IN THE BUSINESS OF YOUR SUCCESS™

ADP Lunch & Learn
Course Materials

Crossing the Line: White Collar Crime (Part 1)

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1. Crossing the Line: White Collar Crime (Part 1)

Learning Objectives:

Upon successful completion of this segment, you should be able to:

- identify the types of fraud that currently take place in organizations;
- recognize the motivation for fraud among white-collar workers;
- distinguish between "asset misappropriation" and "financial reporting" fraud;
- explain how organizations can minimize the possibility of fraud occurring.

Segment Overview:

There's little doubt that accountants are once again on the look-out for complex fraud schemes that are taking place. But what is it that causes some ordinary people, including successful financial managers, to commit extraordinary crimes? Convicted fraudster *Walt Pavlo* and *Kelly Richmond Pope*, accounting professor at DePaul University, examine what causes some business people to cross the line.

Field of Study:

Auditing

Course Level:

Update

Course Prerequisites:

Work experience in financial reporting or auditing, or an introductory course in accounting

Advance Preparation:

None

Recommended Accreditation:

1 hour group live
2 hours self-study

Required Reading (Self-Study):

"Don't Ask/Don't Tell About Corporate Fraud"
By Professor Kelly Richmond Pope, of DePaul University
For additional info, go to:
http://accountancy.depaul.edu/docs/cvs/Pope1.pdf
See page 9.

Video Transcript:

See page 14.

Running Time:

22 minutes

Outline

I. Background

A. Crossing the Line
   1. Documentary by Dr. Kelly Richmond Pope
      a. assistant professor of accounting
      b. DePaul University
   2. "Ordinary People Committing Extraordinary Crimes"
      a. available: http://vimeo.com/31228845

B. Walter Pavlo's History
   1. Standard upbringing
      a. engineering degree
      b. MBA degree
      c. position in corporate finance at MCI

II. Unfolding of a Fraud

A. Motivation
   1. Need to
      a. please management
      b. meet expectations
   2. Desire to be appreciated as special

B. Reality
   1. Being a fraudster was
      a. difficult
      b. not glamorous
   2. Coming "clean" actually led to a life that was
      a. better
      b. more transparent

C. Huge Discrepancy Between How People
   1. Anticipate they will react
   2. Actually react to a situation

D. Potential Fraud Presented as an Opportunity to
   1. Help the company
   2. Further one's career

III. Looking at Fraud

A. Current Environment
   1. Companies are less likely to cut back on internal controls
      a. in bad economic times
   2. Any reduction in internal controls would lead
      a. to an increase in fraud

B. Types of Fraud
   1. Asset Misappropriation
      a. results in direct personal gain
   2. Financial Reporting
      a. results in indirect personal gain

C. Each Fraud Has Its Own Motivation

Outline (continued)

IV. Detecting Fraud

A. Regulation May Aid in Detecting Fraud
  1. But question of motivation is paramount
    a. why people engage in criminal activity
    b. how people engage in fraud
  2. Fraud is less related to economic conditions than it is
    a. to opportunity
    b. to rationalization

B. Incidence of Fraud
  1. More likely to occur in bad economic times
  2. Part of a cyclical pattern
    a. more fraud schemes
    b. followed by increased regulation

V. Deterring Fraud

A. "Where Were the Auditors?"
  1. Valid inquiry after fraud occurs
  2. But management provides information to auditors
  3. Employees have
    a. orchestrated fraud scheme
    b. supported fraud scheme

B. Candid and Transparent Communication
  1. Organization must report on what's taken place
  2. Individuals must feel comfortable in reporting potential fraud

VI. Going Forward

A. Consider the Real Consequences of
  1. What you do
  2. What you don't do

B. It's Not Just Tone-at-the-Top
  1. White-collar crimes can be committed by anyone
  2. Rank-and-file employees face same pressures as C-suite

Group Discussion

Instructions for Segment

- As the Discussion Leader, you should introduce this video segment with words similar to the following:

  "In this segment, a convicted fraudster and an accounting professor examine what causes some people to commit white-collar crimes."
- Show Segment 1. The transcript of this video starts on page 14 of this guide.
- After playing the video, use the questions provided or ones you have developed to generate discussion. The answers to our discussion questions are on page 6. Additional objective questions are on pages 7 and 8.

