Fraud Introduction

Conan C. Albrecht, PhD

Lots of ethical problems in business world in recent years

- F/S frauds (WorldCom, Enron, Adelphia, etc.—these have been worldwide)

- Inappropriate executive loans

- Insider trading

- Special executive favors (e.g. IPOs)

- Technology breaches
  - Privacy Problems
  - Corporate thefts
 - Internet Scams

Lots of problems in recent years

- Mutual fund frauds
- Stock option backdating
- Sloppy board room behavior
- Lying, bribes, etc.
- Increased fraud against organizations
- Making loans to people who didn't qualify—sub-prime losses

Largest Bankruptcy Filings in U.S.

Lehman Brothers, Inc	$691.0 billion	September 2008
Washington Mutual, Inc	$327.9 billion	September 2008
WorldCom, Inc.	$103.9 billion	July 2002
Enron Corp.	$ 65.5 billion	December 2001
Conseco, Inc.	$ 61.4 billion	December 2002
Pacific Gas and Electric	$ 36.2 billion	April 2001
Texaco	$ 34.9 billion	April 1987
Financial Corp. of America	$ 33.9 billion	September 1998
Refco, Inc.	$ 33.3 billion	October 2005
IndiMac Bancorp, Inc.	$ 32.7 billion	July 2008

# The NASDAQ Bubble

The NASDAQ "Bubble"
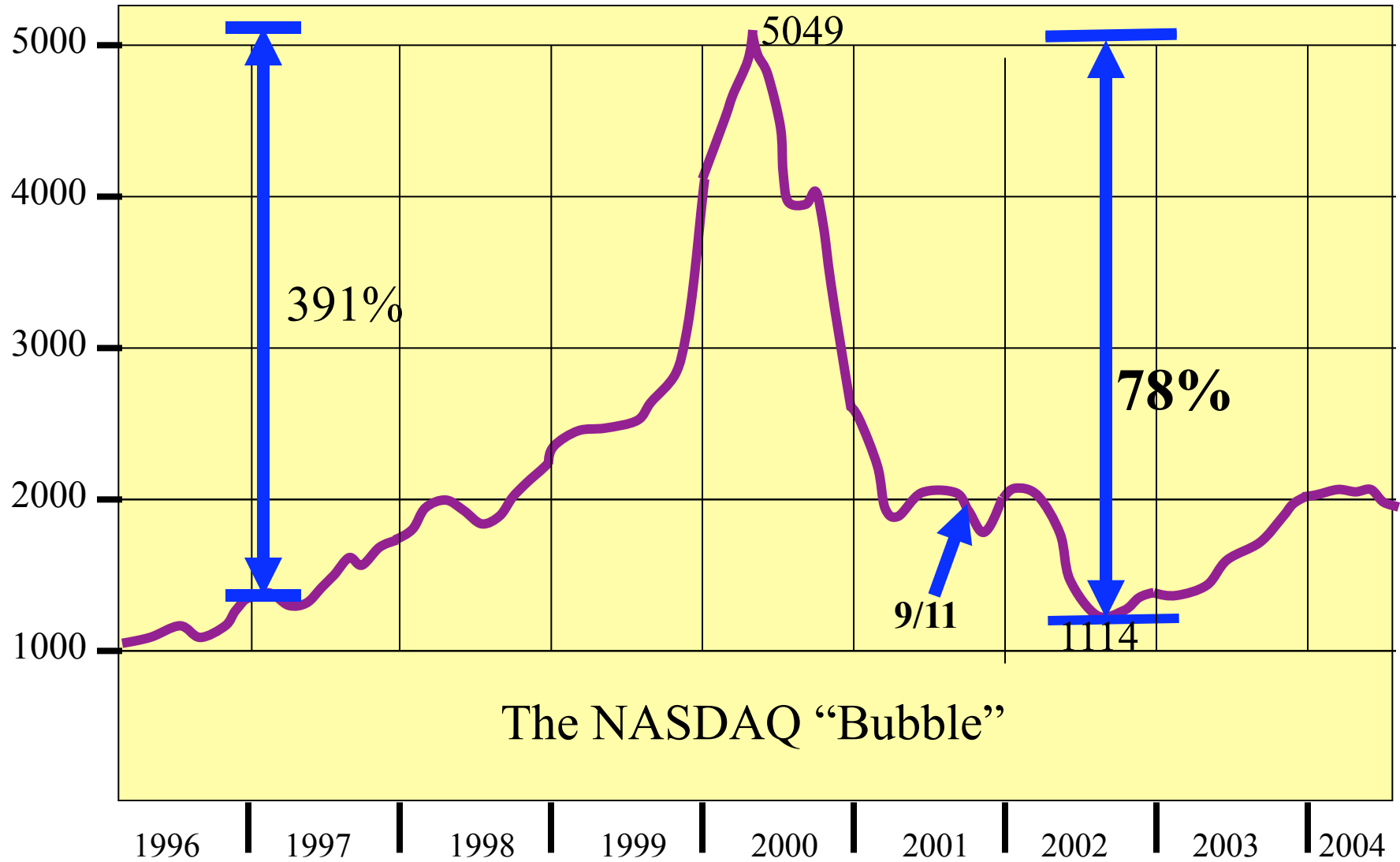
An Example of Unethical Greed

Jack Grubman was a telecom analyst for Citigroup's Salomon Smith Barney. He was also the father of twins whom he wanted to enroll in Manhattan's 92nd Street Y, home of a prestigious nursery school that is supposedly harder to get into than Harvard. In 1999, Grubman, who wasn't particularly excited about AT&T as an investment, had rated the company's stock as "neutral." However, in early 1999, Sanford Weill, chairman of Citigroup, asked Grubman to take a "fresh look" at AT&T. Grubman began a review but also stated in an e-mail that was titled "AT&T and the 92nd Street Y" that he'd love Weill's help in getting his twins in to the Y's preschool. Shortly after the memo was written, Grubman upgraded AT&T's stock to "buy." Not long after the upgrade, Salomon won some lucrative AT&T business. At about the same time, Citigoup gave $1 million, spread over five years, to the 92nd Street Y, and the Grubman twins were admitted to the preschool.

