

The Fraudster Mindset

What does a fraudster look like? Can you tell the evil from his or her face? Are there warning signs one can see so as to be on alert? I have been asked these questions over the years. The fact is there is no easy way to look at a person and know for sure their criminal intent. The faces of fraud are everywhere. Fraudsters may be male or female, young or old, short or tall. Fraudsters are your brothers and sisters, friends and neighbors, people from all walks of life and often those you least expect to scheme and scam. If you had come across Bernard Madoff walking the streets of Manhattan prior to December 2008 and his arrest for the mother of all Ponzi schemes, you would have thought you just saw the face of a 70-year-old grandfather out for a leisurely stroll. Certainly not the monster who stole billions of dollars from people who trusted him and in the process destroyed the lives of so many.

Yet there are faces of fraud. They are not in facial characteristics or expressions. They are not in the color of one's eyes, hair, or skin. Fraud is gender and race neutral. The aura of fraud comes not from how a person looks or where they come from but from their criminal intent and the resulting self-serving actions, ruthlessness, and arrogance. The faces of fraud are personified in the mindset of the swindler. The faces of fraud are felt in the financial, reputational, and emotional impact of their deceptive actions. The faces of fraud are burned into the memories of the victims. The faces of fraud run the gamut from simple schemes that hit and run like advance fee loan

scams to long-running and complex financial accounting frauds such as the ones that occurred at Enron, HealthSouth, and WorldCom.

Some scammers are better than other schemers in playing out their frauds. It may be their years of deception or just their personal level of evil. Either way, their success means your loss. Fraudsters have no souls. How else can you explain why they will use every possible lie, deception, and con to defraud you out of your valuables and life savings? Fraudsters are silver-tongued devils who will say and do anything with such convincing words and actions that victims easily fall prey. It is no coincidence that Satan's appellation is the "Prince of Lies."

A SILVER-TONGUED DEVIL

In 1986, I encountered a young man who was working in a telephone and mail order sales operation that sold rare coins to elderly investors. This particular salesman, although in his early twenties and fairly new at the game, was already an accomplished fraudster. One of his most effective pitches was aimed at elderly women who he would call to sell them grossly overpriced and misrepresented rare coins. When he got such a potential victim on the line, he would tell her that her voice reminded him of his late grandmother. He would say that it was his grandmother who raised him when his own mother abandoned him at birth. He would explain that it was his grandmother who loved him, and sadly died in the last year. The fraudster would tell the potential victim that she reminded him of his "grammy," and he deeply missed her. He would ask the woman to just talk a bit as her voice eased his pain and brought back loving memories.

What person wouldn't be moved by such words from a supposedly loving grandson who adored his late grandmother? Many an elderly woman who this con man spoke to believed those words. Except the words were false, all lies, intended to bring sympathy and trust while making the person vulnerable for the close. The scammer would then move in for the kill. He would say that he wanted to do something special for the woman. He would offer her very valuable coins for a fraction of the selling price, but she had to promise not to tell anyone because his boss would fire him for selling the coins so

cheaply. It was his way to thank the woman for the good memories she helped him remember.

He would further tell the mark that she should put the coins in a safe deposit box for many years and they would grow in value many times over their purchase price. Then years from now she could give them to her grandchildren as gifts for a college education or keep them to provide for her financial independence. He wanted the victim to put the coins away where no one would see them. If an experienced numismatist who grades coins for a living looked at them, that person would know that the coins were inferior, low grade, and worth a fraction of the price the victim paid. This fraudster was very good at scamming people and would brag about how easy it was to victimize the elderly using his phony deceased grandmother story. His evil eventually caught up with him; I arrested him, and he went to prison on a fraud conviction. He had no remorse until the handcuffs were on his wrists.

SELL THE SIZZLE, NOT THE STEAK

Few frauds personify the faces of fraud premise better than boiler room scams. Boiler rooms are high-pressure telephone sales operations that target victims using misrepresentations and lies to sell everything from penny stocks to vacation cruises, rare coins to vitamins, and cleaning supplies to Who's Who memberships. In theory, anything can be sold in a fraudulent telemarketing operation. All that is needed is a good spiel or pitch and a persuasive fraudster delivering it to an unsuspecting victim. The salespeople use aliases or phone names so they have anonymity. Boiler rooms are usually located far from the victim and close down relatively soon after opening, all to lessen the chances of the perpetrators being arrested. All these factors give the operators and salespeople the mistaken belief that they are immune from prosecution.

