Psychology of Fraud - Insights from a Fraud Investigator

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WHAT WE WILL COVER TODAY

• Top fraud trends
• The psychology of fraud perpetrators
• The psychology of those that assist fraudsters
TOP FRAUD TRENDS

REPORT TO THE NATIONS
2018 GLOBAL STUDY ON OCCUPATIONAL FRAUD AND ABUSE
HIGH COST OF FRAUD

• 5% of revenue lost to fraud and abuse each year

• Cost of external assistance with investigation for insurance or criminal purposes
  • Lawyers
  • Forensic accountant

• Higher insurance costs in following year(s)
HIGH COST OF FRAUD

• Non-monetary loss can be more damaging than the actual monetary loss
  • Loss of reputation
    • Public assumptions
  • Loss of employee morale
  • Loss of productivity due to internal investigation
FIG. 12  What types of organizations are victimized by occupational fraud?
RECOVERING FUNDS IS THE EXCEPTION

- In **53%** of the reported frauds, there was **NO recovery**
- Money not in interest bearing bank account, **often gambled away**
  - The one time it was....
- For the **15%** of reported frauds in which there was **full recovery**, the source of recovery was usually an insurance policy
INSIGHTS ON FIDELITY BONDS

• Likely only chance at meaningful recovery

• Civil litigation to recover losses often fruitless

• Watch your internal controls if you expect your insurance to pay…
Underneath that statement, each application includes the following question in bold typeface (underlined where indicated):

**The correspondent account, suspense account, or transit account is used most often by dishonest employees. Are all correspondent accounts, suspense accounts, and transit accounts balanced and reconciled regularly and completely balanced and reconciled by a second person at least monthly?**

On the application, the Bank answered “Yes” to this question.
The walkthrough of examples enclosed with your letter states as follows: “Mr. [REDACTED] was responsible for reconciling the general ledger balance to the correspondent bank account statement and therefore the resulting differences were not detected by other bank personnel.” This statement suggests that the correspondent account was not completely balanced and reconciled by a second person at least monthly.

[REDACTED] reserves the right to rescind the bond *ab initio* if it is determined that the Bank made misrepresentations or incorrect statements of material facts on the bond application.
Most fraudsters do not take a job with intent to commit fraud, it is often a crime of opportunity.

88% of fraudster not previously charged or convicted

- However, many frauds are not reported due to perceived reputational risk
- Background checks and reference checks are still important
WHICH ONE LOOKS SUSPICIOUS?

$3$ million

$4.6$ million

$1.0$ million

$31$ million

$20$ million

$1.1$ million
TIPS ARE THE TOP METHOD OF DETECTION

FIG. 9 How is occupational fraud initially detected?

<table>
<thead>
<tr>
<th>Method</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tip</td>
<td>40%</td>
</tr>
<tr>
<td>Internal audit</td>
<td>15%</td>
</tr>
<tr>
<td>Management review</td>
<td>13%</td>
</tr>
<tr>
<td>By accident</td>
<td>7%</td>
</tr>
<tr>
<td>Other</td>
<td>6%</td>
</tr>
<tr>
<td>Account reconciliation</td>
<td>5%</td>
</tr>
<tr>
<td>Document examination</td>
<td>4%</td>
</tr>
<tr>
<td>External audit</td>
<td>4%</td>
</tr>
<tr>
<td>Surveillance/monitoring</td>
<td>3%</td>
</tr>
<tr>
<td>Notified by law enforcement</td>
<td>2%</td>
</tr>
<tr>
<td>IT controls</td>
<td>1%</td>
</tr>
<tr>
<td>Confession</td>
<td>1%</td>
</tr>
</tbody>
</table>
PSYCHOLOGY OF FRAUD
WHO PERPETRATES FRAUD?

FIG. 24 How does the perpetrator’s level of authority relate to occupational fraud?

- **Employee**: 44% of cases with a median loss of $50,000
- **Manager**: 34% of cases with a median loss of $150,000
- **Owner/executive**: 19% of cases with a median loss of $850,000
- **Other**: 3% of cases with a median loss of $189,000
WHY DO EMPLOYEES STEAL?

