACFE states that becoming a CFE immediately sets an individual apart and launches an individual to the top of their profession.

When an individual becomes a CFE, he or she automatically becomes a member of the ACFE. The ACFE is the world's largest anti-fraud organization and the premier provider of anti-fraud training and education. With more than 80,000 members throughout the world, the ACFE works to reduce fraud and corruption around the globe.

> One of the authors of this book, W. Steve Albrecht, was the first president of the ACFE and one of its headquarters buildings in Austin, Texas, is named after him.

The ACFE has the following requirements for an individual to become a CFE:

- Be an associate member of the ACFE in good standing.
- Meet the specified *academic* and *professional* requirements.
- Be of high moral character.
- Pass the CFE Examination.
- Agree to abide by the Bylaws and Code of Professional Ethics of the ACFE.

Academic Requirements

Generally, applicants for CFE certification have a minimum of a bachelor's degree (or equivalent) from an institution of higher learning. No specific field of study is required. If you do not have a bachelor's degree, you may substitute two years of fraud-related professional experience for each year of academic study. For example, if you successfully attended college full time for only two years, you would need an additional four years of professional experience to satisfy the education requirements.

Professional Requirements

When an individual becomes a CFE, he or she must have at least two years of professional experience in a field either directly or indirectly related to the detection or deterrence of fraud. The following categories are deemed acceptable as fraud-related experience:

- **Accounting and Auditing:** A candidate may qualify to become a CFE if he or she has experience as an accountant or auditor (e.g., internal or external auditor) and has had certain responsibilities for the detection and deterrence of fraud by evaluating accounting systems for weaknesses, designing internal controls, determining the degree of organizational fraud risk, interpreting financial data for unusual trends, or following up on fraud indicators.
- **Criminology and Sociology**: Only those professionals with education or research in the fraud and white-collar crime dimensions of sociology or criminology may claim experience under this category. An experienced background in general sociological fields is insufficient.
- **Fraud Investigation:** Experience in the investigation of civil or criminal fraud, or of white-collar crime for law enforcement agencies or in the private sector qualifies an individual to become a CFE. Examples include federal, state, or local law enforcement (e.g., FBI, IRS, inspectors general, and district attorney investigators), as well as insurance fraud investigators and fraud examiners working for corporations, businesses, or other associations.
- **Loss Prevention:** Security directors for corporations or other organizations who deal directly with issues of loss prevention may claim this experience as credit to

become a CFE. Security consultants dealing with fraud-related issues are also eligible. Experience as a security guard or equivalent is not acceptable.

- **Law:** Candidates with experience in the legal field might qualify, provided the experience deals with some consideration of fraud. Examples include prosecuting lawyers, fraud litigators, and others with an anti-fraud specialization.

If an individual's experience does not fall into one of these categories, but his or her responsibilities include the detection, investigation, or deterrence of fraud, he or she must make a case why this experience is relevant.

CFE Examination

The CFE Exam is an examination that tests your knowledge and expertise in the four primary areas of fraud examination: Financial Transactions & Fraud Schemes, Law, Investigation, and Fraud Prevention & Deterrence. It contains 500 objective (multiple choice, true/false, etc.) questions and is taken online. It takes approximately 10 hours to complete the CFE Exam. Each of the four sections is allocated a maximum of 2.6 hours to complete and has 125 questions. You have 30 days to complete all four sections of the CFE Exam and submit it to the ACFE for grading. You must complete each section in one sitting, but you do not have to complete all four sections at once.

Fraud-Related Careers

As the number of frauds and the amounts of fraud losses increase, so do the opportunities for successful careers in fraud fighting. A number of years ago, *U.S. News & World Report* identified fraud examination as one of the fastest-growing and most financially rewarding careers.[26] The American Institute of Certified Public Accountants (AICPA) touted fraud examination/fraud auditing as one of the six fastest-growing and most profitable opportunities for accountants. Although there are numerous opportunities for fraud-fighting professionals, careers in forensic work can be broadly classified according to employer, as shown in Table 1.4.

The following chart identifies the fraud-fighting career of W. Steve Albrecht, one of the authors of this book.

TYPE OF FRAUD-FIGHTING WORK	DESCRIPTION
Publications	Written several books and many academic and professional articles on fraud prevention, detection, and investigation
Corporate fraud training	Provided in-house corporate training to over 50 corporations on the topics of fraud prevention, detection, and investigation
Consulting with organizations	Helped organizations design fraud detection and investigation approaches and provided various types of fraud-related consulting for many corporations
Expert witnessing in fraud cases	Retained as an expert witness in 37 major financial statement and other fraud cases, many in the billions of dollars
Audit committee work	Chaired the audit committees on the boards of directors of nine different public and private companies

TABLE 1.4 FRAUD-RELATED CAREERS

TYPES OF EMPLOYERS	TYPE OF CAREER
Government and law enforcement	FBI, postal inspectors, Criminal Investigation Division of the IRS, U.S. marshals, inspector generals of various governmental agencies, state investigators, and local law enforcement officials.
CPA firms	Conduct investigations, support firms in litigation, do bankruptcy-related accounting work, provide internal audit and internal control consulting work.
Corporations	Prevent, detect, and investigate fraud within a company. Includes internal auditors, corporate security officers, and in-house legal counsels.
Consulting	Serve as an independent consultant in litigation fraud work, serve as expert witness, consult in fraud prevention and detection, and provide other fee-based work.
Law firms	Lawyers provide litigation and defense work for companies and individuals being sued for fraud and provide special investigation services when fraud is suspected.

As you can see from Steve's experience, there are many different ways to make a difference as a fraud-fighting professional. Indeed, taking this course can be the first step in preparing you for a very rewarding and exciting career in fighting fraud.

The cost of fighting fraud is high. In high-profile civil cases, it is not uncommon for defendants and plaintiffs to spend tens of millions of dollars defending and prosecuting alleged frauds. Many large fraud cases involve multiple law firms, multiple lawyers from each firm, multiple investigators, expert witnesses, and large support staff. Often, after spending large sums of money defending or prosecuting a fraud case, a pretrial settlement is reached, with no public announcement of the terms of the settlement.

Throughout the next few months, you will find your study of fraud examination to be very interesting and helpful—whether or not you become a professional fraud-fighter. As a businessperson, understanding the tremendous costs of fraud and learning to recognize fraud may someday mean the difference between your business surviving or failing. If you become a financial consultant, you will be better equipped to help your clients avoid high-risk and fraudulent investments. As an investor, you will learn skills that help you distinguish between fraudulent and profitable investments. If you become an auditor, you will find the document examination and evidence-gathering skills you learn here invaluable. If you work with taxes, you will be alert to when information from clients is questionable. Finally, the interviewing skills you learn will be helpful in nearly every possible profession you may choose.

You may find, to your surprise, that fraud examination and forensic accounting are not only rewarding and challenging, but also intriguing and endlessly interesting (what good mystery isn't?). We hope you enjoy the adventure as you study fraud this term.

Remember this …

Very few fraud-fighting specialties are offered at U.S. universities. Instead, a person should choose a path of study that will result in obtaining those skills that are most helpful for fraud-fighters. The Association of Certified Fraud Examiners is a professional organization composed of fraud-fighting professionals that certifies individuals as certified fraud examiners. There are many different fraud-fighting careers, including auditing, consulting, law, investigation, and law enforcement.

