

# Part 1

PART ONE

## Setting the scene

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# 1

CHAPTER ONE

## The lessons worth learning from past mistakes

By three methods, we may learn wisdom: First, by reflection, which is noblest; second, by imitation, which is easiest; and third by experience, which is the bitterest.

*Confucius 559–471 BC*

### THE CASEBOOK APPROACH TO FRAUD—LESSONS WORTH LEARNING FROM PAST MISTAKES

Any wisdom that I have around fraud investigation has come from a combination of reflection and experience. I'm hoping to spare you some of the more painful and bitter parts of experience by setting out case studies where reflection and imitation will be sufficient to digest the lessons to be learned.

I could almost have entitled this book 'The successful fraudster's casebook', except that nearly every fraudster covered here was eventually unearthed. However, many of them got away with it for years and enjoyed a successful career until their eventual exposure. In the two major bribery cases I've covered, one corrupt individual did successfully get away with it throughout his employment. He was only brought to justice some five years after his retirement and even then, although he served a term in Ford Open Prison, he never did reveal where he had salted away most of his ill-gotten gains and has continued to live off the fruits of his corruption to this day.

For my own investigations covered in this book, I have deliberately picked several cases where matters were not as clear or as straightforward as I would have wished during the investigation. They are all cases that helped hone my experience and knowledge. In one instance from my early days, my report about the initial case led to the opposite of its intended

effect and in another later case the fraudulent individuals were only exposed through the civil courts some six years after we had concluded our investigative work and had moved on to other cases. But don't worry, I have included some successful cases as well!

Successful fraud auditors ('frauditors') are successful for three key reasons:

1. They have learnt their craft through good practical experience.
2. When they made a mistake in the past, they analysed what went wrong and have made sure since that they haven't made the same mistake again.
3. They know and understand themselves—their own strengths and their limitations—and they know and understand the fraudster's mindset and modus operandi.

## **WHY DO WE NEED TO LEARN LESSONS FROM OTHERS' PAST CASES?**

There are days when I have cynically wondered if organisations really can ever learn any lessons from past mistakes, particularly in the world where I spent most of my career, central and local public services. But I know that the only way that you truly can get better at my line of work has been the ability to know when, how and why you got it wrong and to make sure that you do not repeat that the next time the same situation arises. The problem with organisations is that while individuals may have learnt from their past mistakes, organisational learning can get lost between one generation of management and the next. This is particularly true in any organisation where politics or collective and individual over-ambition get in the way of logic and sense.

So, what are the critical questions to answer if we are to learn the lessons from other organisations that have been defrauded? And how can we benefit from those answers? Seeing others' mistakes and investigative successes objectively can enable us to map them onto similar scenarios in our own organisations and help focus our investigative efforts where something has come to light. They can also help us to identify areas worthy of closer attention and analysis to see if we have the same symptoms in our organisations.

Perhaps the first critical question is to ask why is there a need to pursue the guilty if you are the victim of a fraud. Can't you just leave that to the police? Well, firstly, the police may not consider your fraudster to be worth pursuing. Secondly, if they do decide to pursue them it could be years before the case comes to court, if at all, with no guarantee that your funds will be recovered. For smaller organisations, the fraud could easily take them under long before any police enquiries are complete. Finally, unless you are very lucky, the chances are that the fraudster will have stolen more than can easily be recovered. Generally, most frauds are not spotted until they are either well under way or it is some time after they have been committed. By that time, the fraudster will have made some effort to dispose of part if not all of their ill-gotten gains.

This leads on to the second question. If there is no in-house fraud team, why can't the organisation call in a specialist? After all, they will almost certainly be able to do something

immediately useful for the organisation, rather than wait for the police. Well, you can—and it may be your only option. But fraud specialists don't come cheap, we like to think that our skills are highly specialised and that comes at a premium, particularly if the organisation calls in one of the forensic arms of the larger accounting firms.

If there is any kind of professional internal audit service or if they or others have previous experience of a fraud investigation, then I would always urge organisations to do as much as they can in-house, bringing in the experts where really needed. It is usually a far cheaper and often more effective option. You will know your organisation best and there is no steep learning curve required to get to grips with the organisation before getting to grips with the case. Any experienced and sensible individual, auditor or line manager, who follows the processes that I set out in 'how to be a successful frauditor' should be able to manage most of the internal investigation with the in-house professional assistance from HR and legal, using any professional fraud auditing advice where best needed.

