FRAUD

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Entry in the SAGE Encylopedia of Criminal Psychology

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Fraud may simply be defined as “violation of trust.” At its core, it is a human act intended to deceive another in such a way that the victim suffers a loss, and the perpetrator makes an unlawful gain. Fraud is perhaps best defined as: “All multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprise, trick, cunning, or dissembling, and any unfair way which another is cheated” (Black’s Law Dictionary). As compact as Black’s definition is, “fraud” still encompasses a huge range of human activity. The word itself is malleable. Standing alone, “fraud” is a noun, as in “A fraud was committed.” If we add “de” in front of it to form “defraud,” it comes a verb, as in “Sam defrauded Bill.” If we add “ulent” to the end of it, it becomes the adjective “fraudulent,” as in “Dan engaged in fraudulent behavior.” A multi-headed hydra in its diverse manifestations, even the word “fraud” appears capable of morphing itself as different parts of speech to suit the occasion.

Fraud is theft, but not by force. This is a critical point to understand about the nature of fraud. There is no robbery at gunpoint, no direct threat of harm or injury to the victim, or even any use of physical force. Rather, the victim, in most instances, willingly gives away money or something of value because of the lies and misrepresentation and the inherent betrayal of trust that characterizes fraud. Thus, fraud is a deception, and such deception is natural and could be covert or overt. Many living creatures, from the viceroy butterfly, which looks like the bitter and mildly poisonous monarch butterfly, to the king snake, which closely mirrors the very deadly coral snake, to the cuckoo, which brazenly lays her egg in a crow’s nest and abdicates maternal responsibility, deception is adaptive and thriving in nature. The first instance of fraud may well have occurred when two cavemen engaged in barter—exchange of goods—with one giving up a club in exchange for some berries. To the extent the gleam in the eyes of each caveman was indicative in one instance of the slight crack in the club, and in the second instance, that the less-than-fresh, two-day old berries were about to spoil, it pointed to a “mutually” fraudulent transaction! Also consider that in Genesis, Chapter 27, of *The Bible*, there is a narrative of how Jacob impersonates his elder brother, Esau, to trick his blind father into giving Jacob the inheritance that is Esau’s birthright. This is a classic trust crime relating to fraudulent usurping of a sibling’s property rights.

“White-collar crime” refers to a financially motivated nonviolent crime committed by business and government professionals. Within criminology, it was originally described as "a crime committed by a person of respectability and high social status in the course of his occupation" (Sutherland). Typical white-collar crimes include (financial reporting) fraud, asset misappropriation, false advertising, labor relations, bribery, conflicts of interest, Ponzi schemes, insider trading, cybercrime, copyright infringement, money laundering, price-fixing and other anti-trust violations, identity theft and forgery. A combination of two criteria is generally deemed necessary to define crime, viz., legal description of an act as socially injurious, and legal provision of a penalty for the act.

The general theory of crime postulates that criminal and noncriminal behavior result from the pursuit of self-interest and that "human behavior is premised on individual calculations of relative costs and benefits of action." (Gottfredson & Hirschi). ***See also SAGE Encyclopedia entry under Economics of Crime.*** However, the "general theory of crime" has been criticized as perhaps not being so general after all, because it certainly would not encompass criminogenic organizations, and that organizational offending perhaps does need a separate classification. Consider also that we have at least one federal law in the U.S., the Racketeer Influenced Corrupt Organizations (RICO) Act of 1970. RICO provides for extended criminal penalties and a civil cause of action for acts performed as part of an ongoing criminal organization, particularly gambling organizations, criminogenic enterprises, and criminal syndicates. The RICO Act focuses specifically on racketeering, and it allows the leaders of a syndicate to be tried for the crimes which they ordered others to do or assisted them in doing. ***See also SAGE Encyclopedia entry under Corporate Crime; Criminal Organizations and Networks; Organized Crime Activities; Organized Crime Typologies.***