Present-day boiler room operations are typically located in an office or suite of offices with banks of telephones staffed by telephone salespeople. The common denominators in all boiler rooms are the telephones, misrepresentations, and high-pressure sales pitches. Depending on the degree of evil, boiler rooms may actually provide

the victim with the ordered merchandise at grossly inflated prices or in some cases nothing at all. Boiler rooms exist with the proposition of “sell the sizzle, not the steak.” Victims initially fall for the perception of something good and valuable but are eventually left with the realization of deception and loss.

Telemarketing fraud is nothing new. It has been with us since the 1920s when telephone con men contacted investors and sold them worthless stocks and bonds. It was called boiler room fraud, which is the dark and illegal side of telemarketing. The only thing that has changed over the years is that telemarketing fraud has now grown to victimize even more people. We are all affected, but especially the elderly who are particularly targeted by fraudsters. We all want to believe when that telephone rings, we are that special someone who has just won that prize, that trip to the Bahamas, or that investment opportunity that will make us rich beyond our wildest dreams. Unfortunately, all these scam artists do is sell the sizzle and not the steak.

Boiler room operators of the past would often set up shop in the basements of office buildings because the rents were cheap and it was a good place to hide from postal inspectors and other law enforcement officers. These operations would sometimes be in or near the basement boiler rooms, thus the term. But there is another meaning. What is a boiler? It is a device under intense pressure. The same is true in a boiler room. The salespeople are under intense pressure to make sales, and they apply that pressure to their victims. Since the salespeople usually get paid only on a commission basis, they will say and do anything to make a sale. The more they lie and deceive, the more people they can defraud, and the more money they can make. The red flags of telemarketing fraud as well as other investment scams include these statements made by fraudsters to unsuspecting victims:

- You’ve been specially selected to receive this offer.
- This investment is low risk and provides a higher return than you can get anywhere else.
- We guarantee the results.
- You’ll be rich beyond your wildest dreams.
- It’s so safe that I put my mother into this same investment.

- You'll get a wonderful free bonus if you buy our product.
- You've won a valuable free gift.
- You have to make up your mind right away as this offer expires today.
- We're members of the Better Business Bureau and authorized by Visa and MasterCard.

When you boil fraud down to its basics, it is all about lying, cheating, and stealing. It's selling the sizzle and not the steak. Let me explain further. Imagine yourself at a summer barbecue on a warm and sunny day. It's time to eat, and the host lights the grill to cook the steaks. You are very hungry and you watch the grill heat up. Your host puts on the thick, marbled steaks, and you hear the sizzle. The meat cooks and fat drips, causing the flames to flare. You smell the meat cooking. The juices pool up on the surface of the steaks. Your mouth waters and your taste buds erupt, and you want that steak more than anything. The steak could be tough as leather. It could be the worst piece of meat, but your mind tells you otherwise. You are falling for the perception of a good steak, not the reality of what's actually on the grill. The same thing happens in telemarketing fraud. Scammers sell you the perception, not the reality.

DR. DONALD CRESSEY AND THE FRAUD TRIANGLE

Although it is common knowledge that people and corporations commit fraud, it is not fully understood why they do it. Understanding the motive behind fraud is important in preventing it. Dr. Donald Cressey, a famed teacher and pioneer in fraud research and an important fraud expert, developed the Fraud Triangle Theory (Exhibit 1.1) to explain why people commit fraud. Dr. Cressey came to the conclusion that the propensity for fraud occurred when three critical elements came together: motive, opportunity, and rationalization. Each of these three elements is necessary and interrelated in order for a person to actually commit a fraud. The absence of any one of them would not allow a person to commit a fraud. Every corporate executive needs to understand the Fraud Triangle and why employees commit various kinds of fraud. In fact, everyone needs to understand

**EXHIBIT 1.1** Fraud Triangle

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the warnings of the Fraud Triangle to protect against the faces of fraud.

