

CORPORATE FRAUD HANDBOOK

Prevention and Detection

FOURTH
EDITION

JOSEPH T. WELLS

Corporate Fraud Handbook

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Fourth Edition

Joseph T. Wells

WILEY

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To my loving wife, Judy Gregor Wells

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Preface

As I wrote in my fifth book, *Occupational Fraud and Abuse*, few people begin their careers with the goal of becoming liars, cheats, and thieves. Yet that turns out to be the destiny of all too many. Corporate fraud and abuse—as we have seen in such headline-grabbing cases as Enron, WorldCom, Olympus, and Autonomy—costs organizations and investors billions and billions annually. The losses in human terms are incalculable.

Corporate Fraud Handbook: Prevention and Detection is for those whose job it is to reduce these losses: fraud examiners, auditors, investigators, loss prevention specialists, managers and business owners, criminologists, human resources personnel, academicians, and law enforcement professionals, among others.

There are four broad objectives of this work:

1. To detail a classification system to explain the various schemes used by executives, owners, managers, and employees to commit these offenses
2. To quantify the losses from these schemes
3. To illustrate the human factors in fraud
4. To provide guidance in preventing and detecting occupational fraud and abuse

How this book came about is a story in itself. As improbable as it seems looking back, I am well into my fourth decade in the field of fraud detection and deterrence. Like many of you, my career path did not start where it ended up. In the third grade, I distinctly remember pledging to be an astronomer. But by college, quantum physics had proved my undoing. Just a few credits shy of a math/physics degree, I switched to business school and majored in accounting.

After two years toiling in the ledgers of one of the large international auditing firms, I decided I could not stand it any more; my life had to have more excitement. So I became a real-life, gun-toting FBI agent. Thankfully, I did not have to use my pistol too many times to track down heinous robbers. And I learned in a hurry that the expensive crimes were not the bank robberies, anyhow—they were the bank embezzlements. For the next nine years, I specialized exclusively in investigating a wide range of white-collar crimes in which the federal government was a party at interest. The cases ran the gamut, from nickel-and-dime con artists to Watergate.

PREFACE

My second decade was with Wells & Associates, a group of consulting criminologists concentrating on white-collar crime prevention, detection, and education. That eventually led to the formation of a professional organization, the Association of Certified Fraud Examiners. For 25 years, I have been chairman of the Board of Directors. I hope to spend the remainder of my professional career with what I have discovered to be my secret love: writing.

Corporate Fraud Handbook: Prevention and Detection has its genesis in *Occupational Fraud and Abuse*. At the time, I was intrigued by the definition of “fraud” as classically set forth in *Black’s Law Dictionary*:

All multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprise, trick, cunning or dissembling, and any unfair way by which another is cheated.

This definition implied to me that there was an almost unlimited number of ways people could think up to cheat one another. But my experience told me something else: After investigating and researching literally thousands of frauds, they seemed to fall into definite patterns. If we could somehow determine what those patterns were and in what frequency they occurred, it would aid greatly in understanding and ultimately preventing fraud. And since so much fraud occurs in the workplace, this particular area would be the starting point.

So I began a research project with the aid of over 2,000 certified fraud examiners (CFEs). They typically work for organizations in which they are responsible for aspects of fraud detection and deterrence. Each CFE provided details on exactly how their organizations were being victimized from within. That information subsequently was summarized in a document for public consumption, the *1996 Report to the Nation on Occupational Fraud and Abuse*. Since that time, the report has been published on six occasions, the latest being in 2012.

Although the reports provide a basic framework, this book is intended for a different audience—those of you who need to know all the details. You will discover that while fraud may outwardly seem complex, it rarely is. You do not need an accounting degree—just an understanding of fundamental business procedures and terminology. As the saying could go, fraud ain’t rocket science.

Rather than an unlimited number of schemes, this book suggests that occupational fraud and abuse can be divided into three main categories: asset misappropriation, corruption, and fraudulent statements. From the three main categories, there are several distinct schemes identified and classified, and they are covered in detail herein.

The book begins with an overview of the complex social factors that go into creating an occupational offender. People do things for a reason, and understanding why employees engage in this behavior is the key to creating ways to prevent it. You will therefore find these pages rich in personal detail.

Following the introduction, the book is divided into chapters devoted to the specific occupational fraud and abuse schemes. Each of the chapters is organized similarly. First, a case study provides insights. Next, the scheme itself is flowcharted and the

Preface

scheme variations are scheduled, along with statistics for each method. Finally, observations and conclusions on each chapter will help in devising prevention and detection strategies.

A project such as this is not a solo venture, even though I accept final responsibility for every word, right or wrong. I must first gratefully acknowledge the thousands of CFEs who provided the case examples. I am especially appreciative of the efforts of John Warren, who did much of the detailed research. Jim Ratley, Jeanette LeVie, John Gill, Andi McNeal, Catherine Lofland, and Nancy Bradford merit special recognition. Mary-Jo Kranacher provided invaluable guidance in Chapters 12 and 13. Several writers assisted in preparing case studies: Michael C. Burton, Sean Guerrero, Brett Holloway-Reeves, Katherine McLane, Suzy Spencer, and Denise Worhach.

