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A.B.C.'S OF BEHAVIORAL FORENSICS

APPLYING PSYCHOLOGY TO **FINANCIAL
FRAUD PREVENTION AND DETECTION**

WILEY

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Praise for
*The A.B.C.'s of Behavioral Forensics:
Applying Psychology to Financial Fraud
Prevention and Detection*

“Fraud is an important part of enterprise risk. Although it falls in the finance and accounting function it is also a people issue. The authors have taken an important step forward in helping organizations by examining issues of relationships, emotions, narcissism, and larger group and organizational dynamics that will help leaders understand and deter fraud.”

—Harry M. Jansen Kraemer
Former CEO, Baxter International and
Professor of Leadership, Kellogg School of
Management, Northwestern University

“I have known Sri for 25 years and have found him to be one of the most eclectic thinkers I have ever known. He draws his insights not only from his formal accounting and psychology education but also from a wide range of philosophic sources not often read by business students and practitioners. He has given considerable thought to a wide range of topics, including ethics, governance, and auditing. In *A.B.C.'s of Behavioral Forensics*, you will find that he and his coauthors have been adept at bringing a broad view of their diverse interests to bear on the emerging discipline of behavioral and financial forensics. You will, upon reflection, note that they have not only addressed the narrower issues of forensics but also the broader issues of philosophy, ethics, and governance. This book can be read usefully at the surface level or, given more time and thought, a reader will be led to think more deeply about how society is

impacted when otherwise good people, particularly our leaders, violate their trust. Reading this book will be a good and profitable use of your time.”

—Andrew D. Bailey, Jr., PhD, CPA, CMA
Professor of Accounting Emeritus,
University of Illinois at Urbana-Champaign,
and former Deputy Chief Accountant,
U.S. Securities & Exchange Commission

“Daven, Sri, Joe, and Kelly have done a great job of helping us understand the importance of recognizing the very personal and individual human factors that can drive someone to fraudulent behavior. They also provide insights and guidelines that can help us recognize the potential fraudster.”

—Peter Pesce
Partner Emeritus, A.T. Kearney

“This excellent work forces us beyond any easy and dangerously narrow examination of fraud to the understanding of complex motivations that set in motion results that can be startling in their financial consequence. With recognizable and pertinent case studies, these exceptionally qualified authors demonstrate how certain human behavioral factors precede and enable a fraud—be it carried out by one person, a colluding group, or by suggestions from leadership. What the authors then do is thoroughly describe these defining emotions, the essential relationship between the fraud perpetrator and the victim, and what can lead an individual to reverse his or her ‘honesty course.’ With certain knowledge that fraud is theft, even though it is not carried out by force, and struggling with the question of why do people cross the line, the reader is moved to an understandable and professionally

sophisticated discussion of the factors attributable to the human mind followed by the delivery of methods for identifying early-stage fraud and for mitigating its consequences. This critically important and highly readable book is essential for anyone responsible for or caring about businesses and organizations today, or for anyone desiring deeper insight into certain explanations for the considerable fraud that surrounds our daily lives.”

—Jameson A. Baxter
Chair, Putnam Funds

“Leaders with integrity attempt to define and determine the personality characteristics of truth and honesty in themselves and others. However, it's a search often fraught with uncertainty. *The A.B.C.'s of Behavioral Forensics* will help you to be aware of the signals of devious behavior. Most important, it will increase your sensitivity to the importance of the issue. Corrupt activities are often allowed to continue due to our own indifference.”

—Duane R. Kullberg
Former CEO, Arthur Andersen & Co.

“As a fraudster, I succeeded for almost two decades because I understood how to exploit the psychological and emotional weaknesses of my victims. This book teaches auditors and antifraud professionals about fraud psychology, the “soft underbelly of fraud”—the emotional manipulation, big and small lies, and other behavioral cues that fraudsters employ to successfully execute their crimes. I call it the art of spinning, and the authors have described it as the predator-prey dance. Without such an understanding of the behavioral dynamics of fraud, victims will always be doomed to lose (lots of money) and fraudsters will always have the upper hand.”

—Sam E. Antar
Former Crazy Eddie CFO, former CPA,
and a convicted felon

“This is a brilliant idea for a book on the topic of fraud, which isn't always obvious to those being victimized. Understanding the psychological elements of how we rationalize behaviors associated with fraud enables our understanding of why even those whom we trust the most are capable of committing fraud. The authors have done a magnificent job of simply explaining the psychological and sociological characteristics of a fraudster. If you work with money, this book is a must read.”