Example of Pressure
Wall Street's Expectations

- Investors want decreased risk and growing returns.
- Risk is reduced when variability of earnings is decreased.
- Rewards are increased when income *continuously* improves.

Firm A

Firm B
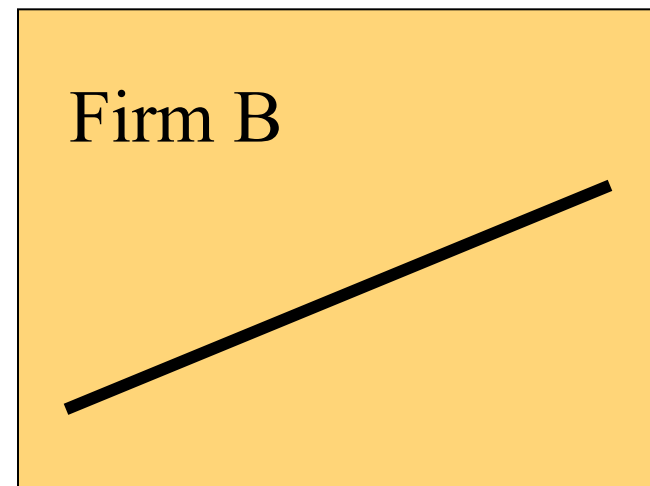
Which firm will have the higher stock price?

Actual Complaint in $2.8 Billion Financial Statement Fraud Case

- "The participants in the illegal scheme included virtually the entire senior management of (the company), including but not limited to its former chairman and chief executive officer, its former president, two former chief financial officers and various other senior personnel. In total, there were over 20 individuals involved in the earnings overstatement schemes."

Meeting WS Projections

| Firm	1st Qtr	2nd Qtr	3rd Qtr
Morgan Stanley	$0.17		$0.23
Smith Barney	0.17	$0.21	0.23
Robertson Stephens	0.17	0.25	0.24
Cowen & Co.	0.18	0.21	
Alex Brown	0.18	0.25	
Paine Webber	0.21		0.28
Goldman Sachs	0.17		
Furman Selz	0.17	0.21	0.23
Hambrecht & Quist	0.17	0.21	0.23
Actual Earnings	$0.08	$0.13	$0.16
Fraud	**0.09**	**0.09**	**0.07**
Reported EPS	0.17	0.22	0.23
Fraud (Millions)	**$62 M**	**$61M**	**$71M**

How People Got Involved

- The CFO instructed the chief accountant to increase earnings by $105 million. The chief accountant was skeptical about the purpose of these instructions but he did not challenge them. The mechanics were left to the chief accountant to carry out. The chief accountant created a spreadsheet containing seven pages of improper journal entries, 105 in total, that he determined were necessary to carry out the CFO's instructions. Over 20 people were involved in making or instructing to make similar entries.

Breeching One's Ethics--
A Costly Business Problem

- Large Fraud of $2.6 Billion over 9 years
  - Year 1 $600K
  - Year 3 $4 million
  - Year 5 $80 million
  - Year 7 $600 million
  - Year 9 $2.6 billion
- In years 8 and 9, four of the world's largest banks were involved and lost over $500 million
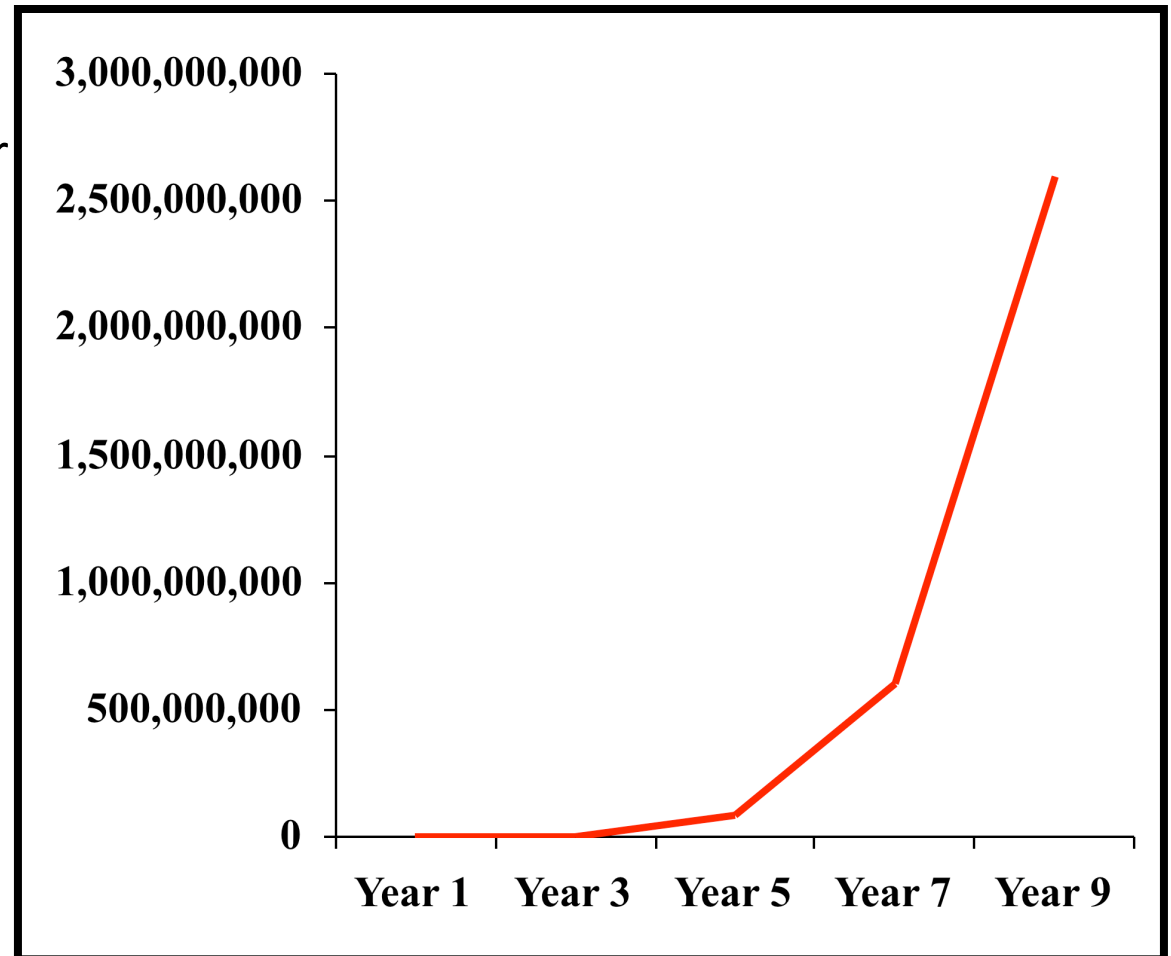
Some of the organizations involved: Merrill Lynch, Chase, J.P. Morgan, Union Bank of Switzerland, Credit Lyonnaise, Sumitomo, and others.

