The Psychology of Fraud

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Objectives

- Survey of academic research of the psychology of fraudsters and fraud victims
  - The elements that are commonly present when a trust employee becomes a trust violating employee.
  - Reasons that fraud victims have articulated for trusting a fraudster, even to their own detriment.
  - Behavioral traits common to fraudsters, their supervisors and victims.
  - The one thing that fraudster’s always need to succeed.
- Case studies illustrating the psychology of fraudsters and fraud victims

Disclosures

- I am not a psychologist.
- The area of psychology of fraud, fraudsters and fraud victims is relatively new, unsettled and, at times, contradictory.
- This is an overview of available research.
Cressey’s Hypothesis: The Fraud Triangle

Non-Sharable Financial Problem

Opportunity

Rationalization

“At first glance, a psychological explanation for fraud would appear simple – greed and dishonesty. Such an explanation is, however, overly simplistic.”

Psychology of Fraud

Duffield and Grabosky, 2001

“In looking at fraud in a general sense, as well as specific categories of fraud, it should be remembered that psychological factors might be viewed as a marker for fraud but not a comprehensive explanation for it.”

Psychology of Fraud

Duffield and Grabosky, 2001
“Fraud, like other crime, can be explained by three factors: a supply of motivated offenders, the availability of suitable targets and the absence of capable guardians - control systems or someone to ‘mind the store’, so to speak.”

Psychology of Fraud
Duffield and Grabosky, 2001

“If individuals truly believe they did nothing wrong, there is no need to rationalize. An explanation of the behavior would be descriptive, void of any persuasive elements.”

Rationalization
Murphy, 2012

1. Moral justification
2. Advantageous comparison
3. Euphemistic labeling
4. Minimize, ignore or misconstrue consequences of the act
5. Denial of the victim
6. Displacing responsibility
7. Diffuse responsibility

Categories of rationalization
Murphy, 2012 (citing Murphy and Dacin, 2011)
“Therefore, the [Fraud Triangle] has become conventional wisdom. … Today, [this] approach is still a dominant one, however questionable the conceptual and empirical basis for it may be.”

Beyond the fraud triangle
Schuchter and Levi, 2015

“When fraudsters never intended to commit fraud at any stage and honestly believe that their behaviour is not criminal, opportunity alone is obligatory for fraudulent behaviour. According to these respondents, there is no pressure, no inventive and no rationalization at all.”

Beyond the fraud triangle
Schuchter and Levi, 2015

“This type of offender who sees nothing wrong in their behaviour patterns can be allowed to the category type (1) slippery-slope fraudsters’.”

Beyond the fraud triangle
Schuchter and Levi, 2015
“The trust violators interviewed take advantage of organisational deficiencies, and, according to them, are easily able to commit fraud by their expert knowledge or special capability and by the incompetence of the persons in their professional environment.”

Beyond the fraud triangle
Schuchter and Levi, 2015

“Contrary to findings in the literature and the previously mentioned international fraud standards, we found that only opportunity is (perhaps tautologically) mandatory for committing a white-collar crime, according to our interviewed offenders.”

Beyond the fraud triangle
Schuchter and Levi, 2015

“This inner voice was governed by hassle and trench warfare from all directions within the organisation”
“After a while the inner voice disappeared [...] then it [the fraud] became a day-to-day routine”

From mouths of fraudsters
Schuchter and Levi, 2015
“The inner voice said: Do not do that, drop it, do not make that”
“The appeal was greater than the inner voice”
“I have repressed the inner voice”

From mouths of fraudsters
Schuchter and Levi, 2015

“The inner voice persisted the first time. After all my undetected transactions over a period of several years, I was able to sit back and relax. It is brutal. Put that in your pipe and smoke it.”

From mouths of fraudsters
Schuchter and Levi, 2015

“My incentive was not to appear as a loser”
“It is driven by greed. The incentive was tangible in my case, so materialistic. I lost ground; many of us feel the same. Then you will overcome your own limitations. You want a higher and higher wage.”