• Legitimate financial need is rare anymore

• Other basic reasons employees steal
  • Low morale
  • Feel employer has mistreated or “wronged” them
  • Feel underpaid and/or under appreciated
  • Consequences of theft are minimal
  • Lack of preventative measures
WHY DO OWNERS/EXECUTIVES STEAL?

• Same reasons generally apply to owners/executives, but there are others
  • Greed – many risk more than they stand to gain
  • Arrogance – power and money lead to feeling of invincibility
  • Personality Disorder – lack of empathy, denial even in face of overwhelming evidence of guilt
FIG. 29 What are the most common occupational fraud schemes in high-risk departments?

<table>
<thead>
<tr>
<th>Industry</th>
<th>Cases</th>
<th>Billing</th>
<th>Cash Larceny</th>
<th>Cash on Hand</th>
<th>Check and Payment Tampering</th>
<th>Corruption</th>
<th>Expense Reimbursements</th>
<th>Financial Statement Fraud</th>
<th>Noncash</th>
<th>Payroll</th>
<th>Register Disbursements</th>
<th>Skimming</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting</td>
<td>290</td>
<td>29%</td>
<td>14%</td>
<td>17%</td>
<td>30%</td>
<td>23%</td>
<td>12%</td>
<td>13%</td>
<td>7%</td>
<td>14%</td>
<td>2%</td>
<td>19%</td>
</tr>
<tr>
<td>Operations</td>
<td>266</td>
<td>15%</td>
<td>8%</td>
<td>15%</td>
<td>8%</td>
<td>36%</td>
<td>11%</td>
<td>4%</td>
<td>20%</td>
<td>5%</td>
<td>2%</td>
<td>11%</td>
</tr>
<tr>
<td>Executive/upper management</td>
<td>223</td>
<td>35%</td>
<td>14%</td>
<td>16%</td>
<td>15%</td>
<td>62%</td>
<td>29%</td>
<td>30%</td>
<td>20%</td>
<td>12%</td>
<td>3%</td>
<td>9%</td>
</tr>
<tr>
<td>Sales</td>
<td>216</td>
<td>10%</td>
<td>12%</td>
<td>12%</td>
<td>6%</td>
<td>34%</td>
<td>13%</td>
<td>6%</td>
<td>25%</td>
<td>2%</td>
<td>5%</td>
<td>14%</td>
</tr>
<tr>
<td>Customer service</td>
<td>155</td>
<td>5%</td>
<td>16%</td>
<td>31%</td>
<td>8%</td>
<td>19%</td>
<td>4%</td>
<td>1%</td>
<td>15%</td>
<td>3%</td>
<td>5%</td>
<td>14%</td>
</tr>
<tr>
<td>Administrative support</td>
<td>147</td>
<td>33%</td>
<td>7%</td>
<td>21%</td>
<td>14%</td>
<td>26%</td>
<td>22%</td>
<td>8%</td>
<td>19%</td>
<td>13%</td>
<td>3%</td>
<td>14%</td>
</tr>
<tr>
<td>Finance</td>
<td>110</td>
<td>17%</td>
<td>15%</td>
<td>21%</td>
<td>16%</td>
<td>37%</td>
<td>13%</td>
<td>16%</td>
<td>15%</td>
<td>6%</td>
<td>2%</td>
<td>10%</td>
</tr>
<tr>
<td>Purchasing</td>
<td>94</td>
<td>18%</td>
<td>5%</td>
<td>6%</td>
<td>5%</td>
<td>77%</td>
<td>10%</td>
<td>3%</td>
<td>31%</td>
<td>3%</td>
<td>2%</td>
<td>4%</td>
</tr>
</tbody>
</table>
CASE STUDY - SCOTT TUCKER

- $3.5 billion payday loan business
- 1997-2013
- More than 4.5 million borrowers impacted
PAYDAY LOAN BUSINESS MODEL