Review of the Learning Objectives

- **Understand the seriousness of the fraud problem and how it affects individuals, consumers, and organizations**. Although it is difficult to get accurate fraud statistics, the statistics and studies that are available suggest that fraud is increasing in both amount and frequency. Fraud is extremely costly to organizations and economies, often resulting in the bankruptcy of companies. When someone embezzles from an organization, that organization must generate many times the amount embezzled in additional revenues to recover the effect on net income.
- **Define fraud**. Fraud is theft by deception. There are two ways to get something from someone illegally—through force or by trickery. Fraud involves all the different ways of using trickery to get another person's or organization's assets.
- **Understand the different types of fraud**. Frauds can be classified by type of victim, type of perpetrator, or type of scheme. The most common victims of frauds are organizations, in the case of employee, vendor, and customer fraud; stockholders and debt-holders, in the case of management fraud; and individuals, in the case of investment scams and other types of consumer frauds.
- **Understand the difference between fraud committed *against* an organization and fraud committed *on behalf* of an organization.** The most common way to classify fraud is to simply divide frauds into those that are committed *against* an organization and those that are committed *on behalf* of an organization. Fraud that is committed against an organization is typically a form of employee (occupational), vendor, or customer fraud. Fraud that is committed on behalf of an organization is a form of management fraud or financial statement fraud.
- **Understand the difference between criminal and civil fraud laws and how these laws relate to fraud**. Criminal laws are used to right a wrong—to send someone to jail or to have the government invoke fines and penalties. Civil cases are used to seek remedies—usually in the form of financial restitution.
- **Understand the types of fraud-fighting careers available today**. Fraud-fighting professionals today include lawyers, auditors, accountants, consultants, and government employees. Fraud-fighting

professionals can best prepare for their careers by studying those skills useful in fighting fraud. The ACFE certifies individuals as CFE.

KEY TERMS

perpetrators, p. 2
jurisdiction, p. 2
victims, p. 3
Association of Certified Fraud Examiners (ACFE), p. 3
net income, p. 3
revenue, p. 3
profit margin, p. 3
fraud, p. 4
financial statement, p. 5
miscellaneous fraud, p. 8
employee embezzlement, p. 8
vendor fraud, p. 9
customer fraud, p. 9
management fraud, p. 9
investment scams, p. 9
evidential matter, p. 12
criminal law, p. 12
statute, p. 12
civil law, p. 12

QUESTIONS

Discussion Questions

1. What is fraud?
2. How does fraud affect individuals, consumers, and organizations?
3. List and describe the five different types of frauds.
4. What is the difference between civil and criminal laws?
5. For each of the following, indicate whether it is a characteristic of a civil or a criminal case:
   a. Jury may consist of fewer than 12 jurors.
   b. Verdict must be unanimous.
   c. Multiple claims may be joined in one action.
   d. "Beyond a reasonable doubt."
   e. Purpose is to right a public wrong.
   f. Purpose is to obtain remedy.
   g. Consequences of jail and/or fines.
   h. Juries may have a less-than-unanimous verdict.
6. Why was Charles Ponzi so successful with his fraud scheme?
7. What are some of the different types of fraud-fighting careers?
8. How do employee fraud and management fraud differ?
9. Do you think the demand for careers in fraud prevention and detection is increasing or decreasing? Why?
10. Why are accurate fraud statistics hard to find?
11. Describe the relationship between fraud, net income, profit margin, and the revenue required to make up for fraud losses.
12. Why does it usually require trust for someone to be able to commit a fraud?
13. In what ways is the Ponzi scam similar to other frauds?
14. In your own words describe a CFE.
15. In your own words describe the purpose of the ACFE.

True/False

1. All frauds that are detected by organizations are made public.
2. Perpetrators use trickery, confidence, and deception to commit fraud.
3. One of the most common responses to fraud is disbelief by those around the fraud.
4. Manufacturing companies with a profit margin of 10 percent must usually generate about 10 times as much revenue as the dollar amount of the fraud in order to restore net income to its pre-fraud level.
5. Fraud involves using physical force to take something from someone.
6. Identity theft is an example of employee embezzlement.
7. When perpetrators are criminally convicted of fraud, they often serve jail sentences and/or pay fines.
8. Management fraud is deception perpetrated by an organization's top management.
9. A Ponzi scheme is considered to be a type of investment scam.
10. Most people agree that fraud-related careers will be in demand in the future.
11. In civil cases, fraud experts are rarely used as expert witnesses.
12. Many companies try to hide their losses from fraud rather than make them public.
13. The only group/business that must report employee embezzlement is the federal government.
14. Advances in technology have had no effect either on the size or frequency of fraud or on the detection or investigation of fraud.
15. Fraud losses generally reduce a firm's income on a dollar-for-dollar basis.
16. The single most critical element for a fraud to be successful is opportunity.
17. Fraud perpetrators are often those who are least suspected and most trusted.

18. Unintentional errors in financial statements are a form of fraud.
19. Occupational fraud is fraud committed on behalf of an organization.
20. Companies that commit financial statement fraud are often experiencing net losses or have profits that are significantly lower than expectations.
21. Indirect fraud occurs when a company's assets go directly into the perpetrator's pockets without the involvement of third parties.
22. In vendor fraud, customers don't pay for goods purchased.
23. A negative outcome in a civil lawsuit usually results in jail time for the perpetrator.
24. When fraud is committed, criminal prosecution usually proceeds before civil litigation.
25. A fraud may be perpetrated through an unintentional mistake.
26. It is most often people who are not trusted who commit fraud.
27. Management fraud is when managers intentionally deceive their employees about the potential of raises, vacations, and other perks.
28. Despite intense measures meant to impede it, fraud appears to be one of the fastest-growing crimes in the United States.
29. The ACFE is a nonprofit organization dedicated to the prevention and dedication of fraud throughout the world.
30. There is no difference between a Certified Fraud Examiner (CFE) and a Certified Public Accountant (CPA).

Multiple Choice

1. Why does fraud seem to be increasing at such an alarming rate?
   - **a.** Computers, the Internet, and technology make fraud easier to commit.
   - **b.** Most frauds today are detected, whereas in the past many were not.
   - **c.** A new law requires that fraud be reported within 24 hours.
   - **d.** People understand the consequences of fraud to organizations.
2. Which of the following is *not* an important element of fraud?
   - **a.** Confidence.
   - **b.** Deception.
   - **c.** Trickery.
   - **d.** Intelligence.
3. Fraud is considered to be:
   - **a.** A serious problem that continues to grow.
   - **b.** A problem that affects very few individuals.
   - **c.** A mild problem that most businesses need not worry about.
   - **d.** A problem under control.
4. People who commit fraud are usually:
   - **a.** New employees.
   - **b.** Not well groomed and have long hair and tattoos.
   - **c.** People with strong personalities.
   - **d.** Trusted individuals.
5. "The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets" is the definition of which of the following types of fraud?
   - **a.** Employee embezzlement or occupational fraud.
   - **b.** Investment scams.
   - **c.** Management fraud.
   - **d.** Vendor fraud.
6. Corporate employee fraud-fighters:
   - **a.** Work as postal inspectors and law enforcement officials.
   - **b.** Prevent, detect, and investigate fraud within a company.
   - **c.** Are lawyers who defend and/or prosecute fraud cases.
   - **d.** None of the above.
7. Investment scams most often include:
   - **a.** An action by top management against employees.
   - **b.** Worthless investments or assets sold to unsuspecting investors.
   - **c.** An overcharge for purchased goods.
   - **d.** Nonpayment of invoices for goods purchased by customers.
8. Which of the following is *not* true of civil litigation?
   - **a.** It usually begins when one party files a complaint.
   - **b.** The purpose is to compensate for harm done to another.
   - **c.** It must be heard by 12 jurors.
   - **d.** Only "the preponderance of the evidence" is needed for the plaintiff to be successful.
9. Future careers in fraud will most likely be:
   - **a.** In low demand.
   - **b.** In moderate demand.
   - **c.** Low paying.
   - **d.** In high demand and financially rewarding.

