ENHANCING YOUR PROFESSIONAL SKEPTICISM

Exercising professional skepticism is a necessary part of a fraud examiner’s job, and especially so when it comes to detecting fraud. But what kinds of questions does a questioning mind ask to identify a fraud perpetrator’s trail? And how does a mindset of professional skepticism translate into fraud-finding action? This session will teach you how to think like a fraudster to enhance your professional skepticism and improve your ability to uncover fraudulent activity during your professional engagements.

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James D. Ratley graduated from the University of Texas at Dallas, with a bachelor’s degree in Business Administration. In 1971, he joined the Dallas Police Department as a police officer. Mr. Ratley was assigned to several police department divisions, including vice, child abuse, and internal affairs. He was a member of numerous department task forces that concentrated on major fraud cases.

In 1986, Mr. Ratley left the police department to join Wells & Associates, a forensic accounting practice, where he was in charge of fraud investigations. He handled investigations regarding internal frauds, conflicts of interest, and litigation support. In 1988, he was named Program Director for the Association of Certified Fraud Examiners and oversaw all aspects of the ACFE’s training and education programs.

In 2005, Mr. Ratley was awarded the Association of Certified Fraud Examiners’ Cressey Award. The Cressey Award is the ACFE’s highest honor. It is bestowed annually for a lifetime of achievement in the detection and deterrence of fraud. In 2006, Mr. Ratley was named President of the ACFE. In 2010, Mr. Ratley was selected as one of Security magazine’s Most Influential Security Executives for 2010. This honor is bestowed each year to the top security executives who positively impact the security industry, their organizations, their colleagues, and their peers.

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Introduction
The word skepticism is derived from the Greek word skeptesthai, meaning “to reflect, look, or view.” The word skeptic began its transition to its current meaning as a label given to an ancient school of Greek philosophers who doubted the possibility of real knowledge. Over the centuries, skepticism has evolved to describe a questioning mindset or attitude of doubt. However, in his 1924 work, “Essays and Soliloquies,” Miguel de Unamuno eloquently described skeptics in a more positive and practical light:

Skeptic does not mean him who doubts, but him who investigates or researches as opposed to him who asserts and thinks that he has found.

It is within this view that skepticism provides value to professional duties. In practice, skepticism involves a search for the truth by:

- Applying reason to determine the validity of a claim
- Critically analyzing all evidence received
- Finding a factually supported conclusion, not the justification of a preconceived conclusion

Importance of Professional Skepticism
In many professions, adopting a skeptical mindset helps an individual more effectively fulfill his duties. Scientists, teachers, investigators, doctors, auditors—anyone who must collect and assess information as part of their job—all benefit from applying reason and critical analysis in their search for a factually supported conclusion.

Further, for some professions, a skeptical mindset is required by standards and regulations that govern members. For example, International Standard on Auditing 240 (as well as its U.S. counterpart, AU 240) explicitly requires external auditors to maintain an attitude of professional
skepticism throughout the audit and to recognize the possibility that fraud might exist, regardless of the auditor’s previous experience with the organization. Similarly, guidance promulgated by the Institute of Internal Auditors stresses the importance of skepticism in the internal auditor’s ability noticing the red flags of fraud and uncovering fraudulent activity.

For any professional—auditors, management, and staff members alike—applying professional skepticism is the key to detecting fraud. Because fraud is inherently clandestine, a skeptical mind—one that does not automatically take information at face value and that seeks more explanation for things that do not make sense—is required to overcome a fraudster’s attempted concealment.

Additionally, openly exercising a skeptical mindset can help deter potential fraudsters from undertaking their schemes. Knowing that others are actively and continually searching for truth increases the perception in the tempted individual’s mind that his fraudulent actions will be detected, which is often the most effective means of preventing fraud from the outset.

**Professional Skepticism Traits**

But what does professional skepticism look like? How does the application of a skeptical mindset appear in practice? Applying reason and critical analysis to a situation requires the following traits.

**Informed**

To seek the truth, an individual must gather all the relevant information about the topic at hand. A skeptical mindset will not settle on a conclusion without convincing evidence that all pertinent data has been considered.
### Ethical
Exercising skepticism also requires a strong ethical stance, one that can stand up to scrutiny and pushback. A skeptical mind is not easily influenced by others and refuses to ignore evidence that is contrary to any hypotheses; it instead rests on its own constant critical analysis and relentless search for the truth.

