

>> Welcome to the podcast series of Raising the Bar, Sydney. Raising the bar in 2019, saw 21 University of Sydney academics take their research out of the lecture theatre and into bars across Sydney all on one night. In this podcast you'll hear Clinton Freeze talk, rationalising fraud, insights from offenders. Enjoy the talk.

[ Applause ]

>> Ladies and gentlemen, as Kotzur pointed out when he started. I spent a lot of time in the UK. And in preparation for this talk I spent a lot of time in pubs and bars and I became quite partial to the idea of pub games. So, given it's still early and before it gets too rowdy and boozy, I thought I'd kick us off something of a pub game. It's based on a challenge by an academic called Dan Ariely who's someone who I admire greatly, and the premise is a simple one. It involves a table with 12 numbers. They've all got one digit in two decimal places like 1.69, 1.82, and the task is – and I want people to now – and I'll buy a beer given the context, I'll buy a beer for the first person to raise their hands with the right answer. The task is to identify the two numbers that add up perfectly to 10, so only to have these numbers sum perfectly to 10 here. Someone helped me out here.

>> 4.81 and 5.19.

>> 4.81 and 5.19. Thank you, really loud.

[ Applause ]

I knew he'd be motivated by the beer [brief laughter] Ladies and gentleman, that's a task which Dan Ariely has built his academic career on and thankfully we had someone in the audience with a bit of a rain man persona to answer it quickly because for the podcast audience that would have been appalling podcast to get through, we just sat there thinking, but what Ariely, really is working on, it's not arithmetic. He's doing a series of experiments about honesty and in a book called 'the Honest Truth about Dishonesty', he goes through a series of experiments which are really geared at how we report what we do. So, it turns out that in his experiments you had 20 of these things and you had five minutes to solve them and you got 50 cents for each one you got correct, and for you as undergrads, of which literally thousands of undergrads have completed this task on average in five minutes they can get about seven of these correct. So, a little bit slower than the rule here up the front. Ariely changes the experiment a few times to look at how context impacts our decisions about honesty. In a second iteration of the experiment, he has the same setup. So, you have five minutes to answer 20 of these problems, but in this case you self-report the answer, and in fact there's one additional step after you complete the exercise you go forward and you put the paper in a shredder and then you go to the administrator of the experiment and you nominate how many you got correct. And in this self-reporting shredding activity, what we find is that people tend to report higher numbers so that number seven suddenly becomes 12, so people will report that they've got 12 right, even under the same circumstances, and I'm talking about

thousands of people doing these tasks. And Ariely calls this, the fudge factor, and the fudge factor stems from this tension between us wanting to do the right thing on one hand, but on the other wanting to benefit, and wanting to gain as much as we can. And in the third iteration of the experiments, he changes it again, and in this case he has two people in the room doing the experiment. They've got again, five minutes to answer 20 of these problems. But in this case, after one minute, the person next to the person doing the experiment gets up and says, I've completed them all, and clearly his lying that I've answered all 20 in 60 seconds goes forward and gets paid \$10 for doing it. And what Ariely finds is, that in that condition, people now on average start to report that they've got 15 of these correct. So, they've gone from seven when they had max, 12 when they self-report to 15 when they witness what might be dishonesty from someone else. And what Ariely concludes through these experiments and he's done a whole bunch of other ones, is that the good news is that there are very few of us who we might say are psychopathic, but the bad news is that all of us are capable of being dishonest. And in fact, we are much more conditioned by our environments and our context. Our honesty is much more conditioned by our environments and our context than we would ordinarily like to think. Tonight, I want to talk about dishonesty. I want to talk honestly about dishonesty and I want to do so in the context of serious dishonesty. So, I'm going to talk about a research project, which has involved me talking to a group of people who have committed fraud and they've received custodial sentences, and these interviews have happened in prison. What I want to do is take us into the mind of offenders, of which I've spoken to hundreds in prisons in Australia, the UK and Canada. I want to highlight some thinking patterns that enabled people who are otherwise normal to cross the line and carry out misconduct. And what I want to also do is try to challenge some of the stereotypes that we hold up around what are fraudster is, and what a fraudster does. I want to do it all in 28 minutes. So, I'm going to dig in here. Like most criminal categories, fraud is not well defined. The definition in the Crimes Act is in each state resemble something like gaining a financial advantage through deception. And each of the state Crimes Act have a set of infringements which are fraud offences. We know that the majority of frauds are actually not the type of sort of sensationalised images that we read in newspaper articles and we see on television. They're not Ponzi schemes with Bernie Madoff or elaborate tax evasion schemes. They're actually overwhelmingly the asset misappropriation in the workplace and overwhelmingly the victim is the employer or clients of the organisation. Now, estimating the cost of fraud in Australia is a very fraught thing to do because of two things. Much fraud goes undetected and much fraud goes unreported. The Australian Institute of Criminology has had a go at trying to estimate the magnitude and scale of fraud in the Australian economy in the last decade, and it's estimated to have been between six and \$8 billion, and to put that into some sort of perspective, that's more than twice the financial costs of the second category of crime, which is drug related crime, and it's more than the cost of funding all of our police forces. So, fraud is a big deal by any measure. When we think about fraud, we often conjure up images which really