10. Studying fraud will help you:
    a. Learn evidence-gathering skills.
    b. Avoid high-risk and fraudulent activities.
    c. Learn valuable interviewing skills.
    d. All of the above.
11. Which of the following is *the least* reliable resource for fraud statistics?
    a. FBI agencies.
    b. Health agencies.
    c. Insurance organizations.
    d. Fraud perpetrators.
12. Which of the following statements is true?
    a. On a per-incident basis, bank robberies are more costly than frauds.
    b. Fraud is often labeled the fastest-growing type of crime.
    c. FBI agencies usually investigate frauds that occur within organizations.
    d. None of the above statements is true.
13. Which of the following is *not* an element of fraud?
    a. False representation.
    b. Accidental behavior.
    c. Damage to a victim.
    d. Intentional or reckless behavior.
14. What is the best way to minimize fraud expense within an organization?
    a. Effective early detection of fraud.
    b. Effective investigation of fraudulent behavior.
    c. Effective prevention of fraud.
    d. Effective research of fraud.
15. What is the most important element in successful fraud schemes?
    a. Promised benefits.
    b. Confidence in the perpetrator.
    c. Profitable activities.
    d. Complexity.
16. Which of the following characters is least likely to be involved in a fraud?
    a. A middle-aged person with a middle management position.
    b. A long-haired teenager wearing leather pants.
    c. A recent college graduate.
    d. A senior executive who has significant stock options.
17. Which of the following is *not* a common type of fraud?
    a. Direct employee embezzlement.
    b. Employee bribes.
    c. Executives embezzling from petty cash.
    d. Investment scams.
18. Which of the following is *not* a form of vendor fraud?
    a. Overcharging for purchased goods.
    b. Shipment of inferior goods.
    c. Nonshipment of goods even though payment has been made.
    d. Not paying for goods purchased.
19. Civil law performs which of the following functions?
    a. Remedy for violation of private rights.
    b. Remedy for violations against society as a whole.
    c. Punishment for guilt "beyond reasonable doubt."
    d. Monetary fines for federal damages.
20. Fraud fighting can include which of the following type(s) of careers?
    a. Professors.
    b. Lawyers.
    c. CPA firms.
    d. All of the above.
21. Which of the following is *not* an example of employee embezzlement?
    a. Land conservation employees stealing equipment.
    b. Cashiers stealing money from the cash register.
    c. Angry employees vandalizing the building with spray paint.
    d. Salespeople overcharging for products and pocketing the excess cash.
22. Which of the following is *not* an example of vendor fraud?
    a. A vendor overcharges a contracting job that it completed on time.
    b. A vendor bills for services not performed.
    c. A vendor bills for goods not provided.
    d. A vendor has much higher prices than its competitors.
23. "Intentional manipulation of financial statements" describes which kind of fraud?
    a. Management fraud.
    b. Criminal fraud.
    c. Stock market fraud.
    d. Bookkeeping fraud.
24. Which of the following is required to become a CFE?
    a. An individual must commit to abide by a strict code of professional conduct and ethics.
    b. Be an associate member in good standing of the ACFE.

   c. Be of high moral character.
   d. All of the above are required to become a CFE.

25. Which of the following is *not* true regarding the ACFE.
   a. It is the largest anti-fraud organization in the world.
   b. It has roughly 12,000 members throughout the world.
   c. The entire organization is dedicated to anti-fraud-fighting efforts.
   d. It is the premier provider of anti-fraud training.

SHORT CASES

Case 1

Clever, Inc., is a car manufacturer. Its 2018 income statement is as follows:

Clever, Inc. Income Statement for the Year Ended December 31, 2018	
Sales revenue	$20,000
Less cost of goods sold	10,000
Gross margin	$10,000
Expenses	8,000
Net income	$ 2,000

Alexander, Inc., is a car rental agency based in Florida. Its 2018 income statement is as follows:

Alexander, Inc. Income Statement for the Year Ended December 31, 2018	
Sales revenue	$20,000
Expenses	15,000
Net income	$ 5,000

During 2018, both Clever, Inc., and Alexander, Inc., incurred a $1,000 fraud loss.

1. How much additional revenue must each company generate to recover the losses from the fraud?
2. Why are these amounts different?
3. Which company will probably have to generate less revenue to recover the losses?

Case 2

You are having lunch with another student. During the course of your conversation, you tell your friend about your new fraud examination class. After you explain the devastating impact of fraud on businesses today, she asks you the following questions:

1. What is the difference between fraud and error?
2. With all the advances in technology, why is fraud a growing problem?
   How would you respond to your friend?

Case 3

For each of the following examples, identify whether the fraud is employee embezzlement, management fraud, investment scam, vendor fraud, customer fraud, or miscellaneous fraud.

1. Marcus bought a $70 basketball for only $30, simply by exchanging the price tags before purchasing the ball.
2. Craig lost $500 by investing in a multilevel marketing scam.
3. The Bank of San Felipe lost over $20,000 in 2018. One of its employees took money from a wealthy customer's account and put it into his own account. By the time the fraud was detected, the employee had spent the money and the bank was held responsible.
4. The CEO of Los Andes Real Estate was fined and sentenced to six months in prison for deceiving investors into believing that the company made a profit in 2018, when it actually lost over $150 million.
5. The government lost over $50 million in 2018 because many of its contractors and subcontractors charged for fictitious hours and equipment on a project in the Middle East.
6. A student broke into the school's computer system and changed her grade in order to be accepted into graduate school.

Case 4

Fellow students in your fraud examination class are having a hard time understanding why statistics on fraud are so difficult to obtain. What would you say to enlighten them?

Case 5

You're telling your boyfriend about your classes for the new semester. He is very interested and intrigued by the idea of becoming a fraud detective, but wants to know whether fraud detectives will have job security and the type of work that is available. How would you respond to his questions?

Case 6

A bookkeeper in a $3 million retail company had earned the trust of her supervisor, so various functions normally reserved for management were assigned to her, including the authority to authorize and issue customer refunds. She proceeded to issue refunds to nonexistent customers and created documents with false names and addresses. She adjusted the accounting records and stole about $15,000 cash. She was caught when an auditor sent routine confirmations to customers on a mailing list and received an excessive number of "return-to-sender" replies. The investigation disclosed a telling pattern. The bookkeeper initially denied accusations but admitted the crime upon presentation of the evidence.

You are a lawyer for this retail company. Now that her fraud has been detected, would you prosecute her criminally, civilly, or both? What processes would you use to try to recover the $15,000?

Case 7

You are a new summer intern working for a major professional services firm. During your lunch break each day, you and a fellow intern Bob eat at a local sandwich shop. One day, Bob's girlfriend joins you for lunch. When the bill arrives, Bob pays with a company credit card and writes the meal off as a business expense. Bob and his girlfriend continue to be "treated" to lunch for a number of days. You know Bob is well aware of a recent memo that came down from management stating casual lunches are not valid business expenses. When you ask Bob about the charges, he replies, "Hey, we're interns. Those memos don't apply to us. We can expense anything we want."

1. Is fraud being committed against the firm?
2. What responsibility, if any, do you have to report the activity?

Case 8

After receiving an anonymous note indicating fraudulent activities in the company, XYZ Company officials discover that an employee has embezzled a total of $50,000 over the past year. Unfortunately, this employee used an assumed identity and has suddenly disappeared. The CFO at XYZ wants to know how badly this fraud has hurt the company. If XYZ has a profit margin of 7 percent, approximately how much additional revenue will XYZ have to generate to cover the loss?

Case 9

Your friend John works for an insurance company. John holds a business degree and has been involved in the insurance business for many years. In a recent conversation, John shares some company information with you. He has heard that the internal auditors estimate that the company has lost about $2.5 million over the last year as a result of fraud. Because you are a certified fraud examiner, John asks you how this will affect the company's profitability. John doesn't have access to the company's financial information.

1. Compute the additional revenues needed to make up for the lost money, assuming that the company has profit margins of 5, 10, and 15 percent.
2. Give examples of three types of fraud that could affect the insurance company.

Case 10

You are an accounting student at the local university pursuing your master's degree. One of your friends has been intrigued by the numerous frauds that have been reported in the news. This friend knows you are going to pursue a job as an auditor with a large public accounting firm, but your friend does not understand the difference between what you will be doing and what fraud examiners do. Write a paragraph that explains the difference between auditing and fraud examination.

Case 11

You own a local pizza delivery store. Cesar Rodriquez has been working for you as a manager for two years and has been a close friend of yours. Cesar has the reputation of being a hard worker and has not taken vacation for the entire time he has worked for you. Last week, Cesar left town to attend a family funeral. While he was gone, you received several phone calls that seemed suspicious. During these suspicious calls, a potential customer would call and ask for the manager. When you answered the phone (representing the manager), the customer would ask for the "manager's special." When informed that there was not a "manager's special" offered this weekend, the caller would quickly hang up. This occurred several times. When Cesar returned, you decided to spend an evening observing the order-taking process. It became apparent that Cesar was skimming cash from the business. Cesar would take the order for the "manager's special" without entering the sale into the computer. Cesar would then deliver the pizza and pocket the money.