I have worked with every variant of the options for using outside professionals to help with a fraud investigation, from letting them run the whole case to 'cherry-picking' specialists to help with one-off parts of the investigation or the civil court process. The only time that I ever felt I had no choice but to go with outside specialists running the case was when I had a very small team many years ago and, apart from me, no one with any fraud investigation experience. The case needed the undivided attention of a team and involved a number of locations scattered around the UK. I simply didn't have the resource in-house to conduct the enquiries in a sensible time-frame so I felt that the only sensible option was to bring in an outside specialist team to help me. Even then, I got together with the organisation's procurement specialist and between us we drew up a specification and made sure that a good cross-section of specialist firms got invited to our briefing about the case. From that we invited expressions of interest and then asked for bids back in 24 hours (by and large you can't afford to hang about with a fraud investigation) and got them.

So how would I sum up the options?

### **Scenario:**

#### **1. No in-house expertise in fraud, small team**

- a) If management believe that you have or are suffering a significant fraud, then call for help and pay the price of bringing in specialists to do the whole investigation. If not, get a specialist in short term to do a scoping study and try to do what you can.
- b) Revert to specialist help for the entire investigation if you don't have enough bodies to spare.

#### **2. No in-house expertise in fraud, larger team**

- a) Get a specialist in to scope and possibly run the investigation but if possible get your staff to work alongside so that they can both learn the ropes and keep the specialist in the picture about your organisation.
- b) See 1 b) above.

**3. Some in-house expertise in fraud, small team**

- a) If management believe that this is a complex or significant fraud look for specialist advice but do the investigation yourselves if you can.
- b) If you haven't enough expert knowledge in-house, try co-sourcing with forensic specialists.

**4. Some in-house expertise in fraud, larger team**

- a) In all except the most complex circumstances try to do the investigation in-house.
- b) If the investigation starts to eat too much of your available sources, consider co-sourcing with a forensic partner.

**5. In-house expertise, but taking civil action, small team**

- a) You should be able to run the investigation yourselves, but for court purposes you will need to sign up a specialist forensic accountant.
- b) Otherwise, only call in specialists to supplement staff shortfalls in the investigative team and make sure that you manage them, not they you.
- c) When you pick a specialist for court, make sure that they have a track record of being on the winning side in a high proportion of their cases. Civil actions are balance of probabilities not reasonable doubt, so a 75% success rate isn't good enough, you want nearer 90%.

**6. In-house expertise, but taking civil action, larger team**

As per a) and c) above. You won't have the b) problem, will you!

Outside specialists with good knowledge of what happens in your type of business can be particularly helpful to support an investigation, as they may well know better than you where you are likely to find the bodies. I would still argue that you need to maintain control and manage the investigation, as, ultimately, their interest is in making a commercial profit but yours is in stopping the losses to your organisation and doing your best to recover stolen funds.

**WHAT ARE THE LESSONS TO LEARN?**

These will vary for each of us and I am sure that you will make your own mind up from reading the cases in this book. There are perhaps a few generic themes in certain cases worth picking out at this stage.

**Lessons to learn—part one**

This set of themes is largely about the reasons why frauds go undetected until it is too late.

*Theme 1: Collective or group 'three monkeys' syndrome*

(See no evil, hear no evil and speak no evil)

I've spent most of my working life being far too cynical for most of my bosses and then events have reinforced that I was right to feel that way all along. It is a natural trait in most

organisations to emphasise the positive and I don't have a problem with that. But there is also a natural tendency, particularly where there is strong-minded senior or top management, not to take bad news particularly well. In many corporate organisations and government bodies, this can manifest itself in an unwillingness on the part of those immediately below the top Board to bring 'bad news' to the table. That in turn transmits itself throughout the organisation. Eventually, even when everyone knows that a crisis is staring him or her in the face, no one speaks up about it.



'Peter gets the usual reaction when he tells the Audit Committee he's found a fraud.'

Management will try to 'bury' problems or manipulate performance data to hide something that is going wrong, rather than look for the cause. Equally, Boards of directors, particularly non-exec directors, can find it hard to do their fiduciary duty in organisations run by powerful, charismatic and wilful leaders. They too develop the syndrome and don't want to fall out of favour with their peers. It is hard to challenge when you are a lone voice and many whistleblowers and chief auditors over the years have been the first to lose their jobs when they have dared to stick their heads over the parapet and challenge top management.

In this book, there are two variations on the 'three monkeys' syndrome. We have the powerful and wilful bosses, as in the cases of 'Crazy' Eddie Antar, Colleen McCabe and Barrie Minkow. We also have the blind senior management where they just couldn't bring themselves to admit that they had made a mistake and got into bed with a fraudster, such as some of the cases I have included from my police experience and NHS days.

### *Theme 2: 'Alice in Wonderland'—the 'Magic Mushroom' syndrome*

There is an old saying that if it sounds too good to be true, then it probably is too good to be true. Fantasy has played a large part with some fraudsters and all con artists. The ability to

lie convincingly and then get others to believe what they are hearing when it defies all logic. Barry Minkow, Sam E Antar, Ramalinga Raju and Tim Johnston are classic examples.