Special thanks go to the CFEs and other professionals who furnished details of their cases: Bradley Brekke, CFE; Anthony J. Carriuolo, Esq.; H. Craig Christiansen, CFE, CPA; Harvey Creem, CFE, CPA; Jim Crowe, CFE; Harry D'Arcy, CFE; Marvin Doyal, CFE, CPA; Tonya L. DiGiuseppe, CFE, CPA; Harold Dore, CFE, CIA; Stephen Gaskell, CFE; Gerald L. Giles, Jr., CFE, CPA; Paul Granetto; James Hansen, CFE; Paul Hayes, CFE; Charles Intrigo, Esq.; Terry Isbell, CFE, CIA; Douglas LeClaire, CFE; Barry Masuda, CFE; Terrence McGrane, CFE, CIA; David McGuckin, CFE; David Mensel, CFE, CPA; Dick Polhemus, CFE; Trudy Riester, CFE; Lee Roberts, CFE; Peter Roman, CFE; James Sell, CFE, CPA; Harry J. Smith III, CFE, CPA; and Donald Stine, CFE, CPA.

Finally, I must thank the one person without whom these pages would not have been written. My wife, Judy, has endured countless weekends and early mornings alone while I sat at this keyboard. She has become accustomed to me jumping up in the middle of dinner to write down a new thought on a scrap of paper. And she has done every bit of it by cheering me on, never complaining. First to Judy Gregor Wells—then to those of you trying to make a better world by reducing fraud—this book is dedicated.

Joseph T. Wells
Austin, Texas
April 2013

About the ACFE

The Association of Certified Fraud Examiners (ACFE) is the world's largest antifraud organization and premier provider of anti-fraud training and education. Together with more than 65,000 members, the ACFE is reducing business fraud worldwide and inspiring public confidence in the integrity and objectivity within the profession.

Established in 1988, with headquarters in Austin, Texas, the ACFE supports the profession by providing expert instruction, practical tools, and innovative resources in the fight against fraud. The ACFE hosts conferences and seminars year-round while offering informative books and self-study courses written by leading practitioners to help members learn how and why fraud occurs and to build the skills needed to fight it effectively. Members of the ACFE also have the ability to expand their antifraud knowledge and assert themselves in the antifraud community by obtaining the Certified Fraud Examiner (CFE) credential. This globally preferred certification indicates expertise in fraud prevention, deterrence, detection, and investigation.

The ACFE oversees the CFE credential by setting standards for admission, administering the Uniform CFE Examination, and maintaining and enforcing the ACFE Code of Professional Ethics. CFEs on six continents have collectively investigated more than one million suspected cases of civil and criminal fraud.

The ACFE is also committed to providing educational resources to the academic community and has established the Anti-Fraud Education Partnership to address the unprecedented need for fraud examination education at the university level. In pursuit of this objective, the ACFE has provided free training and educational materials to institutions of higher learning throughout the world.