1. Write a paragraph explaining why Cesar should be terminated from employment.
2. Write a paragraph explaining why it is important that Cesar is prosecuted for his crime.

Case 12

Bob, who works as a credit manager for a large bank, has a reputation for being a very hard worker. His convenient downtown apartment is located near the bank, which allows him to work undisturbed late into the night. Everyone knows that Bob loves his job because he has been with the bank for many years and hardly ever takes a vacation. He is a very strict credit manager and has the reputation for asking very difficult questions to loan applicants before approving any credit.

Nancy, Bob's director, noticed that Bob had not taken a mandatory week-long vacation for a number of years. Given Bob's history of being tough on approving credit for the bank, should Nancy be concerned?

Case 13

Upon hearing that you are enrolled in a fraud class, a manager of a local business asks, "I don't understand what is happening with all these major scandals such as the Bernie Madoff scandal, the Goldman Sachs accusations, and the Enron fraud. There are billions of dollars being stolen and manipulated. How can any good auditor not notice when billions of dollars are missing?" How would you respond?

Case 14

While discussing your class schedule with a friend who is an accounting major, your friend describes why she decided not to take the fraud class you are enrolled in: "With advances in audit technology and the increased digitalization of business records, fraud detection is a dying part of a financial statement audit." How would you respond?

Case 15

After telling one of your parents that you want to be a fraud examiner after graduation, your father expresses concerns about your career choice. How would you explain to your father the kind of career opportunities you will have as a fraud examiner, the types of organizations that will hire you, and the kind of work you will be doing?

Case 16

You are a student at ABC University. You recently read in the school's daily newspaper about a terrific investment opportunity that promises to repay you a 44 percent annual return on your investment. Although you don't understand the complicated nature of the investment, several of your friends are investing money. You have an extra $5,000 that you earned last summer that you would like to invest. Should you invest your $5,000? Why or why not?

CASE STUDIES

Case Study 1[27]

Gus Jackson was hired away from a "Big Four" public accounting firm to start a new internal audit function for ABC Company, a newly acquired subsidiary of a large organization. His first task involved getting to know ABC's management and supporting the public accountants in their year-end audit work.

Once the year-end work was finished, Gus started an audit of the accounts payable function. Jane Ramon, who had worked on the parent company's internal audit staff for about four years, supported him in this activity.

The accounts payable audit went smoothly, although many employees made no effort to conceal their hostility and resentment toward anyone associated with the new parent company. One exception was Hank Duckworth, the accounts payable manager. Hank was extremely helpful and complimentary of the professional approach used by the auditors. Gus had actually met Hank four years earlier, when Hank had been an accounting supervisor for an audit client where Gus was the junior accountant.

As the audit neared completion, Gus reviewed an audit comment Jane had written—a statement concerning some accounts payable checks that lacked complete endorsement by the payees. Both Gus and Jane recognized that in some situations and in some organizations less-than-perfect endorsements were not a critical concern; but these checks were payable to dual payees, and the endorsement of each payee was required. Gus asked Jane to make some photocopies of the examples so the evidence would be available for the audit closeout meeting with management.

Jane returned 20 minutes later with a puzzled expression. "I pulled the examples," she said, "but look at these!" Jane placed five checks on the desk in front of Gus. "What do you make of these?" she asked.

"Make of what?" asked Gus.

"Don't you see it? The handwriting on all the endorsements looks the same, even though the names are different! And these are manual checks, which in this system usually means they were pushed through the system as rush payments."

"They do look similar," Gus replied, "but a lot of people have similar handwriting."

It hit Jane and Gus at the same time. All five checks had been cashed at the same convenience store less than 5 miles from the home office, even though the mailing address of the payee on one of the checks was over 200 miles away!

Jane decided to pull the supporting documentation for the payments but found there was none! She then identified other payments to the same payees and retrieved the paid checks. The endorsements did not look at all like the endorsements on the suspicious checks. To determine which of the endorsements were authentic, Jane located other examples of the payees' signatures in the lease, correspondence, and personnel files. The checks with supporting documentation matched other signatures on file for the payees.

Gus and Jane decided to assess the extent of the problem while investigating quietly. They wanted to avoid prematurely alerting perpetrators or management that an investigation was underway. With the help of other internal auditors from the parent company, they worked after normal business hours and reviewed endorsements on 60,000 paid checks in three nights. Ninety-five checks that had been cashed at the convenience store were identified.

Still, all Gus and Jane had were suspicions—no proof. They decided to alert executive management at the subsidiary and get their help for their next step.

The Follow-Through

Because the subsidiary had little experience with dishonest and fraudulent activity, it had no formalized approach or written fraud policy. Gus and Jane, therefore, maintained control of the investigation all the way to conclusion. With the help of operating management, the auditors contacted carefully selected payees. As is often the case involving fictitious payments to real payees, the real payees had no knowledge of the payments and had no money due to them. The auditors obtained affidavits of forgery.

In order to identify the perpetrator, the auditors documented the processing in more detail than had been done in the original preliminary survey for the routine audit. There were seven people who had access, opportunity, and knowledge to commit the fraud. The auditors then prepared a personnel spreadsheet detailing information about every employee in the department. The spreadsheet revealed that one employee had evidence of severe financial problems in his personnel file. It also showed that Hank Duckworth's former residence was three blocks from the convenience store.

Armed with the affidavits of forgery, the auditors advised management that the case was no longer merely based on suspicions. Along with members of operating management, the auditors confronted the convenience store owners to learn why they had cashed the checks and who had cashed them.

The convenience store manager had a ready answer. "We cash those for Hank Duckworth. He brings in several checks a month to be cashed. He used to live down the street. Never had one of those checks come back!"

The rest is history. Hank was confronted and confessed. The fully documented case was turned over to law enforcement. Hank pled guilty and received a probated sentence in return for full restitution, which he paid.

Questions

1. What clues caused Jane to suspect that fraud was involved?
2. Why is it important for fraud examiners to follow up on even the smallest inconsistencies?
3. In an attempt to identify possible suspects, the auditors researched the personnel files of every employee in the department. What things might they have been looking for to help them identify possible suspects?

Case Study 2: Sweepstakes—legitimate or deceptive?

Sweepstakes Company Agrees to Pay Up[28]

A recent newspaper contained the following story:

> *Publishers Clearing House agreed to pay $34 million in a deal with 26 states to settle allegations the sweepstakes company employed deceptive marketing practices. The $34 million will cover customer refunds, legal expenses, and administrative cost to the states. Each state's share has yet to be determined. In the lawsuits, state attorney generals accused Publishers Clearing House of deceptive marketing for its sweepstakes promotions. The suit alleged that the company was misleading consumers by making them believe they had won prizes or would win if they bought magazines from Publishers Clearing House.*
>
> *As part of the settlement, the company will no longer use phrases like "guaranteed winner." "This will in fact revolutionize the sweepstakes industry," Michigan Attorney General Jennifer Granholm stated. "We listened to the states' concerns and have agreed to responsive and significant changes that will make our promotions the clearest, most reliable and trustworthy in the industry," said Robin Smith, chairman and CEO of the Port Washington, N.Y.–based company.*
>
> *Publishers Clearing House reached an $18 million settlement last August with 24 states and the District*

of Columbia. The states involved in the latest settlement are Arizona, Arkansas, Colorado, Connecticut, Delaware, Florida, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, New Jersey, North Carolina, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Vermont, West Virginia, and Wisconsin.

Questions

1. Based on this information, do you believe Publishers Clearing House has committed fraud?
2. Why or why not?

Case Study 3: Trading after Hours

Several years ago, Prudential Securities was charged with fraud for late trading. This was the first major brokerage house to be charged with the illegal practice of buying mutual funds after hours.

