Corporate fraud & corruption

February 2015 Issue

February 2015 | SPECIAL REPORT: CORPORATE FRAUD & CORRUPTION

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Despite the robust anti-corruption action being taken by global authorities, corporate fraud and corruption remain an increasingly pervasive worldwide threat. The perpetrators of fraud and corruption now target an ever-widening playing field due to technological advancements and the relentless march of globalisation. Companies must be on their guard, as ignoring potential threats could lead to major disruption to their business processes, an erosion of employee integrity and a stained corporate identity, not to mention fines and other penalties arising from illegal conduct.

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FORUM: Anti-corruption and bribery developments in Latin America

CONTRIBUTORS

Bell Gully

COMAD, S.C.

Cooley LLP

Corrs Chambers Westgarth

Dolus Counter-Fraud Advisors LLC

Freshfields Bruckhaus Deringer

Husch Blackwell LLP

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FW moderates a discussion on anti-corruption and bribery developments in Latin America between Roberto Hernández-García at **COMAD, S.C.**, Mauricio Almar at Halliburton, Isabel Franco at **KLA-Koury Lopes Advogados**, Ivan E. Velez at **KPMG LLP**, and Patrick Henz at **Primetals Technologies**.

Global profiles of the fraudster

KPMG LLP Having conducted numerous fraud investigations we are amazed at how often we hear "John? John did that? He was the last person I would have suspected." Regrettably that is quite often the point. Fraud investigation specialists have long debated whether...

With a smile not a gun: understanding human factors in fraud forecasting

Dolus Counter-Fraud Advisors LLC At her sentencing hearing in Manhattan, Annette Bongiorno, Bernard Madoff's former secretary, stood weeping before Federal Judge Laura Taylor Swain. "I never figured out the truth," she said. "I did what I was told. I didn't know what was going on." Handing down a prison...

The long-arm of US anti-bribery and corruption laws – are you subject to US jurisdiction?

Corrs Chambers Westgarth It was widely announced on 22 December 2014 that French power and transportation conglomerate Alstom SA had agreed to plead guilty to violating the US Foreign Corrupt Practices Act (FCPA). In addition, four corporate executives of Alstom have been charged...

Implications of heightened judicial supervision of corporate criminal settlements

Sullivan & Cromwell LLP Corporations facing law enforcement investigations in the US increasingly have found that the successful negotiation of a settlement agreement with the prosecutors is no longer the final step to achieving resolution. Rather, federal judges – whose involvement in the...

Insolvency-related fraud in Argentina

Marval, O'Farrell & Mairal In Argentina, insolvency is governed by Law No. 24,522, as amended (the Argentine Bankruptcy Law or ABL). Insolvency-related fraud in Argentina is generally related to: (i) schemes for excluding debtor's assets from the estate or affecting secured creditor's security interest...

Employees' fraud via a fly-by-night company in Russia

Freshfields Bruckhaus Deringer This article concerns ways to protect a company's interests in case of employee fraud via a fly-by-night company, which is quite typical for Russian business. Consider the following scenario: some chief employees of a company (Company) create a new company...

Bribery and corruption in New Zealand

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Bell Gully New Zealand is widely regarded as one of the least corrupt countries in the world. Notwithstanding that reputation, there is increasing evidence of corrupt conduct. We summarise here some of the potential criminal and civil consequences of engaging in such...

Fraud at the workplace – key issues affecting employers in Malaysia

Shearn Delamore & Co. There are countless fraudulent activities and corrupt practices which can take place within an organisation, from simply falsifying a medical certificate to giving potential bidders inside knowledge of proposals from others. Such activities are no longer confined nor limited to...

Q&A: Managing fraud and bribery risks in the healthcare sector

FW moderates a discussion on managing fraud and bribery risks in the healthcare sector between Wendy C. Goldstein at **Cooley LLP**, Brian G. Flood at **Husch Blackwell LLP**, Omid Yazdi at **KPMG LLP**, and Michael K. Loucks at **Skadden, Arps, Slate, Meagher & Flom LLP**.