Psychologists and criminologists believe that fraud, like any other crime, can best be explained by three factors: a supply of motivated offenders, the availability of suitable targets, and the absence of capable guardians. Recently, the A-B-C taxonomy, or the "bad apple, bad bushel, and bad crop" theory has been proposed as part of the emerging discipline of behavioral forensics (Ramamoorti et al.) Behavioral forensics, a growing and potentially expansive field, asserts that behind every fraud is the central, inexorable fact: there are one or more people behind it. We cannot be content asking the "how" question focusing on the instruments of fraud, rather we need to be asking the "why" question, or what were the human motivations that caused otherwise good people to do bad things? What makes corporate executives turn to the dark side? Going forward, we need to consider the human factor seriously in the study of the phenomenon of fraud globally. In this connection ***please also see the SAGE encyclopedia entry under Behavioral Theory of Crime; Psychology of Criminal Conduct; Social Bonds Theory of Crime; Social Learning Theory of Crime.***

The A.B.C. (apple, bushel, crop) theory posits moving from the individual to a colluding group to an entire culture or environmental factor when considering fraud. A.B.C. theory anticipates the need for a multilevel analysis of a phenomenon as complex as fraud. There is also a clear expectation that different units of analysis corresponding to the level of fraud perpetration (i.e., apple, bushel, and crop) may be called for. Under the A.B.C. typology, an individual acting alone would be characterized as a bad apple. When there are accomplices and thus collusion is involved, it is a case of a bad bushel. When the organization's leaders engage in corrupt behavior, however, and the whole culture is toxic, we have a case of a bad crop. The bad crop syndrome can even afflict an entire industry, as we have recently seen in the case of the LIBOR (London Interbank Offered Rate) rigging scandal or several insider trading rings.

The major elements of "differential association theory" can be summarized as follows (Sutherland and Cressey):

- Criminal behavior is learned; it's not inherited, and the person who isn't already trained in crime doesn't invent criminal behavior.
- Criminal behavior is learned through interaction with other people through the processes of verbal communication and example.
- The principle learning of criminal behavior occurs with intimate personal groups.
- The learning of crime includes learning the techniques of committing the crime and the motives, drives, rationalizations and attitudes that accompany it.
- A person becomes delinquent because of an excess of definitions (or personal reactions) favorable to the violation of the law.

See also SAGE Encyclopedia entry under Differential Association Theory; Sociological Theories of Crime; Strain Theory of Crime.

The fraud problem has been described as a "violation of a position of financial trust" and for embezzlement to occur, there must be: 1) a non-sharable problem, 2) an opportunity for trust violation and 3) a set of rationalizations that define the behavior as appropriate in a given situation. (Cressey) He wrote that none of these elements alone would be sufficient to result in embezzlement; instead, all three elements must be present. Given Donald Cressey's seminal role in creating the fraud triangle, sometimes it is referred to as the Cressey fraud triangle, with the three vertices of opportunity, pressure/incentive, and rationalization.

At least two types of white-collar criminals have been conjectured in the literature, the "accidental" or "situational" fraudsters, and the "predators." These have also been referred to as the "benign" and the "malignant" bad apple respectively. Others have urged that additional research be conducted about predators and accidental (situational) fraudsters to better define these notions and to develop meaningful criminological profiles. Treating all white-collar criminals as one undifferentiated, homogenous group appears suspect and perhaps unwarranted. Examining theory from other disciplines such as psychology, psychiatry, sociology, anthropology, and criminology, can aid in efforts to understand and prevent fraud. It can greatly help with developing criminological profiles in the context of white collar crime. ***See also SAGE encyclopedia entry under Criminal Profiling; Personality Pathology; Psychoanalytic Theory of Crime; Criminal Risk Assessment.***