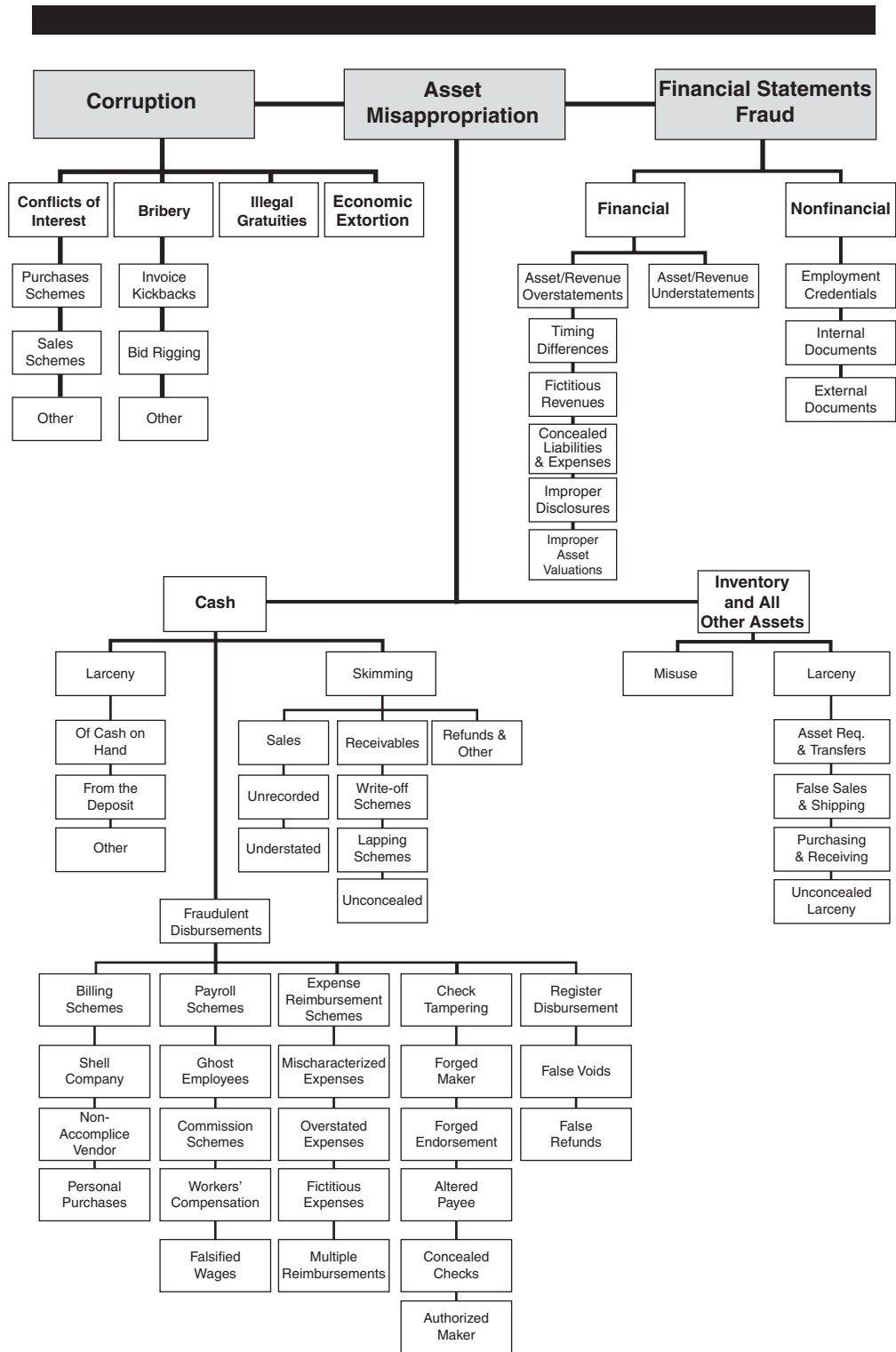
Criminologist and former FBI agent Dr. Joseph T. Wells, CFE, CPA, is chairman and founder of the ACFE as well as an advisory member of the Board of Regents. Dr. Wells writes, researches, and lectures to business and professional groups on fraud-related issues. He has won top writing awards from both the *Internal Auditor* and the *Journal of Accounting* magazines, and he is a winner of the Innovation in Accounting Education Award presented by the American Accounting Association. He was named to *Accounting Today* magazine's annual list of the "Top 100 Most Influential People" in accounting nine times. In 2010, for his contributions to the anti-fraud field, he was honored as a Doctor of Commercial Science by York College of the City University of New York.

ABOUT THE ACFE

Labeled “the premier financial sleuthing organization” by the *Wall Street Journal*, the ACFE has also been cited for its efforts against fraud by media outlets such as *U.S. News & World Report*, the *New York Times*, CNN, CNBC, *Fortune*, ABC-TV’s *Nightline* and *20/20*, and CBS News’ *60 Minutes*.

Further information about the ACFE is available at www.acfe.com, or (800) 245-3321.

Introduction



In the world of commerce, organizations incur costs to produce and sell their products or services. These costs run the gamut: labor, taxes, advertising, occupancy, raw materials, research and development—and, yes, fraud and abuse. The latter cost, however, is fundamentally different from the former: The true expense of fraud and abuse is hidden, even if it is reflected in the profit and loss figures.

For example, suppose the advertising expense of a company is \$1.2 million. But unknown to the company, its marketing manager is in collusion with an outside ad agency and has accepted \$300,000 in kickbacks to steer business to that firm. That means the true advertising expense is overstated by at least the amount of the kickback—if not more. The result, of course, is that \$300,000 comes directly off the bottom line, out of the pockets of the investors and the workforce.

DEFINING “OCCUPATIONAL FRAUD AND ABUSE”

The example just given is clear-cut, but much about occupational fraud and abuse is not so well defined, as we will see. Indeed, there is widespread disagreement on what exactly constitutes these offenses.

For purposes of this book, “occupational fraud and abuse” is defined as “the use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.”¹

This definition’s breadth means that it involves a wide variety of conduct by executives, employees, managers, and principals of organizations, ranging from sophisticated investment swindles to petty theft. Common violations include asset misappropriation, fraudulent statements, corruption, pilferage and petty theft, false overtime, use of company property for personal benefit, and payroll and sick time abuses. Four elements common to these schemes were reported by the Association of Certified Fraud Examiners (ACFE) in its first *Report to the Nation on Occupational Fraud and Abuse*, released in 1996: “The key is that the activity (1) is clandestine, (2) violates the employee’s fiduciary duties to the organization, (3) is committed for the purpose of direct or indirect financial benefit to the employee, and (4) costs the employing organization assets, revenues, or reserves.”²

An “employee,” in the context of this definition, is any person who receives regular and periodic compensation from an organization for his or her labor. The term is not restricted to the rank-and-file but specifically includes corporate executives, company presidents, top and middle managers, contract employees and other workers.

