White-Collar Crime Organizational Misconduct and Fraud Examination

An Accounting Behavioral and Criminological Approach

FRANK S. PERRI

Preface — An Inconvenient Truth about White-Collar Crime

Traveling throughout the country lecturing on white-collar crime, organizational misconduct, and its offenders plus from experiences in teaching university students, an impression that I am left with is that fraud examiners, accountants, management, those who work within the criminal justice system, and academia to name a few, are not exposed to complete information about the criminal and behavioral profile of white-collar offenders. There appears to be an imbalance between how they are perceived as offenders and what they truly represent in terms of harboring a criminal mindset that is open to exploiting others and organizations. On the one hand they are considered offenders who would not have engaged in misconduct at their organization but for financial pressures such as trying to get through an economic downturn. However, on the other hand, research confirms that there are offenders who go out of their way to exploit an organization to satisfy their motives that is not dependent on any type of pressure except that they are criminal entrepreneurs no different than a street-level offender setting up a narcotics distribution apparatus.

What is lacking in our understanding of white-collar offenders is that just as there is a continuum of criminality with non-white-collar offenders, the same holds true in these cases. White-collar offenders are not a homogenous offender class in terms of the extent of their criminality, why they offend, the number of victims created, and the methods they go about to offend. In some cases non-white-collar offenders are deemed low-level offenders because they break the law on minor matters, but are not engaged in severe, harmful acts towards others. Yet in other cases some offenders target children to exploit or those who are serial burglars that go from one home to another thieving. The same dynamic holds true for white-collar offenders—they too engage in different types of fraud schemes that may be more financially devastating than others together with targeting different victims to satisfy their motives.

We may have an employee exploiting weak internal controls at work to embezzle low amounts of money that cannot be easily traced to his or her actions. Alternatively, corporate leaders encourage financial statement fraud in the billions of dollars by artificially inflating income to give the impression to outsiders that their business is more successful than it actually is. However they also personally profited at the expense of the organization, employees, and shareholders by selling their stock options at artificially inflated prices because of the false accounting information they provided to the securities market. Moreover, we observe predatory fraud offenders who specifically target individuals and infiltrate organizations—both for and not-for-profit—to financially exploit without remorse leaving victims penniless and organizations bankrupt.

Despite the trillions of dollars lost to white-collar crime, comparatively this offender has escaped the type of in-depth scrutiny and academic analysis non-white-collar offenders are subjected to, due to an implied credibility about their character they have received from the accounting profession, the criminal justice system, academia, and society at large. Instead of digging deeper to understand and refine their criminal profile, we ended up relying on outdated and unfounded assumptions to construct opinions about their character traits that are more likely than not inaccurate. This insight actually exposes people and organizations to being victimized time and again because assumptions are not based on fact, but myth. Consider that just because these offenders aggress against others in a manner not reflective of traditional notions of criminality, or in ways that are easily recognizable by the general public, does not mean they are not capable of inflicting harm to others due to how they perceive exploitable opportunities.

Moreover, people typically do not hesitate in unequivocally denouncing offenses that appear obvious, such as murder, terrorism, and sexual assault because they do not experience moral ambiguity about the unacceptability of these offenses accompanied by public condemnation. Yet moral ambiguity appears to have uniquely attached itself to white-collar offenders because how we intellectually understand them and how we feel about them may be at odds, which ultimately impacts our response to their misconduct. We may denounce their behavior, but at the same time refer to them as "good people who did a bad thing" or labeled "accidental offenders" because it was never their true desire to engage in fraud despite the financial and emotional damage caused. Would we attribute the character trait of goodness to a rapist or terrorist or label them as accidental offenders knowing the planning that went into their crimes? Yet, this moral ambiguity persistently cloaks the white-collar crime classification, ultimately influencing the perception that a different kind of offender exists.

In addition, moral ambiguity is preserved because there is a viewpoint that in some circumstances government tolerates corporate offenders by balancing the harm they cause against the perceived greater good they provide such as economic growth, employment opportunities, and the political stability maintained by not compromising the efficiency of the market place that provides tax revenue. If we hope to diminish the impact of moral ambiguity, the gap between what we want to believe about these offenders and what the evidence tells us about what they actually represent must be bridged. In order to properly assess their risk to society, an updated offender profile based on a better understanding of their behavioral traits is needed. For decades, we generally relied upon sociological and criminological scholars to educate us on this crime classification and specifically on the issue of corporate misconduct, but without in-depth scholarship about the offenders themselves. Although their insights were invaluable in exposing corporate misconduct, in the past other disciplines such as the legal, accounting, and behavioral sciences were not actively involved in white-collar crime scholarship, but today they are because a multiple disciplinary approach to studying white-collar crime is needed. Greater collaboration among disciplines allows for improved offender profiling, and fraud prevention and detection amongst practitioners to reduce the risk inherent in this crime.