• Customers are high-risk (previous history of non-payment)

• Only 7 out of 10 will repay, and there is virtually no recourse

• Pricing is about $30 for every $100 advanced. Loan maturities are approximately 14 days
  • Tenure at job
  • Claimed regular income
  • Established bank account
PAYDAY LOAN BUSINESS MODEL

• Scaled from $300,000 initial investment in a single store front in 1997 and used Internet to speed things up and make them more convenient and efficient through use of online lending software

• Could approve loans in 3/10ths of a second

• Use of Internet allowed companies to make loans to borrowers in states where they did not have a physical presence and that did not allow Payday lending. So, in 2003, a couple of states sued
• Tucker entered into business relationships with three Native American tribes to gain the protection of “tribal sovereign immunity”

• State supreme courts in the states that sued ruled that this was permissible

• In a subsequent suit brought by the FTC, it was found that Native American tribes are subject to the FTC Act and that Tucker’s companies violated the Act
RELATIONSHIPS WITH NATIVE AMERICAN TRIBES

• The processing center operations were located in Overland Park, not OK or NE where the tribes are located. However, employees were told to lie and say they were located in OK or NE if asked.

• Tribes received approximately 1%-2% of AMG’s revenue, while 99%-98% was retained by Tucker’s companies.

• At least $400 million went directly to Tucker, in part through personal expense and purchases paid out of the tribal entity bank accounts.
Money went to support Tucker’s lifestyle:

- Level 5 Racing Team - 4 Porsche and 6 Ferrari automobiles and related racing team assets ($60 million)
- Learjet ($14 million)
- High-priced jewelry
- Aspen home ($8 million) and a Leawood, KS home ($1.8 million)
- Over $200+ million sitting in various bank accounts
FRAUD: WHERE DID TUCKER’S COMPANIES GO WRONG

• Lending website informed borrower of amount they could borrow based on their claimed income and employment

• Borrowers had to electronically indicated that they had read certain documents online and to preauthorize electronic funds withdrawals from their accounts to repay the loans

• The loan principal was made available the next day via electronic deposit into the borrower’s bank account
The Loan Note and Disclosure had to include the TILA box to disclose the cost of the loan in clear and simple terms.

For a $500 loan, the TILA box would indicate finance charges of $150 and a total of payments of $650. The loans were for 14 days, so the stated APR on this loan would be 782.14%.
However, the actual repayment schedule was as follows:

- On the borrower’s payday, the entire amount of the finance charge was withdrawn, but none was applied to principal unless borrower arranged to pay-off the loan.
- This would occur for four more paydays.
- On the fifth payday, the lender would begin to withdraw an additional $50 to apply to the principal balance of the loan.
ACTUAL AMOUNT PAID ON $500 LOAN WAS $1,925

<table>
<thead>
<tr>
<th>Payday</th>
<th>Withdrawal</th>
<th>Amount Applied to Finance Charge</th>
<th>Amount Applied to Principal</th>
<th>Principal Balance Remaining</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$150</td>
<td>$150</td>
<td>$-</td>
<td>$500</td>
</tr>
<tr>
<td>2</td>
<td>150</td>
<td>150</td>
<td>0</td>
<td>500</td>
</tr>
<tr>
<td>3</td>
<td>150</td>
<td>150</td>
<td>0</td>
<td>500</td>
</tr>
<tr>
<td>4</td>
<td>150</td>
<td>150</td>
<td>0</td>
<td>500</td>
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<tr>
<td>5</td>
<td>200</td>
<td>150</td>
<td>50</td>
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<tr>
<td>6</td>
<td>185</td>
<td>135</td>
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<td>400</td>
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<td>7</td>
<td>170</td>
<td>120</td>
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<td>350</td>
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<td>8</td>
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<td>10</td>
<td>125</td>
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<td>13</td>
<td>80</td>
<td>30</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>14</td>
<td>65</td>
<td>15</td>
<td>50</td>
<td>0</td>
</tr>
</tbody>
</table>