Breeching One's Ethics--a Costly Business Problem

- Fraud Losses Reduce Net Income $ for $

- If Profit Margin is 10%, Revenues Must Increase by 10 times Losses to Recover Affect on Net Income
  – Losses……. $100 Million
  – Revenue…...$1 Billion

- Fraud Robs Income

```
Revenues  $100    100%
Expenses    90     90%
Net Income   $ 10      10%
Fraud        1
Remaining    $  9
```

To restore the $1 of lost income, need $10 more dollars of revenue.

Breeching One's Ethics--a Costly Business Problem

- **General Motors**
  - $436 Million Fraud
  - Profit Margin = 10%
  - $4.36 Billion in Revenues Needed
  - At $20,000 per Car, 218,000 Cars

- **Bank**
  - $100 Million Fraud
  - Profit Margin = 10 %
  - $1 Billion in Revenues Needed
  - At $100 per year per Checking Account, 10 Million New Accounts

Breeching One's Ethics--a Costly Problem

- While GM was playing catch up, Toyota, Ford, Honda and others were getting ahead. The same is true of countries with high rates of corruption. They are playing catch up while other economies move ahead. Corruption and bad ethics are the silent thieves that hold countries, economies, companies and even individuals from moving forward.

KisMAC

KisMAC 0.21a

Q▾ Search For...   ?

#	Ch	SSID	BSSID	Enc	Type	Signal	Avg	Max	Packets	Data	Last Seen
0	36	NCCGroup4	00:17:DF:7D:9B:BB	WPA	managed	0	27	27	0	0B	2008-03-25 14:15:18 -0400
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2	6	NCCGroup4	00:17:DF:7D:9D:34	WPA	managed	67	67	68	0	0B	2008-03-25 14:15:18 -0400
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26	1	NCCGroup6	00:17:DF:7D:92:16	WPA	managed	13	13	13	0	0B	2008-03-25 14:15:18 -0400
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33	6	NCCGroup4	00:17:DF:7D:A2:44	WPA	managed	0	12	12	0	0B	2008-0

None of your preferred networks are available.

Select the network you want to join from the list, and then enter the network password if necessary.

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Back to home page   Listed in category: Video Games > Other

Xbox 360!!! BUY IT NOW $400!!!!! Need cash fast!!!!

Item number: 8240472538

Bidder or seller of this item? Sign in for your status

Bidding has ended for this item

If you are a winner, Sign In for your status.

List an item like this or buy a similar item below.

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Similar items from all eBay sellers   Help

Item Name	Price	End Date
Need for Speed: Most Wanted (Xbox 360) *NIB* FAST SHIP	US $0.99	Dec-12-05 08:47:02 PST
Need "CASH" for XBOX 360?	US $0.01	Dec-12-05 16:38:27 PST
XBOX 360 PREMIUM GAME SYSTEM NEW IN BOX FAST SHIPPING!!	US $750.00	Dec-08-05 10:43:43 PST
NBA 2K6 (Xbox 360) GAME XBOX360 NEW SEALED !*FAST SHIP*	US $37.00	Dec-09-05 21:24:12 PST

Sold for: **US $400.00**

Auction ended early with Buy It Now.

Ended:	Dec-05-05 20:12:32 PST
Start time:	Dec-05-05 12:35:03 PST
History:	1 bid (US $400.00 starting bid)
Buyer:	bs romero (13 ⭐)

Item location:	Brooklyn, NY
	United States
Ships to:	United States
Shipping costs:	US $19.99 -- UPS Ground

⬇ Shipping, payment details and return policy

⬇ **Larger Picture**

Seller information

rcarr87 (12 ⭐) Not a registered user

Feedback Score: 12
Positive Feedback: 87.5%
Member since Apr-12-04 in United States

Read feedback comments
Add to Favorite Sellers
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Description

I bought this as a gift for my son, and I have recently run into financial problems. I need to sell this ASAP because I need the cash fast. Someone is about to get a great deal on this so take advantage of it before you miss out!!! Details Below

SOLD OUT EVERYWHERE!

This connects gamers to the world of Xbox 360 games and graphics through high and standard-definition connections.

Xbox 360 Ethernet Connectivity Cable
Instantly connect to Xbox live.

Xbox 360 Media Remote Control
Watch DVDs and control the Xbox 360.

Project Gotham Racing 3 Xbox 360
The hottest new racing game for the Xbox 360.

I WILL SHIP THIS ITEM THE DAY I RECIEVE PAYMENT!!! BE THE FIRST TO GET THIS HOT NEW ITEM!

Audio Output:	Surround Sound
Expansion Slots Total:	2 (2) x memory
Max. Resolution:	1920 x 1080
Processor:	1 x IBM PowerPC 3 cores 3.2 GHz
Video Output:	ATI Xbox 360 - 256-bit - 2D/3D graphics acceleration

Connections
3 x USB, 1 x network (RJ-45)

Fusing powerful hardware, software, and services, Xbox 360 fully engages you in a gaming experience that is more expansive, dramatic, and lifelike, where the possibilities are limitless and your imagination knows no boundaries

If you're a serious gamer looking for the ultimate console, the search ends here. Xbox 360 is fully loaded. It's the unsurpassed gaming and entertainment experience right out of the box delivering the Ultimate gaming and entertainment experience for the best value.

