

Fraud Intelligence

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“Blinkers off”: counter-fraud, is it a self-serving profession?

“We’ve had a hundred years of psychotherapy and the world’s getting worse” - James Hillman, American psychologist (1926-2011).

Veronica Morino asks a similar question about fraud and corruption and the specialists who are supposed to help us make it go away: after 50 years of fraud prevention and investigation, is the world simply getting more fraudulent and greedier? Not forgetting that for every cloud, there’s a silver lining: are other beneficiaries of fraud and corruption (after the fraudsters) the accountants, lawyers, compliance officers, and that thriving new profession of “Fraud Examiners”, who, like the therapists, might reflect, “the more ill, the more we have to pay the bills”?

Fraud and corruption – permanent challenges

The Association of Certified Fraud Examiners in their study “*Report to the Nation on Occupational Fraud and Abuse*”^[1] assess the financial costs to be more than 5% of turnover in a typical organisation, which, if correct, represents an enormous drain on the profitability of companies, the effectiveness of public sector organisations and the efficiency of national economies.

This article takes a close look at the professional body of knowledge around “Fraud Examination”, one of the preferred approaches to tackling fraud and corruption, and explores its possible limitations and shortcomings. The analysis will hopefully stimulate debate about alternative ways to address the “dark side” of organisations more effectively.

Spectacular business failures have prompted greater legislation and regulation designed to make management more accountable. However, even after the recent tidal waves of legislation, it seems that companies and organisations still lack the skills to identify fraud and corruption risks and pick up the warning signs early.

Rise of the fraud therapists

The “fraud experts” and corporate functions expected to take charge – accountants, internal auditors, controllers,



risk managers, compliance officers and legal advisors – draw on which bodies of professional knowledge, exactly? In this context the “Fraud Examination” discipline takes centre stage; it originated with Joseph Wells (a US Certified Public Accountant, who worked as an external auditor at Coopers and Lybrand (now PricewaterhouseCoopers) and also at the FBI as special agent). His idea was to combine strands from traditionally distinct disciplines, including criminology, accounting, auditing and risk management, with the formalisation of the “Fraud Triangle” theory as the start point. The “Fraud Triangle” comes out of criminology, notably the work of Southerland (*White collar Crime*) and Cressey (*Other People’s Money: A Study in the Social Psychology of Embezzlement*). Southerland posited that individuals would be able to gradually detach from honesty if they saw that their professional success depended acting unethically or illegally. He termed the techniques used to justify illicit behaviour “rationalisations”. Cressey went further, arguing that, for violation of the position of financial trust to take place, three elements are necessary:

1. Need/motivation: for some kind of advantage;
2. Opportunity: there must be scope to “cheat”, combined with a (perceived or real) low possibility of being caught;
3. Rationalisation: the perpetrators have to be able to explain the crime to themselves in a way that makes it morally acceptable or justifiable.

Fellow criminologists argued that Cressey concentrated too much on the individual, overlooking social and organisational factors, and that Southerland’s approach revolved around micro-sociological theories that focussed on the link between individuals and their immediate organisational circumstances, ignoring broader historical, economic and political factors.

Despite these limitations, Wells formalised the three factors into the appealing term “Fraud Triangle” and used this theory as the foundation for his “Fraud Examination”, in which fraud was seen as a problem requiring control, by the organisation, of the individual’s frail morality and the Fraud Triangle was presented as a technical device for preventing acts normally deemed unacceptable. There was no discussion of the “norms” and otherwise of acceptable behaviour but reference to the Fraud Triangle encouraged organisations to take responsibility for individuals’ unethical natures by instituting control measures.

Auditors and their research colleagues then sought to develop the Fraud Triangle, analysing, among others, aspects like individual and corporate pressure as part of the “motivation” for committing fraud, and introducing the “Fraud Diamond”, with the “fraudster’s capabilities” as a fourth element, i.e., fraud can only take place when the right person has the right capabilities. All the studies stressed a need for increased controls and assigned this responsibility to the organisation.

In 1988 Wells founded the Association of Certified Fraud Examiners (ACFE), whose mission is “to reduce the incidence of fraud and white-collar crime and to assist the membership in fraud detection and deterrence”; a noble goal, and the ACFE today lays claim to be the world’s largest anti-fraud organization and premier provider of anti-fraud training and education. [2]

However, the ACFE approach tends to a specific perspective, which, rather than accepting fraud and corruption as commonplace, and part of human nature (but a cost that can be managed), fosters a climate of suspicion, with fraud viewed as a dual failure - of individual ethics and of the organisation’s attempt to control for individual probity and honesty.