### Independent of Mind
Regardless of the individual’s position within (or outside of) the organization and his ties to others, a person exercising professional skepticism remains independent in his thinking, refusing to compromise reason to loyalty.

### Persistent
The search for the truth can seem endless; new information often arises at every turn. If the individual learns of information that negates or conflicts with earlier evidence, he must be willing to ask another question, and then another, until the facts are clear enough to support a conclusion.

### Perceptive
A skeptical mindset requires being inherently perceptive. While gathering and assessing information, the individual must be:
- Constantly alert for red flags
- Able to connect information from multiple sources
- Able to identify patterns in evidence collected

### Effective Communication Skills
Much of exercising professional skepticism involves collecting information from other individuals. Especially when it comes to detecting fraud, the ability to “read” an individual as they respond to a request—
that is, to identify hesitation, unspoken messages, and even signs of deception—is critical in picking up on areas that merit further exploration before a conclusion can be reached.

**Able to Question Without Being Adversarial**

Employing a skeptical mindset inherently involves questioning information received. Much of that questioning can be done internally, by applying reason and critical thinking. However, some of it must be done externally, by asking others for additional information, sometimes tirelessly so. When submitting requests to others that might indicate doubt about the accuracy of previous information gathered, the individual must be able to form such requests politely, yet firmly, so that he does not come across as adversarial while still being able to obtain the information sought.

**Challenges in Applying Skepticism**

Although the traits explained above are likely seen as admirable and desirable by most professionals, applying an attitude of professional skepticism can be challenging for many reasons.

Nearly everyone has an inherent desire to believe what they are told, particularly when the information comes from someone they know. Even seasoned anti-fraud professionals can find it difficult to set aside past experience and knowledge with other individuals and critically analyze information as if from a source with unproven honesty. Similarly, familiarity with an organization’s controls can lead to an assumption of reliability, which might undermine the ability to skeptically analyze their effectiveness.
Another challenge in applying skepticism is the tendency of people to seek out evidence and gather facts that support their expected conclusion. This inclination, called confirmation bias, can occur unintentionally, such as through selective memory or slanted interpretation of ambiguous information, even when a professional is attempting to maintain skepticism in an engagement.

Employing skepticism also requires devoting resources to seeking the truth. In many engagements, time and cost constraints necessitate a focus on efficiency—which can conflict with performing a truly critical analysis of all evidence available.

Finally, following up on inconsistencies, asking probing questions when an individual seems less than transparent, seeking out independent verification of facts, and other techniques for skeptically gathering evidence can be uncomfortable—particularly if the other person does not want to be asked any more questions. A concern over seeming impolite can be difficult to overcome (though remembering that the honest have nothing to hide can help with this challenge).

Applying Skepticism to Fraud Detection

During the Cold War, Ronald Regan made famous the phrase “trust, but verify,” a saying first coined by Russian leader Vladimir Lenin. Although it clearly has its place in heated politics, the phrase also effectively applies to any situation in which a skeptical mindset is appropriate.

But applying an attitude of skepticism to fraud detection requires going one step further than simply trusting but verifying. The intrinsic dishonesty involved in fraud requires the fraud examiner to actually take on the mindset of the fraudster by constantly asking, “If I worked in this
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position or process, how could I defraud the company and get away with it?”

Additionally, applying professional skepticism to detect fraud involves continually analyzing the presence and significance of each of the three factors of the fraud triangle—pressure, opportunity, and rationalization—as each new piece of evidence is collected. The following discussion provides some examples of ways that anti-fraud professionals can apply professional skepticism during each phase of the evidence-collection process.