Auction is for photograph only.

2007 National Business Ethics Survey

- Ethical misconduct in general is very high and back at pre-Enron levels—during the past year, more than half of all employees saw ethical misconduct of some kind.

- The number of companies that are successful in incorporating a strong enterprise-wide ethical culture into their business has declined since 2005. Only nine percent of companies have strong ethical cultures.

2007 National Business Ethics Survey

- The risk of ethical misconduct has risen to pre-Enron levels. More than half of employees have seen ethical misconduct in their companies

- Management may have no knowledge about this misconduct, because more than two in five employees did not report it thorugh company channels.

2007 National Business Ethics Survey

- Despite hotlines and other mechanisms introduced in recent years, employees who do not report misconduct fear retaliation and believe that their action will have no impact. Their fear is well founded: some 12 percent of employees who reported misconduct experienced retaliation.

2007 National Business Ethics Survey

- Conflicts of interest, lying, and abusive behavior pose the greatest ethics risks to businesses, because these actions are most prevalent and least reported.

- Yet, the survey found that companies with strong ethical cultures reduced their ethics risk by a very significant margin. Only 9 percent of companies have strong ethical cultures.

The Extent of Fraud

- Survey of 5,331 students at 32 graduate schools across the USA and Canada
  - 56 percent of MBAs admitted to cheating
  - 54 percent of Engineering students
  - 50 percent of Science students
  - 48 percent of Education students
  - 45 percent of Law students
  - 39 percent of Social Science and Humanities students
    - » McCabe, Academy of Management Learning & Education, 2006

Integrity Risks--Questionable State of Ethics

- Did You Cheat to Get Into Graduate School?
  - "Yes"
  - 43% Liberal Arts
  - 52% Education
  - 63% Law and Medicine
  - 75% Business

-

- Source: Rutgers University survey of students

Questionable State of Ethics

- MBAs

- 76% were willing to understate expenses that cut into their companies' profits

- Convicts in 11 minimum security prisons had higher scores on an ethical dilemma exam than MBAs

Questionable State of Ethics

- Cyber-Ark did a survey of 300 system administrators in 2008:

  – 88 percent said they would take sensitive data with them if fired

  – 33 percent said they would take company password lists with them if fired

Deterioration in Ethical Values

	Year	Year
College students who cheated in H.S.	1940 (20%)	2002 (75-98%)
Self-reported cheating	1983 (11%)	1993 (49%)
Believe cheating is common	1940 (20%)	1997 (88%)
Used cheat sheets	1969 (34%)	1989 (68%)
Let others copy work	1969 (58%)	1989 (98%)
Willing to lie to get job	2000 (28%)	2002 (39%)
Students who had stolen	2000 (35%)	2002 (38%)

(Based on several different ethics studies)

Why people are less ethical today

Modeling   **Labeling**

Ethical or Unethical

Modeling and Labeling

- **Bad Modeling/Lack of Good Modeling**
  - Makes up our news—more explicit than ever
  - Focus of TV/movies
  - Dishonest "leaders"
  - Sports, business, entertainment "heroes"
  - Good models are rare

- **Lack of Positive Labeling**
  - Home….average family spends 10 hours less time together a week than 20 years ago
  - Vocabulary of kindergarten children
  - Schools
  - Churches

Fraud Definition and Costs

Definition of Fraud

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

Robbery (Extortion) + Fraud (Trickery)

Nature of Fraud

- Two ways to get something for nothing
  - Robbery
  - Fraud
- Fraud Involves Confidence
- No Small Frauds—only big ones that are caught early

- People Won't Usually Come Forward With Information
- No dead bodies—only symptoms
- Perpetrators increase amounts and get sloppy

Employee Statement:

4-1-XX	$10		5-16-XX	$40		6-25-xx		$400
4-4-XX	$20		5-19-XX	$40		6-26-XX		$600
4-7-XX	$20		5-20-XX	$40		7-8-XX		$600
4-9-XX	$20		5-21-XX	$40		7-9-XX		$700
4-10-XX	$20		5-22-XX	$20		7-14-XX		$400
4-14-XX	$40		5-27-XX	$30		7-15-XX		$600
4-16-XX	$30		5-28-XX	$40		7-16-XX		$600
4-22-XX	$30		5-29-XX	$40		7-23-XX		$600
4-23-XX	$30		5-30-XX	$50		8-4-XX		$20
4-24-XX	$30		6-2-XX	$40		8-8-XX		$20
4-25-XX	$30		6-3-XX	$50		8-11-XX		$30
4-28-XX	$30		6-4-XX	$50		8-14-XX	What	$30
4-29-XX	$30		6-5-XX	$50		8-19-XX	Happened	$20
4-30-XX	$30		6-9-XX	$30		8-22-XX	Here?	$40
5-1-XX	$20		6-10-XX	$40		8-24-xx		$400
5-5-XX	$30		6-11-XX	$30		8-27-XX		$600
5-6-XX	$30		6-12-XX	$50		8-28-XX		$700
5-7-XX	$20		6-13-XX	$50		9-2-XX		$400
5-8-XX	$20		6-16-XX	$50		9-5-XX		$100
5-9-XX	$30		6-17-XX	$50		9-12-XX		$100
5-12-XX	$30		6-18-XXb	$30		9-15-XX		$200
5-13-XX	$30		6-20-XX	$70		9-16-XX		$400
5-14-XX	$30		6-23-XX	$100				
5-15-XX	$30		6-24-XX	$200				

I increased the amounts because no one noticed the difference on the charge reversals. I can't believe it went this long without anyone ever suspecting a thing, especially because of the large amounts.