—Russ Cancilla
Vice President & Chief Security Officer (retired), Baker
Hughes

“Our profession has a rich body of literature on the subject of fraud. Unfortunately, the literature has had a significant gap in understanding all elements of fraud and its motivation and execution. This book identifies and closes this gap by focusing on what is perhaps the most important key: psychology.”

—W. Ken Harmon, DBA
Provost and Vice President for Academic Affairs,
Professor of Accounting, Kennesaw State University

“I'm often asked, ‘What is the difference between an accountant and a forensic accountant?’ and ‘What distinguishes a forensic accountant from a good forensic accountant?’ I've pondered these questions for years, but the answer to both questions invariably circles back to profiling the white-collar criminal. While all accountants focus on numbers (the quantitative), the forensic

accountant must be in tune with the qualitative. In other words, to be a successful forensic accountant or fraud investigator, it is absolutely essential to understand the psychological mindset of the fraudster and the intangible attributes that cannot be captured on a balance sheet or income statement.

“In *A.B.C.'s of Behavioral Forensics*, Dr. Ramamoorti and Dr. Morrison, along with Joe Koletar and Kelly Pope, introduce us to several intriguing characters—all of the characters are real-life fraudsters—and take us on a journey through the concepts of psychology and psychiatry. Building and expanding on Cressey's fraud triangle, the authors do a wonderful job of weaving the clinical aspects of 'mind science' into a practical application of criminology, on a personal and attention-keeping level. With easy to understand language along the way—and literally providing the A.B.C.'s and building blocks for profiling corruption and white-collar crime—this book is a must read, whether fraud examination is just an interest for you, you're new to the profession, or you're a seasoned expert.”

—David Sawyer, CPA, CFF, CITP
Partner and Practice Leader,
Forensic Services, Frazier & Deeter LLC,
and four-time president of the
Georgia chapter of the Association
of Certified Fraud Examiners

“This book is an important addition to the literature on behavioral forensics. At a time when corporate governance and risk mitigation are at the top of the agenda for governments and private enterprises in all sectors, the authors have skillfully dissected several ideas at the intersection of accounting and psychology. Of particular

value are the several topical examples and anecdotes that elucidate the concepts discussed.”

—Ramesh Venkat
Chief Executive Officer, Reliance Private Equity, India

“Brilliant! With the depth, integrity, and passion we have come to expect from Sri, this important work by an eminently qualified team of authors teaches us about ourselves—why we, as humans, do what we do. Anyone interested in understanding the contributing factors that affect the potential for fraud will benefit from the compelling insights contained herein and enjoy Sri's instructive storytelling. G. R. Moorti was certainly prescient!”

—Michael J. Powell
Intellectual Property Attorney and Registered
Mediator, Baker Donelson

“Excellent book that is immensely thorough and a must read for accountants, auditors, investigators, senior management, and audit committee members. This book is very well organized and does a superb job of blending the key theoretical/behavioral aspects of forensics with very good practical examples. It is eminently readable and right on the mark.”

—Alan N. Siegfried, MBA, CPA, CIA
Former Auditor General, Inter-American Development Bank

“I really enjoyed reading the book. It presents an interesting insight into the deep recesses of mind. A difficult subject has been presented in simple terms.”

—V. Varadarajan
Director, Compliance and Money
Laundering Reporting Officer (MLRO),
Kotak Mahindra (UK) Limited

“This study examines the psychological fabric of fraud, which has reached epidemic proportions in contemporary society. It is particularly illuminating when it examines the relationship between the destructive charismatic corporate executive and his or her ever-gullible followers.”

—Jerrold Post, MD
Professor of Psychiatry, Political Psychology, and
International Affairs, Director of the Political
Psychology program, Elliott School
of International Affairs, George Washington University

“‘This doesn't make any sense to me.’ Or ‘Something's not right here.’ These have frequently been the words of a junior auditor, compliance officer, or junior staff employee to me that are the beginning of a long, in-depth investigation of fraud. Often, they have not been expressed by the ‘smartest guy in the room,’ nor have they been spoken by an experienced management executive. Yet they have a ‘gut feeling,’ a ‘women's intuition,’ or a keen awareness that something is simply *wrong*. At long last, there is a book about the psychology of fraud that will guide us in the understanding of why it is that some people whom we ‘like’ and, even more important, trust, commit frauds. The text also guides us toward the next steps forward. *A.B.C.'s of Behavioral Forensics* is an essential read for anyone working in the field of accounting, auditing, compliance, and operations management.”

