



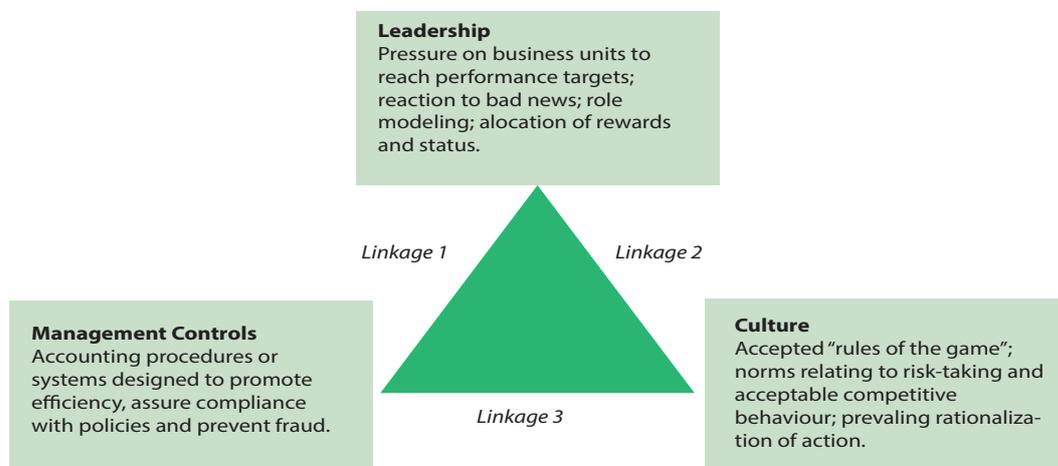
## Fraud's DNA – Organizational Fraud Triangle

By Paul B. Cogswell, JD, CFE, CCEP

This article is one in a three part series hoping to address the fraud triangle which has been so widely published.

Fraud is unique as well as ubiquitous, in that the essence of the wrongdoing is in the lie itself. According to Black's Law Dictionary fraud is "a knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment. It goes on to further refine motive as "a misrepresentation made recklessly without belief in its truth to induce another person to act." There are literally as

I have always been amused and somewhat intrigued by films that center on magic, or put more plainly the sleight of hand. One of a more recent genre is, "Now You See Me." Four street magicians rally together to act as modern day Robin Hoods to relieve a questionable insurer of their supposedly ill-gotten gains. The reason I bring this film up – and many others like it – is there is always a component of fraud that assists the fraudster. Organizations can confuse hope with strategy. In each event of fraud, there is a desire to believe what we all want to forget. The



The organizational fraud triangle is also known as MOM (means opportunity and motive)

many shades of grey as there are types of fraud but the purpose of this article to point to motivations for fraudulent behavior beyond understanding the operational and legal definitions.

Many criminologists have found the study of fraud fascinating because of this broad definition. In Joseph Wells' book entitled, "Occupational Fraud and Abuse," he provides a reason for this fascination. "In the broadest sense, fraud can encompass any crime for gain which uses deception as its principle modus operandi. There are but three ways to illegally relieve a victim of his money: Force, trickery, or larceny. All of those offenses which employ trickery are fraud."

It becomes clear then that the seminal action that constitutes fraud is deception. But there is also an organizational component as well. I liken it to my early days in college where I was challenged to grow bacteria in Petrie dish. The environmental components have to be just right. There is much similarity between this and the environment of certain organizations making it more conducive for those that might commit fraudulent acts.

old adage, if it's too good to be true it isn't, generally applies in situations where fraud doesn't flourish. On the other hand, corporations where we all fervently align with slogans such as "whatever it takes" and "make it happen" can not only provide significant pressures to succeed but can also implant cultural seeds of potential fraud that can be then easily sown by the ethically challenged and chronically misunderstood.

There are many articles that address fraud remediation and prevention efforts, fewer articles address the organizational issues of fraud. I would postulate that this is due to the fact that one has trouble pinpointing where rationalizing bad acts ends and justifying them begins.