Defining “Fraud”

In the broadest sense, fraud can encompass any crime for gain that uses deception as its principal modus operandi. Of the three ways to illegally relieve a victim of money—force, trickery, or larceny—all offenses that employ trickery are frauds. Since deception is the linchpin of fraud, we will include *Merriam-Webster’s* synonyms: “‘Deceive’ implies imposing a false idea or belief that causes ignorance, bewilderment, or helplessness; ‘mislead’ implies a leading astray that may or may not be intentional;

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‘delude’ implies deceiving so thoroughly as to obscure the truth; ‘beguile’ stresses the use of charm and persuasion in deceiving.”

Although all frauds involve some form of deception, not all deceptions are necessarily frauds. Under common law, four general elements must be present for a fraud to exist:

1. A material false statement
2. Knowledge that the statement was false when it was uttered
3. Reliance of the victim on the false statement
4. Damages resulting from the victim’s reliance on the false statement

The legal definition is the same whether the offense is criminal or civil; the difference is that criminal cases must meet a higher burden of proof.

Let’s assume an employee who worked in the warehouse of a computer manufacturer stole valuable computer chips when no one was looking and resold them to a competitor. This conduct is certainly illegal, but what law has the employee broken? Has he committed fraud? Has he committed theft? The answer, of course, is that it depends. Employees have a recognized fiduciary relationship with their employers under the law. Let’s briefly review the legal ramifications of the theft.

The term “fiduciary,” according to *Black’s Law Dictionary*, is of Roman origin and means

*a person holding a character analogous to a trustee, in respect to the trust and confidence involved in it and the scrupulous good faith and candor which it requires. A person is said to act in a “fiduciary capacity” when the business which he transacts, or the money or property which he handles, is not for his own benefit, but for another person, as to whom he stands in a relation implying and necessitating great confidence and trust on the one part and a high degree of good faith on the other part.*³

So, in our example, the employee has not only stolen the chips; in so doing, he has violated his fiduciary capacity. That makes him an embezzler.

*To “embezzle” means willfully to take, or convert to one’s own use, another’s money or property of which the wrongdoer acquired possession lawfully, by reason of some office or employment or position of trust. The elements of “embezzlement” are that there must be a relationship such as that of employment or agency between the owner of the money and the defendant, the money alluded to have been embezzled must have come into the possession of defendant by virtue of that relationship and there must be an intentional and fraudulent appropriation or conversion of the money.*⁴

In other words, embezzlement is a special type of fraud.

“Conversion,” in the legal sense, is

an unauthorized assumption and exercise of the right of ownership over goods or personal chattels belonging to another; to the alteration of their condition or the exclusion of the owner’s rights. An unauthorized act which deprives an owner of his property permanently

*or for an indefinite time. Unauthorized and wrongful exercise of dominion and control over another's personal property, to the exclusion of or inconsistent with the rights of owner.*⁵

So by stealing the chips, the employee also engages in conversion of the company's property.

The legal term for stealing is "larceny," which is

*felonious stealing, taking and carrying, leading, riding, or driving away with another's personal property, with the intent to convert it or to deprive the owner thereof. The unlawful taking and carrying away of property of another with the intent to appropriate it to a use inconsistent with the latter's rights. The essential elements of a "larceny" are an actual or constructive taking away of the goods or property of another without the consent and against the will of the owner and with a felonious intent. Obtaining possession of property by fraud, trick or device with preconceived design or intent to appropriate, convert, or steal is "larceny."*⁶

As a matter of law, the employee in question could be charged with a wide range of criminal and civil conduct: fraud, embezzlement, obtaining money under false pretenses, or larceny. As a practical matter, he probably will be charged with only one offense, commonly larceny.

"Larceny by fraud or deception" means that

*a person has purposely obtained the property of another by deception. A person deceives if he purposely: (1) creates or reinforces a false impression, including false impressions as to law, value, intention or other state of mind; but deception as to a person's intention from the act alone that he did not subsequently perform the promise; or (2) prevents another from acquiring information which would affect his judgment of a transaction; or (3) fails to correct a false impression which the deceiver previously created or reinforced, or which the deceiver knows to be influencing another to whom he stands in a fiduciary or confidential relationship; or (4) fails to disclose a known lien, adverse claim, or other legal impediment to the enjoyment of property which he transfers or encumbers in consideration for the property obtained, whether such impediment is or is not valid, or is or is not a matter of official record.*⁷

The fraudulent aspect of occupational frauds, then, deals with the employee's fiduciary duties to the organization. If those duties are violated, that action may be considered fraud in one of its many forms. Under the definition of occupational fraud and abuse in this book, the activity must be clandestine. *Black's Law Dictionary* defines "clandestine" as "secret, hidden, concealed; usually for some illegal or illicit purpose."⁸

Defining "Abuse"

Obviously, not all misconduct in the workplace meets the definition of fraud. A litany of abusive practices plagues organizations, causing lost dollars or resources but not actually constituting fraud. As any employer knows, it is hardly out of the ordinary for employees to:

- Use employee discounts to purchase goods for friends and relatives.
- Take supplies or use equipment belonging to the organization.