One of the goals of this book is to present a more in-depth analysis of white-collar offenders by offering a framework that brings different academic disciplines into the conversation so that we can understand them in a more holistic manner, how their criminality facilitates organizational misconduct, and how they engage in predatory fraud schemes. Often books on white-collar crime and fraud examination tend to be one dimensional, meaning they just examine criminological aspects of white-collar crime while others focus solely on the technical aspects of how fraud schemes are perpetrated. Without a multiple disciplinary approach, there are simply too many questions about white-collar crime, organizational misconduct, and fraud examination for one discipline to answer in more complete terms. When we do not enlist the help of other disciplines to fill in the gaps to unanswered questions, we end up speculating about this offender's criminal and behavioral profile based on what we want to believe about them. Yet, by offering diverse disciplinary perspectives, one begins to appreciate the synergy created on how these different insights fit together to explain why white-collar crime, its offenders, and organizational misconduct thrives, thus ultimately relying less and less on offender profile speculations.

Practically, not applying a holistic approach to studying white-collar crime is where antifraud professionals and some in academia erred for decades explaining in part why people and organizations are repeatedly victimized. As a result, there appears to be a perception, albeit erroneous, that white-collar offenders reflect a homogenous offender group in terms of the extent of their criminality while displaying a value system reflecting a virtuous lifestyle. We often believe that fraud offenders commit crimes outside their character, however their offenses are very much within their character especially since on balance their crimes are planned and can occur over a period of months and years. What is known about these offenders is that they manifest their aggression in a different form against others and organizations to satisfy their motive for financial gain, while relying on their own unique rationalizations to morally distance themselves from their misconduct, yet creating victims nonetheless no differently than non-white-collar offenders.

Moreover, it is assumed fraud offenders are characteristically and optically different because they are better educated, employed, and engage in civically-minded behaviors, thus they do not reflect the unstable, unemployed street-level offender many people equate with being criminally inclined. Unfortunately people are seduced by offender socioeconomic status distinctions and interpret such differences as representative of whether someone is at risk to break the law. Although distinctions between white-collar and non-white-collar offenders matters, what is more important are the similarities of how they manifest their criminal thinking to exploit vulnerable situations regardless of the crime they prefer to engage in. For example, some offenders sell drugs to addicts who may be too weak at the moment to overcome their addiction while others profit by exploiting an organization's weak internal controls or another's trust. Acknowledging the similarities of how fraud offenders think about exploitable opportunities is the first step in diluting the moral ambiguity surrounding their profile.

In addition, over the past several decades criminology and the behavioral sciences have taken a decisive turn toward incorporating individual differences, especially in regard to their behavioral traits, as important risk factors facilitating their fraudulent behavior. Consequently, it is incumbent upon students and antifraud professionals alike to make every effort to understand the human aspect of fraud offending that has been lacking in their training. Typical classes in accounting, for example, do not teach students about fraud offenders themselves and risk factors facilitating organizational misconduct, but instead focus on the technical aspects of fraud scheme perpetration. Yet, it is not just students and professionals that need training in this area, but also those in management and human resources that inevitably encounter people who will engage in fraud to satisfy their personal agendas at the expense of the organization that employs them.

When we immerse ourselves into understanding the human aspects, we begin the process of reducing the probability of fraud from occurring in the first place as opposed to having to deal with fraud after the fact when it may be too late for victims to be compensated for their loses. However, it is understandable that students and antifraud professionals may not have the time to complete entire courses in the social and behavioral sciences to understand human behaviors, especially those that may bring out the worst, and not the best in people. In part, one of the goals of this book is to accelerate student learning in these various disciplines without having to take full-time courses in them. However it is imperative that an earnest effort is made to understand behavioral topics facilitating criminal activity, the relevance of group dynamics to explain why organizational misconduct thrives on a wide-scale basis, and legal concepts that explain why people believe they only engaged in an unethical, but not an illegal act. Equally important is appreciating the behavioral profile of corporate fraud offenders and how people at the highest level of an organization display certain personality traits that serve as risk factors increasing the probability of engaging in corruption.

Understanding personality traits is important especially as it relates to those that occupy leadership positions because of the impact they have on leadership style, the tone they set for the organization influencing their culture, and how subordinates respond to incidences of misconduct. We learn how corrupt leadership displays certain reoccurring behavioral patterns that increase the risk they will find fraud an acceptable solution to problems such as how to maintain profitability. Furthermore, we find both intriguing and concerning the possibility that certain personality traits promote both occupational success in organizations and facilitate criminal tendencies at the same time. Of course this does not mean that corporate leaders are by definition corrupt, but it does suggest that harboring antisocial attitudes does not disqualify one from entering the higher ranks of the corporate world—working class citizens may, and do, exhibit these traits. Moreover, understanding personality is important because of its impact on how offenders perceive risk-taking and whether certain types of personalities are more prone to rely on unethical and criminal behavior to satisfy their motives.