don't relate to what we see in terms of the majority of offenders. The average fraud offender looks disturbingly like me. It's a middle-aged male, beaten down by life. You know, someone who works in accounting and finance, they've typically been working at their firm for six or seven years, but what we know is that the fraud offender is very heterogeneous. Unlike most criminal categories, there's a reasonable presence of females in the group. Men are overwhelmingly better at women at crime, but fraud is one category where there's something like a 70/30 split and in some categories of fraud it's very even. I don't know what it says about me, but what it says I don't think is good, but I've been quite interested in white collar crime throughout my life. When I studied law, it was the bar that I found most interesting. It's what I've tended to teach in a law school, and when I practised, it's what I was most interested in doing. I'm a bit of a junky for TV shows about fraud, or white-collar crime, podcasts, books, newspaper stories. And I first got involved in studying this domain in Canada. I was working at Queens University in Canada and moving between Queens and Cornell and got involved in a project that was looking at collusion and how people make choices to co-offend in fraud and I think the thing that struck me most about that exercise was that the people we spoke to in prisons, and we went into about a dozen prisons in the United States, which is the mother-load of fraud offending in the world. The people we spoke to didn't jive with the ideas I had about the type of person who committed fraud. Overwhelmingly, they were complex stories that contained inevitable experiences. They were told by people who were normal, crushingly normal and they often contain elements of crisis and tragedy and they were told by people who often gave an account of why they did what they did. And it was through those stories about why people commit fraud that I really got interested into the idea of rationalisation and I want to put an argument tonight that rationalisation, the way that we seek to justify behaviours is central to understanding why fraud occurs and also opens up some ideas about what organisations can do to try and mitigate the flow of fraud in organisations. Fraud as an umbrella concept is something which applies to all countries and rationalisation is an inherent part of it. Theoretically, rationalisation is a very complex idea and theoretically we often come at it through ideas in psychology or social psychology like cognitive dissonance, which is the idea that we struggle to commit an antisocial act if we have a pro-social self-image or moral disengagement, which is the study of the circumstances which allow us to touch from its sort of ethical and moral self in order to perpetrate things that we might otherwise think are ethical or even ideas around impression management. Two Australian academics, from ANU, Katherine Hall and Vivian Holmes wrote a paper where they defined rationalisation essentially as a self-explanatory story, a self-justifying story, which tends to shape a behaviour as more acceptable. It often contains elements of self-deception and it tends to act to reduce the anxiety and the negative feeling associated with particular behaviours. The reality is that humans have an endless capacity for rationalisation, where we're master at it. I'm fantastically good at it, you know the idea that I'm going to start a diet on Monday or I will be no longer needing to go to the gym today because I'm feeling quite muscled