Introduction

- Get paid for more hours than worked.
- Collect more money than due on expense reimbursements.
- Take a long lunch or break without approval.
- Come to work late or leave early.
- Use sick leave when not sick.
- Do slow or sloppy work.
- Work under the influence of alcohol or drugs.
- Surf the Internet on the job.
- Attend to personal matters during business hours.

The term “abuse” has taken on a largely amorphous meaning over the years, frequently being used to describe any misconduct that does not fall into a clearly defined category of wrongdoing. *Merriam-Webster’s* states that the word “abuse” comes from the Latin word *abusus*—to consume—and that it means “1. A corrupt practice or custom; 2. Improper or excessive use or treatment: misuse; 3. A deceitful act: deception.”⁹

Given the commonality of the language describing both fraud and abuse, what are the key differences? An example illustrates: Suppose a teller was employed by a bank and stole \$100 from her cash drawer. We would define that broadly as fraud. But if the teller earns \$500 a week and falsely calls in sick one day, we might call that abuse—even though each has the exact same economic impact to the company—in this case, \$100.

And, of course, each offense requires a dishonest intent on the part of the employee to victimize the company. Look at the way each typically is handled within an organization, though: In the case of the embezzlement, the employee gets fired; there is also a possibility (albeit remote) that he will be prosecuted. In the case in which the employee misuses sick time, she *perhaps* gets reprimanded, or her pay is docked for the day.

But we also can change the “abuse” example slightly. Let us say the employee works for a governmental agency instead of in the private sector. Sick leave abuse—in its strictest interpretation—could be a fraud against the government. After all, the employee has made a false statement for financial gain (to keep from getting docked). Government agencies can and have prosecuted flagrant instances of sick leave abuse. Misuse of public money in any form can end up being a serious matter, and the prosecutive thresholds can be surprisingly low.

Here is one real example: Many years ago I was a rookie FBI agent assigned to El Paso, Texas. That division covered the Fort Bliss military reservation, a sprawling desert complex. There were rumors that civilian employees of the military commissary were stealing inventory and selling it out the back door. The rumors turned out to be true, albeit slightly overstated. But we did not know that at the time.

So around Thanksgiving, the FBI spent a day surveying the commissary’s back entrance. We had made provisions for all contingencies—lots of personnel, secret vans, long-range cameras—the works. But the day produced only one measly illegal sale out the back door: several frozen turkeys and a large bag of yams. The purchaser of the stolen goods tipped his buddy \$10 for merchandise valued at about \$60. The offense occurred late in the day. We were bored and irritated, and we pounced on the purchaser

as he exited the base, following him out the gate in a caravan of unmarked cars with red lights. The poor guy was shaking so badly that he wet his pants. I guess he knew better than we did what was at stake.

Because he was in the wrong place at the wrong time and did the wrong thing, our criminal paid dearly: He pled guilty to a charge of petty theft. So did his buddy at the commissary. The employee was fired. But the purchaser, it turned out, was a retired military colonel with a civilian job on the base—a person commonly known as a double dipper. He was let go from a high-paying civilian job and now has a criminal record. But most expensively, I heard he lost several hundred thousand dollars in potential government retirement benefits. Would the same person be prosecuted for petty theft today? It depends entirely on the circumstances. But it could, and does, happen.

The point here is that the term “abuse” is often used to describe a variety of petty crimes and other counterproductive behavior that have become common, and are even silently condoned, in the workplace. The reasons employees engage in these abuses are varied and highly complex. Do abusive employees eventually turn into out-and-out thieves and criminals? In some instances, yes. We will describe that later. But next we turn to some classic research into why so-called good employees turn bad. Although some of these studies are decades old, they are landmarks in the anti-fraud field.