The regulators who accused Prudential Securities charged them with carrying out a large-scale, late-trading scheme that involved more than 1,212 trades that were valued at a remarkable $162.4 million. These trades were placed after hours in order to benefit favored hedge funds. The complaint did not contain information regarding any profits that were protected by the scandal.

The regulators who accused Prudential stated that Prudential should have noticed the considerable number of trades that were being placed after 4 p.m. and should have begun an internal inquiry. However, the complaint stated that Prudential possessed "no internal supervisory procedures" to detect trades placed after hours.

Market timing, often done in conjunction with late trading, involves rapid in and out trading of a mutual fund designed to take advantage of delays in marking up prices of securities in the funds. By buying before the markups and selling quickly after them, Prudential traders realized quick profits for the firm's clients at the expense of others. A group of managers and top-producing brokers were charged by the SEC and/or state in separate civil actions related to market timing. The firm denied all wrongdoing.

Normally, orders to buy funds after 4 p.m. should be filled at the price set the next day. In late trading, which is illegal, orders instead get the same day's 4 p.m. price, enabling investors to react to news a day ahead of other investors.

In order to accomplish late trading, the complaint stated that Prudential clients would engage in the following activities: Prudential clients would submit a list of potential trades to brokers before the 4 p.m. deadline by fax, e-mail, or telephone. After 4 p.m., clients notified Prudential which of the long list of trades it wished to execute. Prudential brokers would take the original order, cross out the trades the client didn't want to execute, and then forward the order to the firm's New York trading desk. The time stamp on the fax would often deceptively reflect the time it was received originally, not the time that the client confirmed the order. For example, in just one afternoon, at 4:58 p.m., Prudential's New York office executed more than 65 mutual fund trades, for a total of $12.98 million.

According to the complaint, Prudential did nothing to substantiate the orders that were received before 4 p.m. In early 2003, the brokerage firm issued a policy change requiring branch managers to initial a cover sheet for trades before faxing them to New York. Lists of trades could be received at Prudential's New York trading desk as late as 4:45 p.m. Accusations against the firm state that, "The orders were never rejected and were always executed at same-day prices."

The complaint further stated that Prudential also allowed the brokers involved in the market-timing and late-trading scheme to have dedicated wire-room personnel to execute trades. It has been suggested that the brokers compensated the wire-room employees for their efforts by sharing year-end bonuses. The state alleged that Prudential also authorized one broker to obtain special software that gave the employee "electronic capacity to enter bulk mutual fund exchanges after 4 p.m."[29]

Questions

1. Determine whether this case would be prosecuted as a criminal or civil offense, and state reasons to support your conclusion.
2. Who are the victims of this late-trading scheme, and what losses do they incur?

Case Study 4

You serve on the board of directors of a multinational manufacturing company. You have just received a whistle-blower complaint that one of the managers in another country, where a large production facility is located, has been understating manufacturing costs to make his production results look better than other facilities. Answer the following questions:

1. What should you do with this information?
2. As a board member, can you immediately involve the top management of the corporation in your actions, whatever they may be?

3. What are the risks to the company if this fraud is material (significant) to the company's financial statements?

DEBATES

For the past year, you have been working as a secretary/processor for a local construction company, XYZ Homes, which specializes in the building of low-cost, limited-option homes. You left a comfortable, good-paying job to work for XYZ because it was family owned and operated by longtime friends.

Soon after you began working for XYZ, you noticed questionable behavior on the part of Mr. and Mrs. XYZ's two sons, who are company salesmen. In fact, you are positive that they are falsifying documents to increase their commissions and to trick local banks into approving mortgages to customers who don't meet credit standards.

You are trying to decide how to handle the situation when one of the sons approaches you and asks you to produce and sign a memo to a bank, falsely stating that a certain potential home buyer is creditworthy. You refuse to do so and, after much consideration, approach Mr. XYZ about the situation. To your surprise, he simply brushes off your comments as unimportant and laughingly states that "boys will be boys."

What would you do in this situation? Is the fact that you correctly refused to produce and sign a false memo enough, or are you obligated to report these crimes to the banks and proper authorities? Discuss the options, responsibilities, and implications you are facing.

INTERNET ASSIGNMENTS

Your best friend wants to know why "on earth" you are taking a fraud examination class. He is curious about what careers this class prepares you for. Go to the Internet and find information about two different careers that you could pursue in the field of fraud examination.

Write two or three brief paragraphs about what you found. Remember to include the Web sites where your information came from so that your friend can do some investigating of his or her own.

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CHAPTER 2

Why People Commit Fraud

TO THE STUDENT

This chapter covers some of the basic principles of fraud. It begins with a description of the types of people who perpetrate fraud. We then discuss why people commit fraud, including the fraud triangle. Finally, we examine how honest individuals are recruited to participate in fraud schemes. By understanding these basic principles, you will see fraud perpetrators in a different light and begin to understand how a trusted friend or colleague could, unfortunately, become involved in fraud.

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- **Know the types of people who commit fraud.**
- **Explain why people commit fraud.**
- **Describe the fraud triangle.**
- **Explain the fraud scale.**
- **Understand how pressure contributes to fraud.**
- **Understand why opportunity must be present for fraud to occur.**
- **Understand why people rationalize.**
- **Understand how people are recruited to participate in fraud schemes.**

I, Dennis Greer, am making this statement on my own, without threat or promises, as to my activities in regard to the activity of kiting between Bank A and Bank B. Before the fraud, I was having extreme emotional and financial difficulties. For religious reasons, I was required without notice to move out of where I was living, and I had no place to go. Also, my grandmother—the only family member I was close to—was dying. I had to live out of my car for three weeks. At the end of this time, my grandmother died. She lived in Ohio; I went to the funeral and returned with a $1,000 inheritance. I used this money to secure an apartment. The entire sum was used up for the first month's rent, deposit, and application fee. From that time, mid-June, until the first part of August, I was supporting myself on my minimum-wage job at the nursery. I had no furniture or a bed. I was barely making it. I was feeling very distraught over the loss of my grandmother and problems my parents and brother were having. I felt all alone. The first part of August arrived, and my rent was due. I did not have the full amount to pay it. This same week, I opened a checking account at Bank B. I intended to close my Bank A account because of a lack of ATMs, branches, and misunderstanding. As I said, my rent was due, and I did not know how to meet it. On an impulse, I wrote the apartment manager a check for the amount due. I did not have the funds to cover it. I thought I could borrow it, but I could not. During the time I was trying to come up with the money, I wrote a check from my Bank B account to cover the rent check and put it into Bank A. I did not know it was illegal. I knew it was unethical, but I thought since the checks were made out to me that it wasn't illegal. This went on for about a week—back and forth between banks. I thought I could get the money to cover this debt, but I never did. My grandmother's estate had been quite large, and I expected more money, but it was not to happen. After a week of nothing being said to me by the banks, I began to make other purchases via this method. I needed something to sleep on and a blanket and other items for the apartment. I bought a sleeper sofa, a desk, a modular shelf/bookcase, and dishes and also paid off my other outstanding debts—college loans, dentist bill, and credit. I was acting foolishly. No one had questioned me at the banks about any of this. I usually made deposits at different branches to try to avoid suspicion, but when I was in my own branches, no one said a thing. I thought maybe what I was doing wasn't wrong after all. So I decided to purchase a new car, stereo, and a new computer to use at home for work. Still, I did not have a problem making deposits at the banks. But I was feeling very guilty. I knew I needed to start downsizing the "debt" and clear it up. I began to look for a better-paying job. Finally, last week I got a call from Bank B while I was at work. They had discovered a problem with my account. I realized then that the banks had found out. Later that day, I got another call from Bank A. They told me that what I had been doing was illegal and a felony. I was in shock. I didn't know it was that bad. I realize now how wrong what I did was. From the start, I knew it was unethical, but I didn't know it was indeed a crime until now. I have had to do a lot of thinking, praying, and talking to those close to me about this. I am truly sorry for what I have done, and I don't *ever* plan to do it again. All I want now is to make amends with the banks. I do not have the money to pay back either bank right now. I realize this hurts them. I want to try to set this right, whether I go to prison or not. I am prepared to work however long it takes to pay the banks back in full with reasonable interest from a garnishment of my wages from now until the full amount is paid and settled. I committed this act because I was feeling desperate. I was emotionally a wreck and physically tired. I felt I didn't have a choice but to do what I did or return to living in my car. I know now that what I did was wrong, and I am very sorry for it. I am attempting to seek psychological counseling to help me deal with and resolve why I did this. I feel I have a lot to offer society, once I am able to clean up my own life and get it straightened out. I pray the bank employees and officers will forgive me on a personal level for the hardship my actions have caused them, and I want to make full restitution. I have done wrong, and I must now face the consequences. This statement has been made in my own words, by myself, without threat or promise, and written by my own hand.