Marjorie A. Maguire-Krupp, CPA, CFA, CIA
Former Vice President, Enterprise Risk Management,

Compliance & Audit, International Consumer
Finance Division, AIG

“I wish I could have read this book when I was in the early stage of my accounting career. People at the average age of a fraudster, between 45 and 55 years, had many years of professional experience compared to me. I looked up to them, knowing little about their vulnerability to committing or condoning fraud during mid-life transition and even less about the psychology and interpersonal dynamics at play.”

Brigitte W. Muehlmann, PhD, CPA
Associate Professor, Sawyer Business School, Suffolk
University

“Understanding why fraud happens is as important as understanding what happened. *A.B.C.'s of Behavioral Forensics* offers important insight into the mind of the white-collar criminal. It's good reading for accounting professionals, journalists, lawyers, psychiatrists, and laypeople alike.”

Bethany McLean
Coauthor, *All the Devils Are Here* and *The Smartest
Guys in the Room: The Amazing Rise and
Scandalous Fall of Enron*

A.B.C.'s of Behavioral Forensics

**APPLYING PSYCHOLOGY TO FINANCIAL FRAUD
PREVENTION AND DETECTION**

**Sridhar Ramamoorti
David E. Morrison III
Joseph W. Koletar
Kelly R. Pope**

WILEY

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For my father, G. R. Moorti (1927-2011), who was persuaded that I would be the psychologist among the accountants and the accountant among the psychologists

For Dr. Gil Geis (1925-2012), reputed University of California-Irvine criminologist and president of the Association of Certified Fraud Examiners (1992-2002) for his mentoring and encouragement

With apologies to the Reverend Charles Lutwidge
Dodgson, aka Lewis Carroll of *Alice in Wonderland* fame,
“The time has come,” the Walrus said,
“To talk of many a thing:
Of shoes and ships and sealing-wax
Of psychology and accounting!”

*Imagine how hard physics would be if particles could
think!*

—Murray Gell-Man, Physics Nobel Laureate

Foreword

In more than a quarter century as a forensic accountant, I have encountered many corporate executives, managers, and staff who allegedly committed fraud. Every one of these “characters” has been fascinating and somewhat mysterious, like the protagonist in a whodunit. Each person apparently decided to falsify records or give untruthful or misleading answers to questions. Nevertheless, in every case, an objective analysis suggested to me it was inevitable that they would, in time, get caught. Their actions conflicted with basic common sense, but these apparently smart businesspeople went ahead anyway. Why? That is the riddle that hooked me on a career fighting fraud.

Data analytics now offers powerful tools and techniques to help deter or more quickly detect potential wrongdoing, reaching into huge populations of data and identifying anomalies that merit further investigation. Behavioral forensics has similar potential to help businesspeople identify anomalous behaviors that may indicate a heightened risk of fraud or other wrongdoing. In terms of widespread practical implementation, behavioral forensics may be some years behind data analytics, but its potential is just as exciting.

The authors of *The A.B.C.'s of Behavioral Forensics* have both academic credentials and extensive business experience. This helps to make their material more accessible and more practical than a textbook or academic paper. This book will likely introduce you to new terms and to ways of thinking that may seem quite alien at first, but, trust me, you will warm up to it. Confirming much of what you intuitively know about people and human nature, your patience will be rewarded with valuable insights and “Aha!”

moments as you recognize and understand better the behavior of a former customer or supplier, boss or colleague. Medical diagnosis should be left to the professionals, but understanding behavioral forensics could help you to more effectively prevent, deter, and detect fraud.

Fraud is a human act and both influences and is influenced by the prevailing culture and society—the twin conceptual towers on which the field of anthropology is founded. I am enthusiastic about the prospects for behavioral forensics in the coming years as the societal and cultural aspects of fraud become a greater focus of research in economic anthropology. This book is a great introduction to a topic that accountants, auditors, compliance officers, lawyers, fraud examiners, financial managers, and other business professionals could benefit from understanding more as we all work to help combat the costly global scourge of fraud.

Toby J. F. Bishop
Director, Deloitte Forensic Center
Deloitte Financial Advisory Services LLP
and former president and CEO
Association of Certified Fraud Examiners

Preface: A Serendipitous Journey to This Book

The man who knows how will always have a job. The man who also knows why will always be his boss.

—Ralph Waldo Emerson

Advances are made by answering questions. Discoveries are made by questioning answers.

