Fraud Prevention and Deterrence

Understanding Criminal Behavior
Behavioral Analysis -- Reinforcement

- Punishment is the least effective method of changing behavior
- Causes only a “temporary suppression of the behavior”
- Behavior returned when punishment discontinued
Reinforcement

- Positive reinforcement is the most effective method of changing behavior.
- A *positive reinforcement* presents a positive stimulus in exchange for the desired response.
- A *negative reinforcement*, on the other hand, withdraws a negative stimulus in exchange for the response.
- *Punishment* is the application of a negative stimulus.
Reinforcement

- B.F. Skinner concluded that behavior is most effectively modified by managing and modifying desires through reinforcement.
- Replace destructive behaviors with productive ones.
- Incentives and task-related bonuses follow this principle.
- Condition incompatible behavior.
- Reward honesty, openness, and cooperation.
- Legitimacy—in order for people to change behavior to follow law, must believe legitimate.
Theory of Differential Association

- Criminal behavior is learned.
- It is learned through interaction with other persons in a process of communication.
- It is acquired through participation within intimate social groups.
- Involves all the mechanisms that are involved in any other learning.
- Learning differs from pure imitation. Criminal behavior is not explained just through needs and values.
Social Control Theory

- Essentially, social control theory argues that the institutions of the social system train and press those with whom they are in contact into patterns of conformity.
- To the extent a person fails to become attached to society, his or her chances of violating the law are increased.
- Suggests that people confronted with the possibility of violating the law are likely to ask of themselves: “What will my spouse—or my mother and father—think if they find out?”
Differential Reinforcement Theory

- Behavior is reinforced when positive rewards are gained (positive reinforcement) or punishment is avoided (negative reinforcement). It is weakened by negative stimuli (punishment) and loss of reward.
Sample Prep Question

1. According to Skinner, the most effective way to modify a person’s behavior is through:

A. Punishment
B. Positive reinforcement
C. Negative reinforcement
D. None of the above
Correct Answer: B

- Skinner concludes that behavior is most effectively modified by managing and modifying desires through reinforcement; he wants to replace destructive behaviors with productive ones, instead of trying to punish an already existing impulse. Punishment fights a losing battle in manipulating behavior because it works through negatives—administering penalties and taking away desirables.
2. Social control theory asserts that the farther an individual strays from the norms of society, the more likely he or she is to commit a crime.

A. True
B. False
Correct Answer: A

- Essentially, social control theory argues that the institutions of the social system train and press those with whom they are in contact into patterns of conformity. Schools train for adjustment in society, peers press the ethos of success and conventional behavior, and parents strive to inculcate law-abiding habits in their youngsters. The theory rests on the thesis that to the extent a person fails to become attached to the variety of control agencies of society, his or her chances of violating the law are increased.
3. The theory of differential association is used frequently to explain white-collar criminality. Which of the following is one of the assertions or principles of differential association?

A. People are genetically predisposed to be criminals.
B. Criminal behavior is acquired through participation with intimate personal groups.
C. Criminal behavior is explained by an individual’s general needs and values.
D. Learning is the same as pure imitation.
Correct Answer: B

- The theory of differential association states that:
  1. Criminal behavior is learned.
  2. It is learned from other people in a process of communication.
  3. Criminal behavior is acquired through participation with intimate personal groups.
  4. The learning process includes the shaping of motives, drives, rationalizations, and attitudes.
  5. Motives are learned from definitions of legal codes as being favorable or unfavorable.

(Cont.)
Correct Answer: B

6. A person becomes a criminal because of an excess of definitions favorable to violation of the law over definitions unfavorable to violation of the law.

7. Differential association may vary in frequency, duration, priority, and intensity.

8. Learning criminal behavior involves all the mechanisms of other learning.

9. Learning differs from pure imitation.

10. While criminal behavior is an expression of general needs and values, it is not explained by these needs and values.
Fraud Prevention and Deterrence

White-Collar Crime
White-Collar Crime

- The term was coined by Edwin H. Sutherland in December 1939 during his presidential address in Philadelphia to the American Sociological Society.
What Is White-Collar Crime?