Financial Pressure and Other Motives

Financial pressure is often the motive for why people commit fraud. It is the element that causes a person to act or react and often implies an emotion or desire.¹ It is the driving force behind a person changing from a law-abiding citizen to one who commits a felony. There are many motivations to commit fraud; most of them are greed related. They include living beyond one's means, an immediate financial need, debts, poor credit, a drug or gambling addiction, and family pressure, to name a few.

In the movie *Wall Street*, the character Gordon Gekko was fond of saying "Greed is good. Greed is right. Greed works."² Greed epitomized Wall Street in the 1980s. Just as greed led many down the path to insider trading and other financial crimes, it is a motivating force in all kinds of frauds, especially the corporate frauds seen over the last few years. The recent housing bubble and the associated subprime mortgage meltdown, mortgage and securitization frauds,

and the resulting devastating impact on the economy, prove once again that greed and fraud are ever-present.

Although greed is the usual motive, sometimes revenge and ego play a role. An employee may feel anger and hostility against a company for some perceived wrong and may try to get back at the company by defrauding it. Although the argument goes that this is revenge, when this behavior results in money in the pocket, it boils down to greed, pure and simple. Sometimes the motive is a desire to beat the system. Fraudsters often think they are smarter than everyone else, and they believe that no one can stop them. Pressure to perform is often a motive for fraud. Sometimes the perpetrator commits fraud to help improve the bottom-line financial results. Emotional instability is also a motivating factor, but this is seen far less than the other motives for fraud.

An excellent example of greed as a motive is a case I investigated involving a multimillionaire industrialist from New York. He owned businesses all over the country. He lived in a mansion in one of Long Island's most exclusive communities. He gave large donations and endowments to universities, museums, hospitals, and other charitable organizations. Most amazing of all, he served several presidents in a variety of diplomatic and economic assignments in his lifetime. He was well-respected, and reference materials include pages of his accolades and achievements. Compared with all the good this man did throughout his lifetime, the one stain on his career is his conviction for fraud. Unfortunately, he conspired with others to submit a fraudulent insurance claim on one of his many businesses.

Why would this otherwise good man do something that was so contrary to the rest of his life? What was his motive? The answer is simply greed. His path to a courtroom and sentencing before a federal judge started with an insurance claim for damage at one of his factories. The problem was that the type of damage that occurred was not covered by his policy. The damage was in the hundreds of thousands of dollars. Rather than just let it go and view it as a business loss, this industrialist decided to take the advice of his public adjuster and falsify the claim by changing the cause of damage to one that was covered by the policy. Payoffs were made to insurance adjusters to go along with the fraudulent claim. The kickbacks that were paid took almost half of the proceeds from the insurance claim.

This insurance fraud might have gone undiscovered if not for the fact that greed overtook the insurance adjusters involved. They continued to engage in staged and inflated insurance claims with dozens of other insureds and insurance adjusters in settling bogus insurance claims. When I eventually discovered their crimes and confronted them, the adjusters admitted their long involvement in insurance fraud, the many phony claims they had submitted to numerous insurance companies, and the many co-conspirators with whom they had worked. Again proving that there is no honor among thieves, they gave up the name of the industrialist. After a short investigation, the industrialist admitted his involvement and pleaded guilty to charges of mail fraud.

Opportunity

Opportunity is the favorable circumstance that allows a fraud to occur. The degree of opportunity that a person has to commit fraud is usually determined by his or her position of authority in their company and access to assets and records. Poor internal controls contribute to opportunity and fraud. An employee who can both open a new vendor account and also pay that vendor provides an example of weak internal controls and a good opportunity for fraud. People who can approve their own expense reports for payment are also provided opportunity for fraud and abuse. Blank check stock that is not properly inventoried and locked is another example of opportunity.

Strong separation of duties, robust internal controls, and constant management oversight reduce the opportunity for fraudsters to commit and succeed at fraud. Of the three Fraud Triangle elements, opportunity is the one area in which fraud prevention can excel. Removing or lessening the opportunity to commit fraud and abuse is important in any fraud prevention program but is absolutely critical for a corporate fraud prevention program.