Discussion Questions

1. Crossing the Line: White Collar Crime (Part 1)

You may want to assign these discussion questions to individual participants before viewing the video segment.

1. According to Professor Pope, fraud schemes are more likely to occur in bad economic times. According to Walt Pavlo, fraud is less related to economic conditions than it is to opportunity and rationalization. Are these statements mutually exclusive or is it possible for both speakers to be correct? With which speaker(s) do you agree? Why?
2. Why is "tone at the top" important in deterring fraud? What message about fraud is sent by the top management of your clients' organizations?
3. While "tone at the top" may be important, why do Professor Pope and Walt Pavlo focus on fraud that is committed by white-collar and rank-and-file employees? Do you agree with their perspective? Why?
4. How does Professor Pope believe that companies can prevent greater frauds from taking place? Do you agree? Why? What are your clients doing to deter fraud?
5. In previous programs on this topic, speakers have concluded: "Time is the enemy of all frauds." What does that mean in this context?
6. Walt Pavlo observes that potential white-collar fraud is usually presented as an opportunity to help the company and to further one's career. Do you agree or disagree? Why? How does that knowledge aid in preventing and deterring fraud schemes?

Discussion Questions (continued)

7. Both Professor Pope and Walt Pavlo believe that, given the right circumstances, ordinary people can and will commit extraordinary crimes, including fraud schemes. Do you agree or disagree with them? Why?

Suggested Answers to Discussion Questions

1. Crossing the Line: White Collar Crime (Part 1)

1. According to Professor Pope, fraud schemes are more likely to occur in bad economic times. According to Walt Pavlo, fraud is less related to economic conditions than it is to opportunity and rationalization. Are these statements mutually exclusive or is it possible for both speakers to be correct? With which speaker(s) do you agree? Why?
   - Participant response is based on your background, perspective and experience.

2. Why is "tone at the top" important in deterring fraud? What message about fraud is sent by the top management of your clients' organizations?
   - Participant response is based on your clients – their organization, their leadership, and their policies – as well as on your perspective and experience.

3. While "tone at the top" may be important, why do Professor Pope and Walt Pavlo focus on fraud that is committed by white-collar and rank-and-file employees? Do you agree with their perspective? Why?
   - According to Prof. Pope and Mr. Pavlo, white-collar crimes can be committed by anyone. And rank-and-file employees face the same pressures as C-suite officers.
   - Participant response is based on your background, perspective and experience.

4. How does Professor Pope believe that companies can prevent greater frauds from taking place? Do you agree? Why? What are your clients doing to deter fraud?
   - According to Prof. Pope, businesses must adopt candid and transparent communication, so individuals feel safe in reporting potential fraud.
   - Participant response is based on your background, perspective and experience.

5. In previous programs on this topic, speakers have concluded: "Time is the enemy of all frauds." What does that mean in this context?
   - Because the duration of a "typical" fraud is 18 months, it is inevitable that someone in the organization – an auditor; an employee; a contractor – is bound to notice something about the fraud or the fraudster. Hopefully, they will then do something about it.

6. Walt Pavlo observes that potential white-collar fraud is usually presented as an opportunity to help the company and to further one's career. Do you agree or disagree? Why? How does that knowledge aid in preventing and deterring fraud schemes?
   - Participant response is based on your background, perspective and experience.

7. Both Professor Pope and Walt Pavlo believe that, given the right circumstances, ordinary people can and will commit extraordinary crimes, including fraud schemes. Do you agree or disagree with them? Why?
   - Participant response is based on your background, perspective and experience.

1. Crossing the Line: White Collar Crime (Part 1)

You may want to use these objective questions to test knowledge and/or to generate further discussion; **these questions are only for group discussion purposes.** Most of these questions are based on the video segment; **a few may be based on the required reading for self-study** that starts on page 9.