White-collar crime violations are those violations of law to which penalties are attached that involve the use of a violator’s position of economic power, influence, or trust in the legitimate economic or political institutional order for the purpose of illegal gain, or to commit an illegal act for personal or organizational gain.
Public Perceptions and Profiles

- Most defendants are white males of moderate social status.
- In his 1953 study of embezzlers, Donald R. Cressey found that most of those he examined “had lived beyond their means for some time before deciding to embezzle.”
- What is loosely called “class” or “social status” does have an effect on crimes.
Public Perceptions and Profiles

- Of all factors, organizational opportunity remains the determinant aspect of white-collar crime.
- White-collar defendants are more likely to insist on a trial than other offenders.
- The higher an individual’s status, the more likely the person was to be imprisoned.
- More often than prison, the punishment of choice for white-collar criminals is the imposition of fines.
Contributing Factors

- America’s economy runs on credit, which often means rising personal debt. The offenders in the sample often showed serious discrepancies “between their resources and their commitments.”

- New information technologies mean that the opportunity for wrongdoing is growing, and many of the techniques are not widely comprehended by businesses or individuals.
Contributing Factors

Most broadly, the authors observe an American culture based on affluence and ever-higher levels of success. Television, and advertising in general, promise that no one has to settle for second best, prompting those who find themselves running behind to make an attempt to conceal the difference, crossing ethical and sometimes legal lines.
Organizational Crime

- **Organizational** crime is that which is committed by businesses, particularly corporations, and the government.
- **Occupational** crime involves legal offenses committed by individuals in the course of their occupation.
- An anti-trust offense would be an organizational crime; accepting or offering bribes is an occupational offense.
Opportunities for Unlawful Behavior

- Complex companies provide a structure that can foster misbehavior. They provide many settings where misconduct is possible.
- Specialization also hides illegal activities, especially where a firm’s tasks are kept separate and unrelated.
Criminogenic Organizational Structures

- Edward Gross asserted that all organizations are inherently criminogenic (that is, prone to committing crime), though not necessarily criminal.
- Gross makes this assertion because of the reliance on “the bottom line.” Without necessarily meaning to, organizations can invite fraud as a means of obtaining goals.
Criminogenic Organizational Structures

- Organizations encourage loyalty. According to Diane Vaughan, the reasons are that:
  - Organizations tend to recruit and attract similar individuals.
  - Rewards are given out to those who display characteristics of the “company man.”
  - Long-term loyalty is encouraged through company retirement and benefits.
  - Loyalty is encouraged through social interaction such as company parties and social functions.
  - Frequent transfers and long working hours encourage isolation from other groups.
  - Specialized job skills can discourage personnel from seeking employment elsewhere.
Criminogenic Organizational Structures

- The use of formal and informal rewards and punishments, plus social activities and pressures to participate, link an employee’s needs and goals to the company’s success.

- In short, the interests of an organization and its employees coincide, and that situation may set the stage for unlawful conduct by individuals on the organization’s behalf.

- Criminologist Charles McCaghy says profit pressure is “the single most compelling factor behind deviance by industry, whether it be price fixing, the destruction of competition, or the misrepresentation of a product.”
Criminogenic Organizational Structures

- Other rationalizations by businesses:
  - Government regulations are unjustified because the additional costs of regulations and bureaucratic procedures cut heavily into profits.
  - Regulation is unnecessary because the matters being regulated are unimportant.
  - Damage is so diffused among a large number of consumers that, individually, there is little loss.
  - Violations are caused by economic necessity; they aim to protect the value of stock, to ensure an adequate return for stockholders, and to protect the job security of employees by ensuring the financial stability of the corporation.
Controlling Organizational Crime

- Efforts to control corporate crime follow three approaches:
  1. Voluntary change in corporate attitudes and structure
  2. Strong intervention of the political state to force changes in corporate structure, accompanied by legal measures to deter or punish
  3. Consumer action

- Mass media publicity about law violations probably represents the most feared consequence of sanctions imposed on a corporation
Enforcement Effort: Preventing and Reducing Fraud

- Enforcement strategies include two main theories:
  - Compliance
    - Economic incentives for voluntary compliance
  - Deterrence
    - Detect offenders and punish them
Corporate Sentencing Guidelines

- Advisory, but judges are still required to examine the adequacy of a company’s compliance and ethics program
- Judge can increase base fine by up to 400% or reduce by 95%
- Fine multipliers
- Fine reducers
- Organizations required to pay full restitution when possible
Occupational fraud is committed largely by individuals or small groups of individuals in connection with their occupation.
Research in Occupational Fraud and Abuse

