**ANSWERS TO EXERCISES**

**Chapter 1**

**Review Questions**

1-1  (Learning objective 1-1) What is fraud examination?

*Answer: Fraud examination is a process for resolving allegations of fraud from inception to disposition. Fraud examinations involve not only financial analysis, but also interviewing witnesses, taking statements, writing reports, testifying to findings, and assisting in the prevention and detection of fraud.*

1-2  (Learning objective 1-2) What is the fraud theory ­approach?

*Answer: The fraud theory approach is the methodology used for resolving allegations of fraud by developing a worst-case scenario of what could have occurred, then attempting to confirm or refute that theory.*

1-3  (Learning objective 1-3) Occupational fraud and abuse ­includes any personal enrichment that results from misuse or ­misapplication of the employing organization’s resources or ­assets. There are four key elements to this activity. What are they?

*Answer: The four key elements to occupational fraud abuse are that it (1) is clandestine, (2) violates the employee’s fiduciary duties to the organization, (3) is committed for the purpose of direct or ­indirect financial benefit to the employee, and (4) costs the employing organization assets, revenues, or reserves.*

1-4  (Learning objective 1-4) Under the common law, fraud generally consists of four elements, all of which must be ­present. List them.

*Answer: The four legal elements of fraud are (1) a material false statement, (2) knowledge that the statement was false when it was uttered, (3) reliance on the false statement by the victim, and (4) damages as a result.*

1-5  (Learning objectives 1-4 and 1-5) What is the difference between occupational fraud and occupational abuse? Give ­examples.

*Answer: Occupational fraud tends to be more costly and less common than abuse. Occupational fraud consists of such actions as asset misappropriations, corruption, and fraudulent financial statements. Occupational abuse consists of petty offenses such as taking extended lunch periods or breaks, showing up late for work or leaving early, and doing slow or sloppy work.*

1-6  (Learning objective 1-7) Edwin H. Sutherland, a ­criminologist, coined the phrase “white-collar crime.” What did he mean by this term? How has the meaning of this phrase changed over time?

*Answer: Sutherland coined the term “white-collar crime” to describe criminal acts of corporations and individuals acting in their corporate capacity (e.g., crime in the executive suite). Over time, the term has come to encompass almost any financial or economic crime, from the mailroom to the boardroom.*

1-7  (Learning objective 1-7) Sutherland developed what is known as the “theory of differential association.” What is the principal tenet of his theory?

*Answer: The theory of differential association’s principal tenet is that crime is learned. Sutherland believed that this learning typically occurred in intimate personal groups.*

1-8  (Learning objective 1-8) Cressey interviewed nearly 200 embezzlers in order to develop his theory on the causation of fraud. As a result of his research, what was Cressey’s final ­hypothesis?

*Answer: “Trusted persons become trust violators when they conceive of themselves as having a financial problem which is non-shareable, are aware this problem can be secretly resolved by violation of the position of financial trust, and are able to apply to their own conduct in that situation verbalizations which enable them to adjust their conceptions of themselves as trusted persons with their conceptions of themselves as users of the entrusted property.”*

1-9  (Learning objective 1-9) Cressey believed that non-­shareable problems provided the motivation for ­employees to commit occupational fraud. What did he mean by “non-shareable”?

*Answer: Cressey meant that the problems, at least in the eyes of the potential offenders,* *must be kept secret from others, so as to avoid embarrassment or, more importantly, a loss of status.*

1-10  (Learning objective 1-9) Cressey divided the non-­shareable problems of the subjects in his research into six different subtypes. What are they?

*Answer: The subtypes are (1) violation of ascribed obligations, (2) problems resulting from personal failure, (3) business ­reversals, (4) physical isolation, (5) status gaining, and (6) employer–employee relations.*

1-11  (Learning objective 1-11) Albrecht concluded that there were three factors that led to occupational fraud. What are they?

*Answer: Albrecht’s list is very similar to the fraud ­triangle. The three factors he identified are (1) situational pressures, (2) opportunities, and (3) personal integrity.*

1-12  (Learning objective 1-12) What factor did Hollinger and Clark identify as the primary cause of employee deviance?

*Answer: The research of Hollinger and Clark strongly ­suggests that job dissatisfaction among employees—across all age groups but especially younger workers—is the most likely cause of counterproductive or illegal behavior in the ­workplace.*

1-13  (Learning objective 1-13) The *2011 Global Fraud Survey* covered a number of factors that are related to ­occupational fraud. List these factors.

*Answer: The* 2011 Global Fraud Survey *gathered data on occupational fraud and abuse relating to (1) the cost of fraud and abuse, (2) position, gender, tenure, and criminal history of the perpetrator, (3) size of the victim organization, (4) actions taken against occupational fraudsters by their victims, (5) methods by which occupational frauds were detected, (6) commonness of schemes, and (7) costs associated with various schemes.*

**Discussion Issues**

1-1 (Learning objective 1-1) How does “fraud examination” differ from “forensic accounting”?

*Answer: Fraud examination is a process used to resolve ­allegations of fraud from inception to disposition. Forensic ­accounting is any accounting work done in anticipation of ­litigation.*

1-2  (Learning objective 1-2) There are several steps involved in the fraud theory approach. What are they?