Dennis Greer

This is based on a true confession written by a person who was involved in the fraud of check kiting[1]—using the float time between banks to give the impression that he had money in his accounts. The case includes many of the common pressures and rationalizations that a person goes through when faced with an opportunity to commit fraud. Pressure, rationalization, and opportunity will become central themes in this chapter as we discuss the fraud triangle[2] and the various reasons why people commit fraud.

In Chapter 1, we talked about what fraud is, the seriousness of the fraud problem, many of the different types of frauds, how much fraud costs organizations, and the difference between civil and criminal law. In this chapter, we will discuss who commits frauds and why individuals commit fraud. We will also discuss how a person, once he or she has become involved in fraud, will then use various types of power to recruit others to participate in fraud. To prevent, detect, and investigate fraud, you must understand what motivates fraudulent behavior and why otherwise honest people behave unethically.

Who Commits Fraud

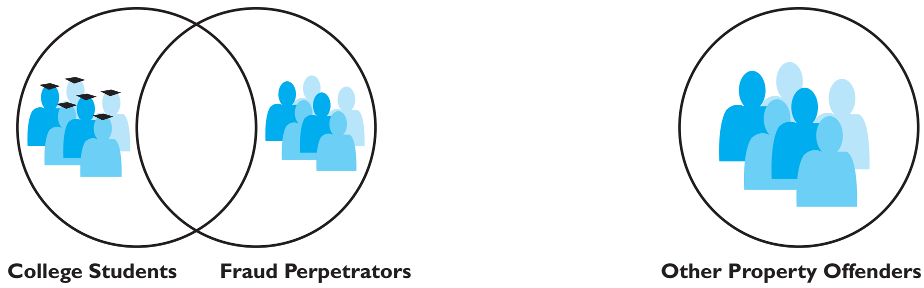
Research shows that anyone can commit fraud. Fraud perpetrators usually can't be distinguished from other people on the basis of demographic or psychological characteristics. Most fraud perpetrators have profiles that look like those of other honest people.[3]

Several years ago, a study was conducted to determine the physical and behavioral characteristics of fraud perpetrators. In this study, fraud perpetrators were compared with (1) prisoners incarcerated for property offenses and (2) a sample of noncriminal, college students. The personal backgrounds and psychological profiles of the three groups were compared. The results indicated that incarcerated fraud perpetrators were very different from other incarcerated prisoners. When compared to other criminals, they were less likely to be caught, turned in, arrested, convicted, and incarcerated. They were also less likely to serve long sentences. In addition, fraud perpetrators were considerably older. Whereas only 2 percent of the property offenders were female, 30 percent of fraud perpetrators were women. Fraud perpetrators were better educated, more religious, less likely to have criminal records, less likely to have abused alcohol, and considerably less likely to have used drugs. They were also in better psychological health. They enjoyed more optimism, self-esteem, self-sufficiency, achievement, motivation, and family harmony than other property offenders. Fraud perpetrators also seemed to express more social conformity, self-control, kindness, and empathy than other property offenders.[4]

> **Remember this …**
>
> *Individuals involved in fraud are typically people just like you and me, but who have compromised their integrity and become entangled in fraud. When doing business in the future, remember that fraud perpetrators will, unfortunately, often be those colleagues in whom you place a great amount of trust.*

When fraud perpetrators were compared with college students, they differed only slightly. Fraud perpetrators suffered more psychic pain and were more dishonest, more independent, more sexually mature, more socially deviant, and more empathetic than college students. However, fraud perpetrators were much more similar to college students than they were to

FIGURE 2.1 PROFILES OF FRAUD PERPETRATORS



property offenders. Figure 2.1 illustrates the differences among the three groups.

It is important to understand the characteristics of fraud perpetrators because they appear to be very much like people who have traits that organizations look for in hiring employees, seeking out customers and clients, and selecting vendors. This knowledge helps us to understand that (1) most employees, customers, vendors, and business associates and partners fit the profile of fraud perpetrators and are capable of committing fraud and (2) it is impossible to predict in advance which employees, vendors, clients, customers, and others will become dishonest. It can even be said that the profile of fraud perpetrators is very much like yours or mine or that of our parents or grandparents and very different from that of property offenders. In fact, when fraud does occur, the most common reaction by those around the fraud is denial. Victims cannot believe that trusted colleagues or friends have behaved dishonestly. Quotes like "I can't believe he (she) would embezzle from me. He (she) was my most trusted friend (employee) (customer)" are very common when fraud occurs. Fraud-fighting professionals respond to these kinds of reactions by saying something like "Of course he (she) was; the ones you didn't trust couldn't have done it. It was your trust and confidence in him (her) that made the embezzlement possible."

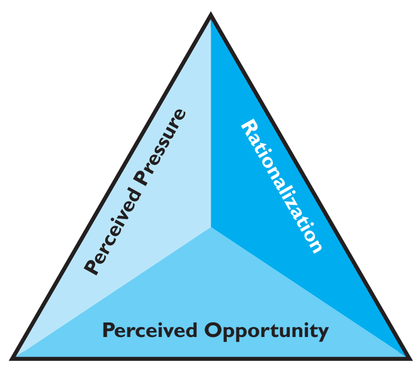
The Fraud Triangle

Although there are thousands of ways to perpetrate fraud, Dennis Greer's example (in the opening case of the chapter) illustrates the three key elements common to all of them. His fraud included (1) a perceived pressure, (2) a perceived opportunity, and (3) some way to rationalize the fraud as acceptable. These three elements make up what we call the fraud triangle,[5] as shown in Figure 2.2.[a]

After moving into an apartment, Dennis Greer could not pay the second month's rent. Faced with the choice between being dishonest or going back to living in his car, Dennis chose to be dishonest. Every fraud perpetrator faces some kind of **perceived** or **real pressure**. Most pressures relate to financial needs, although nonfinancial pressures, such as greed, the need to report financial results better than actual performance, frustration with work, or even a challenge to beat the system, can also motivate fraud. In Dennis Greer's case, he had an actual or real pressure. You may look at a fraud perpetrator and think "but he or she didn't have a real pressure." However, it doesn't matter what you think—what matters is the perception of the perpetrator at the time of the fraud. Later in this chapter, we will discuss the different kinds of pressures experienced by fraud perpetrators.

Dennis found a way to commit fraud by repeatedly writing bad checks to give the impression that he was depositing real money in his accounts. He didn't need access to cash, to use force, or to even confront his

FIGURE 2.2 THE FRAUD TRIANGLE



[a]In recent years, some researchers have added "capability" as a fourth element of the fraud triangle, suggesting that an individual's personal traits and abilities play a major role in the perpetration of fraud. As a result, in some circumstances, the fraud triangle may be referred to as *the fraud diamond.*

victims physically. Rather, he simply wrote checks to himself in the privacy of his own apartment and deposited them in two different banks. His weapons of crime were a pen and checks from the two financial institutions. Whether or not Dennis could actually get away with his crime didn't matter. What mattered was that Dennis believed he could conceal the fraud—in other words, he had a **perceived opportunity**. It is obvious in this case that as Dennis used his check kiting scheme to embezzle more and more money, the scheme would become harder and harder to conceal. Sooner or later, his dishonesty was going to be discovered. In this case, although he had a real opportunity to embezzle, he only had a perceived opportunity to conceal the fraud, especially over the long term.