Scammers commit the frauds they do because they have the opportunity. A mailroom employee may not be able to conspire with a vendor to create a contract that provides no service but yields a kickback to the employee. Yet, a mail clerk could steal incoming mail

containing highly confidential proprietary information and sell it to a competitor in a foreign country. It all depends on the opportunity available to potential fraudsters and how that opportunity is limited.

Rationalization

The Fraud Triangle's third element is rationalization. Rationalization is how the fraudster justifies inappropriate actions. It is "the provision of reasons to explain to oneself or others behavior for which one's real motives are different and unknown or unconscious."³ When the elements of need and opportunity come together, the fraudster is convinced that what occurred is not bad or wrong.

Fraudsters often think of themselves as honest. Rather than considering themselves as criminals who just defrauded their company, they make themselves into victims. They may say: *I was only borrowing the money, I'll pay it back someday; This is not much money, the company is rich and won't really miss it; Everybody does it; They owe it to me; I'll stop once I get over this financial hump; It's for a good purpose; The company mistreats me.* Rationalization is another way of saying the end justifies the means.

In my career in law enforcement, I arrested hundreds of fraudsters. None of these criminals ever expected to get caught. They all thought that they would get away with their crimes. They rationalized what they did and came to believe they were invulnerable. If they didn't rationalize their actions, their consciences would take over.

FRAUD DIAMOND

As further research was conducted into fraud and the fraudster's motivation, a variation of the Fraud Triangle was advanced. The Fraud Diamond adds the fourth element of *capability* to the existing elements of motive, opportunity, and rationalization. A person may be in a job function where he or she can commit fraud but their capability to actually carry out the fraud may be limited. Capability includes the fraudster's personality and traits including knowledge, creativity, and ego that differentiate from opportunity.

While opportunity refers to the person's role and access to commit fraud, the fourth element takes this one step further. The fraudster "must be intelligent enough to understand and exploit internal control weaknesses and to use position, function, or authorized access to the greatest advantage."⁴ Another aspect of capability is self-confidence and being able to handle the stress that occurs when perpetrating fraud.⁵

FRAUD THEORIES

In addition to the traditional theories of fraud just described, I have designed some theories of my own. Over my many years as a fraud investigator, I have seen more than my share of schemes, scams, cons, and frauds. Some were simple, such as credit card fraud and loan scams. Others were complex financial crimes such as insider trading, securities fraud, and RICO (Racketeer Influenced and Corrupt Organizations) cases. Some were so well thought out and successful that they were repeated time after time. Although some of these new theories may seem light-hearted and even whimsical at first, they speak volumes about how and why fraud is perpetrated and is all too often successful.

Tip of the Iceberg Theory

When first discovered, very few frauds yield their true extent, along with the actual amount of the loss. Often the fraud first seen is just a small part of the actual deceit, like most of an iceberg is hidden below the surface. As an investigator conducts the investigation, interviews people, reviews supporting documentation, and takes other related steps in the process, a much larger fraud is usually revealed. Corporate fraud is no different.

An excellent example of the Tip of the Iceberg Theory of Fraud is an insurance fraud industry case I investigated in the 1990s in New York, which is discussed later in the book. The case started with an anonymous tip to an insurance company that a homeowner's

property claims were fraudulently inflated. One of the first claims I investigated was for \$8,000, a rather small amount in terms of insurance fraud that would be authorized for federal prosecution. I believed that multiple fraudulent claims were involved and kept digging. My hard work paid off. By the end of the case several years later, more than 250 defendants had been arrested and convicted, and more than \$500 million in staged and inflated commercial and homeowner property claims were uncovered.

Potato Chip Theory

Committing fraud and getting away with it can become addictive. Once one succeeds at an embezzlement scheme or payment of a bribe to a foreign government official to secure a contract and gets away with it, it gets harder and harder to stop that activity. This may be characterized as the Potato Chip Theory of Fraud. Just as a person is often unable to eat only one potato chip, once employees start committing fraud, they often cannot stop. Assuming the person does not get caught, he or she will commit fraud after fraud, even branching out to new frauds to obtain more money and other things of value.