Similarly, although it is unfortunate that organizational misconduct occurs at all, there is a normalcy to its pervasiveness. While normalcy should not be interpreted to mean that its existence is condoned, there are risk factors that come together creating a strong negative synergy increasing the probability that organizational misconduct will occur, be tolerated, and even celebrated at times. The reality is the majority of people work in an organizational setting, thus it is useful to learn how organizations facilitate fraudulent behaviors from its leadership all the way to its subordinates. At the organizational level, we need to appreciate the influence of group dynamics that serves as a risk factor increasing the probability that people who might not have any motivation to engage in white-collar crime do engage in it once they are in a group setting. What is it about a group setting that makes people more susceptible to engage in misconduct? Although fraud examination, in part, is about understanding the accounting behind the fraud schemes, it is also about understanding fraud offenders themselves and the organizational risk factors that gave rise to the fraud in the first place.

What fraud examination refers to must be expanded to acknowledge the relevance of other disciplines assisting antifraud professionals to be aware that fraud risk factors come in different forms. Just as accounting fraud symptoms prompt professionals to look deeper into the numbers, they must also understand the environments they are immersed in so that they can consider individual behavioral traits that serve as proxies for a fraud attitude and observe organizational cultures that endorse fraud as a way of doing business. By more surgically assessing organizational environments and the people they interact with, auditors and fraud examiners improve the professional skepticism they are required to display. Too often these professionals neglect their professional skepticism because they were never exposed to understanding how fraud offenders think about manipulating an audit or fraud examination engagement. That being said, when we understand those individual and organizational risk factors coming together, we now have a framework to rely on to explain why misconduct is so foreseeable especially when we observe similar characteristics of how misconduct keeps reoccurring regardless of the industry.

Consider also that some of the topics covered may appear unique because part of my motivation in writing this book is to debunk the perception that white-collar offenders are one-dimensional. Often books on white-collar crime focus on topics that are obvious to the reader, but in this case, the topic list is expanded to include areas that are not expected such as the links between white-collar crime and terrorism, violent white-collar offenders, what role gender plays in fraud offenses, fraud victimology, and how offenders should be punished. Moreover, we examine why regulatory agencies might fail in detecting blatant fraud especially how Bernard Madoff manipulated the United States Securities and Exchange Commission for years even after the Commission was put on notice on numerous occasions by numerous experts about his crime occurring in plain sight coupled with Madoff's own suspicious behaviors that should have triggered a more surgical investigative response into his business affairs. In addition, we need to understand why the Bernard Madoffs of the world are skilled predatory offenders taking advantage of the investing public, especially those considered well-educated and traditionally not thought of as being at risk for exploitation.

If these schemes repeat themselves so often, why are we still beguiled by these offenders only to become their victims? What predatory skill base and tactics do offenders rely on facilitating the ease in which victims happily give them money? Furthermore, from a fraud investigative perspective, we learn how understanding a person's personality traits can influence how fraud examination interviews are conducted so that they may expose a fraud suspect's culpability. Also, we examine the issue of deception detection important during fraud examination interviews, myths surrounding our perception that people are good at deception detection, and different strategies available to disclose deception during an interview. Plus the very important topic of corporate governance is covered because when we analyze why corporate fraud occurs as often as it does, it is because management, the board of directors, and auditors failed in their duty of detecting fraud that is rather blatant due to their negligence. However, there are times these parties purposely ignore known misconduct when it was their duty to expose it and offer solutions to reduce the risk of misconduct from occurring again. We examine the cause of their failures and solutions to reduce the risk of audit failures together with fraud risk management topics to assist management and board members in their fiduciary duties.

To build an applicable framework that will help us organize information, a variety of mutually reinforcing sources are considered that facilitates learning synergy derived from insights from antifraud professionals, academic research, and white-collar offenders themselves. However, a conservative approach on how the information is presented in this book is taken for several reasons. First, it is my obligation to support the book's content and to not overstate one's opinion if it does not have some basis in quality research. Too often opinions about white-collar crime are based on speculation, but offered as fact. Secondly, if a conservative approach is taken, one can apply this book's lessons with confidence, whether in becoming more competent auditors, executives, fraud examiners, or to better understand one's own work environment.

Lastly, part of my motivation to write this book came from the feedback I received throughout the years from students, lay persons, and antifraud professionals. Not only has the material helped them in their professional capacity to perform their duties with more precision, but it has helped them on a personal basis when faced with ethical issues involving misconduct they witnessed. Often people work in organizations that are toxic and lack integrity, impacting not only the quality of one's work, but also their own mindset. This book assists us to better interpret our experiences when immersed in such environments where misconduct thrives. Now this multiple disciplinary framework facilitates the understanding of the people we are surrounded by, how they impact organizational culture, which ultimately impacts how we react to situations—for better or for worse. Moreover, the book can help protect one from going down the proverbial slippery slope of potentially engaging in fraud when we may not think we are engaging in it. People may believe that they engaged in unethical, but not criminal behavior, only to find themselves facing criminal charges because they did not understand the dynamics that lead to them engaging in more than just unethical behavior in the first place.