*Answer: The fraud theory approach involves analyzing the available evidence, developing a theory of what fraud could have occurred based on a worst-case scenario, testing the ­theory, revising it or amending it as necessary, then proving the theory through additional investigative work.*

1-3  (Learning objectives 1-3 through 1-6) How does ­occupational fraud and abuse differ from other kinds of fraud? Give examples of other fraud types.

*Answer: Typically, any crime that uses deceit as its principal modus operandi is considered fraud. Occupational fraud ­involves those frauds that are committed against organizations by individuals who work for those organizations. Other fraud types include but are not limited to: insurance frauds committed by customers and ­policyholders, Internet frauds and scams perpetrated by ­individuals, frauds against governmental organizations ­committed by companies and individuals, frauds against banks committed by outsiders, and credit card frauds perpetrated against businesses.*

1-4  (Learning objectives 1-7 and 1-8) How does the study of criminology relate to the detection or deterrence of fraud? How does it differ from the study of accounting or auditing?

*Answer: Criminals commit frauds. Accounting relates to the classification of assets, liabilities, income, expenses, and equity. Auditing involves the verification of books and records. While accounting and auditing give us information on how fraud is committed, the study of criminology helps us understand why fraud is committed. The simple fact is that books don’t commit fraud, people do. Understanding both how and why fraud is committed helps us better detect and deter it.*

1-5  (Learning objective 1-7) Sutherland’s contribution to criminology, in addition to giving us the term “white-collar crime,” involved developing the theory of differential ­association. What are the implications of this theory with ­respect to ­occupational fraud?

*Answer: Sutherland’s main point was that the tendency to commit crime is learned, not inherited. He believed that ­criminals learned both the techniques of committing crimes and the value systems of criminals in small, intimate groups. This explains, in part, why prisoners frequently return to crime after they are let out of confinement. While ­behind bars, they talk to other inmates and learn the specifics of how to better commit their crimes. They also are taught the unique values that “street” criminals hold, such as “getting something for nothing” and “society owes me a good living.”*

 *Occupational fraudsters, on the other hand, learn their techniques by working with books, records, inventory, and other assets. They frequently hear about other employees who were not successful in their crimes. Rather than being ­discouraged by someone being caught, the potential criminal often learns a different lesson: that the method the other person used to commit fraud was faulty and that a different one must be devised in order to succeed. They also learn the value ­systems that some businesses have: Profit is everything, and the end justifies the means. Such values obviously send the wrong ­message.*

1-6  (Learning objective 1-8) Cressey’s “fraud triangle” states that three factors—non-shareable financial need, perceived ­opportunity, and rationalization—are present in cases of ­occupational fraud. Which of these three factors, if any, is the most ­important in causing executives, managers, and ­employees to commit occupational fraud?

*Answer: All three are equally important. A fire cannot exist without fuel, oxygen, and heat; a fraud cannot exist without motive, opportunity, and rationalization. If a person has ­unlimited motive but no opportunity, he or she cannot commit fraud. If a person has opportunity but doesn’t need the money, the fraud is unlikely to occur. Should an individual have both motive and opportunity but cannot salve his or her conscience through rationalization, the crime will most likely not be ­committed.*

1-7  (Learning objectives 1-8 and 1-9) Cressey described a number of non-shareable financial problems that he uncovered during his research. Which of these, if any, apply to modern-day executives who are responsible for large financial ­statement frauds? In the 50-plus years since Cressey did his study, are the factors he described still valid? Why or why not?

*Answer: Three non-shareable financial problems seem to be at the root of today’s financial frauds: violation of ascribed obligations, problems resulting from personal failure, and business reversals. Many modern-day businesses begin “cooking the books” when executives realize that they will not be able to meet their financial obligations. Similarly, some ­executives are too ashamed to admit that they don’t have the talent or wherewithal to steer an enterprise through rough ­economic conditions. And sometimes, business reversals—from loss of a major client or contract, recessions, high costs of ­capital, and the like—are at the root of these so-called non-shareable ­financial problems.*

 *One could argue that these factors are as valid today as they were over half a century ago. What motivates people to act changes little over time, although the methods that they use to accomplish their illegal goals (e.g., computer frauds) may.*

1-8  (Learning objectives 1-8 through 1-11) Albrecht, in his research, developed the “fraud scale” and furnished a list of the reasons employees and executives commit occupational fraud. How are Albrecht’s conclusions similar to Cressey’s? How are they ­different?

*Answer: Cressey’s three factors were a non-shareable ­financial need, perceived opportunity, and rationalization. ­Albrecht’s consisted of financial pressure, perceived ­opportunity, and personal integrity. One of the factors, ­perceived opportunity, was named by both researchers. Cressey’s non-shareable financial need is similar to Albrecht’s financial pressure; ­however, Cressey’s is more specific. Nearly everyone suffers financial pressures of some kind, but most do not turn to fraud in order to alleviate them. The ability to rationalize illegal ­conduct and personal integrity could be viewed as one and the same. However, personal integrity is difficult to measure, while specific rationalizations are easier to identify.*

1-9  (Learning objective 1-13) The ACFE’s *2011 Global Fraud Survey* found, among other things, that the frauds committed by women had smaller median losses than those by men. What are some possible explanations for this finding?

*Answer: The sizes of losses due to occupational fraud are ­almost always determined by the employee’s access to assets. This explains why executives account for the largest losses. Women, because of the so-called “glass ceiling” (where they are not promoted into jobs equal to their male counterparts’), typically occupy lower-level positions.*