1. Pavlo says there is often a disconnect between:
   a) a fraudulent crime and its punishment.
   b) acting ethically and making the right decision.
   c) how we report white collar crime and how we feel about it.
   d) how we think we will react and how we do react.

2. Dr. Pope says that companies are less likely to cut back on internal controls when:
   a) there are tough economic times.
   b) the economy is booming.
   c) new regulations are coming out.
   d) there are a lot of publicized fraud cases.

3. The downfall of MCI and WorldCom led to, among other things:
   a) Sarbanes-Oxley legislation.
   b) widespread white collar crime.
   c) an increased incidence of fraud.
   d) increased insider trading.

4. Pope reminds us that _______ give(s) information to auditors.
   a) the CEO
   b) lawyers
   c) management
   d) low-level employees

5. According to Pavlo, __________ will often create an intimidating atmosphere for employees.
   a) Sarbanes-Oxley
   b) corporate greed
   c) the quest for results
   d) consequences

6. Pope says that white-collar crime:
   a) is mainly a C-level issue.
   b) can be committed by anyone.
   c) is a direct result of greed.
   d) can be completely eliminated.

7. Henry Markopoulos was a witness to the Madoff Ponzi scheme, but he failed to expose it because:
   a) he was afraid of repercussions.
   b) he tired of trying after 10 years.
   c) he reported to a less powerful company representative.
   d) he confronted Madoff several times without results.

8. The results suggest that when fraud is discovered, unsuccessful social confrontation:
   a) lessens reporting intentions.
   b) results in demotion of the witness.
   c) often leads to resignation.
   d) affects who whistle-blowers prefer to report to.

9. According to the paper, “Executive Overconfidence and the Slippery Slope to Fraud”:
   a) earnings management in a single period may go undetected if performance improves.
   b) an overconfident manager is more likely to anticipate the need for earnings management in future periods.
   c) the managers at Gateway computer were probably pessimistic about Gateway’s future performance.
   d) men are more confident than women because they are biologically programmed to be that way.

Objective Questions (continued)

10. Catherine Schrand recommends that:
    a) firms shy away from executives with too much confidence.
    b) overconfident executives be supervised more closely.
    c) firms recognize the downside of overconfidence.
    d) firms seek to hire overconfident executives.

Self-Study Option

Instructions for Segment

When taking a segment on a self-study basis, an individual earns CPE credit by doing the following:

1. Viewing the video (approximately 25 minutes). The transcript of this video starts on page 14 of this guide.
2. Completing the Required Reading (approximately 20 minutes). The Required Reading for this segment starts below.
3. Completing the online steps (approximately 55 minutes).

Required Reading (Self-Study)

DON'T ASK/DON'T TELL ABOUT CORPORATE FRAUD

By Professor Kelly Richmond Pope, of DePaul University
For additional info, go to:
http://accountancy.depaul.edu/docs/cvs/Pope1.pdf

According to a recent study by Mei Feng (University of Pittsburgh), Weili Ge (University of Washington), Shuqing Luo (National University of Singapore) and Terry Shevlin (University of Washington), CFOs engage in financial statement fraud largely due to pressure from CEOs, not a desire to receive a personal financial gain. The study – entitled "Why Do CFOs Become Involved in Material Accounting Manipulations?" – analyzed a sample of accounting manipulations data disclosed between 1982 and 2005. This raises questions about internal confrontations between subordinates and the CFO, between the CFO and the CEO, and between employees related to other frauds.

Steven E. Kaplan (Arizona State University), Kelly Richmond Pope (DePaul University), and Janet A. Samuels (Arizona State University), spearheaded a study that investigated how an unsuccessful confrontation can aid an organization in uncovering fraud. They investigated two independent variables: (1) the presence or absence of an unsuccessful social confrontation with the transgressor regarding the fraud and (2) the type of fraudulent act that occurred. Detecting fraud at corporations using outside sources is difficult, so discovering fraudulent activity often starts with employees. It is therefore important to foster an environment for internal whistle-blowing.