An excellent example is a longtime employee of a corporation who was investigated for allegedly receiving kickbacks from a vendor. Applying the Potato Chip Theory of Fraud, other avenues of possible fraud were investigated. Knowing that expense reporting fraud is very common, a review of this employee's travel and entertainment reports found personal expenses fraudulently claimed as business expenses. Thus, two different frauds against the company were discovered.

Greed and the successful perpetration of fraud become addictive, yet if fraudulent behavior continues, the perpetrator will eventually be found out. Criminals make mistakes no matter how smart they think they are. They get bolder and bolder each time they are not discovered. Experience has taught us that they eventually make fatal mistakes leading to detection. However, employees involved in fraud can do great damage until they are caught. The longer a fraud continues, no matter the employee level, the greater the potential

- Living beyond means
- Financial difficulties
- Unusually close association with vendor and/or customer
- Control issues, unwillingness to share duties
- Divorce/family problems
- Wheeler-dealer attitude
- Irritability, suspiciousness, or defensiveness
- Addiction problems
- Past employment-related problems
- Complaints about inadequate pay
- Refusal to take vacations
- Excessive pressure from within organization
- Past legal problems
- Complaints about lack of authority
- Excessive family and/or peer pressure for success
- Instability in life circumstances

EXHIBIT 1.2 Behavioral Red Flags of Fraudsters

Source: Association of Certified Fraud Examiners, *2012 Report to the Nations on Occupational Fraud and Abuse* (Austin, TX: ACFE, 2012), 57.

financial and reputational damage. Exhibit 1.2 is a list of many of the behavioral red flags of fraudsters.

Rotten Apple Theory

It has often been said that one rotten apple can spoil an entire barrel. This can be applied to unchecked fraud in an organization or group. True leaders can inspire their employees to reach new heights of personal growth and career development. They can be role models who help create a new generation of corporate leaders. Employees want to emulate the leaders they see at their companies. Executives and managers who lead by example in compliance and integrity lessen the risk of fraud by their employees.

Unfortunately, the opposite also applies. Poor leaders who lack character and integrity, and who turn to fraud and abuse, can damage the people they lead. In a twist on imitation being the sincerest form

of flattery, there are examples of employees who turn to fraud because their managers were doing it and getting away with it. This is also called the Culture of Noncompliance Theory because when there is no culture of compliance, a breakdown of rules, policies, and accountability occurs.

A manager committed thousands of dollars of fraud by charging personal expenses on his corporate credit card. He did this on a continuing basis, and his subordinate saw that he did it. The employee copied the fraudulent behavior of his boss. When discovered, the subordinate unsuccessfully claimed that he was just doing what his superior did and should not be fired. This strategy did not work, and both were fired.

Another variation of the Rotten Apple Theory of Fraud is seen when a manager fails to provide adequate supervision of a team, leaving the team members with no direction. When oversight is lacking, successful fraud is easier to commit. Expense reporting fraud is much more common in groups in which it is known that managers do not thoroughly review the submitted payment requests. Although these kinds of managers do not personally commit the fraud, they promote it by not being alert and fully engaged. “Trust but verify” should be an ongoing policy.

Low-Hanging Fruit Theory

Although priority attention should be given to high-risk fraud such as financial misstatement and accounting issues, one must not forget about the lower risk but high occurrence frauds such as procurement frauds. Procurement frauds include invoicing for fictitious goods or services when working with vendors, contractors, and other third parties. It is often thought that fraudsters are cunning, imaginative, and brilliant in devising and executing their many schemes, but this presumption is often a misconception. Investigators, at times, give these violators too much credit for thoroughly thinking through their fraudulent activity and subsequent actions.

The reason that so much fraud is eventually discovered is simply that most fraudsters make mistakes that lead to their discovery. If the “low-hanging frauds” are not given appropriate attention, the

fraudster employees will continue their crimes until discovered. This could be months or years, and by that time, more damage will have been done. Executives should ensure that their fraud investigation units do not overlook these low-hanging frauds, as they will solve several problems.

First, they are usually simple frauds that do not take a significant amount of investigative time. Second, by stopping this fraudulent activity, there is an immediate benefit by removing a bad employee while sending a strong message about the company's commitment to fraud prevention. Third, the fraudster is removed before he or she is able to commit much more complex and serious frauds.

