

Contents

Part I

THE NATURE OF FRAUD

1

Chapter One

THE SERIOUSNESS OF THE FRAUD PROBLEM

3

Fraud Involves Deception, 4

Confidence Is a Necessary Ingredient of Fraud, 5

Types of Fraud, 5

Who Commits Fraud, 7

The Extent of Fraud, 8

Concluding Comments, 12

Appendix: The Most Common Employee Frauds, 13

Chapter Two

FRAUD PERPETRATORS AND THEIR MOTIVATIONS

The First Element of the Fraud Triangle: Pressure

15

The Fraud Triangle, 17

 The Fire Triangle: A Comparison, 18

Pressures to Commit Fraud, 20

 Financial Pressures, 20

 Vice Pressures, 22

 Work-Related Pressures, 24

 Other Pressures, 25

Concluding Comments, 25

Chapter Three

INTERNAL CONTROL FACTORS

*The Second Element of the Fraud Triangle: Opportunity
(Part A)*

27

Controls that Prevent and/or Detect Fraudulent
Behavior, 27

 The Control Environment, 28

The Accounting System, 31	
Control Procedures, 31	
Segregation of Duties and Dual Custody, 32	
System of Authorizations, 33	
Independent Checks, 34	
Physical Safeguards, 35	
Documents and Records, 35	
Concluding Comments, 35	

Chapter Four

NONCONTROL FACTORS

<i>The Second Element of the Fraud Triangle: Opportunity (Part B)</i>	36
---	----

Inability to Judge the Quality of Performance, 36	
Failure to Discipline Fraud Perpetrators, 38	
Lack of Access to Information, 40	
Ignorance, Apathy, or Incapacity, 41	
Lack of an Audit Trail, 42	
Concluding Comments, 43	

Chapter Five

HOW PERPETRATORS EXPLAIN THEIR ACTIONS

<i>The Third Element of the Fraud Triangle: Rationalization</i>	44
---	----

Rationalization, 45	
We All Rationalize, 46	
Rationalization and Honesty, 49	
Example: The Role of Rationalization, 49	
Concluding Comments, 51	

Part II

THE DETECTION OF FRAUD	53
-------------------------------	----

Chapter Six

FRAUD SYMPTOMS

<i>Employee, Management, and Investment</i>	55
---	----

Symptoms of Employee Fraud, 56	
Accounting Anomalies, 57	
Internal Control Weaknesses, 58	

Analytical Anomalies, 59	
Extravagant Lifestyle, 59	
Unusual Behavior, 59	
Tips and Complaints, 59	
Symptoms of Management Fraud, 60	
Operating Performance Anomalies, 60	
Management Characteristics that Indicate Possible Motives, 62	
Organizational Structure Anomalies, 62	
Irregularities in Relationships with Outside Parties, 63	
Using Fraud Symptoms to Prove Management Fraud, 64	
Symptoms of Investment Fraud, 64	
Auditors' Responsibility for Recognizing Fraud Symptoms, 67	
The Nature of the Symptoms, 69	
Concluding Comments, 72	

Chapter Seven

FRAUD SYMPTOMS

Accounting, Control, and Organizational Structure

73

The Relationship between Accounting, Internal Control, Firm Structure, and Operational Systems, 74

Fraud Symptoms, 76

 Irregularities in Source Documents, 76

 Faulty Journal Entries, 78

 Inaccuracies in Ledgers, 81

Unexplained Changes in Financial Statements, 83

 Internal Control Weaknesses, 93

 Overly Complex Organizational Structures, 95

Concluding Comments, 96

Chapter Eight

FRAUD SYMPTOMS

Analytical Procedures and Relationships with Other Parties

98

Analytical Fraud Symptoms, 98

Fraud Symptoms Involving Relationships with Other Parties, 104

 Change of Auditors, 105

 Management Turnover, 110

- Related-Parties Transactions, 111
- Unusual Relationships with Customers, 113
- Unusual Relationships with Vendors, 114
- Concluding Comments, 116

Chapter Nine

FRAUD SYMPTOMS

- Tips and Complaints, Changes in Behavior or Lifestyle, and Demographics* 118

- Fraud Symptoms, 118
 - Tips and Complaints, 118
 - Changes in Behavior, 125
 - Extravagant Lifestyle, 128
 - Demographic Indicators, 130
- Concluding Comments, 135