Employee signature
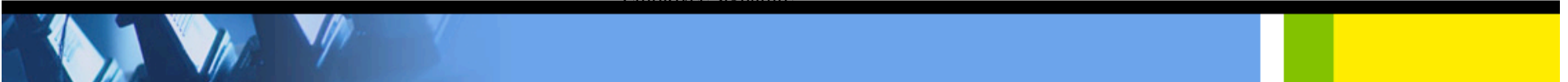
Why People Don't Come Forward

- Whistle Blower Fears
- Only See Symptoms-- Not Sure It is Fraud
- Don't Want to Wrongly Accuse Someone
- Don't Know Who To Tell
- Organizations Don't Make Coming Forward Easy

Reactions To Fraud

Denial

Denial

Denial

Anger

Rationalization

Depression

Acceptance

"There's No Way It Could Be Him!"

Fraud Perpetrators

So what does the fraudster look like?

- Like you and me
- No specific psychological profile
- 70% male, while females make up 30%, females are 2% of property offenders
- Older
- More religious
- Less substance abuse

Who Are The Fraud Perpetrators?

- Employees
- Managers
- Colleagues
- Friends
- Suppliers/Customers
- Contractors
- Neighbors
- Bishops/Ministers

We know much about the profiles of:
   Rapists
   Bank Robbers
   Murderers

Until recently, we knew little about the profile of fraud perpetrators.

Who Commits Fraud?

Normal Citizens   Fraud Perpetrators   Bank Robbers

Sample   Sample   Sample

No Significant Differences   Major Differences
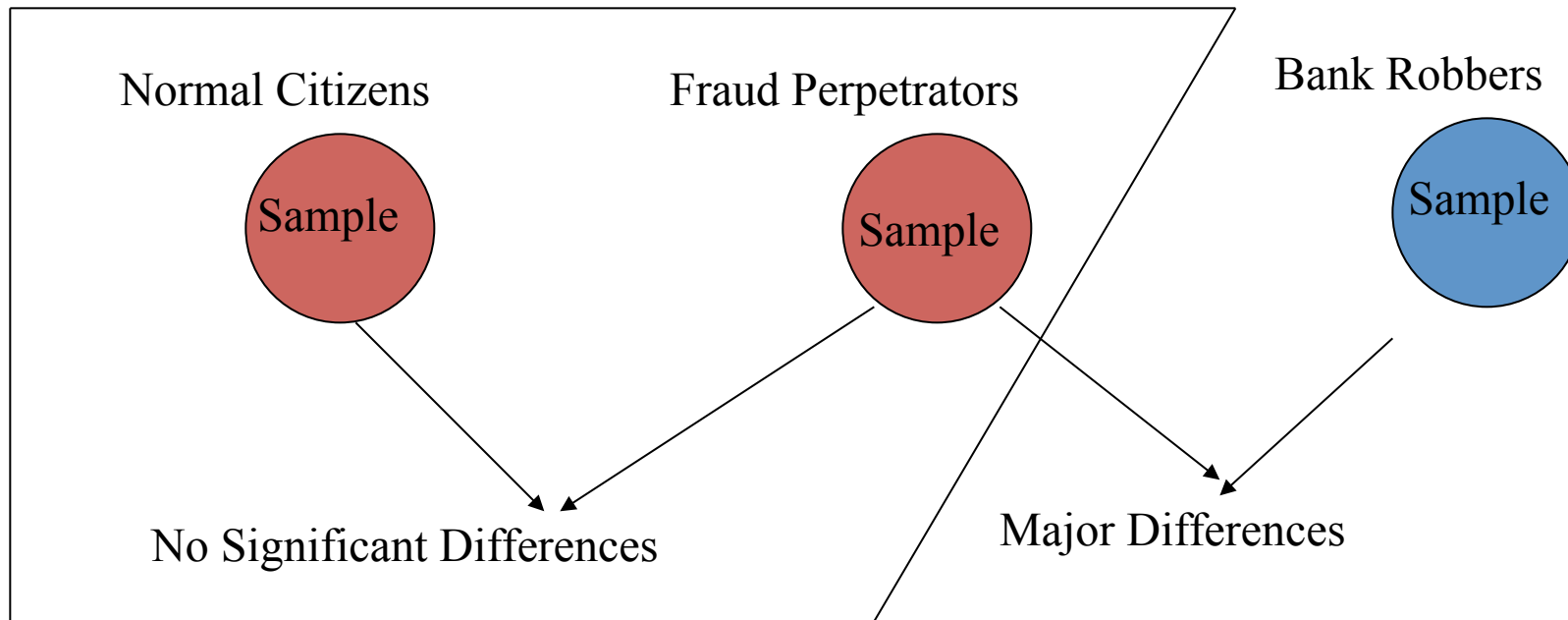
While people who commit rape, murder, bank robbery and other property offenses have distinguishing characteristics, fraud perpetrators look more like more citizens than criminals!

Demographics

- Married
- Active Church Members
- Children
- Good Education
- First-Time Offenders
- Good Employees
- Don't Abuse Alcohol

Conclusion: Fraud Perpetrators Look Exactly Like Us!

Psychological Characteristics

- Optimistic
- High Self-Esteem
- Achieving
- Family Harmony
- Socially Conforming
- Self Control
- Kind
- Sympathetic

Length of Time With Company

- Less Than 3 Years…………………...26 Percent
- 3-5 Years……………………………….14 Percent
- 5-10 Years…………………………..30 Percent
- 10-20 Years…………………………20 Percent
- Over 20 Years………………………10 Percent

Just Because Individuals Have Been
Honest for 10 Years Doesn't
Mean They'll Be Honest Tomorrow!

Perpetrators' Ages

- Under 26 Years Old……………..14 Percent
- 26-35 Years Old…………………28 Percent
- 36-45 Years Old………………..36 Percent
- 46-55 Years Old………………..12 Percent
- Over 55 Years Old………………10 Percent

Combining Pressure & Opportunity is Like Mixing Diesel Fuel & Fertilizer!