Addition by Subtraction Theory

One of the best ways to reduce fraud is by removing the source of the problem. When a company terminates an employee who has committed fraud, a risk is removed and that improves the company. This theory refers to the benefits that an organization receives when it takes a proactive approach to fraud detection and investigation. As simple as that may sound in theory, it is often hard to do in practice. It requires a business to take a zero tolerance and hard-core approach to fraudulent behavior by its employees, partners, and vendors. In a case involving embezzlement by a relatively low-level employee, the evidence was overwhelming that the fraud did indeed occur. In addition, the employee admitted his involvement when confronted with the evidence found by investigators.

When the manager was provided with the evidence, he commented that he was sorry he had to terminate the employee because that worker had the potential to be a high-level executive one day. What the manager failed to realize was the Addition by Subtraction Theory of Fraud. The company is best served when a dishonest employee is removed before he or she moves up the corporate ladder where far more damage can be done. If a business is going to have a zero tolerance for fraud, it must apply to all employees. As soon as a high-level executive who commits any kind of fraud is not held accountable, the entire program has lost credibility.

Fraudster as Employee Theory

The employee who commits fraud against the company he or she works for should not be considered an employee. Good employees are critical to the operation of a business. As stated previously, they are ideally concerned about the future of the business, working hard to ensure its growth and future, maintaining integrity, and bettering the company. Fraudsters masquerading as employees use their positions to find weaknesses in the internal controls and exploit them to commit fraud. These people are not out to better the company, other employees, shareholders, customers, or partners. They are only out to line their pockets with ill-gotten gains, and they have ceased to be employees—they have gone into business for themselves. Executives need to understand this concept when dealing with employees who commit fraud.

Short Memory Syndrome

The short memory of society leaves us perpetually vulnerable to fraudsters. Philosopher, poet, and novelist George Santayana said, “Those who cannot remember the past are condemned to repeat it.” Although he was not referring to fraud when he made this statement, it surely applies today. Charles Ponzi created the Ponzi scheme almost 100 years ago, and it has generated untold news stories of deception and shock year after year. Through the various iterations, and untold millions of victims and financial losses, the Ponzi scheme is still going strong. Why is that? Are we incapable of learning from the misfortunes of others when they fall victims to tricks, cons, and fraud? Are fraudsters smarter than honest citizens? Are greed and naiveté too powerful to resist? The Bernard Madoff investment fraud reinforces the Short Memory Syndrome that causes continual suffering.

In a memorable cartoon strip on the first Earth Day in 1971, the title character of the Walt Kelly comic strip *Pogo* uttered the famous quote, “We have met the enemy and he is us.” Pogo was reflecting on the sad state of the environment and the growing problem of pollution when he made this comment. Yet, Pogo’s timeless quote

is just as relevant to our victimization by fraud and how often we enable the fraudsters in committing their crimes. We need to resist the lure of scammers. No one makes huge investment returns every year, especially when the economic markets are in a downward cycle. We need to take responsibility for fraud prevention, whether on the individual consumer or business level. We need to constantly repeat and remember that if something sounds too good to be true, it usually is.

Recidivist Fraudster

It would be unfair to say that fraudsters are incapable of reforming their criminal ways. Many of them have served their sentences and became productive members of society. Still, there are some who on the surface appear to be reformed but who never really get it. Their arrogance, manipulative abilities, sense of being smarter than others, and contempt eventually return them to fraud. They claim that as reformed fraudsters they can best embrace fraud detection and prevention using the French proverb of “Set a thief to catch a thief.” Barry Webne and Steve Comisar are examples of supposedly reformed fraudsters who became fraud prevention speakers and consultants but who in reality continued their recidivist fraudster ways. But Barry Minkow’s egregious behavior may be the most blatant example of this theory.

After serving seven and a half years in prison for orchestrating the ZZZZ Best \$100 million securities fraud in the late 1980s, Minkow left prison claiming that he had turned over a new leaf. He was an outspoken proponent of holding fraudsters accountable and hosted a national radio show. He founded a fraud investigation firm whose intent was to expose corporate fraudsters. He even became a minister at a church in San Diego. It certainly seemed that Minkow had found a new purpose to his life and had put his fraudulent ways behind for good. Unfortunately, his fall from grace makes him a poster child for the recidivist fraudster.