*Theme 3: The 'first over the cliff' philosophy or 'lemming syndrome'*

This is a bit unfair to lemmings, as modern studies have shown that it is a myth that they follow each other blindly over cliffs into the sea. But time and time again human beings have demonstrated these very traits. The Firepower story is a classic of this type. So too is the Barry Minkow case study. It also applies to Crazy Eddie and to a lesser extent Satyam. Everyone wanted a piece of their companies when they thought that they would get massive returns on their investments and they were so desperate to invest that they were oblivious to many of the basic precautions that any rational person would have taken or considered.

*Theme 4: 'Greedy and needy' people will steal money from their employers*

Ultimately, they haven't got what they want or perceive they need and they look for opportunities to get it. If you don't check up on them or have adequate and effective supervisory controls over them, they will steal from you. Worse than that, when they get a taste for it, they can't stop. Cases in this book include the 'Laird' of Tomintoul (Anthony Williams), the 'Toys 'Я Us' sex and drugs man, Paul Hopes and Joyti De Laurey.

*Theme 5: Prevention is always better than the cure*

In many of the cases in this book the fraudsters could have been stopped in their tracks before they got going. In some instances, checks and proper vetting procedures would have given organisations the opportunity not to take these people or organisations into their fold. In other instances, financial lifestyle checks of employees with spending authority would have identified that they were a serious risk to their organisation.

*Theme 6: When employees forget why rules are necessary the fraudster steps in to fill the gap*

This isn't a variant of three monkeys as this happens at the grass roots and middle management levels of the organisation. Senior management can be blissfully unaware until it is far too late. It is the prescribed, alleged and actual business. There are always three systems in any organisation, the one laid down (prescribed), the one management tell you that they apply (the 'alleged') and the one that employees adopt in practice. When there isn't too much drift between the three there isn't a problem. But once familiarity lends itself to short cuts being taken by employees to avoid unnecessary work or 'improve the system' on the ground then doors are opened for the alert internal fraudster.

The classic starting point is when someone is supposed to check the work of another but they have worked together for years and are social friends. Almost inevitably they don't check



their friend as thoroughly as they would a stranger. Where regular staff or contractors are repeating the same work routines with each other, this familiarity leads to controls getting dropped. Joyti De Laurey's bosses trusted her. They didn't check their own bank statements for months—or they would have spotted her frauds very early on. Sam E Antar got successive audit teams compromised and reliant on their trust of him not to look too closely at dodgy areas of Crazy Eddie's business. Alex Watson-Jones persuaded a willing management to ease his way to a £2.8 million payout by getting them to relax controls so that they could spend their budget before the year-end.

### *Theme 7: The Law of Unintended Consequences*

All investigators should embrace this principle, as it is often how a sequence of events exposes a fraud or corrupt act. The law (as first expounded by US sociologist Robert Merton in 1936) is that in any complex social activity three possible unexpected consequences can occur. A positive outcome that wasn't intended, a negative outcome that wasn't intended and an unforeseen outcome that hadn't been considered.

It is the unforeseen outcome that often casts a light into the dark and murky world of the fraudster. It can also bite the investigator. In one of my earliest cases in my days at the NHS, I learnt a hard lesson when I wrote an investigative report that the recipients deliberately chose to misread. Their interpretation was possible because I had been unintentionally loose with the language that I had used to set out the details of what was going on. What I had written was factually accurate and I had wrongly assumed that they would draw the same conclusions that any auditor or investigator reading my report would have drawn. I had forgotten both to remember that a report has to be written for its intended audience and that for non-investigators you must hammer home that point that you are trying to make and not leave any ambiguity in the conclusions that you want your audience to draw from the facts.

The corporate credit card scandal at the Metropolitan Police happened because of the unforeseen consequences of changing the means by which police officers were required to account for their spending each month. Also at the Met, the contract changes to the vehicle recovery contract led to an exponential rise in the cost of one type of activity that eventually caused all of us to look very closely at what was going on. Barrie Minkow's Ponzi fraud, Sam E Antar's sales and accounting fraud and Ramalinga Raju's accounting fraud all created unintended consequences that eventually derailed them and exposed their frauds despite the failure of external auditors to unearth the frauds through normal audit work.

### **Lessons to learn—part two**

My second set of themes is about lessons to be learned from the investigation and the pursuit of the fraudster to get the organisation's funds back and to stop the fraud.

***Theme 8: Don't forget to stop the fraud first!***

The external auditors had a whistleblower with Barrie Minkow but by delaying their contact with the SEC until the maximum allowed by the legislation and by not clearly passing on their concerns to their successors or the rest of his Board they unintentionally allowed thousands more investors to get stung before the nonsense was stopped.