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With a smile not a gun: understanding human factors in fraud forecasting

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BY

Alexander Stein

Dolus Counter-Fraud Advisors LLC

At her sentencing hearing in Manhattan, Annette Bongiorno, Bernard Madoff's former secretary, stood weeping before Federal Judge Laura Taylor Swain. "I never figured out the truth," she said. "I did what I was told. I didn't know what was going on." Handing down a prison term with demand to forfeit all property and money gained through her work at Madoff Securities, estimated at $16.4m, Judge Swain said Ms Bongiorno had "wilfully blinded herself" to illegal acts.

In finding Ms Bongiorno culpable as an accomplice to her boss' massive Ponzi scheme, Judge Swain invalidated contrived ignorance as an avoidance of guilt, and delivered a speck of justice to victims, though negligible economic restitution. Sadly, the world is filled with Annette Bongiornos and Bernie Madoffs. Wilful blindness is

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ubiquitous. It is a basic, vexing element of the human condition wherein we both wittingly and unthinkingly, ignore, deny, negate, misperceive, overlook and otherwise 'un-know' substantial aspects of the world and our lives in it.

This is the *sine qua non* of fraud. As mordantly put by Sam Antar, former Crazy Eddie CFO, de-licensed certified public accountant, and convicted felon, "white collar crime is a crime of persuasion. It is a crime committed with a smile rather than a gun. Many white collar criminals are likable and charming people. They use their likable personality as a tool to gain the confidence of their victims. That is why white collar criminals are called 'con men'."

Only some people become criminals, but everybody lies, deceives and evades. And as Joseph Wells, founder and chairman of the Association of Certified Fraud Examiners, sagely reminds forensic accountants the world over, "fraud is committed by people, not numbers." But as legions of nobly-intentioned CFOs, risk, compliance, and anti-fraud professionals sharpen their digital pencils and debug their algorithms trying to prevent the next big fraud, wilful blindness about fraud's central element – people – hunkers in plain sight.

Our fixation on simplistic accountings of fraudster pathology and holy motivational trinities – rationalisation, opportunity, pressure – borders on fetish, and eclipses both the actual psychological complexities of deception, persuasion and fraudulence, and the intricate psychosocial ecosystems which incubate and engender successful frauds. Two-dimensional conceptualisations of the underpinning mechanics of criminal fraudulence provide scant practical value, either after-the-fact or as a predictive tool. These typify the historically entrenched focus on fraudsters wholly in terms of psychopathology, viewing fraud as an asymmetrical bipolar event between the fraudster as dominant figure, and victims in the subordinate position. Crucially absent is conceiving the intertwining matrix of relationships involved in fraud, whether between individuals or within an institution. Stakeholders and participants exist together in a dynamic network. Fraudster and victims are entwined in a relationship of mutual, albeit deeply imbalanced, interdependency; each requires and uses the other, though obviously with vastly different intentionality and outcomes.

How can these soft elements be identified, much less usefully leveraged, solely on the basis of fact patterns, banking and accounting records, or other hard documentation? The tendencies and activities specific to each dishonest actor – important data in its own category for pre-empting, derailing or responding to a malfeasant episode – vary according to where and from whom he learned his trade, the particulars of situation and circumstance and, most pertinently, to the character, constitution and psychological reflexes of all involved parties.

Human psychology – the doings of mental function and their behavioural manifestations – is profoundly more complex and inscrutable than appears. Tidy and ostensibly rational explanations

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for the drivers of asocial deceit and malfeasant persuasion – contemptuousness, arrogant self-belief, greed, sociopathy, bald opportunism – are, on closer inspection, themselves merely a conceptual mirage, providing little more than a reassuring pseudo-sensicalness to inexplicable and dangerous dispositions and actions.

