The Nature & Extent of Fraud

Seriousness of the Fraud Problem

- Statistics on how much fraud is occurring, whether it is increasing or decreasing, and how much the average fraud costs come from four basic sources:
    - Government agencies: FBI, FDIC, IRS, etc.
    - Researchers
    - Insurance companies
    - Victims of fraud
- The 2016 *Report to the Nations on Occupational Fraud & Abuse* by the Association of Certified Fraud Examiners (ACFE) estimates that:
    - U.S organisations lose roughly 5% of their annual revenues to fraud.
    - Applied to the 2015 GWP, this 5% translates to a projected global fraud loss of $6.3 billion.
    - The median loss caused by the occupational fraud cases in their study was $150,000 with more than 23% of all cases causing losses of at least $1 million.
- Because fraud affects how much we pay for goods and services, each of us pays not only a portion of the fraud bill but also for the detection and investigation of fraud.
- With the advent of computers, the Internet, and complex accounting systems, perpetrators now need only make a telephone call, misdirect purchase invoices, bribe a supplier, manipulate a computer program, or simply push a key on the keyboard to misplace company assets.
- Losses incurred from fraud reduce a firm's income on a dollar-for-dollar basis.
    - This means that for every $1 of fraud, the net income of the firm is reduced by $1.
    - Because fraud reduces net income, it takes significantly more revenue to recover the effect of the fraud on net income.
- In addition to the actual reduction of a country's total GDP, the amount of fraud an economy suffers has a big impact on how willing investors are to invest resources in a given economy.

What is Fraud?

- **Fraud** is deception that includes the following elements:
    - 1. A *representation*
    - 2. About a *material* point
    - 3. Which is *false*
    - 4. And is *intentionally or recklessly* so
    - 5. Which is *believed*
    - 6. And *acted upon* by the victim
    - 7. To the victim's *damage*
- The Australian Crime Commission (2011) defines fraud as "an act of deception intended for personal gain or to cause a loss to another person or organisation".
- Fraud *is*: intentional, to trick or deceive someone out of their assets, it is theft and a crime.
    - Fraud *is not*: taken by physical force, a mistake or error, victimless, insignificant because no one is hurt, acceptable or justifiable.
- Fraud definition in s 192E of the *Crimes Act 1900 (NSW)*: http://www.armstronglegal.com.au/corporate-crime/fraud/offence access date 25-2-14

- The offence of fraud is committed where a person obtains property from another by a dishonest act of deception.
    - It is important to note that a person does not commit an offence under this Part by a deception unless the deception was intentional or reckless.
    - A person does not commit this offence by obtaining or intending to obtain property belonging to another unless the person intends to permanently deprive the other of the property.
- Fraud Penalties:
    - The offence of fraud carries a maximum penalty of 10 years jail (imprisonment).
- The law: s 192E *Crimes Act 1900 (NSW)*
    - 1. The accused commits an act of deception; and by that act;
    - 2. obtains property belonging to another, or obtains a financial advantage or causes financial disadvantage; and
    - 3. The obtaining of that property or advantage or causing of that loss is dishonest (as defined)

Charles Ponzi & the Famous Ponzi Scheme

- Carlo "Charles" Ponzi was born in Parma, Italy, in 1882 and then emigrated to the U.S in 1903.
- In 1919, he was considering publishing an export magazine. He received a reply from a man in Spain who included an international postal reply coupon.
- Ponzi noticed that the coupon had been purchased in Spain for 1 cent, yet when he cashed it he was able to get six American 1-cent stamps.
- He believed he could buy $100 worth of stamps or coupons in Spain and then cash in or sell the stamps to a third party. He claimed his net profit on all these transactions was in excess of 400%.
- However, red tape and long delays in transferring currency ate into his imagined profits.
- Still, he bragged about this idea and others wanted in on the investment. He promised to double investors money in 90 days.
- *The scam*:
    - Early investors *did* see the promised returns on their money. Ponzi used the money from later investors to pay off his earlier obligations.
    - However, he was unable to pay returns to newer investors with more new investors.
- Legal action was later taken against Ponzi in 1920 where he was sentenced to five years in federal prison.
- *Fraud, Greed, Deception, and Confidence*:
    - Ponzi's scam is extremely helpful in understanding fraud.
    - Ponzi's scheme involved:
        - Deception
        - Greed by the *perpetrator* (and -this is important- greed by the *investors* who wanted higher-than-sensible returns).
        - Confidence
            - Confidence is the single most critical element for fraud to be successful.
            - By paying early "returns," Ponzi gained investors' confidence and convinced them that he had a legitimate business.
            - The word "con," meaning to deceive, comes from the word "confidence."
            - It is difficult to con anyone out of anything unless the deceived has confidence in the deceiver.

Types of Fraud

- There are three specific ways to classify the various types of fraud.
  - 1. Divide frauds into those that are committed *against* organisations and those that are committed *on behalf* of organisations
    - E.g. in employee fraud – fraud committed against an organisation – the victim is the employee's employer
    - E.g. in financial statement fraud, executives usually commit fraud "on behalf" of the organisation, usually to make the company's financial results look better than they actually are – the victims are investors in the company's stock.
  - 2. Use the ACFE's definition of "occupational fraud"
    - "the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organisations resources or assets".
    - Categories include:
      - Asset misappropriations: the theft or misuse of an organisations assets
      - Corruption: wrongfully using influence in a business transaction in order to procure some benefit for themselves or another person, contrary to their duty.
      - Fraudulent financial statements: falsification of an organisations financial statements.
  - 3. Divide fraud according to victims
    - 1) Fraud where a company or organisation is the victim:
      - Employee embezzlement
      - Vendor fraud
      - Customer fraud
    - 2) Management fraud – victims are shareholders or debt-holders of the organisation
    - 3) Investment scams and other consumer frauds— victims are unwary individuals.
    - 4) Miscellaneous frauds
- Australian Criminal Intelligence Commission:
  - Organised crime groups are increasingly involved in fraud. Financial market diversification, greater levels of economic activity and technological developments have created increasing opportunities for fraud.
  - Fraud can be categorised by *type* or by the *industry* in which it occurs. The main categories of fraud in Australia include:
    - Superannuation fraud
      - Organised crime involvement
      - Sophisticated targeting
      - Early release scams
      - Assuming funds members identities
    - Serious and organised investment frauds
    - Mass marketed fraud
      - Investment fraud
      - Advance fee fraud
    - Revenue and taxation fraud
    - Financial market fraud