Part III

- THE INVESTIGATION OF FRAUD** 137

Chapter Ten

THEFT ACT INVESTIGATIVE METHODS

- The Fraud-Triangle-Plus Approach* 139

- Two Approaches to Fraud Investigation, 139
- Theft Act Investigative Methods, 142
 - Coordinating an Investigation, 144
 - Surveillance and Covert Operations, 146
 - Invigilation, 148
 - Physical Evidence, 150
- Concluding Comments, 152

Chapter Eleven

CONCEALMENT INVESTIGATIVE METHODS

- The Fraud-Triangle-Plus Approach* 153

- Aspects of Documentary Evidence, 153
 - Chain of Custody, 155
 - Marking the Evidence, 155
 - The Organization of the Evidence, 155
 - Original Documents versus Photocopies, 156

Obtaining Documentary Evidence, 157**Audits, 157**

Discovery Sampling, 159

Using Computers, 162

Hard-to-Get Documentary Evidence, 164

Document Examiners, 164

Concluding Comments, 171*Chapter Twelve***CONVERSION INVESTIGATIVE METHODS***The Fraud-Triangle-Plus Approach*

172

Obtaining Publically Available Information, 173**Federal Sources, 173**

US Department of Defense, 173

US Department of Justice, 174

US Bureau of Prisons, 174

Internal Revenue Service, 175

US Secret Service, 175

US Postal Service, 175

Central Intelligence Agency, 175

Social Security Administration, 175

State Sources, 175

State Attorney General, 175

Bureau of Prisons, 176

Secretary of State, 176

Department of Motor Vehicles, 176

Department of Vital Statistics, 177

Department of Business Regulation, 177

County and Local Records, 177

County Clerk, 177

County Land Office and Tax Assessor's Office, 178

County Sheriff and Other Officers, 178

Local Courts, 178

Permit Departments, 178

Private Sources, 179**Publically Available Databases, 179****The Net Worth Method, 181****Concluding Comments, 184**

<i>Chapter Thirteen</i>	
INQUIRY INVESTIGATIVE METHODS	
<i>The Fraud-Triangle-Plus Approach</i>	186
Honesty Testing, 186	
Pencil-and-Paper Tests, 186	
Graphology, 187	
Voice Stress Analysis, 187	
Polygraph Examination, 187	
Interviews, 188	
Understanding the Reactions of Interviewees, 189	
Planning an Interview, 195	
The Interviewer's Demeanor, 195	
The Specific Language of Interviews, 196	
Structuring an Interview, 197	
Interrogations, 197	
Strategy, 198	
The Signed Confession, 199	
Deception and Lying, 199	
Defense Mechanisms Used to Hide Guilt, 201	
Example, 203	
Concluding Comments, 204	
 <i>Chapter Fourteen</i>	
CONCLUDING THE INVESTIGATION	
<i>The Fraud Report</i>	206
Example of a Fraud Report, 207	
 <i>Part IV</i>	
THE PREVENTION OF FRAUD	245
 <i>Chapter Fifteen</i>	
FRAUD PREVENTION	
<i>Creating a Culture of Honesty, Openness, and Assistance</i>	247
Just About Everyone Can be Dishonest, 248	
Total Quality Management and the Control Environment, 254	
A Culture of Honesty, Openness, and Assistance, 255	
Hiring Honest People and Providing Fraud Awareness Training, 255	

A Positive Work Environment, 257	
A Company Code of Ethics, 259	
The Employee Assistance Program (EAP), 260	
The Expectation of Punishment, 260	
Concluding Comments, 261	

Chapter Sixteen

FRAUD PREVENTION

<i>Eliminating Opportunities for Fraud</i>	262
--	-----

A Good System of Internal Controls, 262	
Discouraging Collusion between Employees and Outside Parties, 267	
Alerting Outside Contractors to the Company's Policies, 268	
Monitoring Employees, 269	
Providing a Hot Line for Anonymous Tips, 270	
Conducting Proactive Fraud Auditing, 271	
Concluding Comments, 271	

Part V

A COMPREHENSIVE FRAUD PREVENTION PROGRAM

273

Chapter Seventeen

PREVENTION, DETECTION, AND INVESTIGATION OF FRAUD

<i>An Organizational Program</i>	275
----------------------------------	-----

Organizations and Fraud, 277	
The Current Model, 277	
A Proactive Model, 278	
A Fraud Policy, 281	
Concluding Comments, 286	

Index

289