**Skepticism During Observations**

Throughout the entire engagement, the professional should be observing the environment—the processes, the individuals, the culture—and taking note of any red flags of potential fraud. Specifically, when walking through a transaction or process, the anti-fraud professional should proactively consider how a dishonest individual might:

- Perpetrate a fraud
- Conceal a fraud
- Conspire with others to commit or conceal a fraud
- Override internal controls

The vast majority of fraudsters display some sort of behavioral symptoms of their scheme. Consequently, a mindset of professional skepticism is enhanced by watching for such red flags when observing the individuals within the organization. According to the ACFE’s 2012 Report to the Nations on Occupational Fraud and Abuse, at the time of their frauds:

- 35% of perpetrators are living beyond their means.
- 27% of perpetrators are experiencing financial difficulties.
• 19% of perpetrators have an unusually close relationship with a vendor or customer.
• 18% of perpetrators display control issues or are unwilling to share their job duties.
• 15% of perpetrators are going through a divorce or experiencing other family problems.
• 15% of perpetrators display a wheeler-dealer attitude.
• 13% of perpetrators act noticeably irritable, suspicious, or defensive.
• 8% have known problems with addiction.

Additionally, to be most informative, all observations should be filtered through the lens of the organizational—and departmental—culture. For example, an employee in the accounting department exhibits control issues and refuses to allow others to have input into his area of responsibility. This situation might be viewed quite differently in the following situations:

• A small, friendly company, where other employees frequently help each other, and where management is typically lenient in occasions of employee error
• A very strict corporate environment, where employees are belittled for any errors within their area of responsibility, and where other employees in the accounting department are known to be less competent than the employee in question

Skepticism in Reviewing Documents
In many fraud cases, the perpetrator manipulates documents or records in an attempt to conceal his misdeeds. Common concealment methods include:
• Modifying information on a document
• Duplicating documents or records
• Withholding or destroying documents
Because of the possibility of such manipulation, a mindset of professional skepticism dictates confirmation of evidence with independent third parties. Examples include obtaining:

- Bank statements directly from the bank
- Purchase invoices directly from the vendor
- Sales orders directly from the customer
- Contract terms directly from the other party to the contract

When there is any question about the accuracy or authenticity of a document or record, the anti-fraud professional should consider engaging an expert—such as a forensic document examiner—to assist in determining whether a document has been falsified or manipulated in any way.

**Skepticism in Interviews**

As mentioned previously, most individuals inherently tend to believe what other people tell them. Consequently, interviewing individuals often requires the most intentional application of professional skepticism of any part of an engagement. The anti-fraud professional must not only be asking questions and processing the answers, but must also be alert for inconsistencies or statements that conflict with other evidence that has been gathered. Such responses necessitate proactive investigation; the interviewer must be willing and able to revisit areas of uncertainty until reasonable information has been obtained.

Further, the interviewer must understand and be watching the interviewee for signs of deception. This involves establishing a baseline of the interviewee’s responses (i.e., norming or calibrating), and then
observing closely for unexpected variations from that baseline behavior.

Although a full analysis of warning signs of deception is beyond the scope of this discussion, the following are some verbal clues that might indicate dishonesty during an interview:

- Changes in speech pattern
- Repetition of the question
- Comments regarding the interview
- Selective memory
- Making excuses
- Oaths
- Answering with a question
- Failure to deny or increasingly weaker denials
- Avoidance of emotive words
- Refusal to implicate others
- Tolerant attitudes
- Reluctance to end the interview

Nonverbal clues to deception might include:

- Illustrators
- Hands over mouth
- Manipulators
- Fleeing position
- Reaction to evidence

Dishonest individuals might also display vocal clues that indicate their responses are deceptive, such as changes in the tone, clarity, volume, or speed of their speech.

Professional skepticism can also be enhanced by the knowledge that fraudsters often display common thinking patterns that facilitate their ability to perpetrate their misdeeds. These include the following:
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- Rationalization
- Instant gratification
- Disregard for authority
- Being overly optimistic
- Sense of entitlement
- Lack of remorse
- Egoism and narcissism
- Diffusion of the harm caused by actions

### Conclusion

Although an attitude of professional skepticism is required by some professional standards and is necessary for an individual to be able to effectively detect fraud, the application of this mindset can be challenging for a number of reasons. Nonetheless, with intentional focus on how a fraudster might defraud the organization and conceal his misdeeds through each part of the engagement, the anti-fraud professional can enhance his skepticism and substantially increase the likelihood of uncovering dishonesty, deception, and fraud.