“Fraud Examination”, as defined and advanced by the ACFE, is characterised by the translation bias that downplays criminological research looking at crime from sociological or systemic angles, in favour of a discourse promoting the evaluation, auditing, monitoring and normalization of individuals in the organisation. [3]

The same viewpoint is reflected in the studies conducted by the ACFE, such as the “Report to the Nations on Occupational Fraud and Abuse”, where, in spite of the interesting insights into the nature of occupational fraud, its perpetrators, victims and costs, as well methods for detection and prevention, the results should be treated with caution. The report’s aim of collating expert opinion on fraud is weakened by preconception, partial views of reality, and bias that, again, suggest a causal link between the likelihood of fraud and the level of controls organisations have in place.

The chapter “Detection of Fraud Schemes”, for example, connects fraud with how it was first detected, its duration and the associated loss. The “Detection methods” appear to be included in the survey according to the availability of select corresponding controls - “surveillance/monitoring”, “account reconciliation”, “IT controls”, “internal audit” and “management review”. Methods that reflect more sociological and systemic aspects of the organisation (and, at a more macro level, of society in general), covering topics like (company) culture, communication procedures or training and awareness practices are not included. [4] In defence of this selection it should be said that respondents were offered an “Other” option. The survey findings are also limited by the fact that it is only open to Certified Fraud Examiners (CFEs), whose qualification is based on parameters and knowledge recognised by the ACFE. Investigators, researchers, whistleblowers, fraudsters, victims of fraud or other experts in the field who are not CFEs are excluded from the study.

CFEs are anti-fraud experts who have demonstrated knowledge in four critical areas: “Fraudulent Financial Transactions”, “Fraud Investigation”, “Legal Elements of Fraud”, and “Fraud Prevention and Deterrence”: again, as sociological, cultural, organisational and systemic angles don’t appear to be covered, the likelihood that a high enough number of respondents would suggest new “Detection method” categories, beyond the existing set specified by the ACFE, is pretty low.

The “Detection of Fraud Schemes” chapter concludes that how fraud incidents are detected is not purely incidental and that the probability of discovery can be influenced by the procedures and controls an organisation has in place. The ACFE seems to want to demonstrate a positive correlation between how fraud is detected and specified monitoring and controls activities, with the implication that organisations should have these in place if they are to deal with fraud effectively.

Wells’ original idea of establishing an accredited body of knowledge such as the ACFE was innovative and probably very much needed at the time. He brought his own perspective and experience to the task and, in fairness, most likely never claimed that it was a holistic model. Unfortunately, possibly because many in the

“counter-fraud industry” saw a commercial interest in the “Fraud Examination” body of knowledge’s support for more controls, monitoring, rules and regulations, those measures became the focus and the CFE syllabus and qualification ended up as a partial response to a more complex challenge.

The general consensus is that, in spite of the increased volume of rules and jobs for the specialists, fraud has not decreased in recent decades, nor have companies proved able to deal with it more effectively. By extension, a similar consensus should apply to recognition that any approach which focuses exclusively on individuals’ behaviour and traits and the use of controls and regulations is not likely to work.

No room to think “outside the triangle”

Merely focussing on “Fraud Examination”, as conceived by Wells and the ACFE, will teach us much about how things go wrong, but absent the tools of organisation theory, a comprehensive understanding of all the factors that contribute to fraud will be lacking. “Fraud Examination” needs to be combined with an appreciation of sociological thinking on order and disorder to address the “dark side” of organisations in a more holistic way.

In a follow-up article we will explore alternatives to the current, limited “Fraud Examination” model, approaches that both disenfranchise the specialists and empower people working in organisations to prevent fraud and corruption themselves, and detect it early and effectively.

Notes

1. A periodic research study into the costs, schemes, perpetrators and victims of occupational fraud. The purpose of the report is to summarise the opinion of experts on the

percentage of revenue lost by organisations to fraud each year, categorise the ways in which occupational fraud and abuse occur, and analyse the characteristics both of the individuals who commit occupational fraud and of the victim organisations.

2. Members of the association include accountants, internal auditors, fraud investigators, law enforcement officers, lawyers, business leaders, risk/compliance professionals and educators, all of whom have access to the ACFE’s expert training, educational tools and resources. In addition to being part of the ACFE, members who wish to further their career in anti-fraud can become a Certified Fraud Examiner (CFE) by taking the CFE exam. “The CFE credential is increasingly being designated as a preferred credential in the hiring practices of businesses, government entities and law enforcement agencies.” (www.acfe.com).
3. As the ACFE’s first president Albrecht stated: “Having an effective control structure is probably the single most important step organizations can take to control and detect employee fraud.”
4. The category “Actively looking for red flags”, as described by the Institute of Internal Auditors (IIA, 2014), has not been considered either. The ability to detect fraud and corruption at an early stage, together with the capacity to understand the fraudster’s mindset and so prevent and detect their fraudulent behaviour will be further explored in a follow-up article.

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