RESEARCH IN OCCUPATIONAL FRAUD AND ABUSE

Edwin H. Sutherland

Considering its enormous impact, relatively little research has been done on the subject of occupational fraud and abuse. Much of the current literature is based on the early works of Edwin H. Sutherland (1883–1950), a criminologist at Indiana University. Sutherland was particularly interested in fraud committed by the elite upper-world business executive, whether against shareholders or against the public. As renowned criminologist Gilbert Geis noted, Sutherland said,

General Motors does not have an inferiority complex, United States Steel does not suffer from an unresolved Oedipus problem, and the DuPonts do not desire to return to the womb. The assumption that an offender may have such pathological distortion of the intellect or the emotions seems to me absurd, and if it is absurd regarding the crimes of businessmen, it is equally absurd regarding the crimes of persons in the economic lower classes.¹⁰

For the uninitiated, Sutherland is to the world of white-collar criminality what Freud is to psychoanalysis. Indeed, it was Sutherland who coined the term “white-collar crime” in 1939. He intended the definition to mean criminal acts of corporations and individuals acting in their corporate capacity, but since that time the term has come to mean almost any financial or economic crime, from the mailroom to the boardroom.

Many criminologists, myself included, believe that Sutherland’s most important contribution to criminal literature lay elsewhere. Later in his career, Sutherland developed the theory of differential association, which is now the most widely accepted theory of criminal behavior. Until Sutherland’s landmark work in the 1930s, most criminologists

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and sociologists held the view that crime was genetically based—that criminals beget criminal offspring.

Although this argument may seem naive today, it was based largely on the observation of non-white-collar offenders—the murderers, rapists, sadists, and hooligans who plagued society. Numerous subsequent studies have indeed established a genetic base for “street” crime, which must be tempered by environmental considerations. (For a thorough explanation of the genetic base for criminality, see *Crime & Human Nature: The Definitive Study of the Causes of Crime* by Wilson and Herrnstein.¹¹) Sutherland was able to explain crime’s environmental considerations through the theory of differential association. The theory’s basic tenet is that crime is learned, much as are math, English, and guitar playing.¹²

Sutherland believed that learning of criminal behavior occurred with other persons in a process of communication. Therefore, he reasoned, criminality cannot occur without the assistance of other people. Sutherland further theorized that the learning of criminal activity usually occurred within intimate personal groups. In his view, this explains how a dysfunctional parent is more likely to produce dysfunctional offspring. Sutherland believed that the learning process involved two specific areas: the techniques for committing crime; and the attitudes, drives, rationalizations, and motive of the criminal mind. You can see how Sutherland’s differential association theory fits with occupational offenders: Dishonest employees will eventually infect a portion of honest ones, but honest employees will also eventually have an influence on some dishonest ones.

Donald R. Cressey

One of Sutherland’s brightest students at Indiana University during the 1940s was Donald R. Cressey (1919–1987). Although much of Sutherland’s research concentrated on upper-world criminality, Cressey took his own studies in a different direction. Working on his doctorate in criminology, he decided to concentrate on embezzlers. Accordingly, Cressey arranged for permission to visit prisons in the Midwest and eventually interviewed about 200 incarcerated inmates.

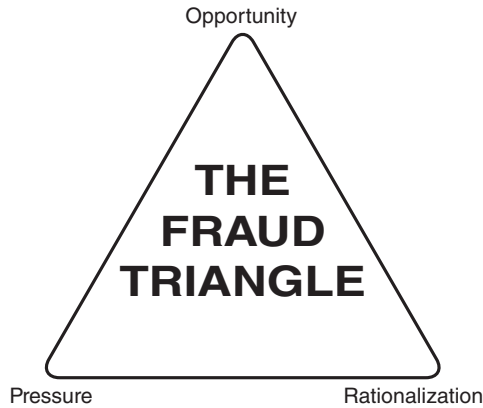
Cressey’s Hypothesis

Cressey was intrigued by embezzlers, whom he called “trust violators.” He was especially interested in the circumstances that led them to be overcome by temptation. For that reason, he excluded from his research those employees who took their jobs for the purpose of stealing—a relatively minor number of offenders at that time. Upon completion of his interviews, he developed what still remains the classic model for the occupational offender. His research was published in *Other People’s Money: A Study in the Social Psychology of Embezzlement*.¹³

Cressey’s final hypothesis was:

Trusted persons become trust violators when they conceive of themselves as having a financial problem which is nonsharable, are aware this problem can be secretly resolved by violation of the position of financial trust, and are able to apply to their own conduct in

Exhibit 1.1 The Fraud Triangle



that situation verbalizations which enable them to adjust their conceptions of themselves as trusted persons with their conceptions of themselves as users of the entrusted funds or property.¹⁴

Over the years, the hypothesis has become better known as the fraud triangle. (See Exhibit 1.1.) The first leg of the triangle represents a *perceived nonsharable financial need*, the second leg represents *perceived opportunity*, and the third leg stands for *rationalization*. As Cressey said:

When the trust violators were asked to explain why they refrained from violation of other positions of trust they might have held at previous times, or why they had not violated the subject position at an earlier time, those who had an opinion expressed the equivalent of one or more of the following quotations: (a) "There was no need for it like there was this time." (b) "The idea never entered my head." (c) "I thought it was dishonest then, but this time it did not seem dishonest at first."¹⁵

