The Fraud Triangle Can Be an Ethics Crystal Ball

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The Fraud Triangle Can Be an Ethics Crystal Ball

By understanding the conditions that lead financial professionals to commit fraud, their leaders can implement policies to deter unethical acts.

By Julie Ragatz

If business ethicists had a holy grail, it would be a tool that would enable us to look into the future and predict when people were going to commit unethical acts. Although it is not exactly a crystal ball, the concept of the Fraud Triangle provides a unique road map to understanding the conditions that often lead well-intentioned individuals to commit fraud.

The Fraud Triangle has three components:

Pressure
The financial services industry places tremendous pressure on people to be productive. Success often is defined solely in terms of "hitting the numbers" or delivering solid financial results. Individual achievement, as well as the lack of individual achievement, is often very public. The perception of personal failure can cause people to struggle with losing face with their colleagues and friends. An advisor's identity often is so wrapped up in their professional success that they have little to fall back on when this identity is under threat.

Opportunity
Financial services practitioners have an excess of opportunity to commit fraudulent acts, both toward their organization and toward their clients. Frequently, when we hire an expert, we don't know what they don't know. Moreover, people often trust their expert advisor simply because they selected that advisor. We all want to believe that we are good judges of character and have confidence in our ability to select the right experts. Finally, financial services practitioners often handle numerous financial transactions and have access to all kinds of sensitive financial information. All of these factors can increase the opportunities for financial services professionals to commit fraud.

Rationalization
Most individuals are heavily invested in the idea that they are ethical. This self-concept becomes hard to maintain when performing a corrupt act. Rationalization provides a way to resolve this tension. An important point about a rationalization is that it does not need to be a particularly good argument; it merely needs to be good enough to resolve the cognitive dissonance. This is one of the reasons that rationalizations often seem so flimsy when exposed to public view.

What Can We Do to Prevent Unethical Acts?

RELIEVE THE PRESSURE
» Promote cooperator-tion. I really like the word "cooperator-tion." I first heard the term used by Dr. Bob Johnson, president and CEO of The American College, who uses it frequently. Cooper-tition describes a philosophy in which teams can and should cooperate with each other and should help each other even as they compete. Some sales leaders believe that they can achieve stronger results by encouraging a sort of hyper-competition among employees. Not only does this increase the pressure to succeed, but it also can isolate individuals by transforming people who could be natural allies into adversaries, by making the work environment a zero-sum game in which the gains of one person come at the expense of someone else.

» Know your people. It is important to identify, as much as possible, those individuals who have a good network and those individuals who do not, and to watch the people in the latter group a little more closely. Fraudsters do not want their activities to be detected, so they often seek opportunities to act in relative isolation.

» Use examples to illustrate that it is possible to come back from failure.
One failure does not mean that you will never succeed — sometimes one failure is just one failure. Guide others to learn from their mistakes and to use what they learned to make improvements and move forward.

**DIMINISH OPPORTUNITY**

» Establish strong internal controls. Only foolish leaders create temptations for their personnel by tolerating weak internal controls. Part of a strong ethical culture means that leaders impose policies that make it easier to do the right thing, and this means making it harder for people to engage in fraud.

» Increase the feeling of professionalism. It is important for leaders to emphasize that practitioners must be worthy of the trust their clients place in them. This can be partially accomplished by encouraging the adoption of professional values. This means talking frequently about professional values — integrity, objectivity, fairness, diligence and confidentiality — and the importance of applying them to daily practice.

» Educate clients. It can be very tempting to be the smartest person in the room. The best way to counteract this temptation is for leaders to create a culture that supports a robust program of client education. A climate of learning and open communication can minimize the temptation to deceive.

**DIMINISH THE FORCE AND POWER OF RATIONALIZATIONS**

» Treat people fairly. Employees often rationalize their own fraudulent behavior as a means of “evening the score” in response to perceived unfair treatment by the employer. It can be tempting, especially in tough economic times, to cut costs by removing actual or perceived benefits from employees. Sometimes this is necessary and appropriate, but it is important to be wary of the unintended negative effects.

» Prevent a “cheating culture.” People who follow the rules can be demoralized when they see others break those rules with impunity. A powerful justifier of fraudulent behavior is the feeling that “everyone is doing it” and that by acting ethically, you are losing out.

» Expose rationalizations. Leaders should take examples of bad behavior and its rationalizations and discuss them with their team. Newspapers are full of potential illustrations of the kinds of excuses used to explain fraudulent activities.

A better understanding of the causal factors of fraud — pressure, opportunity and rationalization — can alert leaders to the kinds of circumstances that create potential footholds for fraudulent activity. Appropriate measures can then be implemented to reduce the opportunities to commit and conceal fraud. It is impossible to prevent unethical behavior completely, but awareness of the Fraud Triangle can provide the tools to help us fight the good fight.

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