

## **Case Study: Who Commits Fraud and What Motivates Them**

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# TimeWarner

**COMPLIANCE WEEK 2012**

*“The Informant”* - Video Clip



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# Case Study: Who Commits Fraud and What Motivates Them

## Objectives –

- 🐼 What is Fraud?
- 🐼 What Leads a Person to Commit Fraud?
- 🐼 How Does it Fit with Compliance
- 🐼 Discussion/Questions



# Case Study: Who Commits Fraud and What Motivates Them

## What is Fraud?

*ACFE: The Use of One's Occupation for Personal Enrichment Through Deliberate Misuse or Misapplication of An Organization's Resources or Assets*

- ✚ Clandestine in Nature (Covert)
- ✚ Violate Perpetrator's Fiduciary Responsibility
- ✚ Committed for Direct or Indirect Financial Benefit
- ✚ Organizational Loss of Assets, Revenue or Reserves



*Source: The Association of Certified Fraud Examiners*

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## What is Fraud?

### Three Basic Elements of Fraud

- 👉 Act
- 👉 Concealment
- 👉 Conversion



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## What is Fraud?

### Characteristics of fraud

- ✿ Fraud is Hidden
- ✿ Frauds Tend to Start Small and Grow Over Time
- ✿ Most Frauds Could be Detected More Quickly if “Red Flags” Were Not Ignored
- ✿ Best Detected by Focusing on Changes
- ✿ Most Fraudsters Have Never Been Previously Charged or Convicted of a Fraud-Related Offense
- ✿ 80% of Frauds Were Committed by Employees From Six Departments: Accounting, Operations, Sales, Executive Management, Customer Service, and Purchasing



*Superman IV*

*Source: The Association of Certified Fraud Examiners  
“2012 Report to the Nation on Occupational Fraud and Abuse”*

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## What is Fraud?

### Characteristics of Fraud – Cont'd

- ✿ Employee Fraud Costs Average Business Approximately 5% of Annual Revenue
- ✿ Fraud Costs World Businesses an Estimated \$2.7 Trillion Annually
- ✿ Three Times as Many Frauds Were Uncovered By a Tip as By any Other Method
- ✿ Frauds by Owners/Executives are More Than 3 Times More Costly than Frauds by Manager and 9 Times Greater than Frauds by Employees
- ✿ 10 – 80 – 10 Rule



*Casablanca*

*Source: The Association of Certified Fraud Examiners  
"2012 Report to the Nation on Occupational Fraud and Abuse"*

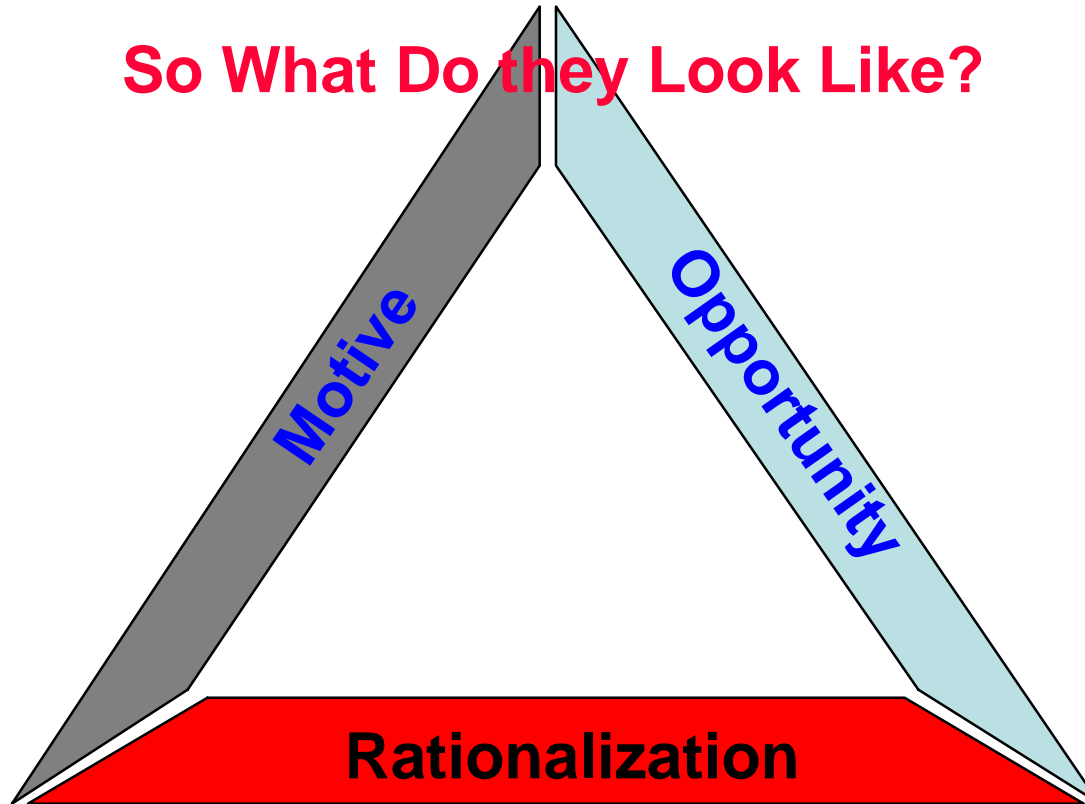
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## What Leads a Person to Commit Fraud?