Why People Commit Fraud

Perceived Pressure
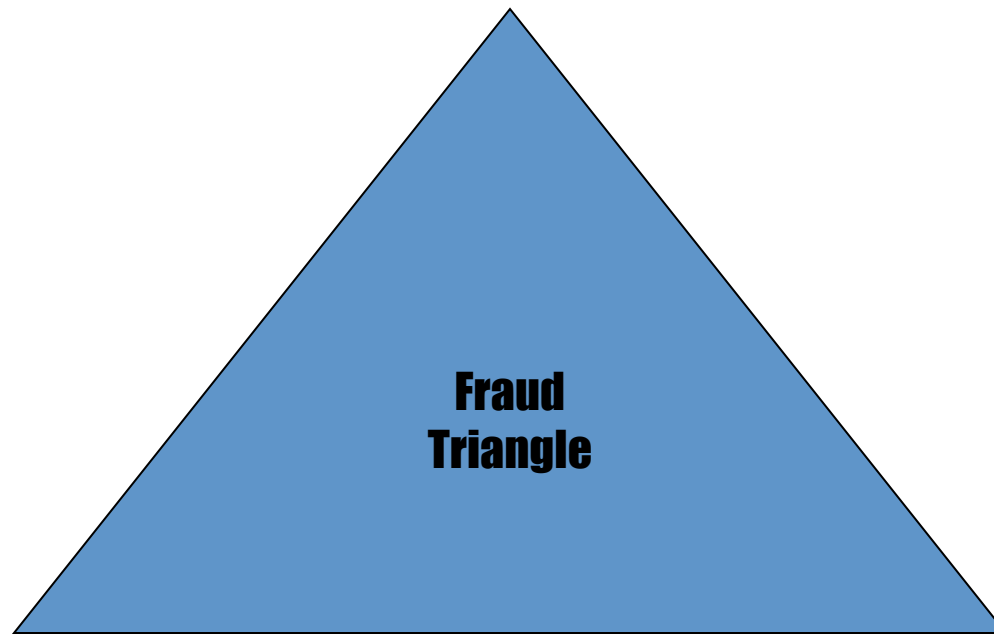
Fraud
Triangle

Perceived Opportunity
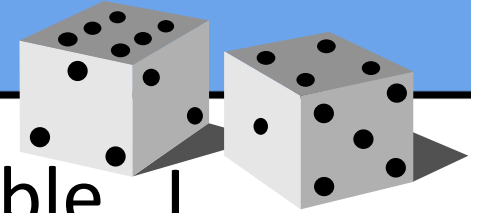
Rationalization

An Analogy...The Fire Triangle

Heat

Fire
Triangle

Fuel

Oxygen
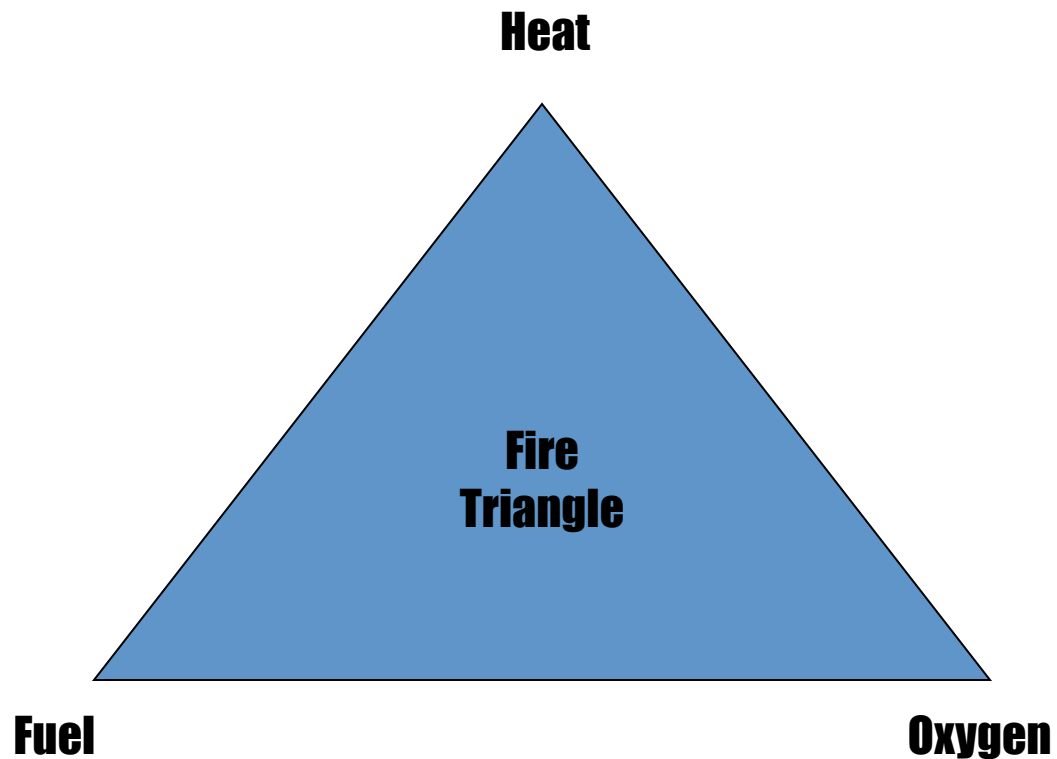
Do the three elements need to be in equal proportion to commit fraud?
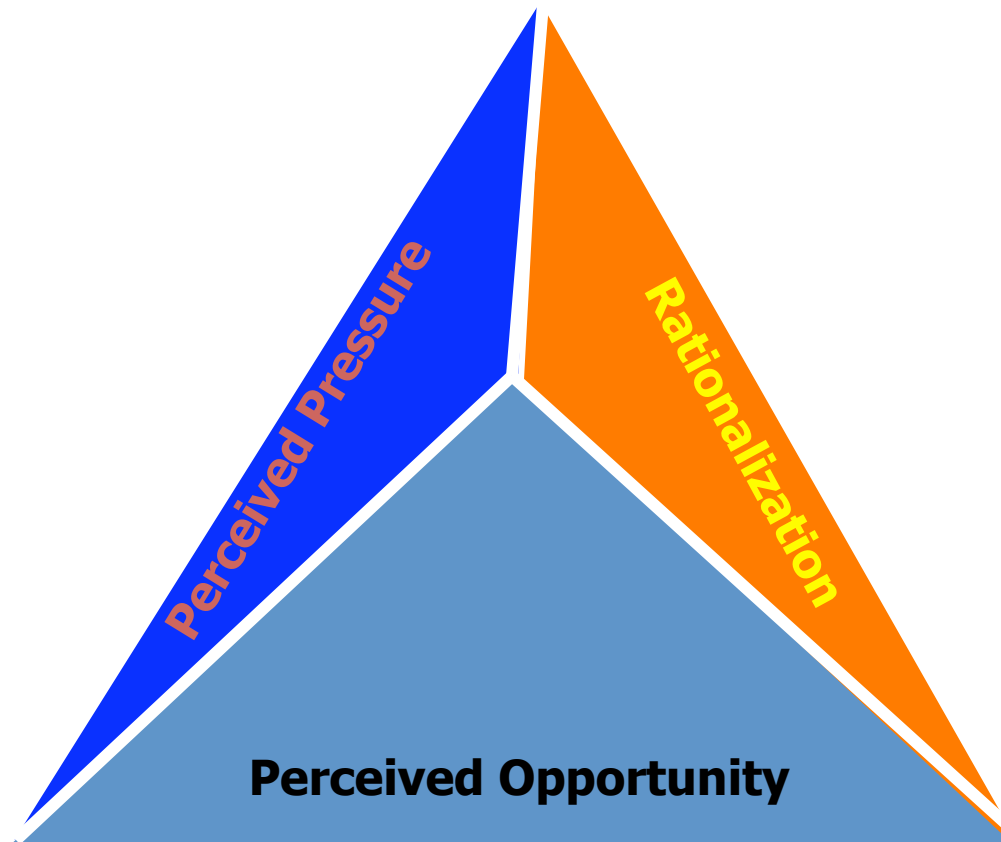
The 4 types of pressures are...