Pmt #5 would often result in a call from the borrower

These figures were not provided to the borrower in any of the documentation
BORROWER HARM

• Borrower’s were cash-strapped to begin with
• Unauthorized withdrawals would keep them from paying other obligations and resulted in overdrafts and NSF fees
• Some borrowers actually had to take out additional payday loans to cover their other obligations, worsening their situation
CONVICTIONS & JUDGEMENTS

- Criminal case (2013-2018): 16 years 8 months in federal prison and potential $3.5 billion judgement
  - Part of reason for length of prison term was his absolute lack of remorse
  - This will be Tucker’s second stint in prison. He spent a year in prison related to a bank fraud scheme and was released in 1992
- He also has a $1.3 billion judgement against him arising from a civil case brought by the FTC. His wife has a $30 million judgement
- Tucker has been charged in Kansas for filing a false tax return that did not reflect more than $100 million that he made through his businesses
HOW TUCKER SAW HIMSELF

• Was Tucker remorseful?

• In a letter to the court, Tucker defended his business practices and implied he was misunderstood
  • “Although I saw myself as being an entrepreneur, a jobs provider, and a contributor to the American economy, I’ve learned that others view me through a different lens. I am very sorry that our leaders castigate me as a villain or some type of predator.”
HOW I SEE TUCKER

• In the Netflix series “Dirty Money

  • Tucker comes across as arrogant and completely rejects the thought that what he was involved in was wrong. His position was “It was just a business. There was demand, and consumers and the business was built around that.”

  • He was asked “Do you think you are a moral person?” After a pause he answered “I’m a business person”
NARCISSISTIC PERSONALITY DISORDER

- NPD involves a pattern of self-centered, arrogant thinking, a lack of empathy and consideration for others, and an excessive need for admiration
  - Manipulative, selfish, patronizing and demanding in all areas of their lives
  - Perceived slights are taken as personal attacks
  - Extremely resistant to changing their behavior
  - Blame others for their problems
Scott Tucker — what is your diagnosis?

- Was he empathic to those who suffered?
  - Showed no remorse

- Did he blame anyone else?
  - Scott appears to (in part) blame the judge for the verdict he got, rather than the 8 weeks of proceedings that the jury witnessed and considered.
TUCKER SEEMS TO BLAME THE JUDGE

- Jury was tired by end of trial (Judge let trial go on too long)
- Judge sent the case to the jury on a Friday, and there was usually no court on Friday
- Judge started the day at 8:30am rather than the normal 10:00am
- Judge did not let the jury go out to lunch as was the norm; the judge had lunch brought in
- SO, the jury was disgruntled and we couldn’t catch a break. They came back with a guilty verdict a little before 5:00pm that day. Jury took the easy way out and found for guilty
WHAT ABOUT TUCKER’S EMPLOYEES?

• Did they knowingly lie?

• Did they understand how the repayment schedule worked?

• Did they understand the financial and emotional harm being inflicted on borrowers?

• How could they knowingly participate in the scheme?

• Were they just “bad people”? 
WHY DO GOOD (?) PEOPLE DO BAD THINGS?

Are actions tied to character?
TOBY GROVES

• Strong moral character historically; raised on family farm

• Brother gets sentenced for bank fraud; 22 years later, Toby sentenced for same fraud

• Misrepresented income, falsified loan documents, reported fictitious homes

• $7 million bank fraud

• Employees, title company personnel, etc. knowingly participated in the fraud?
WHAT CAUSES UNETHICAL BEHAVIOR?

Research indicates most of us are capable of behaving in profoundly unethical ways, and do so without realizing it all the time.
WHAT CAUSES UNETHICAL BEHAVIOR?

- Historically very ethical, Groves Funding company does well for 10 years
- Found himself between a rock and a hard place, needed $240,000
- “Little white lie” to get a loan
- Lie seemed innocent. Thought he could fix the situation before anyone got hurt
WHAT CAUSES UNETHICAL BEHAVIOR?