Dr. Donald Cressey's Fraud Triangle

So What Do they Look Like?



*Source: The Association of Certified Fraud Examiners*



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## What Leads a Person to Commit Fraud?

### The Fraud Triangle – Cont'd

*Motive – A need that can't be shared (usually financial)*

- 🐾 Gambling
- 🐾 Bad Investments
- 🐾 Impatience for the Good Life = High Debt
- 🐾 Drug and/or Alcohol Problem
- 🐾 Family Debt
- 🐾 Extramarital Affairs
- 🐾 Children's Educational Expenses
- 🐾 Pressure to Hit Performance Targets
- 🐾 Ego



*Blazing Saddles*

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## What Leads a Person to Commit Fraud?

### The Fraud Triangle – Cont'd

*Opportunity – An Opportunity to Commit Fraud Can be Real or Perceived. Those Who Think they Will Get Caught, Rarely Commit Fraud.*

- ✿ Segregation of Duties (Do More with Less)
- ✿ Increased Span of Control = Less Review
- ✿ No Management Oversight / Knowledge
- ✿ Human Nature = Must be a Legitimate Reason
- ✿ Business Reason Changes Without Common Sense Reason
- ✿ Lax Controls = Fraud Opportunity by Accident
- ✿ Accidental Discovery
- ✿ Blind Trust



*Lord of the Rings:  
Fellowship of the Ring*

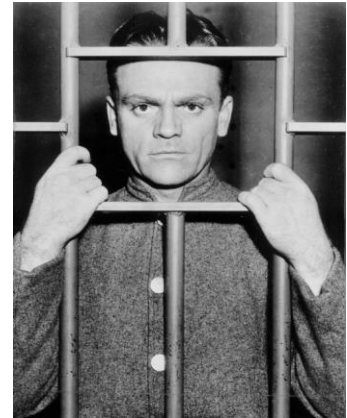
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## What Leads a Person to Commit Fraud?

### The Fraud Triangle – Cont'd

*Rationalization – Most Fraud Offenders Have to be Able to Rationalize Their Behavior as Something Other than Crime.*

- ✚ Only Borrowing the Money
- ✚ Everyone Else is Doing It
- ✚ The Company Owes Me
- ✚ I'm Underpaid
- ✚ I've Made this Company a Lot of Money
- ✚ Didn't Get the Bonus I Deserved
- ✚ Lost Income Due to Management Policies
- ✚ Manipulation Only Temporary, Will Smooth Out Over Time
- ✚ I Didn't Personally Benefit – (Direct vs. Indirect Benefit)
- ✚ I'm Bored



*Each Dawn I Die*

# Case Study: Who Commits Fraud and What Motivates Them

## Compliance Program Takeaways

- 👉 Impact on Conducting Fraud Investigations
- 👉 Small Frauds Matter
- 👉 Controls are Key
- 👉 Managers Must be Engaged and Trained



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*Dark Shadows (2012)*

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# Case Study: Who Commits Fraud and What Motivates Them

## Compliance Program Takeaways

### Impact on Conducting Internal Investigations

Does Understanding *Why* People Commit Fraud Have any Impact on Your Ability to Investigate Wrongdoing?