From mouths of fraudsters
Schuchter and Levi, 2015
“My incentive was early retirement”
“The opportunity was an incentive. [...] Incentive [...] to live over the usually possible standard of living in my situation. [...] Then it became a sporting event. [...] It was a challenge in this sense. [...] Breaking out of this situation is difficult.”

From mouths of fraudsters

Schuchter and Levi, 2015

“We find that, when faced with the opportunity and inventive/pressure, there are three psychological pathways to fraud nestled within attitude/rationalization: (1) lack of awareness, (2) intuition coupled with rationalization, and (3) reasoning.”

Pathways to fraud

Murphy and Dacin, 2011

“[A] path to fraud occurs [...] when the individual is aware that the act is fraudulent and the intuition is conflicting or unclear. In this situation, the individual applies reasoning most likely using some form of a cost benefit analysis.”

Pathways to fraud

Murphy and Dacin, 2011
“In order for individuals to resist committing fraud, they first need to be aware that the behavior in question is indeed fraudulent.”

Pathways to fraud

Murphy and Dacin, 2011

“First, an initial corrupt decision is made by a leader within the organization; this decision takes place within a permissive ethical climate.”

Corruption normalized in three phases

Murphy and Dacin, 2011

“Second, corrupt processes begin to form, primarily through leaders’ instructions to subordinates and the use of rationalizations (or neutralizations) to justify the behavior.”

Corruption normalized in three phases

Murphy and Dacin, 2011
“Finally, corruption becomes routinized and mindlessly followed by all members of the organization.”

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“For many people, these affective reactions immediately lead to an intuition that committing fraud is wrong. ... The only way to overcome that intuition is the ability to rationalize the behavior as acceptable in this particular situation.”

“It is possible that these individuals were aware that they were doing something wrong, but believed that the more important ‘right’ thing was to be loyal to their boss.”
“For fraudsters who feel similar guilt but do not believe they will be caught, they might simply fix the fraud somewhat anonymously by replacing a stolen asset, repaying stolen money, or reversing fraudulent transactions.”

Confess or fix the fraud
Murphy and Dacin, 2011

“Applied to a fraud context, an example of an attitude change would be an increase in attitude favoring fraud. In other words, the attitude might go from ‘committing fraud is wrong’ to ‘committing fraud may not be so bad’.”

Self-affirm, cleanse myself or change my attitude
Murphy and Dacin, 2011

1. Denial of responsibility
2. Denial of injury
3. Denial of the victim
4. Condemnation of condemners
5. Appealing to higher loyalties

Neutralization of shame
Fisher, 2015 (citing Matza 1964)
“As one confidence man put it: For myself, I love to make people do what I want them to, I love command. I love to rule people. That’s why I’m a con artist.”

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Ego/power

Duffield and Grabosky, 2001

“Another characterization of entrepreneurial fraudsters is their tendency to surround themselves with sycophants or organizational conformist who are easily dominated.”

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Entrepreneurial fraudsters

Duffield and Grabosky, 2001

https://youtu.be/BgRoiTWkBHU

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Groupthink

Groupthink

Candid Camera
“Persons who harbor unrealistic impressions of their own capability, when reinforced by sycophants, lack a reality check and may be more likely to engage in risky behavior than more grounded or ‘normal’ executives.”

Duffield and Grabosky, 2001

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“Employees, especially those in large organisations or government departments, may presume personal ownership or entitlement by virtue of occupation (of a position or space) or through regular use/access.”

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Narcissistic personality

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Territorial ownership

Duffield and Grabosky, 2001
“Examples of acquiescence to authority exist with respect to accounting fraud. … It is plausible that the tendency for obedience might have blinded these individuals to the fact that they were committing fraud.”

Pathways to fraud
Murphy and Dacin, 2011

“We posit that the egoist/local ethical climate is likely to lead employees to commit fraud without thinking about it. In this intersection, employees are expected to do most anything to increase company profit.”