Theory and research on the psychology of white-collar offenders has historically been underdeveloped. A certain negative synergy develops when criminal thinking traits combine with the psychological traits of narcissism and psychopathy to create risk factors for white-collar offending. The concept of “the dark triad of human personalities,” viz., narcissists, psychopaths, and Machiavellians (cf. Paulhus and Williams), has been utilized to challenge the completeness/effectiveness of the Cressey “fraud triangle” in that fraudster personality lies beyond its scope. Indeed, it appears rather important to consider the personalities of those who are more likely to commit fraud, particularly if they seem to have little or no conscience, lack empathy for others, and exhibit no contrition even when they are culpable as fraud perpetrators. For dark triad personalities, only the lack of opportunity prevents them from lying, making false representations, and emotionally manipulating people to commit fraud; in other words, if the opportunity exists, these personality types are very likely to perpetrate fraud. This line or argument echoes an earlier observation that for those with a non-existent or underdeveloped conscience (superego, in Freudian terminology), “their acts of dishonesty do not create feelings of guilt or remorse, they can be expected to commit fraud whenever there is an opportunity to do so with little chance of being caught.” (Albrecht et al.) To the extent dark triad personalities typically fall under the “anti-social personality disorder” classification in DSM V of the American Psychiatric Association, ***it may be helpful to refer to numerous pertinent SAGE Encyclopedia entries: Antisocial Personality Disorder in Incarcerated Offenders, Treatment of; Corporate Psychopaths; Criminal Attitudes; Criminal Justice Correlates of Psychopathy; Psychopathy; Historical Antecedents of Psychopathy; Neurobiological Models of Psychopathy; Psychopathic Offenders: Current State of the Research; Psychopathy; Psychopathy Versus Antisocial Personality Disorder; Psychopathy, Etiology of.***

For almost 20 years now, a (global), non-scientific survey of Certified Fraud Examiners (CFEs) has been conducted every two years about the incidence, types, costs, and other characteristics of “occupational fraud and abuse.” Occupational fraud is defined as “the use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.” Occupational frauds are those in which an employee, manager, officer, or owner of an organization commits fraud to the detriment of that organization. The three major types of occupational fraud depicted on “The Fraud Tree” (see next page after text) are: Corruption, Asset Misappropriation, and Fraudulent Statements. ***See also SAGE Encyclopedia entries under Employee Fraud; Occupational and Corporate Crime; Occupational and Corporate Crime: Prevalence and Statistics; Occupational Crime, Categories of.***

Several findings regarding the characteristics of offenders, length of fraud, type of fraud, source or root cause of fraud, how the fraud was detected, the demographics of perpetrators, the size of businesses who were victimized, etc. are reported. The longitudinal consistency of the survey findings over two decades is noteworthy because “it is impossible to know exactly how much fraud goes undetected or unreported, and even calculations based solely on known fraud cases are likely to be underestimated, as many victims downplay or miscalculate the amount of damage" (Association of Certified Fraud Examiners). The latest *Report to the Nations* came out in 2016, and estimates the worldwide cost of fraud to be around $3.7 trillion annually with organizations losing 5% of their revenues to fraud annually. ***See also SAGE Encyclopedia entry under Economics of Crime.***

Interestingly, fraud is still predominantly detected through (anonymous) tips and complaints, accounting for 39.1% of the cases reported in the 2016 ACFE study. Organizations of different sizes tend to have different fraud risks. Corruption was more prevalent in larger organizations, while check tampering, skimming, payroll, and cash larceny schemes were twice as common in small organizations as in larger organizations.

Given the rising incidence of fraud globally, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) released the Fraud Risk Management Guide in September 2016. The COSO Fraud Risk Management Guide uses the following definition: "Fraud is any intentional act or omission designed to deceive others resulting in the victim suffering a loss and/or the perpetrator achieving a gain." Given the key emphasis on intent, ***it may be useful to refer to the SAGE Encyclopedia entry under Mens Rea ("guilty mind").***

Principle #8 of the COSO Internal Control Integrated Framework of 2013 states, "The organization considers the potential for fraud in assessing risks to the achievement of objectives." Consistent with this principle, the COSO Fraud Risk Management Guide lays out five corresponding principles, viz., fraud risk governance, fraud risk assessment, fraud control activity, fraud investigation and corrective action, and fraud risk management monitoring activities. Collectively, these principles offer best practice guidance for organizations in fraud risk assessment and management.