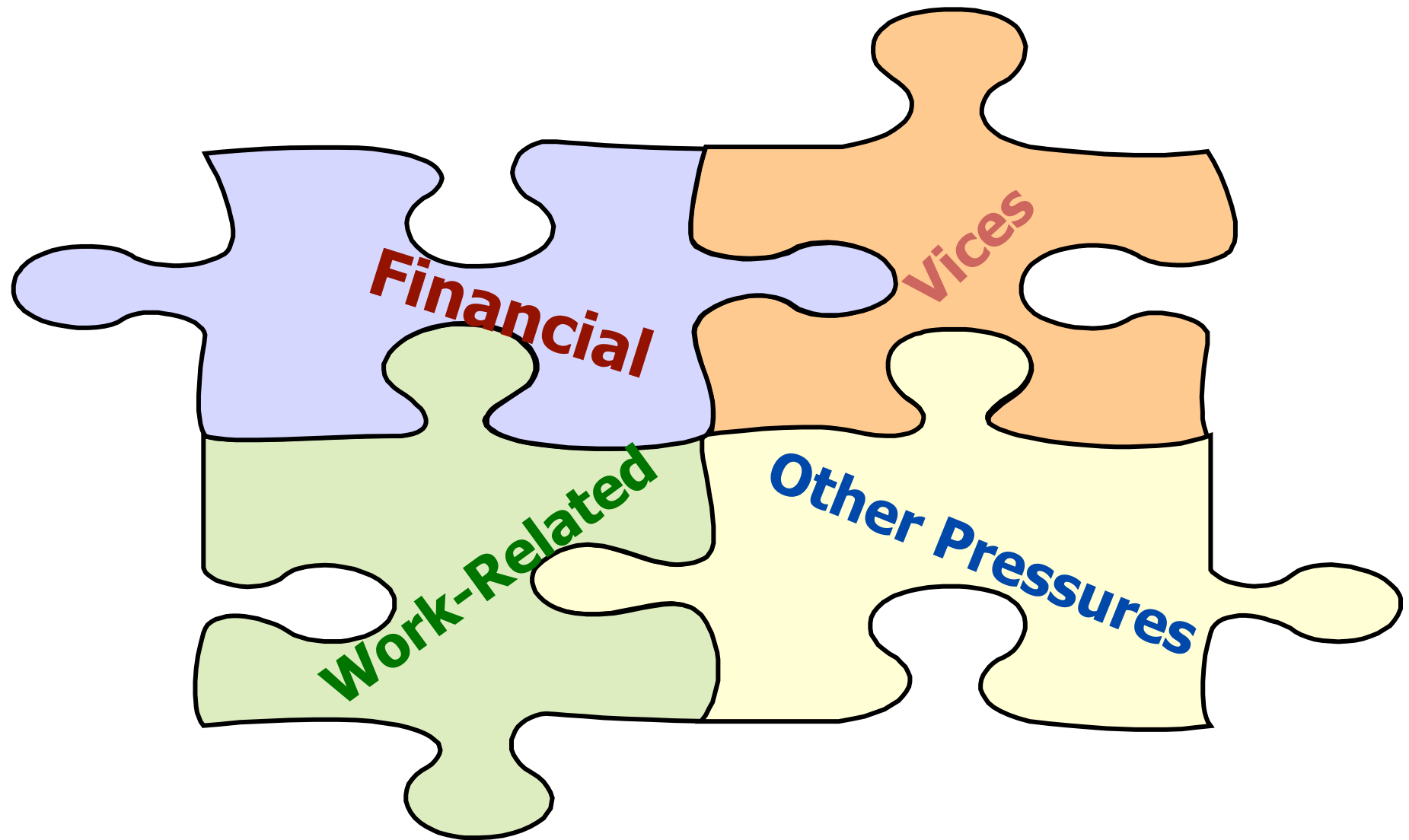
Gambling Example

- I degraded myself in every way possible. I embezzled from my own company; I conned my 6-year old out of his allowance.

- When I was at the blackjack table, my wife could have been home dying from cancer, and I could have cared less.

- After I woke up from an appendectomy, I sneaked out of the hospital and cashed a bogus check. I was still bleeding.