up as it is. These are rationalisations which all of us engage in and in fact I think rationalisation is the heart of being a human, but theoretically I think it's also at the heart of white-collar crime. Fraud as a criminal category is an impulsive act, so the majority of people who receive a custodial sentence for fraud in this country perpetrate their fraud over multiple years. To receive a custodial sentence in Australia, one needs to take about a \$100,000. Typically, as I said, from their employer or their clients, anything less than that will tend to result in community corrections orders or other sanctions. What we know about fraud is that the fraud triangle, which is the dominance theoretical model in the field, tells us that fraud occurs at the confluence of three things. So, the fraud triangle was written by an academic called Donald Cressey in the 1950s and Cressey interviewed 250 people who'd got custodial sentences in the US for embezzlement. And he concluded that fraud occurs when three things aligned, that we have a motivated offender and most of the time we talk about motivation in terms of need and greed, that we have an opportunity to commit fraud, which is almost sort of towards a logical, of course we need an opportunity to actually do it. Finally, we have an ability to rationalise the behaviour to make it acceptable to us which is a little bit like a release fudge factor, which I started off at. Now, since the 1950s, there hasn't been a lot of research into the idea of rationalisation. Most of the work on that topic has tended to be theoretical, and it's tended to come out of fields like psychology, and so I wanted to do a study in which, listen to the voice of offenders and that really set in motion a research project that I've been working on for a hell of a long time now, and I want to talk about it tonight. The project has involved us going into prisons across the Eastern seaboard to talk to offenders about their stories. The process of getting inside prison was very character-building and difficult. We had to get through the ethics clearance boards at the university in the faculty. We then had to do it at every single corrective services institution in every state and that process aged us dramatically and it took a long time. But the process of getting in once we've got through has been a really remarkable and a profound one and I've learnt a lot, that it's made me think a lot about life. The way that we access people is we have an army of research assistants, some of whom are in this room constantly looking at reporting around fraud offences. When we identify someone receives the custodial sentence, we work out what prison system they're involved in and we write to them through that corrective services and ask to speak to them. We weren't sure how many people would reply, yes, they want to talk to us, but the reality is that it's a high percentage, I think in part it is because people who are in prison are bored. They want to tell a story. The alternative is doing something other than talking to us. Prison's quite a frightening place for a lot of white-collar offenders, so we have a relatively high strike rate once we find people. The interviews themselves are long, they tend to be sort of an hour to two hours. Now, we designed in consultation with the range of academics really to induce this idea of rationalisation, how people tell stories or give accounts about why they offended. At time, it's been a deeply saddening experience. People have talked about very dark episodes in their life, dark thoughts and at times it's been hugely memorable as well. For my side

the highlights has been going down once into Victoria with my fellow traveller in this project, Paul Andon, who's a professor at UNSW, who might be in the audience somewhere, and the way to get into prisons in Victoria now was retinal scans. So, after you fill in all the paperwork, you go forward and have your retina scanned, you go in and on the way out you have your retina scanned again to ensure that you know you're not a prisoner getting out and – We did a couple of interviews down in a prison, in the middle of nowhere in rural Victoria, and at the end of it we went through and I got my eyes scanned and it all went through fine. I walked out and Paul must have dodgy eyes because, when he put his head up on the scan, someone else's image appeared on his screen and sort of light started flashing and people started running in and I did what I thought was the only thing I could do, which was to say I've never met this man before in my life. Because I thought this would be a great opportunity for him to get extra access into the prisons, but unfortunately for us, he was uncovered and Paul got out. But we continued on the journey and I think now we're up to talking in excessive of 60 people over prisons, predominantly in Victoria and Queensland. It's interesting that on a per capita basis, Queensland has more fraud offenders than any state in the country, which I'm not sure what to make of, other than, you know, they're good at rugby league and fraud it seems that out there.

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>> Other than talking about the fallibility of retina scans, I think we've learnt a lot, and I want to talk about three things today and then I want to try and make a case about, so what, why is this important? The three things that we have focussed on have been, what do people say when they're prompted to talk about rationalising? And I think the reality is that they're not stable. So, we tend to get answers that are dynamic, that people don't have a singular rationalisation for what they do, but they tend to fall into five buckets. They tend to fall into five buckets. The first bucket is they have no rationalisation. So, we will ask repeatedly through this process, prompt people to give accounts and people won't even understand the line of questioning. In this case, I mean, I think only five to 10% of our respondents, people are, I think lacking in empathy. I think people are being extremely calculated in the way that they're offending. I think the ideas of sort of moral norms and the sort of ethical moorings that stop most of us, you know, participating in crime just aren't present for those people. I got involved in a podcast called, 'Who the hell is Hamish?' earlier this year, and I think if one listens to that, Hamish McDonald is a good example of the type of sociopathy that one might associate with a group that don't require rationalisations to act. But the vast majority of people do give a rationalisation. I think they fall into the remaining four buckets. The first bucket is that it's a temporary loan and they're going to pay it back. Overwhelmingly, this is popular with people who have gambling problems. So, in our sample between a quarter and a third of our respondents had, problem gambling in their profile, which is a very sobering fact, and I think something which I'd like to return to at the end of this talk. Gambling. People with gambling problems who