—Bernard Haisch Director, Calphysics Institute

Fraud, especially financial fraud, has become a global concern for governments and societies all over the world, and it shows no sign of abating. Instead, we remain largely helpless, watching what seems to be a growth industry. The United States has no monopoly on it, either. To try to explain this complex phenomenon is to set a grand goal, yet part of what our team set out to do was to follow Bernard Haisch's insight quoted in the epigraph to the preface and question answers. At the core is the answer that all fraud is greed and that the fraud of one mind is the same as the fraud of many minds.

This preface will have an autobiographical flavor to better describe how it is that such a team of authors came together to write this book—there's a story that runs through it. Genesis stories are important, as American philosopher George Santayana emphasized, for you can't know where you're going until you know where you've been.

Autobiographical narratives can be interesting, but mine (Sri speaking) is unusual because the luck element seems so compelling—including the serendipity in meeting Dr. David “ Daven ” E. Morrison III, a psychiatrist by training, who knows so many of my ex-Arthur Andersen colleagues

and has greatly influenced my thinking over the years. As coauthor, he has made significant contributions to this book.

After training to be a chartered accountant from India and working for Ernst & Young in the Middle East, I came to the United States as a student in the Ph.D. program in accounting and management information systems at The Ohio State University in Columbus. After four years in the Ph.D. program, as luck would have it, and because my second Ph.D. advisor was hospitalized and couldn't supervise my dissertation, I made the momentous decision—really by accident—to switch my disciplinary focus to quantitative psychology.

In transferring to psychology, I was fully supported by my first advisor, Professor Andrew D. Bailey Jr., who had since moved on to the University of Arizona. When I earned my Ph.D. in psychology in 1995, I simultaneously became the first—to the best of my knowledge—certified *psychological* accountant in the United States. I wasn't planning to be the “shrink” among the CPAs, nor am I “certifiable,” but I do know something about how the human mind works.

My foray into the behavioral sciences opened my eyes. It did for me what Marcel Proust described in this profound observation: “The voyage of discovery is not in seeking new landscapes but in having new eyes.” My “eyes” as a professional accountant were focused on the *how* questions: how the books are “cooked,” how the evidence is concealed, and how trust is violated, all from investigations after the fact. It was not until the first few years of this century, watching the prestigious firm of Arthur Andersen collapse while I was employed there, that I came to realize the significance of understanding the *why* question.

My understandings were cemented through interactions with professional colleagues at Ernst & Young's forensic and investigative practice with former FBI Special Agent Dr. Joseph Koletar (a coauthor of this book); David Stulb, now

global leader for Ernst & Young's Fraud Investigation and Dispute Services (FIDS) practice; and Michael Emmert, then the E&Y FIDS managing partner. With David Stulb offering commentary, I was a member of the in-house Ernst & Young faculty that conducted training seminars on “Fraud Risk: Assessment and Response” to more than 1,000 U.S. audit partners and principals across the country. By this time, I was also persuaded that future generations of accountants should take relevant psychology courses—not by accident like me, but by design.

Again as luck would have it, through Madhavan Nayar, the cofounder of the Information Integrity Coalition (IIC), I met Daven Morrison at an IIC meeting. I later served with him on the board of the organization and subsequently became president. Daven and I immediately connected, especially when I found out that his father, Dr. David Morrison, a distinguished psychiatrist, had had a consulting relationship with Arthur Andersen in the 1970s and 1980s. In my quest, I simply couldn't have met a better person than Daven to help me continue thinking seriously about the *why* question. Of course, I appreciate the reciprocal causation—the fact that the *why* and *how* questions may frequently be connected.

Bringing Joseph Koletar into our conversations allowed us to submit a proposal to the newly founded Institute for Fraud Prevention (IFP), a joint initiative of the American Institute of Certified Public Accountants and the Association of Certified Fraud Examiners (ACFE). Our topic was “Bringing Freud to Fraud: Understanding the Mind of the White Collar Criminal.” It is in this IFP-funded 2009 research paper that we laid out the core A.B.C. ideas: the bad apple, the bad bushel, and the bad crop. Numerous “psychology of fraud” presentations internationally confirmed that the A.B.C. characterization resonated with many in the antifraud professional community.

At his alma mater, West Virginia University, Ernst & Young's Chuck Owens, also a former FBI agent, introduced me to Professors Richard Riley and Timothy Pearson, both active with IFP. They got me to write the article on the psychology and sociology of fraud that appears as an appendix in this book.

For some time, Toby Bishop from Deloitte and I served as fellow IFP board members. Toby and I worked together at Arthur Andersen. Brad Preber of Grant Thornton is an ex-Andersen colleague as well. As luck would have it (the third time now), these valued, talented, and seasoned professional colleagues from whom I have learned so much graciously agreed to write the foreword and the afterword, respectively, to this book.