In 2009, Minkow’s investigative report on home builder Lennar Corporation alleged a massive fraud and Ponzi scheme perpetrated by the company. Lennar’s stock dropped more than 30 percent as a result of the report, causing investors to lose more than \$583 million.⁶

In reality, Minkow's investigation of Lennar was a sham intended to "artificially manipulate and depress Lennar's stock" to extort money from the builder.⁷ His conduct resulted in criminal charges, and on March 30, 2011, he pleaded guilty in federal court in Miami, Florida, to conspiracy to commit securities fraud. In an example of an ultimate betrayal, the criminal complaint alleged that Minkow used his close relationship with the FBI to get them to "open up an investigation into Lennar, and then used his knowledge of the investigation to bet against Lennar's stock."⁸

Minkow and most successful fraudsters are charismatic and use their silver tongues to charm and con their victims. Minkow always had a way with words. The federal judge who sentenced him in 1989 recognized it. "You're dangerous because you have this gift of gab, this ability to communicate, you don't have a conscience," stated District Court Judge Dikran Tevrizian.⁹ Apparently, the conscience issue was a challenge for Minkow. One reporter wrote that "Minkow's dealings as a fraud investigator seemed ethically challenged" by shorting "the companies he targeted as a fraud investigator."¹⁰

When fraudsters become fraud investigators, it can become a case of the fox guarding the henhouse. The temptation and power without the ethics and character make for a recipe for disaster. At his guilty plea in the Lennar case, Minkow explained to the judge why he committed the fraud. "I'm not too wise, ma'am."¹¹ Watch out for the supposedly reformed fraudster who retains the slickness and arrogance, along with the gift of gab. They are red flags of a recidivist fraudster. On July 22, 2011, Minkow was sentenced to five years in prison and \$583 million in court-ordered restitution.¹²

FRAUDSTER MINDSET

Fraudsters have a different mindset than honest, law-abiding people. Greed and disdain are prevalent. Arrogance is often a common denominator among fraudsters. Look at Bernard Ebbers, Jeffrey Skilling, Dennis Kozlowski, and the other former corporate titans who became convicted felons. They, like other fraudsters, wrongly believed laws and rules do not apply to them. Fraudsters think

they are smarter than everyone else. They never think they will get caught or be held accountable for their actions. In my career in law enforcement, none of the more than 700 defendants I arrested ever thought they would get caught. That is until I placed the handcuffs on them.

Arrogance has been the downfall of many a fraudster. The late Leona Helmsley, who along with her husband Harry Helmsley ran the Helmsley Hotel empire, was called the “Queen of Mean.” Her arrogance and hostile personality were legendary. She was fond of saying that “we don’t pay taxes; only the little people pay taxes.” She falsely wrote off several million dollars in personal expenses as business expenses to fix up her lavish residence. She also extorted gifts and concessions from contractors doing the work. The tax fraud she committed was \$8 million, which didn’t make sense since she was worth several billion dollars. She was greedy along with being ruthless and arrogant, and that contributed to her conviction in 1989 and a stint in federal prison for tax evasion.

Sometimes the fraudster mindset is to cut one’s losses and run. Really smart fraudsters know that in some cases, fraud investigators will stop their examination when the fraudster admits his or her misconduct. That was what happened in one of the investigations I managed. An accountant at a company was under investigation for falsifying his résumé. He claimed to have an accounting degree from a prestigious university. The company’s background investigation failed to detect that he never obtained an accounting degree. His poor performance as an accountant caused his manager to question his skills, and it was subsequently learned that the accountant lied on his résumé and employment application about his degree. As soon as he was confronted, he quickly resigned.

There were no other indications of wrongdoing by this employee, and his resignation resulted in a closing of the case. It wasn’t until several years later, during an audit of transfer of funds into suspect bank accounts that it was learned the employee had fraudulently transferred hundreds of thousands of dollars into his personal account. The matter was referred to the FBI who confronted the employee and he confessed. He was subsequently sentenced to a prison term and made restitution to the victim company. The lesson to always remember is never to under investigate until you know the full extent

of the subject's possible fraudulent conduct. Cressey's Fraud Triangle and the element of opportunity as well as the Potato Chip Theory of Fraud are things to remember in each fraud investigation.