The three parts of perceived opportunity are...

- To commit fraud
- To conceal fraud
- To avoid punishment

Factors that increase opportunities to commit fraud are…

- Ability to get around internal controls
- Inability to judge performance
- Failure to discipline prior frauds
- Lack of access to information
- Ignorance, Apathy, Incapacity
- Lack of an audit trail

Fraud Opportunities

- Poor Internal Controls
- Poor Training
- Lack of Prosecution
- No Pro-active Fraud Program
- Poor Control Environment
- Growth at any Expense
- Crash Projects

(Crash Projects, Marlene Fraud)

(Pedro Fraud)

The Internal Control Structure

- Internal Control Structure

Control Environment

1. Management philosophy & operating style, modeling
2. Effective hiring
3. Clear organization structure
4. Effective internal audit

Accounting System

1. Valid transactions
2. Properly authorized
3. Completeness
4. Proper classification
5. Proper timing
6. Proper valuation
7. Correct summarization

Control Activities and Procedures

1. Segregation of duties
2. Proper procedures for authorization
3. Adequate documents & records
4. Physical control over assets & records
5. Independent checks on performance

Common Rationalizations

- They Owe Me

- I Am Only Borrowing And Will Pay It Back

- Nobody Will Get Hurt

- They Would Understand If They Knew How Badly I Needed It

- It's For a Good Purpose

- I'll Just Get Over This Hump

(10 Percent Fraud)   (Rich Man Fraud)

We All Rationalize

- Speeding

- Income Taxes

- Husband Rationalization

We judge ourselves by our intentions;

We judge others by their actions!

"I intended to Pay That Money Back"
"I need it worth than they do"
"No one is getting hurt!"
"They would understand if they knew   how badly I need it."

How much is too much pressure, perceived opportunity, and rationalization for a person to cope with?

Every Person Has A Price!

- Abraham Lincoln once threw a man out of his office, angrily turning down a substantial bribe. "Every man has his price", explained Lincoln, "and he was getting close to mine."

Top Ten Reasons Fraud
Is Occurring

Top Ten 10

- 10. You believe that fraud is a problem that affects only other organizations.

- 9. You believe your employees, vendors and customers are all honest and wouldn't commit fraud.

Top Ten

- 8. You believe that if, by chance, fraud is occurring, it is an anomaly and that your employees would tell you about it and, if not, your auditors would find it.

- 7. You believe that even if you had a fraud, it would not be very costly.

Top Ten

- 6. You believe that in the rare instance that you had a fraud, you must not let anyone outside of your organization know about it.

- 5. You believe that in the rare instance you had a fraud, the preferred action is to quickly and quietly terminate the perpetrator and not worry about contacting law enforcement or anyone else.

Top Ten

- 4. You believe you have good controls and that those controls will prevent fraud from occurring.

- 3. You believe that even if fraud were a problem, there is nothing you can do to prevent it.

Top Ten

- 2. You don't believe there are pro-active ways to detect fraud.

- 1. You believe that fraud is only a problem for law enforcement officials and that you shouldn't worry about fraud prevention, detection, or investigation.

6 Inhibitors of Fraud Detection

- 1. Lack of belief (that fraud is a problem)
  - Belief   Action   Results
- 2. It's not cost justified (to fight fraud)
  - "I don't want to do it"
  - Cost of doing nothing is nothing; cost of doing something is $$
    - What is the cost of hiring the lowest bidders to perform airport security?
- 3. Not knowing how much fraud you have
  - Need to track cases in a centralized way

6 Inhibitors of Fraud Detection

- 4. Lack of management support
- 5. Lack of clear, fraud-related expectations
  - It's management's responsibility to be aware of exposures and detect fraud
  - That managers will set example of high integrity and not tolerate those who don't
  - That we don't cheat to meet goals or tolerate those who do
- 6. Not having a fraud policy

Fraud Self-Assessment

Fraud Self-Assessment

- How much did your organization lose to dishonest and fraudulent activity last year?

    - If the answer is "We don't have much fraud," or "not very much," your organization is probably not protecting itself. No large organization is losing less than 1% of its total revenues or budget to fraudulent activity.

Fraud Self-Assessment

- Do you have a written policy telling management and others what to do and what not to do in case of suspected wrongdoing?

    – The only good answer is yes. Without a policy, organizations increase risks associated with mishandling. Many frauds cannot be handled internally without a policy.

Fraud Self-Assessment

- Do you train your managers and employees in their fraud-related responsibilities?

- In many sizeable fraud cases, managers and others knew "something was not right," but did not know what to do. If specific training is not provided, managers may fail to recognize fraud symptoms and fail to take appropriate action.

Fraud Self-Assessment

- Do you terminate employment of perpetrators without regard to position held, performance, or length of service?

- Retention of known perpetrators sets a tone of permissiveness and may terminate fidelity bond coverage (in certain countries.) Inconsistency in termination increases exposure to civil litigation and undermines moral.

Fraud Self-Assessment

- Do you report proven wrongdoing to law enforcement or regulators, without regard to the perpetrator's position, performance or length of service?

- Inconsistency in reporting will support allegations of favoritism. Having knowledge of criminal activity and failing to report it may be a crime itself. Executives and organizations that fail to report wrongdoing may be hiding more serious violations.

Fraud Self-Assessment

- Have you established a way for concerned employees to report suspected wrongdoing without fear of retribution?

- Exposing some types of problems requires direct communication with investigators. Fraud will remain hidden unless the organization encourages employees and others to come forward.

Fraud Self-Assessment

- Do you have the capability to investigate fraud, even the most damaging types of frauds?

- Properly trained internal investigation specialists can handle most investigations. Investigations of fraud for the organization and executive fraud requires disinterested, impartial investigators, independent of management control. Build your internal investigative capability.

Fraud Self-Assessment

- Are fraud concerns discussed openly in audit committee and management meetings? Does management get a written report summarizing all fraud activity?

    – The audit committee probably cannot stop corrupt executives, but an informed audit committee can encourage ethical management to do the right thing. The audit committee can encourage complete investigations and discourage cover up.