In the United States, sentences for white-collar crimes may include a combination of imprisonment, fines, restitution, community service, disgorgement or compensation clawbacks, probation, or other alternative punishment.

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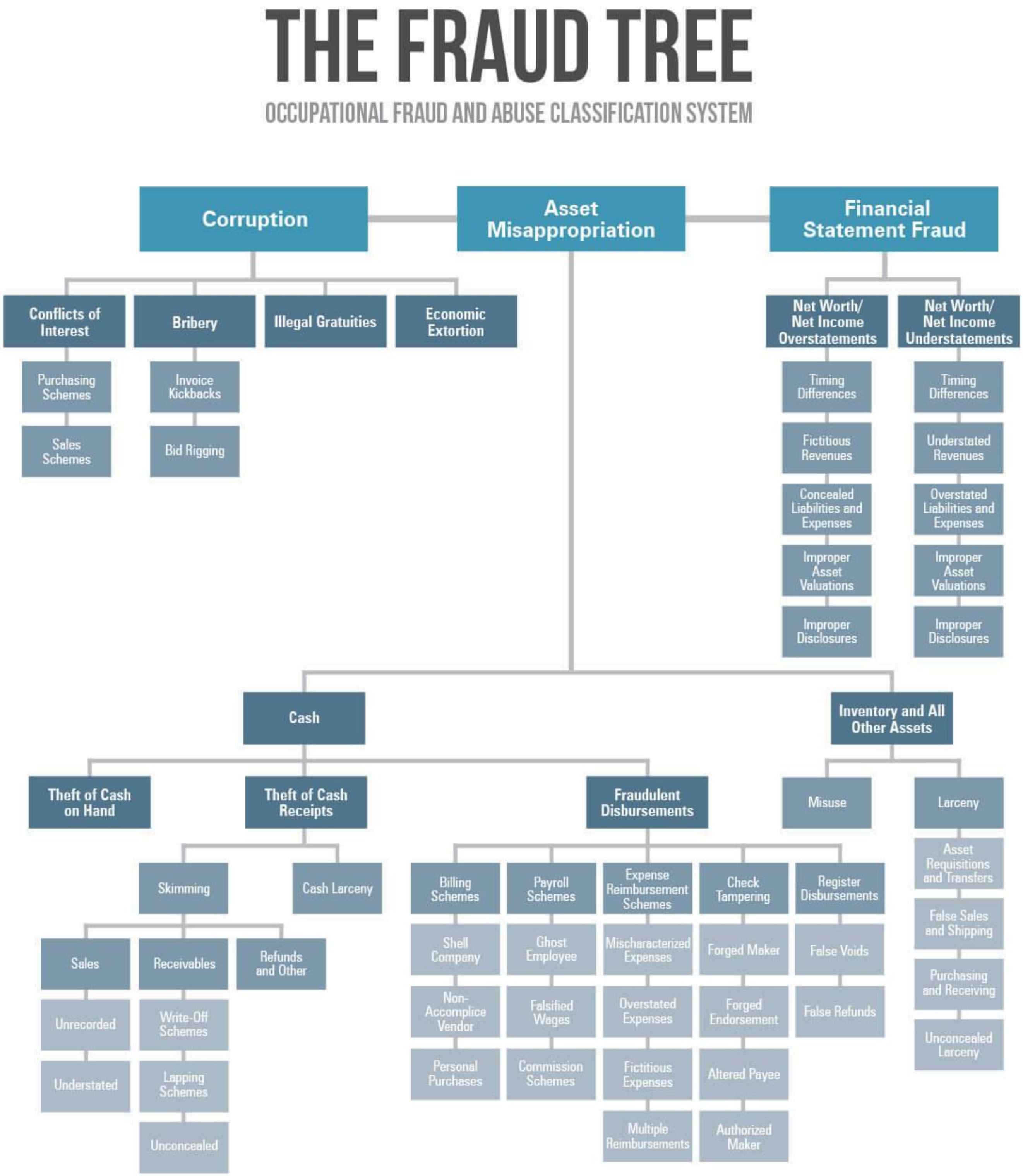

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