Fraud perpetrators need a way to **rationalize** their actions as acceptable. Dennis's rationalizations were twofold: (1) He didn't believe that what he was doing was "illegal," although he recognized it might be unethical; and (2) he believed he would get an inheritance and be able to pay the money back. In his mind, he was only *borrowing*, and, although his method of borrowing was perhaps unethical, he would repay the debt. After all, almost everyone "borrows" money.

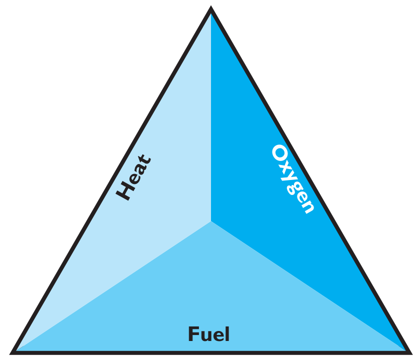
Perceived pressure, perceived opportunity (to commit and conceal), and rationalization are common to every fraud. Whether the fraud is one that benefits the perpetrator directly, such as employee fraud, or one that benefits the perpetrator indirectly by benefiting the perpetrator's organization, such as management fraud, the three elements are always present. In the case of management fraud, for example, the pressure could be the need to make earnings look better or to meet debt covenants, the opportunity could be a weak audit committee or lack of internal controls, and the rationalization could be "We'll only 'cook the books' until we can get over this temporary hump."

In many ways, fraud is like fire. In order for a fire to occur, three elements are necessary: (1) oxygen, (2) fuel, and (3) heat. These three elements make up the "fire triangle," as shown in Figure 2.3. When all three elements come together, there is fire.

Firefighters know that a fire can be extinguished by eliminating any one of the three elements. Oxygen is often eliminated by smothering, by using chemicals, or by causing explosions, as is the case in oil well fires. Heat is most commonly eliminated by pouring water on fires. Fuel is removed by building fire lines or fire breaks or by shutting off the source of the fuel.

As with the elements in the fire triangle, the three elements in the fraud triangle are interactive. With fire, the more flammable the fuel, the less oxygen and heat it takes to ignite. Similarly, the purer the oxygen, the less flammable the fuel needs to be to ignite. With fraud, the greater the perceived opportunity or the more intense the pressure, the less rationalization it takes to motivate someone to commit fraud. Likewise, the more dishonest a perpetrator is, the less perceived opportunity and/or pressure it takes to motivate fraud. The scale in Figure 2.4 illustrates the relationship between the three elements.[6]

FIGURE 2.3 THE FIRE TRIANGLE



As we will show in later chapters, people who try to prevent fraud usually work on only one of the three elements of the fraud triangle: opportunity. Because fraud-fighters generally believe that having good internal controls can eliminate opportunities, they focus all or most of their preventive efforts on implementing controls and ensuring adherence to them.[7] Rarely do they focus on the perceived pressures motivating fraud or on the rationalizations of perpetrators.

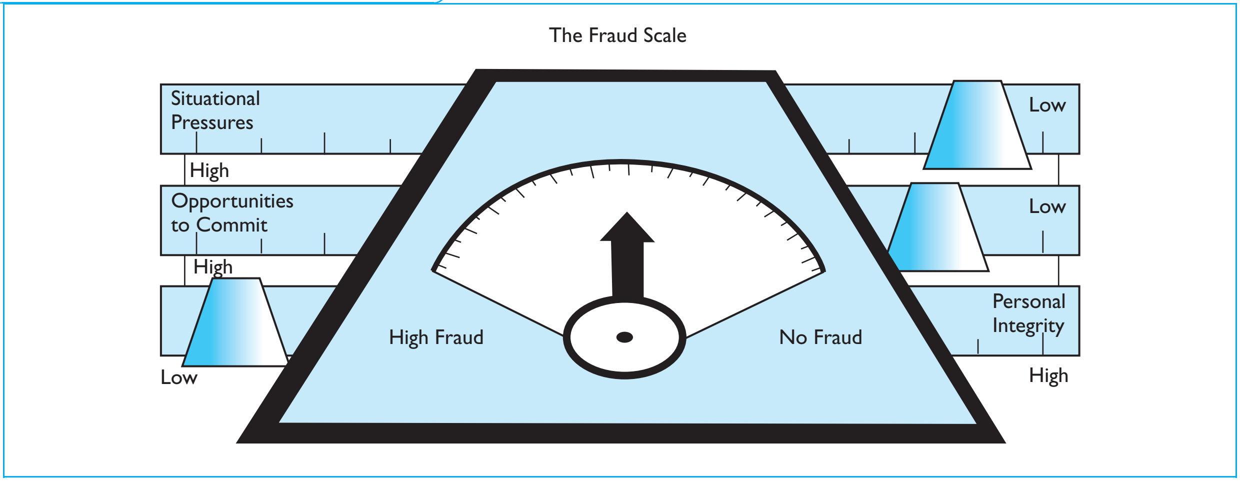
It is interesting to note that almost every study that has been conducted on honesty in advanced countries reveals that levels of honesty and integrity are decreasing. Given the interactive nature of the elements in the fraud triangle, the decreasing levels of honesty present a scary future concerning fraud. Less honesty makes it easier to rationalize, thus requiring less perceived opportunity and/or perceived pressure for fraud to occur.

Rationalizations and related honesty levels, as well as fraud opportunities, will be discussed later in this chapter. We now turn our attention to a discussion of the pressures motivating individuals to commit fraud.

The Element of Pressure

Fraud can be perpetrated to directly benefit oneself or indirectly benefit oneself by benefiting the

FIGURE 2.4 THE FRAUD SCALE



organization. Employee fraud, in which an individual embezzles from his or her employer, usually benefits the perpetrator directly. Management fraud, in which an organization's officers deceive investors and creditors by manipulating financial statements, is most often perpetrated to benefit an organization and its officers. The perpetrators are often benefited by higher stock prices, larger bonuses, or some other indirect means. Consumer fraud such as identity theft—where con artists perpetrate investment scams, impersonation, and other crime against individuals—also benefits perpetrators directly. In this section, we will discuss the different pressures that motivate individuals to perpetrate frauds that benefit them directly. Most fraud experts believe that pressures can be divided into four main groups: (1) financial pressures, (2) vices, (3) work-related pressures, and (4) other pressures.

Financial Pressures

Studies suggest that approximately 95 percent of all frauds involve either financial or vice-related pressures. Dennis Greer's financial pressures were that he was living in his car, didn't have furniture or other living necessities, and was broke. Common real or perceived financial pressures associated with fraud that benefits perpetrators directly include the following:

1. Greed
2. Living beyond one's means
3. Inability to pay bills or personal debt
4. Poor credit
5. Personal financial losses
6. Unexpected financial needs

This list is not exhaustive, and these pressures are not mutually exclusive. However, each pressure in this list has been associated with numerous frauds.[8] Many individuals have committed fraud because they were destitute. Other frauds include perpetrators who were living lifestyles far beyond that of their peers. When one perpetrator was caught embezzling over $1.3 million from his employer, for example, it was discovered that he had spent the money on monogrammed shirts and gold cuff links; two Mercedes-Benz cars; an expensive suburban home; a beachfront condominium; furs, rings, and other jewelry for his wife; a new car for his father-in-law; and a country club membership. Most people would say that this person didn't truly have any financial pressures. But to him, the pressures of needing to possess these luxuries were enough to motivate him to commit fraud.