have cognitive distortions around gambling tend to have a misguided belief that they're able to, if they can access more opportunities, win money back, and put it back into organisations. This rationalisation is not a durable one. So, for most people who start to offend, typically against their employer or a client, those people tend to abandon this rationalisation fairly readily after they realise they won't be able to do it, or even if I could do it, how would they get the money back into the [inaudible] into the firm. The third bucket of rationalisation is to minimise the harm associated with offending or even ignore it. So in this case, these are people who would admit that they're offended, but tend to marginalise the impact of what they do. So, there are people who would say, "The company's insured anyway," or, "It's a big company, it won't notice this," or, "It's the Commonwealth." You know, the tax organisation, they rip us all off. They won't endure any harm in what I do. The fourth bucket is around entitlements, and here a common refrain, and this was probably the most common justification or rationalisation that people advance. The most common refrain would be along the lines of I'm not paid fairly. I'm underpaid relative to you. I deserve this. I'm doing the work, Lucy's getting all the money, I'm the person who's got my shoulder to the wheel here, I'm going to take some sort of money almost as a sort of wages in lieu concept. The final category is what we call othering. Here the offender either displaces or diffuses their responsibility for offending by pointing to others. So in this instance, someone would say, I was told to do it. I was instructed by an owner of a firm that this is necessary for me to do. This is important for my job or everyone else is doing it, which is a diffusion of responsibility idea. Everyone else in the industry is doing it, so should I. We spoke to a lot of people who were drawn from the finance sector in prison, and I think that sort of narrative around, others are doing it, this idea that responsibility is diffused in an industry where insider trading, for example is rife, where private information can be exploited. That was very often invoked by people who were coming out of that sector. So, they were the five main buckets of rationalisation that we heard as well as we spoke to people and I'll return to how we might deal with that or think about that as I go. The second sort of finding, I wanted to talk about was how rationalisation seems to apply a lot during first offending, but then it seemed to give way to a much more fluid idea of offending after the first time. So, when we ask people about their offending, they would often speak at length about the first time. They would tell us the day, the time they did it, exactly where they were, how they felt. It was very emotional when they would retell that first offence, but when we asked about subsequent offending, it would often come in, it was in a bit of a haze, you know, or I wasn't thinking about it, or I no longer really believed that rationalisation, which I talked about up front. And I think in subsequent offending, and I think the myth of the idea that fraud is a one shot large amount and get out, the reality is most fraud occurs sequentially and it gets normalised and it ratchets up over time. Most fraud that serious that involves in custodial sentences occurs over multiple years. So there's an idea around coping, which I think is very useful to explaining fraud. What we saw was people talking, not so much about rationalisation, but about coping behaviours. They would –

these were more emotional coping sorts of ideas. So, they would for example, try to use thought suppression, which you can imagine isn't a very successful strategy, so not thinking about it. We spoke to a number of people who tried to compartmentalise their offending. So I remember one person telling us that, they are only offended on the 15th of the month. You know, they'd go in and they falsify a set of records on this day every month, because that was their way of just minimising their exposure to that nasty thought of doing it. We saw lots of examples of escapism. So people who would engage in different activities to try and stop themselves from thinking about the predicament they're in. Throwing themselves in to community organisations. Gambling was sort of particularly insidious in this sense because it was often a form of escapism and as well as a motivation for offending. The final sort of emotional coping strategy that we saw a lot of evidence off, was what we might call compensation, and this is the idea that people who are offending look to do something pro-social to try and manage their emotions. So, many of our offenders would cite positive things they were doing that often phrase the comments as "I'm not justifying what I did, but I gave a lot of it away", or "I was, you know, really strong in supporting this charity or this needy person was someone who sponsored heavily", and almost the amounts didn't matter. You know, if someone had taken millions of dollars. They'd cite examples of giving away tens of thousands of dollars, but that was important for self-image. So I think the idea of emotional coping is a really important one to understand when we think about prolonged offending in fraud. The final point out of the research I wanted to highlight was the failure of auditing. So, in every instance we talked to bar two. Offending occurred in organisations that were subject to regular audit processes, but the audit did not capture the fraud. The fraud was typically either revealed through a tip off. It was a confession by the person. It may have been facilitated by some sort of enquiry, by management and police might have been involved, but in only two instances, out of literally hundreds across a long period of time was the fraud revealed by the auditor. I think that's a really sobering thought for those of us who think that audit provides comfort against fraud and it's a very complex notion for the audit profession. Why is it that people are unable – What is that sits behind the failure of auditing to uncover fraud? I guess we want to get to the so what of this research, and I know I'm running out of time and keeping you away from the bar, but I want to just talk about three things. I think there's no silver bullet for fraud. So, the first thing is trying to come up with ideas to stop fraud is an extremely difficult task. There's a lot of accounting based work on controls and separation of duties, signatories authorizations and so on, which is no doubt important, but those things existed in nearly all the organisations that were defrauded. And I think there's a productive set of thinking around nudge theory in behavioural sciences that can be helpful to get people thinking about fraud. Things about having prompts, about honesty at key moments, things about setting reminders to people in inductions and regular reminders that surveillance occurs at the firm to elevate the perceived risks associated with offending. What John Braithwaite calls anti rationalisation. So, what can we do in firms to try and negate some of those rationalisations I talked about