- Dr. Steve Albrecht—The Fraud Scale
- Top 3 factors from personal characteristic list:
  - Living beyond their means
  - Overwhelming desire for gain
  - High personal debt
- Risk factor: Too much trust in key employees
- Fraud most likely to occur when:
  - Situational Pressure is High
  - Personal Integrity is Low
  - Perceived Opportunity is High
Albrecht, Howe, Romney, “Deterring Fraud: The Internal Auditor’s Perspective,” p6
ACFE *Report to the Nations*

- Asset misappropriations most frequent type
- Financial statement fraud had greatest median loss
- Tips are most common method of initial detection
- Owners/executives cause losses 4 times higher than managers
- Two-thirds were male
- Only 5% had previous conviction
- Living beyond means/financial difficulty most common behavioral red flags
Sample Prep Question

1. Donald R. Cressey developed a hypothesis that has come to be known as the “fraud triangle.” One leg of the triangle represents a perceived non-shareable financial need (pressure). The second leg is for perceived opportunity, and the final is for ____________________.

A. Rationalization
B. Immediate financial resources
C. Perceived acquiescence
D. None of the above
While working on his Ph.D. in the 1940s, Donald R. Cressey focused his research on embezzlers. His findings resulted in a theory which, over the years, has become known as the fraud triangle. One leg of the triangle represents a perceived non-shareable financial need. The second leg is for perceived opportunity, and the final is for rationalization.
Sample Prep Question

2. Which of the following are the two main theories to control corporate criminal behavior?

A. Prevention and detection  
B. Deterrence and enforcement  
C. Assessment and reliance  
D. Compliance and deterrence
Enforcement strategies include two main theories: compliance and deterrence. Compliance is designed to achieve conformity to the law without having to detect, process, or penalize violators. Compliance systems provide economic incentives for voluntary compliance to the laws and use administrative efforts to control violations before they occur. As a strategy to control crime, deterrence is designed to detect law violations, determine who is responsible, and penalize offenders in order to deter future violations. Deterrence systems try to control the immediate behavior of individuals, not the long-term behaviors targeted by compliance systems.
Sample Prep Question

3. Which of the following is considered a white-collar crime?

A. A stockbroker profits from trades made based on insider knowledge about a company
B. A city official receives kickbacks for tailoring contract requirements to specific vendors
C. An accounting clerk steals incoming payments from customers and makes falsified journal entries to cover her tracks
D. All of the above
Correct Answer: D

- Though there is no consensus within the scholarly community, one current definition of *white-collar crime* is that proposed by Albert J. Reiss, Jr., and Albert Biderman: “White-collar crime violations are those violations of law to which penalties are attached that involve the use of a violator’s position of economic power, influence, or trust in the legitimate economic or political institutional order for the purpose of illegal gain, or to commit an illegal act for personal or organizational gain.”
Sample Prep Question

4. Management from several IT consulting firms conspires to take turns submitting the lowest bids for all contracts in their area; this is considered an organizational crime.

A. True  
B. False
Correct Answer: A

- Organizational crime is that which is committed by businesses, particularly corporations, and the government. In contrast, occupational crime involves legal offenses committed by individuals in the course of their occupation. An antitrust offense, such as bid rigging or price fixing, would be an organizational crime.

- Organizational crime occurs in the context of complex relationships and expectations among boards of directors, executives, and managers on one hand, and among parent corporations, corporate divisions, and subsidiaries on the other.
Sample Prep Question

5. The findings in the ACFE’s *Report to the Nations on Occupational Fraud and Abuse* include which of the following?

A. The most commonly reported red flag displayed by fraud perpetrators prior to the detection of their crime is being employed by the victim entity less than six months.

B. The median losses caused by executives are lower than those caused by staff-level employees.

C. More occupational frauds are committed by men than by women.

D. The majority of fraudsters have been previously convicted of a fraud-related offense.
Among the findings of the ACFE’s 2014 *Report to the Nations* are:

- Sixty-seven percent of fraud cases were perpetrated by males, while females were the primary perpetrators in 33 percent of fraud cases.
- The vast majority of employees who commit occupational fraud are first-time offenders.
- The most frequently cited behavioral red flag in the reported cases involved the fraudster living beyond his or her financial means.
- The majority of occupational frauds are committed by employees and mid-level managers. Owners and executives are involved less often, but the median loss caused by these individuals was approximately four times higher than the median loss caused by managers and nearly seven times that of employees.