Financial pressures can occur suddenly or be long term. Unfortunately, very few fraud perpetrators inform others when they are having financial problems. As an example, consider Susan Jones. She had worked at the same company for over 32 years. Her integrity had never been questioned. At age 63, she became a grandmother. Immediately, she became a "spendaholic." She bought everything she could get her hands on for her two grandchildren. She even became addicted to the Home Shopping Network. During the three years prior to her retirement, Susan stole over $650,000 from her employer. When caught, she was sentenced and served one year in prison. She also deeded everything she and her husband owned to her former employer in an attempt to repay the employer. By giving her employer her home, her retirement account, and her cars, she repaid approximately

$400,000 of the $650,000 she stole. She also entered into a restitution agreement to pay back the remaining $250,000 she still owed. Because she repaid $400,000, the IRS determined that amount to be a "loan" from her employer. However, because the likelihood of her paying back the $250,000 was low, the IRS ruled that amount to be income and therefore taxable. Thus, after she was released from prison, she not only had to make monthly restitution payments to her former employer, she also had to make monthly payments to the IRS for back taxes, fines, and penalties. The fact that someone has been an "honest" employee for a long time (32 years in this example) seems to make no difference when severe financial pressures occur or an individual perceives that such pressures exist. Recent studies have found that while approximately 30 percent of employee frauds are perpetrated by employees during their first three years of employment, 70 percent are committed by employees with 4 to 35 years of experience, and the age group with the highest evidence of fraud involves individuals between the ages of 35 and 44 years old. If you think about it, this is the age when people start to have high financial pressures (children starting college, big mortgages, etc.) and have often worked themselves into positions of trust at their employment; they have more opportunities to embezzle than ever before.

Financial pressure is the most common type of pressure to commit fraud. Usually, when management fraud occurs, companies overstate assets on the balance sheet and net income on the income statement. They usually have pressure to do so because of a poor cash position, receivables that aren't collectible, a loss of customers, obsolete inventory, a declining market, or restrictive loan covenants that are being violated. For example, Cendant was a company whose management committed massive financial statement fraud. Their major pressure was keeping the stock price high because most of the executives held massive amounts of stock options. Quoting from the actual complaint in this case: "The goal of this scheme was to ensure that (the company) always met Wall Street's growing earnings expectations for the company. (The company's) management knew that meeting or exceeding these estimates was a key factor for the stock price of all publicly traded companies and therefore set out to ensure that the company met Wall Street's earnings targets every quarter regardless of the company's actual earnings."[b]

[b]One of the authors (Steve Albrecht) was an expert witness in this case and, as a result, became very familiar with the perpetrators and their motivations.

Vice Pressures

Closely related to financial pressures are motivations created by vices such as gambling, drugs, alcohol, and expensive extramarital relationships. As an example of these vices motivating a person to commit fraud, consider one individual's confession of how gambling led to his dishonest acts.

As I sat on the stool in front of the blackjack table, I knew I was in trouble. I had just gambled away my children's college funds. I stumbled to my hotel room, hoping to wake up and realize this evening was nothing more than a nightmare. While driving back to San Jose from Reno Sunday morning, I could not face the embarrassment of telling my wife. I had to come up with the money. I was sure that if I had only $500, I could win the money back. But how could I get $500? A short time later at work, an accounts payable clerk came to my office seeking assistance with a problem. The clerk was matching invoices with purchase orders. He had found an invoice for $3,200 that did not match the purchase order. Immediately, I realized how I could get the $500 "loan." My company was a fast-growing microchip producer whose internal controls were quite good on paper but were often not followed. The company had a policy of paying, without secondary approval, any invoice of $500 or less. I decided to set up a dummy company that would issue invoices to my employer for amounts up to $500. I was confident my winnings from these "borrowings" would not only allow me to replace the college funds, but would also allow repayment of the "loan." I couldn't believe how easy it was to "borrow" the money. The first check showed up in a PO box I had opened a few days earlier. I called my wife with the bad news. Together with the controller, I would have to fly to Los Angeles over the weekend to meet with lawyers over a company matter. Within minutes, I was on my way to Reno. Upon arrival, I went straight to the craps tables. By 4:00 a.m. I was not only out of money but was in the hole over $600. I was concerned about the losses, but not as worried as before. I would just submit more fictitious bills to the company. Over the next few months, my fraud progressed to the point where I had set up two more dummy companies and insisted that accounts payable clerks not verify any invoice of less than $750. No one questioned my changing the policy because I had worked for the company for over 14 years and was a "trusted" employee. After one year, I had replaced the college fund and purchased a new automobile; I had stolen over $75,000. I was caught when the internal auditors matched addresses of vendors and found that my three dummy vendors all had the same PO box.

Vices are the worst kind of pressures motivating someone to commit fraud. Examples include employees who embezzled because their children were on drugs and they couldn't stand to see them go through withdrawal pains. Other examples involve "successful" managers who, in addition to embezzling from their companies, burglarized homes and engaged in other types of theft to support their drug habits. To understand how addictive vices can be, consider the following confessions from reformed gamblers:

- *"Gambling was the ultimate experience for me—better than sex, better than any drug. I had withdrawal tortures just like a heroin junkie."*
- *"I degraded myself in every way possible. I embezzled from my own company; I conned my 6-year-old out of his allowance."*
- *"Once I was hooked, any wager would do. I would take odds on how many cars would pass over a bridge in the space of 10 minutes."*
- *"I stole vacation money from the family sugar jar. I spent every waking hour thinking about getting to the track."*
- *"After I woke up from an appendectomy, I sneaked out of the hospital, cashed a bogus check, and headed for my bookie. I was still bleeding from the operation."*
- *"I'll never forget coming home from work at night, looking through the window at my family waiting for me, and then leaving to place a couple more bets. I was crying the whole time, but I had simply lost all control."*

If someone will steal from his or her 6-year-old child or sneak out of a hospital still bleeding from an operation, he or she will certainly steal from his or her employer or commit other types of fraud. The number of embezzlers who trace their motivation for embezzlement to alcohol, gambling, and expensive extramarital relationships is high. However, the motivation to steal for drugs may even be higher. Consider these confessions of former addicted drug users:

- *"I began living with a man who was a heavy drug user. We had a child, but the relationship didn't last. By the time it ended, I was high on drugs and alcohol so much of the time I could barely manage to make it to work every day."*
- *"I was the branch manager of a large bank. But secretly I was shooting up in my office all day and stealing money from my employer to finance it."*
- *"One day my daughter stretched out her little arms in front of me. She had made dots with a red pen on each of the creases in her arms. 'I want to be just like my Daddy,' she said proudly."*
- *"My wife and I literally whooped for joy at the sight of our newborn son: a 7-pound baby with big eyes and rosy cheeks—normal and healthy looking. But we both knew the moment we had been dreading was now just hours away. The baby would be going through withdrawal. We didn't want him to suffer because of our awful habit. And we had to keep the doctors from finding out he had drugs in his system, or he would be taken from us and placed in foster care. We felt we had no choice. When the nurses left the room, I cradled our baby in my arms and clipped a thin piece of heroin under his tongue."*
- *"I lost my job. I was robbing and stealing every day to support my habit, which cost $500 per day."*

Someone who will clip a piece of heroin under a newborn baby's tongue or burglarize homes to support his or her habit will surely look for ways to embezzle from employers or commit other types of fraud.

Work-Related Pressures

Whereas financial pressures and vices motivate most frauds, some people commit fraud to get even with their employer or others. Factors such as getting little recognition for job performance, having a feeling of job dissatisfaction, fearing losing one's job, being overlooked for a promotion, and feeling underpaid have motivated many frauds. Here is an example.

I began my career at XYZ Company as a staff accountant. I am a religious person. In fact, I spent a year volunteering with a nonprofit agency that provided relief to people in need of food and shelter. Because of this experience and because of my six years with the company, I was considered a person of impeccable character and a very trusted employee. The president of XYZ is a workaholic and considers an eight-hour day to be something a part-time employee works. As a result, I spent six years working in my finance position, putting in between 12 and 14 hours per day. During this period, I was paid a salary, with no overtime compensation. Early in my career, the extra hours didn't bother me; I considered them an investment in my future. Soon, I was named manager of the purchasing department. After two years in that position, I realized that the 12- to 14-hour days were still an expected way of life at the company. I was becoming bitter about the expectation of overtime and felt that the company "owed me" for the time I had worked for "nothing." I decided to get my "pay" from the company. Working with a favored vendor, I accepted kickbacks to allow over $1.5 million in overcharges to the company. I figured the $80,000 I received in kickbacks was compensation that I deserved.[9]