earlier. What research consistently shows is that, fraud is much higher at firms where employees feel that they're underpaid, and employees feel that they're poorly treated. That research finding is, it's come over, over and over again. I think small prompts matter, you know, Nudge theory is this idea that cheap interventions, which people – they're not mandated rules, but they're things that people can engage with helps the behaviours. There was a recent study in the US which showed that in an insurance claim in the US, the positioned a signature at the top of the page and the bottom of the page and the signature required the person to just confirm that, you know, everything that I've expressed on this form is true and fair and they altered the position. It required people who were making application to be insured to estimate the number of kilometres that they perform. Some of them signed before they've declared the number of kilometres, some of them signed after. There were 13,000 people. They split them into two groups, some signing before they declared, some signing after. The group that signs after they declared that this was all true and fair, estimated that they would travel 40% more kilometres in the preceding year, which is what was used to determine the insurance premium. People who signed after they'd already made their estimate tended to under-report relative to that other group. And I think those ideas of prompts reminders are important things that we don't do well enough in firms. The seconds point about how might we think about fraud is I think to do with gambling. The nexus between gambling and white collar crime, I think he's much stronger than it's ordinarily considered and the debates about gambling regulation in this country, I think one thing that's often absent from them is the financial cost of fraud and the impacts that gambling has in seeding fraud, and I think that's a part of a public policy debate that really needs to be spoke up about. The final thing I wanted to talk about was behavioural change. In nearly every instance of people we talked to, they would talk about how the anxiety of offending, whether it just be the fear of being caught or feelings of moral wrongfulness and guilt and so on, change their behaviour. And most people talked about changes in personality, the social withdrawal, or the opposite of that. They would work different hours. They were uncomfortable taking holidays. They were uncomfortable being promoted. They were very uncomfortable about leaving the firm. They were uncomfortable about having wide emails distributions, and all of these things have started off, a series of user behaviour analytics startups, which I think are likely to what we're going to see more of as we go forward. We're seeing organisations like IBM and Splunk now come up with things which is sometimes called insider threat programmes, but there are things which are looking to get a profile of a behaviour of an employee. So, what does Marshall look at on the internet? What is his hours? When does he take holidays? Where does he go, et cetera? Form this baseline view of him and then when there's drastic movements in his behaviours, try to signal to a manager or someone in the organisation that there's potentially a problem. It's hugely controversial stuff. It sorts of raises all sorts of privacy considerations, false negatives, but I think the reality is there's so much money being invested in this type of user behaviour analytics that some of us may already be subject to it. Firms like the NBN in Australia are heavy

adopters of this already, and it's something for us to think about. Ladies and gentlemen, I think in the last decade we've seen the ethics industry move into full gear, on the back of Royal Commissions, on the back of scandals, on the back of lying about how many arithmetic problems you get right. And I think a common claim in that time, in that space is that universities and schools need to teach more about ethics. We need to have more content in our teaching so that people will perform better, they'll behave more ethically, they'll be more moral. What occurs to me is that sheer ignorance is seldom the problem. In the 1800s, Soren Kierkegaard said the greatest moral challenges to abide by the knowledge we already have. And I think for us, what that means is when we're uneasy about a decision, we really need to highlight the way that we're rationalising what we're doing. We need to interrogate the justifications of what we're doing in order to be sure that we're behaving with integrity and to ensure that we keep out of harm's way, and also hopefully to ensure that we don't end up in prison for fraud. Thank you.

[ Applause ]

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