

HRD Liability Update

Courtesy of Sample & Associates



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Fraud - Bringing Light to the Dark Side of Business by W. Steve Albrecht, Gerald W. Wernz, and Timothy L. Williams (Irwin Professional Publishing, 1995) 296 pp.

Book Review by Dr. John Sample

Combating fraud and criminal acts in business has always been a thorny problem. Corporate senior managers worry that a scandal could erupt during their watch at the helm and shareholders are concerned with the impact of fraud and criminal acts on company survivability, image and dividends. Corporate legal counsel and public relations personnel find that responding to legal attacks and intrusions by the media to be disruptive and costly. Now there is an even greater threat with Federal Sentencing Guidelines. Companies can be held responsible for the criminal acts of their employees, including the potential for court mandated dissolution.

An informative new book by Steve Albrecht and his associates, *Fraud - Bringing Light to the Dark Side of Business*, helps to clarify this murky area of responsibility with practical examples and policy frameworks for corporate America. According to the preface, Steve Albrecht is a professor and fraud researcher with extensive experience. Timothy Williams is a vice president of business ethics for a major telecommunications company, and Jerry Wernz is the director of internal audit and security for a Fortune 500 paper company.

This is not just a book on the principles of auditing for fraud in business. The authors systematically weave a fabric from the behavioral sciences, business strategy, and accounting principles. This integrated view of the fraud perpetrator, their victim organizations, and the methods for investigating and preventing fraud is delightfully free of technical jargon.

The book consists of four major sections and seventeen chapters. Each chapter provides the reader with practical information and many short case histories. Many case histories are from the authors own professional experiences in investigating and testifying in actual fraud cases. In the first chapter, the authors characterize fraud into six types - employee embezzlement, management fraud, investment fraud, vendor fraud, customer fraud, and miscellaneous fraud.

1. Employee fraud occurs when an employee appropriates the businesses assets for which they entrust him or her. Direct embezzlement consists of the theft of cash or inventory. A more sophisticated form of employee embezzlement is the conversion of moneys to a bogus company controlled by the employee. Indirect embezzlement typically involves employees taking bribes or kickbacks from vendors or customers. Lack enforcement of internal controls makes direct and indirect embezzlement more probable.
2. Management fraud occurs when corporate management manipulates financial statements to make the business appear more profitable. Such tactics may inflate the value of corporate assets, enable the business to obtain a loan, or encourage investment from potential stockholders.
3. Investment fraud occurs when they sell worthless investments or securities to investors. A well-known device for scamming investors is known as the Ponzzi scheme. Money from later investors is used to pay high dividends to earlier investors. This tactic creates an illusion of creative and successful investment.
4. Vendor fraud involves overcharging for goods, the shipment of inferior products, or the failure to ship purchased goods. Occasionally, such fraud is committed with the collusion of an internal buyer.
5. Customer fraud may involve failure to pay for products that they have purchased, or duping a business into giving them something for nothing.
6. Miscellaneous fraud, according to the authors, may be for reasons other than financial gain. They cite an example of falsifying birth records of Little League baseball players to allow older and better players to compete in the Little League World Series.

Chapters two through five explore the major components of the A fraud triangle which consists of pressure, opportunity and rationalization. Pressure is discussed in terms of financial, personal vices (such as gambling) and work-related. Opportunity is divided into two parts - internal control and non-control factors. Internal controls are designed to detect and prevent fraud. Non-control factors address the inability to assess levels of individual performance, failure to discipline perpetrators, no access to information, and several other factors. Perpetrators use rationalization, the third aspect of the triangle, to explain their actions. According to the authors, embittered employees may believe that the business owes them, or that the money is only being borrowed and will be paid back.

The four chapters comprising Part II explain the detection of fraud. Symptoms of fraud involving employee, management and investment are discussed in chapter six. The next two chapters discuss approaches for recognizing symptoms of fraud. Chapter seven describes the relationship between accounting, internal controls, structure of the business, and operational systems. Chapter eight gives the reader analytical procedures for capturing unusual transactions and events. Chapter nine, the concluding chapter in Part II, gives the reader tips for detecting fraud, advice for noting changes in behavior of first time perpetrators of fraud and for recognizing the extravagant lifestyle of those who commit fraud. The importance of demographic factors is also discussed in Chapter nine.