***Theme 9: Bringing in the police at the beginning can lead to delays in any civil recovery action***

Government ministries and agencies are particularly prone to this. Foxley is a classic here, where the investigation took years to bring to court. It is sometimes essential to bring in the police, particularly if the fraudster has done a runner or even in the charity case I cover, where the fraudster appeared to be suicidal and the police were called in because of concern for his welfare (they didn't realise that he had defrauded them at that point!). More often than not, early formal involvement of the police can cause two difficulties. First, they are there to solve a crime and catch a criminal; they are not there to help the organisation recover its assets. But once they have seized evidence you may have some difficulty in working out exactly what the fraudster has taken until the police can give you access to the papers they have acquired. Second, from the moment that the police are involved you have to tread carefully in any further work by your own people or those that you have hired in to get to the bottom of matters. It will be difficult to interview any potential suspect or deal with disciplinary issues without running the risk of falling foul of rules of disclosure or PACE (Police and Criminal Evidence Act) requirements that will apply once the police have started their investigation.

Police investigations and subsequent criminal proceedings can be lengthy affairs, particularly in fraud cases unless they are very 'open and shut' and the fraudster confesses. That can leave the civil process of recovering stolen assets in limbo and, for medium-sized organisations, can place a financial burden on them that may even take them to the wall in hard economic times.

***Theme 10: Alerting the fraudster that you are on to them can cost you dearly***

If you can, you should avoid alerting the fraudster that you are on to them until you have no other option. With Alex Watson-Jones, he had carried on at work after committing a major fraud as if nothing had happened. But once he was alerted by management suspending him from the office, he had time to move assets around and hide monies before the police called at his door.

***Theme 11: When you go after a fraudster, go hard!***

History shows that even if they put their hands up and admit their fraud, you still need to keep the pressure on them if you are going to recover as much as possible of whatever cash

and other assets they have stolen from your organisation. Where possible, I favour the multi-tracking approach often used by the NHS Counter Fraud Service. Multi-tracking is simply using all available likely methods to get at the fraudster and recover any losses suffered by the organisation. Single tracking by comparison would mean going for a criminal or civil action but not both.

I used the multi-tracking approach successfully against fraudulent linguists in the police until my early retirement in September 2009. We would go for civil recovery, criminal prosecution if possible and seek to have them removed from their professional panel that enabled them to get employment as a linguist.

### *Theme 12: Leopards and their spots*

Do convicted fraudsters truly reform—or is it simply another variation on the theme that caused them to commit the fraud in the first place? Barrie Minkow and Sam E Antar are two famous, perhaps infamous, US examples. Joyti De Laurey and Nick Leeson are two well-known British examples. All of them will tell you that they have reformed from the characters that committed the frauds for which they all received substantial sentences.

In the two US examples, Minkow became a Doctor of Divinity while in prison and set up the Fraud Discovery Institute, dedicated to exposing other business fraudsters in the US. Sam E Antar runs a website that explains in detail how he was able to get away with his frauds. Both of them have supported training and investigative courses run by the police and major investigative organisations. Antar claims not to take a penny for anything connected with the frauds that he committed, Minkow,<sup>1</sup> until his recent fall from grace, was a senior church pastor and for ten years repaid a third of his earnings from anti-fraud training and presentations about his frauds towards the losses incurred by his victims.

For the UK fraudsters, Joyti De Laurey is now heavily involved with a prisoner's rehabilitation charity and Nick Leeson, who also 'found God' in prison, started a new life in Ireland, gives talks to this day about how he did what he did and its consequences. Nick Leeson is the only one of the four who has always charged a fee to talk about his fraudulent former life. Nick has supported cancer charities and the like but to the best of my knowledge has not repaid any money to investors or others who lost out in the collapse of Barings.

All four have at various times since their frauds came to light courted the media, whether the press, news channels or through websites setting out details of how they committed their frauds. Ego and their need to be on centre stage have played their part with all four. They can all turn on the charm and come across as likeable ex-roguers when in one-to-ones or at group gatherings.

The leopard and spot theme is one about which you can make up your own mind. I'll just sit quietly by with my cup of scented Earl Grey tea (or nice glass of claret!), cynical smile and deeply suspicious mind.

## **GETTING TO GRIPS WITH THE SUCCESSFUL FRAUDITOR'S CASEBOOK**

I've written Chapter 2 as a lead in from this chapter to the rest of the book and the last chapter as very much a pulling together of my thoughts and experiences. In between, each chapter is complete and stands entirely on its own merit—and you can read any chapter in any order, depending on the type of case that takes your interest.

To give a reference point and a structure to the casebook, I have divided groups of chapters into sections, to reflect the dominant themes of those chapters and help signpost any chapter that might be of particular significance at the point when you are reading this book.