The fraudster mindset can also manifest itself in such arrogance that the result is fraudster stupidity. Fraudster arrogance and stupidity are covered in more details in subsequent chapters of this book. Here is an example of such fraudster hubris that his actions made it easy to identify him and determine his involvement in the fraud. When I was a federal agent, I investigated a case involving a scheme to defraud credit card issuers and financial institutions through the submission of fraudulent credit card applications using the U.S. mail. I was notified by several banks and department stores that between February 1 and August 30, 1987, they received credit card applications in the name of Morris Klein that were not submitted by the true Morris Klein.

Each of the many applications listed the same home address in Hempstead, New York, the same home telephone number, the same place of employment, and one of two Social Security numbers. The various banks and department stores mailed credit cards to the address listed on the applications. All of these cards were subsequently used to make purchases. While credit card statements were mailed to the address, only two payments were ever made.

My investigation determined that the home address in Hempstead, New York was not that of Morris Klein. No one by that name lived at that address. The home telephone number used on each fraudulent application was determined to be a test number used by the telephone company. Telephone company installers used this test number to check telephone lines and the number was primed to deliver a busy signal whenever it was dialed. My inquiry with the employer listed on the applications determined that no one by the name of Morris Klein was employed there.

A tip to one of the victim banks helped identify the fraudster. An anonymous caller stated that a man was using a credit card in the name of Morris Klein to place bets at an Off Track Betting (OTB) parlor on Long Island, New York. The caller stated that he recorded the license plate of the vehicle that the subject had driven to the OTB parlor. The caller advised that the vehicle carried a New York vanity license plate bearing the word SLEUTH.

A vehicle with the SLEUTH license plate was observed parked in front of the Hempstead, New York address listed on the fraudulent credit card applications and where the credit cards were mailed. A check with the New York State Department of Motor Vehicles determined that the SLEUTH vanity plate was registered to Richard Macklin. The address of the vehicle was a post office box in Huntington Station, New York.

The post office box was listed to a collection agency in Huntington Station, where Richard Macklin worked. Macklin stole the personal information of Morris Klein while employed at the collection agency. Macklin was arrested and charged with mail and wire fraud. He subsequently pleaded guilty in federal district court and was sentenced to probation and restitution.*

NOTES

1. *Webster's Third International Dictionary*, 1986 ed., s.v. "motive."
2. *Wall Street*, directed by Oliver Stone (1987; Beverly Hills, CA: Twentieth Century Fox, 2003, DVD).
3. *Webster's Third International Dictionary*, 1986 ed., s.v. "rationalization."
4. Jack W. Dorminey, Aaron Scott Fleming, Mary-Jo Kranacher, and Richard A. Riley, Jr., "Beyond the Fraud Triangle: Enhancing Deterrence of Economic Crimes," *CPA Journal*, July 2010, 16.
5. *Ibid.*
6. Rose Whelan, "Minkow Pleads Guilty in Fraud Case," *Wall Street Journal*, March 31, 2011, C3.
7. Rose Whelan, "U.S. Charges Fraud Sleuth in Fraud," *Wall Street Journal*, March 24, 2011, C3.
8. Whelan, "Minkow Pleads Guilty."
9. Al Lewis, "Barry Minkow Backslides," *Dow Jones Newswires*, March 22, 2011, www.denverpost.com/breakingnews/ci_17675964, retrieved August 29, 2012.

*The names of the individuals mentioned in this case study have been changed.

10. Ibid.
11. Curt Anderson, “Guilty Plea for Conman-Turned-FBI Informant,” *Miami Herald*, March 30, 2011, www.signonsandiego.biz/news/2011/mar/30/guilty-plea-for-conman-turned-fbi-informant, retrieved August 29, 2012.
12. Material in this chapter is adapted from Martin T. Biegelman and Joel T. Bartow, *Executive Roadmap to Fraud Prevention and Internal Control: Creating a Culture of Compliance*, 2nd ed., (Hoboken, NJ: John Wiley & Sons, 2012), reprinted with permission.

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