It is a motley crew that constitutes the book's authoring team: an accountant, psychologist, former accounting-firm partner, and now professor; an organizational psychiatrist who has consulted with many C-suite executives; a veteran FBI special agent; and an accounting professor who has done a series of interviews with convicted white-collar felons. Indeed, I am convinced that only when people with different backgrounds apply their minds to answering hard questions will we have an opportunity for breakthrough ideas to surface. But this is also a point of view firmly held by my coauthor Daven Morrison. He will take the baton from me at this point and conclude this preface.

• • •

Research emphasis on fraud prevention and detection entered my (Daven speaking) world by way of Sri, who invited me to the renaissance of the IFP. This was a delightful meeting of inquiring minds: ACFE founder and chairman Joe Wells; Tim Pearson; Dick Riley; John Warren; and Mary-Jo Kranacher, editor of *CPA Journal*; and others. They found my psychiatry background surprisingly relevant

to their efforts in gaining a better understanding of the criminal mind.

As Sri noted earlier, we hit upon the A.B.C. configuration in work done for the IFP by colliding our ideas the way the Fermi lab smashes atoms, fully cognizant there were so many answers to be questioned. Personally intrigued by questions about tone at the top, the history of Andersen's origins and its downfall, and the parallel and tragic story of Continental Bank in Chicago, I was hooked.

The ideas were new, but they brought back memories of my training in psychiatry. I was deeply familiar with the many ways people deceive one another. At times, early in my training, my colleagues and I felt like mercenary soldiers standing guard against malingerers. We knew—or least thought we did—who was really ill and who was just looking for food and shelter (or what was called “three hots and a cot”). As an intern, during my very first Veterans Administration rotation, I had the good fortune of having Phillip Resnick, M.D., as my supervisor. He taught me a fundamental truth about the dance between people caught up in deception and deception detection: The only way to truly know if someone is malingering is if you catch the person in the act or if he or she confesses and tells you.

Despite all the technological advances, this fundamental tenet remains true today, more than 20 years later.

Before and after my medical education, I worked with David Morrison, my father. He has always had a medical mind-set underpinning his consulting practice. Recruited to Chicago to work with Continental Bank, he consulted with Arthur Andersen as well as Amoco and other organizations. The following principles from medicine remain at the core of our shared approach:

- Make the right diagnosis through listening and quality assessment.

- Pursue primary prevention (one can do more good avoiding problems than dealing with them after they manifest).
- Treat the person; don't force-fit the theory backward.

My interests in completing training and joining my father's consulting practice full-time allowed me to find a niche on the team. This niche was related to the “derailing” executive: the executive who had to either change his or her performance or leave. Deception, including large doses of self-deception, and half-truths are common in this arena. Challenges of performance feedback processes and methods were also exposed like a receding tide. Working with derailing executives helped me understand the power of emotion and the importance of having a language and theory that would help others see what I saw with great clarity. These dynamics must apply to fraud, I surmised. And this experience is what I brought to IFP.

Although Joe and Sri generally agreed with my intuitions, it helped me greatly to see and hear the emotions and motivations we had suspected in the interviews of felons conducted and filmed by coauthor Kelly Pope. Being able to see shame, hear about how and why real people chose to commit fraud, and discuss it all with a professional colleague like Dr. Pope was a wonderful opportunity.

Perhaps the most personal tie Sri and I have is to Arthur Andersen. However, we also have a behavioral science connection—after all, the disciplines of psychiatry and psychology are close cousins. If not for Enron, the dynamics around that organization, and its relationship to Andersen, many of us would have had distinctly different career paths. In my efforts to understand what happened, I talked with journalist Bethany McLean, who broke the Enron story. On the question of why C-suite executives aren't more curious about what the implications of Enron are for their organizations, she noted, “There is virtually no concern for

fraud. They don't worry about it because they don't think it could ever happen in their company.” Yet the odds are undoubtedly that it will, and continued self-deception only guarantees that it won't be stopped until it is too late. Humility and the ability to understand fraud risk and consider the potential for fraud will be necessary for future leaders.

There but for the grace . . .

For all of us on the team, we really want to understand the human being who commits fraud, the ultimate domain proper for the nascent field of behavioral forensics.

Acknowledgments

Any book is hardly the work of a single author. This book, involving a multidisciplinary team of authors, has considerably benefited from the detailed reviews and comments of several distinguished practitioners and academics. Indeed, it is their encouragement about topics that are quite distant from the everyday concerns of (forensic) accountants, auditors, and business leaders that kept us focused and going.

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