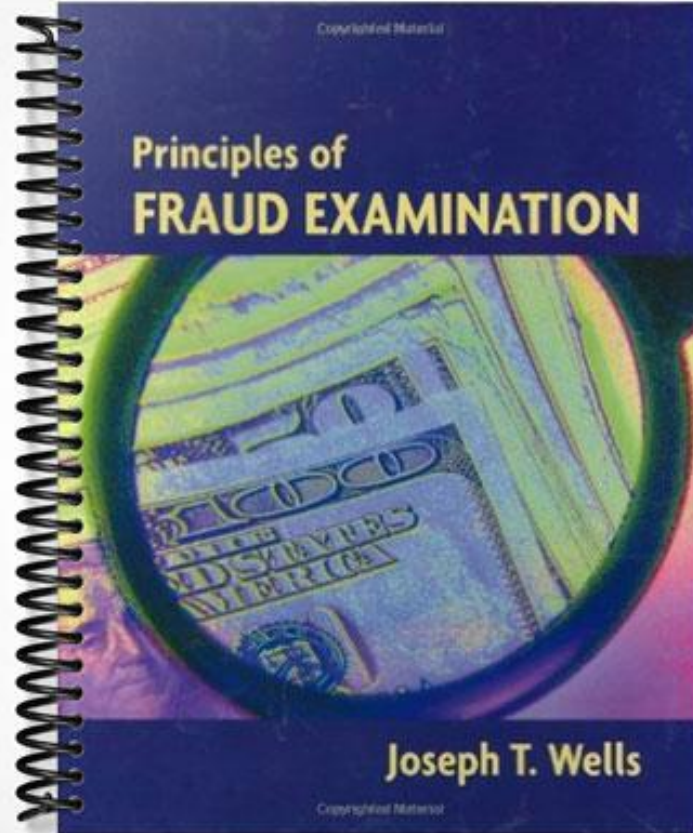


SOLUTIONS MANUAL



ANSWERS TO EXERCISES

REVIEW QUESTIONS

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

Answer: It 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: It is the methodology used for resolving fraud allegations by developing a worst-case scenario of what could have occurred, then attempting to confirm or refute the 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: Occupational fraud consists of activity that (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 can consist of such actions as asset misappropriations, corruption, and fraudulent financial statements. Occupational abuse can consist of petty offenses such as taking too long for lunch or breaks, showing up at work late 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 to mean 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 mean 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. He 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 problem, at least in the eyes of the potential offender, 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?

W-2 ANSWERS TO EXERCISES

Answer: They 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 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 2004 National Fraud Survey covered a number of factors that are related to occupational fraud. List these factors.

Answer: The 2004 National 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 organization and antifraud controls used by the victim, (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, expense, 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