In all cases of trust violation encountered, the violator considered that a financial problem which confronted him could not be shared with persons who, from a more objective point of view, probably could have aided in the solution of the problem.¹⁶

Nonsharable Problems

What, of course, is considered nonsharable is wholly in the eyes of the potential occupational offender, Cressey noted:

Thus a man could lose considerable money at the race track daily but the loss, even if it construed a problem for the individual, might not constitute a nonsharable problem for him. Another man might define the problem as one which must be kept secret and private, that is, as one which is nonsharable. Similarly, a failing bank or business might be considered by one person as presenting problems which must be shared with business associates and members of the community, while another person might conceive these problems as nonsharable.¹⁷

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Cressey divided these “nonsharable” problems into six basic subtypes:

1. Violation of ascribed obligations
2. Problems resulting from personal failure
3. Business reversals
4. Physical isolation
5. Status gaining
6. Employer–employee relations

Violation of Ascribed Obligations

Violation of ascribed obligations—the specter of being unable to pay one’s debts—has historically proved a strong motivator of financial crimes.

Financial problems incurred through non-financial violations of positions of trust often are considered as nonsharable by trusted persons since they represent a threat to the status which holding the position entails. Most individuals in positions of financial trust, and most employers of such individuals, consider that incumbency in such a position necessarily implies that, in addition to being honest, they should behave in certain ways and should refrain from participation in some other kinds of behavior.¹⁸

In other words, the mere fact that a person has a trusted position brings with it the implied duty to properly manage money.

When persons incur debts or in some other way become financially obligated as a result of violation of the obligations ascribed to the role of trusted person, they frequently consider that these debts must be kept secret, and that meeting them becomes a nonsharable financial problem. In many instances, the insurance of such debts is also considered incompatible with the duties and obligations of other roles which the person might be enacting, such as those of a husband or father, but the concern here is with such debts only as they represent conflict with the person’s role as a trusted person.¹⁹

Cressey describes a situation we can all appreciate—not being able to pay one’s debts, and then having to admit it to one’s employer, family, or friends.

Problems Resulting from Personal Failures

Problems resulting from personal failures, Cressey writes, can be of several different types.

While some pressing financial problems may be considered as having resulted from “economic conditions” . . . others are considered to have been created by the misguided or poorly planned activities of the individual trusted person. Because he fears a loss of status, the individual is afraid to admit to anyone who could alleviate the situation the fact that he has a problem which is a consequence of his “own bad judgment” or “own fault” or “own stupidity.”²⁰

In short, pride goeth before the fall. If the potential offender has a choice between covering poor investment choices through a violation of trust and admitting to be an unsophisticated investor, it is easy to see how the judgment of some prideful people could be clouded.

Business Reversals

Business reversals were the third area Cressey detailed as a part of the nonsharable problem. He saw these as different from personal failures, since many businesspeople consider their financial reverses as coming from conditions beyond their control: inflation, high interest rates, raising capital, and borrowing money. Cressey quoted the remarks of one businessman who borrowed money from a bank using fictitious collateral:

Case 36. There are very few people who are able to walk away from a failing business. When the bridge is falling, almost everyone will run for a piece of timber. In business there is this eternal optimism that things will get better tomorrow. We get to working on the business, keeping it going, and we almost get mesmerized by it. . . . Most of us don't know when to quit, when to say, "This one has me licked. Here's one for the opposition."²¹

Physical Isolation

The fourth category of nonsharable problems Cressey described is physical isolation, in which the person in financial straits is isolated from the people who can help him. It's not that the person is afraid to share his problem, it's that he has no one with whom to share the problem. He is in a situation in which he has no access to trusted friends or associates who would otherwise be able to help.

Status Gaining

The fifth category consists of problems relating to status gaining. Although these problems are easily passed off as living beyond one's means or spending money lavishly, Cressey was interested more in their behavioral implications. He noted:

The structuring of status ambitions as being nonsharable is not uncommon in our culture, and it again must be emphasized that the structuring of a situation as nonsharable is not alone the cause of trust violation. More specifically, in this type of case a problem appears when the individual realizes that he does not have the financial means necessary for continued association with persons on a desired status level, and this problem becomes nonsharable when he feels that he can neither renounce his aspirations for membership in the desired group nor obtain prestige symbols necessary to such membership.²²

In other words, it is not the desire for a better lifestyle that creates the nonsharable problem (we all want a better lifestyle); rather, it is the inability to obtain the finer things through legitimate means, and, at the same time, an unwillingness to settle for a lower status, that creates the motivation for trust violation. This problem might be referred to as the keeping-up-with-the-Joneses syndrome.