The five chapters of Part III focuses on fraud investigation. From the perspective of this reviewer, this part of the book provides the most practical information for those who must

take action to uncover fraud in a business. In chapter 10, the authors classify methods of investigation into a process called the AFraud-Triangle-Plus Approach.® The triangle consists of methods for investigating theft (surveillance, Invigilation, physical evidence), concealment (document examination, audits, computer searches, physical asset counts), and conversion of funds (public records search, net worth analysis), and two additional methods (interviewing and honesty testing).

Invigilation is the term used by the authors to describe a specific theft act technique. Invigilation involves the closest of supervision of a suspect such that fraud is nearly impossible. Opportunity is reduced with Invigilation, and subsequent analysis can establish a fraud free profile or clear evidence of fraud.

The authors begin chapter eleven on document concealment with an interesting piece of advice. AWhen faced with a choice between an eyewitness and a good document as evidence, most fraud experts would opt for the document . . . [documents] can=t be cross examined or confused by attorneys, they can=t commit perjury, and they never tell inconsistent stories on two different occasions (p. 153). Investigative techniques discussed include auditing tips, how to access hard to get private documents the use of document examiners, and searches of public sources.

Chapter twelve describes methods for determining how perpetrators of fraud convert their stolen assets. Public records are useful for tracing purchases, payments of debt, changes in lifestyle, and net worth analysis. Public sources discussed by the author include federal, state and local sources. Private sources and publicly available databases are also discussed. Chapter thirteen summarizes the traditional techniques of interviewing and interrogation for determining lying and deception. Newer methods, such as various honesty testing techniques, are also discussed. These newer methods include paper-and-pencil tests, graphology, voice stress analysis, and polygraph examination. The authors hasten to state that some of the newer techniques, such as graphology and voice stress analysis, are controversial. The authors review of interview and interrogation techniques is very practical, especially for those who have never confronted a suspect employee. The ultimate objective is a signed confession. The section on deception and lying includes a discussion of the types of liars, typical defense mechanisms used to hide guilt, and verbal and non-verbal cues to lying.

Chapter fourteen ends Part III of the text with a description of how to conclude a fraud investigation with a final report. According to the authors, a report will be useful in subsequent civil or criminal actions, and is recommended by Institute of Certified Public Accountants. An example of a fraud report exemplifies the four types of investigatory tools described in previous chapters of the text.

Part IV consists of two chapters on the prevention of fraud. Chapter 15 addresses the importance of creating a culture of honesty, oneness and assistance in preventing fraud. The premise of this chapter is that nearly everyone can be dishonest at sometime in their life. The authors provide several theoretical explanations for dishonest practices in America, and they even provide a self-test checklist of common offenses. They recommend five strategies for fraud prevention: (1) hire honest people and provide fraud awareness training, (2) creating a positive work environment, (3) create and publish a code of ethics, (4) provide an employee

assistance program, and (5) develop an expectation that dishonesty will be punished. Chapter 16 discusses fraud prevention through a system of internal controls and auditing. Additional strategies include the discouragement of collusion between employees and individuals outside the business, putting contractors on notice as to the company's policies, employee monitoring (especially extreme changes in lifestyle), encouraging anonymous assistance through a hot line, and proactive auditing.

The text concludes with a 12-step comprehensive fraud prevention program. Fraud is usually never expected in a business, therefore preemptive policies and procedures will not be in place. A surprise incident of fraud typically results in an investigation, action, and resolution. The comprehensive model offered by the authors adds an additional eight steps which make the process more effective. The chapter ends with an example of a fraud policy for a business.

This text will appeal to a variety of readers. Business and accounting faculty will find the text useful in courses for students in applied ethics, auditing, and managerial accounting. Inexperienced internal auditors will appreciate the many case examples and practical tips for beginning and concluding a fraud investigation. Senior management and corporate legal staff charged with the responsibility for developing fraud prevention and resolution mechanisms will find the text invaluable. Private security firms and law enforcement agencies will also find this text useful for conducting commercial fraud investigations in small businesses.

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