

Bank Fraud Newsletter

Investigator's Corner

by David E. Zulawski and Douglas E. Wicklander

Telltale Signs of Fraud

Fraud surfaces periodically in banks. Unfortunately, the internal audit function rarely uncovers an ongoing fraud. Discovery is made by accident.

Generally, an ongoing fraud is discovered as the result of a third party who alleges misconduct on the part of a senior executive. Such allegations sometime appear in anonymous letters addressed to senior management, with only the barest of details to corroborate them. The problem is whether to believe the letter and investigate or disregard it as a crank. Things are much simpler when there is an informant who can be questioned and his or her motive and integrity judged.

Other frauds come to light as the result of apparent accounting problems, such as a significant change in cash flow, profit, market share, or loans issued. Still other discoveries are made while looking for missing documents or money.

Regardless of how the fraud is discovered, usually there were telltale signs that internal theft or fraud was ripe to occur.

Fraud Versus Theft

While the signs for internal theft and fraud have some similarities, there are several basic differences between them. First, and most significant, frauds are always planned whereas thefts may be done spontaneously. Second, fraud requires concealment of the act for its continued success, while theft is an act of opportunity - one which may not avail itself again. Finally, thefts are often done out of genuine need, while frauds are generally the result of greed.

Environmental Signs of Fraud

Poor management is usually associated with fraud. Lack of supervision and failure to follow policies and procedures are often a breeding ground. Management that is unethical or dishonest breeds dishonesty in the ranks. For example, a training manager in a retail store was discovered to be dishonest. Six out of seven people he trained and sent to other stores were later determined to be involved in similar acts of dishonesty.

Other environmental signs that fraud may be possible include:

- Salaries that are not comparable to those of competitors.
- An associate who handles large amounts of money or contracts.
- Senior executive management style that is punitive and political.

Dictatorial management and judging employee performance based on short-term goals contributes to the frustration of associates, as they are managed by crisis. Combine this with little or no long-term planning, and the seeds are sown for a fraud to occur. Abnormal turnover is the red flag in this situation.

High turnover may also result from playing one employee in the department against another in the manager's quest for power. Control is often a key component in the employee relations strategy of fraud-prone managers. Such managers often drift along without a long-term plan. While they demand loyalty, they rarely return it to their subordinates. If they do show loyalty, it is a short favoritism until the next crisis.

As a result of the lack of long-term planning and repeated crises, fraud-prone managers want less formality in policies and procedures in order to enhance their ability to handle problems. Unfortunately for the bank, this lack of control contributes to the likelihood of fraud. Even when these managers have been counseled to follow the rules, they soon return to their old ways. They often express contempt for the rules and feel that they should be exempt because of their position.

Personal Signs of Fraud

Individuals involved in frauds often demonstrate personal characteristics that indicate a propensity to commit frauds. These characteristics, mixed with a corporate environment that supports their ability to perpetrate fraud, create a perfect situation for theft.

Anyone who elects to engage in a fraud must have a mindset that allows him or her to participate without guilt. Fraud-prone managers generally are motivated by either personal need or simple greed, both supplemented by rationalization.

Generally, one of the following motives contributes to the decision to participate in a fraud:

1. Gambling. Fraud-prone managers are often risk takers, and gambling appeals to their need for excitement.
2. Unusual expenses. The fraud may begin with a legitimate need, but its success encourages the fraud-prone manager to continue the theft.
3. Extravagant living standards. The love of things that are out of financial reach can be a powerful inducement to fraud.
4. Undesirable associates. An individual outside the organization contributes and encourages the manager to participate in a fraud. The manager can sign off on fraudulent

documents submitted by the outside conspirator.

The personal characteristics of the fraud perpetrators are often seen much earlier than the fraud itself:

- Fraud-prone managers are often self-centered in relationships at home and at work. This leads to their being disliked by business associates and competitors. Their self-centered attitude causes them to treat others like objects to be used rather than as valued employees.
- Fraud-prone managers are often highly emotional and vain. They are also careless with the facts, bragging and boasting of personal achievements while ignoring others' contributions. Opposing views are treated with hostility and a hurt betrayal that can ruin working relationships. This insensitivity is a function of their self-centered attitude.
- Fraud-prone managers may also be heavily involved with gambling and alcohol.
- Fraud-prone managers are also generally conspicuous consumers. Financial success and its trappings are important to their self-image. An impulsive and impatient nature make it difficult for them to wait for what they feel should be theirs.
- Fraud-prone managers often boast of the important people they know and the places they have visited.
- Fraud-prone managers commonly have extramarital relationships that contribute to the need for money. Hard workers, they may compensate their families with material things because of their hours away from home.

Typical Profile

Studies of executives involved in fraud generate a profile of a male, 35 years of age, who is married and has two children. He has been with the company about nine years and did not start the fraud until he had worked with the organization for six years. The fraud was operating in place for three to five years before it was discovered.

Fraud Trigger

The triggers that cause managers to begin frauds are varied, but some common factors are often present. Most common is an emotional trauma somewhere in the individual's life. This could involve home, work, marriage, or some other aspect.

This emotional trauma changes the person's behavior pattern and is generally noticed by his coworkers. The manager may take charge of a single client or task that he jealously guards as he continues the fraud.

The change to heavy drinking, gambling, expensive social life, or extramarital sexual

activity may be covered by lies and deceptions. These lies are often believed because of the long tenure of the individual before the fraud actually begins.

Whether the fraud stemmed from need or greed, the telltale signs are present long before its discovery. Alert management and an audit team that looks past the numbers may help minimize the organization's losses.