Based on the ACFE 2010 Report to the Nation on Occupational Fraud and Abuse to identify the most common types of fraudulent acts, the researchers used misappropriation of assets and fraudulent financial reporting as case examples to solicit feedback from 96 evening MBA students. Participants in the study were offered the choice of reporting the fraud to two internal recipients-either their supervisor's supervisor or an internal auditor.

The focus of the Kaplan-Pope-Samuels study was to understand what steps should be taken after a person experiences an unsuccessful confrontation about a suspicion of fraud. Many whistle-blowers make numerous attempts at exposing a fraud. For example, Henry Markopolos spent nearly a decade attempting to expose the billion-dollar Madoff Ponzi Scheme. His failed confrontations were due, in part, to his reporting to a less powerful company representative. At Worldcom, whistle-blower Cynthia Cooper's first confrontation to the audit committee resulted in the immediate release of CFO Scott Sullivan from his duties. Cooper's successful confrontation might have been a result of reporting to an internal, powerful group of company representatives.

In order to infuse real-world attributes into the study, each participant was given background information about a hypothetical manufacturing company where the participant "worked". The company had steady operations but recently performed slightly below the industry average. The company's leadership had set more aggressive financial performance goals for the current year and their audit committee worked hard to ensure the integrity and reliability of the financial statements and internal controls.

The results indicated that reporting intentions to the supervisor's supervisor were stronger than those to the internal auditor following an unsuccessful social confrontation with the transgressor. When the social confrontation had not occurred, participants' reporting intentions did not favor either of the reporting channels.

This suggests that after an unsuccessful social confrontation with the transgressor, the witness prefers to report to an employee in a position of power above the transgressor. This is because when the confrontation occurs the witness loses his or her anonymity, which increases the risk of retaliation from the transgressor. In regards to results based on which fraudulent act occurred, the effect of social confrontation on reporting intentions did not vary.

The results of the study have important implications. They are consistent with theory behind the role of power relationships that suggest that whistle-blowing decisions are influenced by the recipient's power. However, this study indicates that this influence may vary depending on the situation. For instance, the recipient's power becomes more pertinent as the witness's exposure to risk and retaliation increase.

The results of the study should provide audit committees and senior executives guidance on whistle-blowing systems related to employee relations. Informing employees of all of the reporting channels that exist for them is critical in encouraging potential whistle-blowers to come forward. The results suggest that when fraud is discovered, unsuccessful social confrontation does not lessen reporting intentions, but affects who whistle-blowers prefer to report to. This is a valuable addition to understanding the actions of employees who have detected fraud.

Are Overconfident Executives More Inclined to Commit Fraud?

No one makes it to the top ranks of corporate management without a healthy amount of self-assurance. Confidence underlies decisive, strong leadership, but does overconfidence lead managers to cross the line and commit fraud?

New research that combines results from the psychology literature and SEC fraud enforcement records is examining how top executives might be inclined to engage in fraudulent behavior because they are overconfident about their firm's ability to perform in the future.

Wharton accounting professor Catherine M. Schrand and doctoral student Sarah L. C. Zechman are developing a paper titled, "Executive Overconfidence and the Slippery Slope to Fraud" that examines patterns in frauds to determine if some frauds evolve, not out of pure self-interest, but because executives are overly optimistic that they can turn their firms around before fraudulent behavior catches up with them.

"The main question is whether we can explain fraudulent behavior using knowledge about human decision making. Some fraudulent behavior is the outcome of managers putting themselves in the position where fraud is their only choice," says Schrand. "They didn't start out thinking they would commit fraud and they were not necessarily trying to hurt anyone, but they ended up being in a position where they felt it was the only way to get out of a bad situation."

Schrand describes the path leading to fraud. An executive believes his firm is experiencing only a bad quarter or patch of bad luck. He also believes it is in the best interest of everyone involved – management, employees, customers, creditors and shareholders – to cover up the problem in the short term so that these constituents do not misinterpret the current poor performance as a sign of the future. In addition, he is convinced that down the road the company will make up for the current period of poor performance. It is the optimistic executive or overconfident executive who is more likely to have these beliefs.