- ✿ Increased Awareness Enhances Workforce Detection
- ✿ Knowing what Motivates a Person can Greatly Focus Your Investigative Activities (Committed by People Like You and Me)
- ✿ Understanding Opportunities Can Enhance Your Ability to Identify Control Weaknesses
- ✿ Understanding What Drives Out-of-Character Behavior, Reminds You That They Will Lie to You (Trust but Verify)
- ✿ Understanding How People Rationalize their Actions Directly Impacts your Success at Obtaining Admissions (Understanding and Empathy)



Sherlock Holmes  
Game of Shadows

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## Compliance Program Takeaways

### Small Frauds Matter

- 🍷 There Are No Small Frauds – Only Those That Didn't Grow to Full Potential
- 🍷 Operations Management Gets Tunnel Vision
- 🍷 Opportunities Often Discovered by Accident
- 🍷 Training / Controls May Not Prevent - Collusion
- 🍷 Can Expose Controls Gaps; Other Employees Learn Too
- 🍷 Can Expose Other Compliance Issues

**Takeaway: Encourage Reporting Even on Small Matters and Investigate Them Seriously.**



*Arthur*

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## Compliance Program Takeaways

### Controls Are Key

- ✿ Fraud Risk is Best Mitigated by Reducing Opportunities
- ✿ Best Done Through a Strong System of Internal Controls
- ✿ Trust is Not Enough
- ✿ Obtaining the Proper balance is critical (0 risk = 0 Business)
  
- ✿ **Takeaway 1:** Compliance Office Must Have a Good Working Relationship w/ Groups Responsible for Internal Controls (Audit, Finance, Controller)
  - ✿ Internal Controls Professionals Play Huge Role (Front Line)
  - ✿ Internal Audit Professionals are Your Eyes and Ears
- ✿ **Takeaway 2:** Compliance Should Understand Key Control Failures Which Lead to Fraud

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## Compliance Program Takeaways

### Key Control Failures

- ✚ Inadequate Segregation of Duties
- ✚ Absence of Bidding
- ✚ Lax Control Environment
- ✚ Absence of Supervisory Control
- ✚ Concentration of Knowledge
- ✚ Inadequate Vendor Limits
- ✚ Absence of Approval Limits



*Sherlock Holmes: A Game of Shadows*



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## Compliance Program Takeaways

### Managers Need to Be Engaged and Trained

- ✿ Managers Need to Know – and Communicate – that Committing Fraud Will Always be Worse than Financial Underperformance
- ✿ Employees Should Feel Comfortable Approaching Manager With Concerns (Potential Opportunities) or Problems (Potential Motives)

### More than Just Setting Tone

- ✿ Managers Need to be Engaged in Helping Identify Fraud
- ✿ Educate Managers to Understand What Motivates Our Employees to Commit Fraud and What it Looks Like When They Do
- ✿ Need to Know what Motivates a Good Employee to Go Bad (Warning Signs)
- ✿ Nearly All Frauds Could be Detected More Quickly if Red Flags Were Not Ignored



*Blood Diamond*

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## Compliance Program Takeaways

### Managers (& You) Should Know Red Flags:

#### Vendor Indicators

- 🚩 Work Preceding Authorization Documentation
- 🚩 Unable to Physically Locate a Vendor
- 🚩 Unusual Receiving Procedures
- 🚩 Undue Vendor Favoritism
- 🚩 Bypassing Preferred or Contracted Vendors
- 🚩 Unusual Payment Trends
- 🚩 Poor Vendor Product Quality
- 🚩 Dramatic Increases In Business
- 🚩 Sole Customer of Vendor
- 🚩 Reliance on One Vendor

#### Employee Indicators

- 🚩 Living Beyond Their Means
- 🚩 Influencing Events Outside Their Area
- 🚩 Moody or Nervous
- 🚩 Regularly Breaks Rules to Get Job Done
- 🚩 Not Taking Vacations
- 🚩 Refuses Promotions
- 🚩 Excessive Credit Transactions
- 🚩 Under Financial / Personal Stress
- 🚩 Inappropriate Anger Toward Person Asking Questions

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### Discussion/Questions??



Ace Ventura Pet Detective