Pathways to fraud
Murphy and Dacin, 2011

“Kunda's (1990) theory of motivated reasoning argues that individuals may be unknowingly biased toward reaching a conclusion they want to reach.”

Forecasts
Murphy and Dacin, 2011
“According to some estimates, scams cost American consumers over $100 billion per year and the U.S. Office of Consumer Affairs has estimated that 85% of all consumers have been deceived, defrauded, or cheated in some manner.”

Langenderfer and Shimp, 2001

“[A]lthough victims were found to be generally socially integrated, they were more likely to live alone than older Americans in general, and also less likely to seek advice on financial matters than nonvictims.”

Langenderfer and Shimp, 2001

[three types of fraud victims]: “(a) those who are repeatedly victimized and unable to distinguish legitimate from illegitimate sales pitches, (b) those who are wary of telemarketers, but feel unable to control the situation when they stay on the line, and (c) those who, as a result of their victim status, have been come so cautious that they are at law risk of being defrauded in the future.”

Langenderfer and Shimp, 2001
“The study also found that nonvictims generally hung up on telemarketers, while victims typically were reluctant to do so.”

Fraud victims

Langenderfer and Shimp, 2001

“[A] reasonably credible tale must be told [by the scammer] that explains why a deal that is ostensibly something for nothing is truly something for something. This deception is at the heart of a successful swindle.”

Fraud victims

Langenderfer and Shimp, 2001

“Scam victims may not pay attention to the details of the proposed transaction because they may not be especially interested; their motivation is limited, so diligent thought is not worth the effort.”

Fraud victims

Langenderfer and Shimp, 2001
“Within social psychology, it is defined as ‘a post-behavioral process through which a problematic behavior becomes less problematic for the person who has displayed it.’”

Rationalization

Murphy, 2012

“Some victims report symptoms that mimic those associated with post-traumatic stress disorder (PTSD)…”

Victims of Fraud

Malamed, 2013

“An element of trust must exist for individuals to engage a financial investment advisor to invest their money. ... In cases of white-collar crime, losses can extend beyond an individual’s hard earned money and include severe emotional and devastating effects.”

Victims of fraud

Glodstein, Glodstein and Fornaro, 2010
How often do perpetrators exhibit behavioral red flags?

ACFE, Report to the Nations 2018

41% Living beyond means
29% Financial difficulties
20% Unusually close association with vendor/customer
15% No behavioral red flags
14% Divorce/family problems

13% “Wheeler-dealer” attitude
12% Irritability, suspiciousness, defensiveness
10% Addition problems
9% Complained about inadequate pay

7% Excessive pressure from within the organization
7% Social isolation
6% Past legal problems
6% Refusal to take vacations
6% Past employment-related problems
5% Complained about lack of authority
4% Excessive family/peer pressure for success
4% Other
3% Instability in life circumstances

How often do perpetrators exhibit behavioral red flags?
ACFE, Report to the Nations 2018

21% Bullying or intimidation
14% Excessive absenteeism
10% Excessive tardiness
7% Excessive internet browsing
4% Sexual harassment
4% Visiting inapprop. websites
4% Other

Of the 45% that engaged in non-fraud-related misconduct
ACFE, Report to the Nations 2018

14% Poor performance evals
13% Fear of job loss
5% Actual job loss
4% Cut in benefits
4% Other
3% Cut in pay
3% Demotion
3% Involuntary cut in hours

Of the 39% with negative HR-related issues
ACFE, Report to the Nations 2018
“[I]f these psychologists and economists are right, if we are all capable of behaving profoundly unethically without realizing it, then our workplaces and regulations are poorly organized. They’re not designed to take into account the cognitively flawed human beings that we are. They don’t attempt to structure things around our weaknesses.”

Joffe-Walt and Spiegel, 2012

The Framework: Psychological Pathways to Fraud

Murphy and Dacin, 2011

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