One of the few researchers in the area of the criminology of fraud was Edwin Sutherland. He postulated a theory regarding white collar crime which at the time was widely discounted since historically individuals believed that criminal behavior was more an effect of nature than nurture, in other words individuals had almost a genetic predisposition to crime. Sutherland's work, referred to as the theory of differential

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association, postulated that criminal behavior is learned through communication. His work was furthered by other criminologists such as Donald Cressey. Cressey studied fraudsters and more specifically the circumstances that led them to commit fraud. In his book, "Other People's Money," he hypothesized that "trusted persons become trust violators when they conceive of themselves as having a financial problem which is non sharable, are aware this problem can be secretly resolved... and are able to adjust the conceptions of themselves as 'users of the entrusted funds or property.'" Cressey, in essence, coined the term rationalization for criminal behavior. The reason we bring this up is to inform the reader that the path to committing fraud is one that fraudsters believe to be generally paved with good intentions.

At the highest level we can grasp the concept of rationalization for the individual, but what about the collective rationalization for organizational fraud? Is there a cultural aspect that contributes as well?

One of the better books that I have found help to understand cultures in which the environment became "just right" is Bethany McClean and Peter Elkind's "The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron." The company, in effect, took on the role of fraudster, found themselves in a non-sharable position and with good intentions paved their own road to failure.

Are there organizational aspects to fraud that we as practitioners can see? While circumstantial this author believes there to be some that at best provide a potential breeding ground for bad actors.

Over the years, for the purpose of use in arguments, I have kept a list of discovered and published acts of fraud and studied the organizations as well as the actors. This is far from a representative sample, however some trends emerge that are common to the organization that are worth sharing and can aid the practitioner in developing an organizational health check. They are listed here simply to provide fodder for further discussion.

- **Tone at the top** - Tone at the top re-

fers to the ethical atmosphere that is created in the workplace by the organization's leadership. If leadership casts the right shadow, an organization's tolerance for workplace fraud diminishes. If, on the other hand, an organization's code of ethics is weak or unreadable or seems to be written defensively, the tone may not be clear. The old adage brevity is the soul of wit could be rewritten to say brevity is the soul of wisdom, and I would go further stating that while brevity is the soul of wit and wisdom, clarity is the soul of brevity. Few words of action and a strong leadership shadow can provide little room for the chronically misunderstood and ethically challenged.

- **Clear and understandable goals and processes** - If an organization can set the right tone at the top they must also be willing to provide clear and understandable processes to enable employees to reach their goal. Cumbersome or burdensome processes that obfuscate objectives and leave little transparency are fertile ground for fraudsters. If one has trouble understanding how to complete a task easily, it provides lots of "air cover" for those who can perpetrate fraud. An organization that harbors needless complexity in their operations cannot only challenge logic, but also hide a multitude of sins.
- **Inspection vs. expectation** - In my early auditing days, my manager told me people always do what you inspect and rarely do what you expect. Sound and logical controls in place deter fraud, so, by converse, an absence of these controls can provide a means to achieve the goal of committing fraud.
- **Focus on the positive** - When you spot an organization that rewards an atmosphere of constant criticism and lacks tolerance for ambiguity along with positive reinforcement, be on the lookout for the most com-

mon form of justification of fraud, "they owed it to me." Being the first one in or the last one out.

- **Understand the specific areas that are prone to fraud risks** - Organizations that understand and identify potential fraud risks by areas that are most prone to fraud are those that use a rifle like approach to prevention and allocate preventive resources wisely.
- **Understand incentives to stay and keep a fraud free workplace and utilize them** - Communication, confidentiality and non-retaliation are essential components to reporting fraud; utilizing these in a simple understandable fashion can go a long way toward building a trusted culture.
- **Transparency** - Understand the current regulatory and external pressures facing the organization and communicate them so that transparency and communication act as deterrence to fraudulent conduct.

Ultimately organizations don't commit fraud. And, while the sentencing guidelines can effectively fiscally imprison a corporation, they can't deprive a corporation of its freedom. Individuals, alone or in concert with others, commit fraudulent acts. Our jobs as fraud and forensic examiners must include the ounce of prevention. Identifying organizational indicators of fraud through occasional organizational examinations helps to keep things on track.

A mentor of mine in this field once told me that every employee population is made up of roughly 10 percent that is above reproach; put them in a room with a bundle of uncounted cash and it will all be there no matter what temptation is put before them. Another 10 percent represent the ethically bankrupt; put them in a room with a vault and they will try to crack the safe the minute you leave. However 80 percent of the population is motivated by the risk-reward pendulum. By manipulating the organization to identify with higher rewards for honesty, you can go further than utilizing any other method. The goal of this article is only to point out where we can best utilize the ounce of prevention we are given as anti-fraud practitioners.