Employer–Employee Relations

Finally, Cressey described problems resulting from employer–employee relationships. The most common situation, he stated, was that of an employed person who resents his status within the organization in which he is trusted. The resentment can come from perceived economic inequities, such as pay, or from the feeling of being overworked or underappreciated. Cressey said this problem becomes nonsharable when the individual believes that making suggestions to alleviate perceived maltreatment will possibly threaten his or her status in the organization. There is also a strong motivator for the perceived employee to want to “get even” when he or she feels ill treated.

A Personal Experience

One of my best-remembered examples involves a personal experience, and not a pleasant one. Most people—if they admit the truth—will have stolen on the job at some time in their careers. Some of the thefts are major, some minor. Some are uncovered; many never are. With this preamble (and the fact that the statute of limitations has long expired!), I will tell you the story of one employee thief: me.

The incident occurred during college. Like many of you, I did not work my way through the university just for experience; it was a necessity. One of my part-time jobs was as a salesperson in a men’s clothing store, a place I’ll call Mr. Zac’s. It seems that Mr. Zac had the imagination to name the store after himself, which may give you a clue as to the kind of person he was.

My first day on the job, it became clear by talking to the other employees that they strongly disliked Mr. Zac. It did not take long to figure out why: He was cheap beyond all reason; he was sore-tempered, paranoid, and seemed to strongly resent having to pay the employees who were generating his sales. Mr. Zac was especially suspicious of the help stealing. He always eyed the employees warily when they left in the evening, I assume because he thought their clothing and bags were stuffed with his merchandise. So his employees figured out novel ways to steal for no other reason than to get back at Mr. Zac. I was above all that, or so I thought. But then Mr. Zac did something to me personally, and my attitude changed completely.

One day I was upstairs in the storeroom getting merchandise off the top shelf. Since the high reach had pulled my shirttail out, I was standing there tucking it in when Mr. Zac walked by. He didn’t say a word. I went back downstairs to work and thought no more of it. But ten minutes later Mr. Zac called me into his small, cubbyhole office, closed the door, and asked, “What were you tucking in your pants upstairs?” Just my shirt, I replied. “I don’t believe you,” Mr. Zac said. “Unless you unzip your pants right now and show me, you’re fired.” At first, of course, it did not register that he was serious. When it finally did, I was faced with a dilemma: Unzip my pants for the boss, or be late on the rent and face eviction. I chose the former, but as I stood there letting my pants fall down around my knees, my face burned with anger and embarrassment. Never before had I been placed in a position like this—having to undress to prove my innocence.

After seeing for himself that I didn't have any of his precious merchandise on my person, Mr. Zac sent me back to the sales floor. I was a different person, though. No longer was I interested in selling merchandise and being a good employee. I was interested in getting even, and that's what I did. Over the next few months I tried my best to steal him blind—clothing, underwear, outerwear, neckties—you name it. With the help of some of the other employees, we even stole a large display case. He never caught on, and eventually I quit the job. Was I justified in stealing from Mr. Zac? Absolutely not. At this age, given the same circumstances, would I do it again? No. But at that particular time, I was young, idealistic, very headstrong, and totally fearless. Criminologists have documented that the reason so many young people lack fear is because they do not yet realize actions can have serious consequences; it never occurred to me that I could have gone to jail for stealing from Mr. Zac.

The impact of job loyalty—or, like Mr. Zac's employees, the lack of it—is an important consideration in the occupational fraud and abuse formula. With changes in the American workforce, we may or may not experience more fraud-related problems. Much has been written recently concerning the downsizing, outsourcing, and increased employee turnover in business. If the employee of the future is largely a contract worker, much of the incentive of loyalty toward organizations could be lost. Such a trend seems to be under way, but its real fraud impact has not been determined. However, fraud is only one cost of doing business. If the outsourcing of corporate America does indeed cause more occupational fraud and abuse, the benefits of restructuring may be seen as outweighing the cost of more crime, at least in the short term. In the long run, it is difficult to justify how employees stealing from organizations can be beneficial to anyone. That was Cressey's theory too.

Sociological Factors

Since Cressey's study was done in the early 1950s, the workforce was obviously different from that of today. But the employee faced with an immediate, nonsharable financial need has not changed much over the years. That employee is still placed in the position of having to find a way to relieve the pressure that bears down upon him. But simply stealing money is not enough; Cressey pointed out that for the trust violator, it is necessary that he believe his financial situation can be resolved in secret. Cressey said:

In all cases [in the study] there was a distinct feeling that, because of activity prior to the defalcation, the approval of groups important to the trusted person had been lost, or a distinct feeling that present group approval would be lost if certain activity were revealed [the nonsharable financial problem], with the result that the trusted person was effectively isolated from persons who could assist him in solving problems arising from that activity.

Although the clear conception of a financial problem as nonsharable does not invariably result in trust violation, it does establish in trusted persons a desire for a specific kind of solution to their problems. The results desired in the cases encountered were uniform: the solution or partial solution of the problem by the use of funds which can be obtained in an independent, relatively secret, safe, and sure method in keeping with the "rationalizations" available to the person at the time.²³