Nowhere do these issues converge more relevantly than in fraud risk forecasting. As distinguished from other facets of risk management, such as economic exposure, AML, investment performance, market fluctuations, strategic positioning, forecasting the probability of white-collar malfeasance bears closer resemblance to profiling and predicting violent criminality. Indeed, in testimony given in 2009 before the New Jersey State Assembly Republican Policy Committee as an expert witness on political corruption and white-collar crime, Mr Antar, the convicted Crazy Eddie CFO, stated that: "white collar crime is more brutal than violent crime. The actions of one or a few corrupt public officials and corrupt businessmen affect the livelihoods of thousands of people. Treat them with the same disdain with which we treat serial killers because white collar criminals are economic predators. We are serial economic predators."

Wielding guns disguised as smiles, economic predators steal value and cause serious harm. If fraud risk protocols concerning nefarious actions aspire to ascertain and harness predictive knowledge of future events, particularly those pivoting on people's hidden impulses and interests, how can we minimise variables and more accurately narrow the margins of unpredictability? What and how we can know about the private, internal intentions and machinations of malfeasant actors before they strike?

In 'The Minority Report', Philip Dick's iconic 1956 science fiction short story, all crime is summarily prevented by precogs, mutants with super-cognitive abilities enabling them to see into the future. Computers analyse and translate the precogs' raw data into reports issued to PreCrime, the enforcement unit which then tracks and apprehends identified suspects for the crime they would have committed had it not been pre-detected. The notion of an authority licensed to trespass into people's thoughts and pre-emptively foreclose their future actions is anathema to human free agency. In the civilised world, the thought police are only the stuff of dystopic sci-fi.

Yet the surface appeal is clear, an apparent solution to the common problem of 20/20 hindsight and near blind foresight. Of course, it is a chimera, and fraught with challenges for anti-fraud professionals. One is defining the legal and ethical boundary separating unwholesome fantasy – say, discovering indicators of someone's desire to defraud – and imminent lawless action. On a practical level, most conventional risk management and fraud detection programs draw on lessons learned in the past-is-prologue school, where assumptions about tomorrow are based on yesterday's trends. Pattern recognition analysis can certainly have value, as do conventional compliance, audit, and integrity checks or other safe-guarding measures. But by and large, predictive insight

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extrapolated from historical patterns project knowably likely, not confoundingly unexpected, trajectories, which immediately leaves actual human tendencies behind a large delta. And hard statistical data can only usefully signal real-time deviations and anomalies from unambiguously pre-defined metrics. More importantly, these methodologies cannot account for or interpret mental architecture and illogical behavioural propensities. They are inadequate to the task of rendering sophisticated portraits of human interrelationships, apprehending deep-level susceptibilities, or forecasting undulating group dynamics.

Many corporations consider pre-emption a viable defence. Psychometric tests and Ekman-influenced 'lie-spotting' interview techniques designed to interpret non-verbal communication, like facial expressions and body language, are increasingly popular gate-keeping mechanisms. But accurately profiling white-collar criminals has historically proved challenging. According to the results of various studies conducted by the Association of Certified Fraud Examiners (ACFE) and noted in their 2010 Report to the Nations on Occupational Fraud and Abuse, approximately 95 percent of white-collar criminals have no previous criminal record. Furthermore, the higher the monetary value of the economic crime, the less likely it is that the perpetrator has a previous criminal record.

In addition, lying and poise are deeply interconnected. In our experience, pre-hiring fraudster screening is the functional equivalent of TSA-mandated shoe removal as an anti-terrorism measure. Front door filters generally misconstrue outward expressions of internal processes, and underestimate capacities to effectively deceive.

Many corporate leaders and risk managers remain sceptical of the role and value of human factor analysis. AML and anti-fraud compliance is deemed a mandatory cost-centre, though these should be institutional centrepieces. Adjusting that should be the first priority. More sophisticated recognition of the human elements in detecting and addressing fraud, as an aligned enhancement to conventional Know Your Customer and due diligence protocols, are absolutely required. Significant education and training are needed in signal and context interpretation and soft data analysis, coupled with organisational systems prepared to capture, translate and respond to critical predictive intelligence.

Anything less is wilful blindness.

Alexander Stein is the founder of Dolus Counter-Fraud Advisors LLC. Dr Stein can be contacted on +1 (212) 242 7126 or by email: astein@doluscounterfraud.com.

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