• Toby’s promise to his father was important to him

• Toby knew it was both illegal and unethical to lie on a mortgage application

• But, how did Toby perceive his options at the time?
BUSINESS VS ETHICS

• Business Decisions
  • What might I gain?
  • How will it affect the future?

• Ethical Decisions
  • Is this fair?
  • Will people be hurt?

Researchers indicate your frame of mind makes a difference
HOW DOES A $240,000 LOAN TURN INTO A $7 MILLION BANK FRAUD

• Toby discovered more losses at his company
• Decided to take out mortgages on houses that did not exist
• Could not do it alone
• Got help from employees and others and some went to jail for it
WHAT ABOUT CO-CONSPIRATORS?

- Often, co-conspirators aren’t bad people, they can’t see the impact (fraud is unintentional)
- People commit fraud because of relationships (we like each other)
- Cognitive association limitations
WE LIE BECAUSE WE CARE
WHY DID PEOPLE KNOWINGLY HELP THESE MEN COMMIT FRAUD?

Groves did not set out to defraud people. Tucker did. Groves’ employees may not have realized their part in a fraud at the time, but Tucker’s surely must have.
HOW ANYONE CAN BECOME A PARTICIPANT OR VICTIM

- Fraudsters often use a combination of persuasion and flattery to gain our assistance
- Many of the psychological attributes a fraudster exploits are what makes us decent people
- Fraudsters often use a combination of distraction, dissimulation, concealment and misdirection
- We may fall victim to our own personality traits
PEOPLE KNOWINGLY HELPED THESE MEN COMMIT FRAUD BECAUSE THEY LIKED THEM

Toby was genuinely a nice guy who hit a bad patch and needed help. Tucker was very generous to employees and publicly supported good causes.
CLASSIC THEORIES OF FRAUD

MOTIVATION

“Differential Association”

- Originally it was thought that criminal behavior was inherited
- Edward Sutherland said criminal behavior is learned through interaction with others who engage in criminal behavior
- You learn criminal behavior and once the benefits of adhering to the law are exceeded by the benefits of not adhering to the law, you will commit fraud
- Fails to address WHY people adopt criminal behavior
COMMON ELEMENTS OF PRESSURE

- Financial strain, but subjectively applied
  - Above-average affluence may feel economically deprived in comparison to their perceived relative standard
    - Keeping up with the Jones’s—true financial deprivation does not exist, it's about ego
  - Threat of loss of something currently owned
    - Adverse business conditions threaten current standard of living— not only potential loss of material possessions, but also of power
COMMON ELEMENTS OF PRESSURE

• Financial strain, but subjectively applied
  • Lifestyle choices
    • Compulsive gambling or other addictive behaviors
  • Relationship breakdowns
    • Divorce settlements, custody or maintenance battles
• True financial need
  • Often will see some repayment in the early periods of the fraudulent activity
COMMON ELEMENTS OF PRESSURE

• Not all pressures are financial
  • Ego/power
    • Power over people
    • Mastery of a situation generates a needed thrill
  • Revenge
    • A common motivation for fraud perpetrated by employees
    • May not be about the money
TOMMY ELROD & “WAKEYLEAKS”

- Player and long-time assistant at Wake Forest University
- Accused of providing Demon Deacon game plans to opposing coaches
- Financial gain? $0
Motivation is a combination of an individual’s personality and the circumstances in which they find themselves.

Psychological factors will influence the way a person interprets the circumstances they are in, and this, in turn, will influence the action they choose to take.

This is why not everyone with a pressure and an opportunity will commit fraud.
RATIONALIZATION

• Reduces the fraudster’s inhibitions

• Nullifies internal objections

• Extenuating circumstances that remove the perception of criminality, at least from the perpetrator’s point of view

  • “They can afford it…”
  • “They did me wrong…”
  • “Everyone is doing it…”
Walter White

- Terminally ill with minimal financial resources (perceived need)
- Former student is involved in drug underworld (perceived opportunity)
- Walter is not a “bad guy,” he’s just doing this for his family (rationalization)
Questions?
Thank You!

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