"He may stretch the rules just a bit or engage in what you might call a 'gray area' of earnings management. But say it turns out that he was wrong and things don't turn around as expected," Schrand continues. "Then he has to make up for the prior period. That requires continuing fraudulent behavior and he has to do even more in the current quarter."

According to the paper, earnings management in a single period is likely to go undetected if performance does improve. If not, the paper states, managers continue to manage earnings in increasing amounts. "Eventually, the manager's only option is to 'cook the books' by falsifying documents and making the kinds of accounting misstatements that are prosecuted by the SEC," the authors write. An overconfident manager with unrealistic beliefs about future performance is more likely to engage in fraud "because he is less likely to correctly anticipate the need for more egregious earnings management in subsequent periods."

Fraud is becoming increasingly prevalent – and also public. Two of the largest corporate frauds in U.S. history, Enron and WorldCom, occurred in the past decade, inspiring increased attention from both the financial press and government regulators. If overconfidence is the reason, does that mean systematically biased decision makers dominate the executive ranks? "A lot of executives exhibit the characteristic of overconfidence in which their expectations are higher than what might be suggested," Schrand says.

"Overconfidence is a human characteristic that exists in the general population for certain types of people, and it is more prevalent in executives." She points out that research in psychology, along with entrepreneurial and management studies, show that people who get promoted to the top levels of a corporation are typically those with enough confidence to take chances. In addition, executives are in top positions because of past successes, and these experiences can cause them to be overly confident.

Keeping Up the Charade

To assess whether overconfident executives are more likely to commit fraud, the researchers reviewed Securities and Exchange Commission accounting and enforcement releases (AAERs) from the 1990s and 2000s to examine patterns in companies that are engaged in fraud.

Waste Management, which in 1998 restated earning from 1992 to 1997 by $1.7 billion – at the time the largest earnings restatement in corporate history – is cited in the paper as an example. The SEC charged the company with systematic fraud in which top executives set earnings targets for each quarter and manipulated accounting, quarter by quarter, until a new chief executive officer ordered an audit of accounting practices and discovered the scheme. "The company's revenues and profits were not growing fast enough to meet these targets, so defendants instead resorted to improperly eliminating and deferring current period expenses to inflate earnings," according to the SEC. The amounts were small at first and went undetected, but they necessarily had to escalate to keep up the charade.

Schrand points to Gateway computer as another example of how fraudulent behavior can snowball over time. In the second quarter of 2000, Gateway managers began an aggressive financing program aimed at customers whose applications for credit in the company's financing program had been rejected. The SEC enforcement release says that by June 8, 2000, Gateway had generated $10 million in such loans (referred to by Gateway as "outbound" loans). Two days later, management was considering a revised goal of originating $20 million of the high-risk loans. When management asked one division head if he could meet his revenue target of $975 million without the incremental revenue from the financing program, the division head responded that he was already counting on $30 million from the program to meet his revenue target.

"The Gateway situation is very analogous to the current subprime crisis," notes Schrand. As with the sub-prime lenders, Gateway's fundamental lending activity – the outbound loan program – was not illegal. The problem that ensued in both cases, however, was that the risk of the lending portfolio was not adequately accounted for through reserves or adequately disclosed, and may not even have been known by managers – in particular, overconfident managers. The outcome in both cases was unexpected losses when the borrowers defaulted.

Not disclosing the change in Gateway's credit policies probably wasn't a material misstatement at first when the program was small, but not disclosing as the program grew became a fraudulent act under SEC rules. The authors suggest that one possible explanation for Gateway's situation is that managers were overly optimistic about future prospects. They did not anticipate at the time they started the program that they would have to extend it to such a degree in order to meet future targets. If they had, they may never have started it in the first place.

The authors explore the relationship between executive confidence and fraud across industry, firm and individual variables. They found fraud is more likely in industries that are complex and undergoing rapid growth, such as high-tech. Schrand notes that the most meaningful variable in linking fraud to specific industries is high stock-return volatility.

"The sample demonstrates industry clustering in risky, dynamic, high growth industries that face significant idiosyncratic risk," the paper states. "The management literature has shown that such industries are attractive to overconfident executives." But Schrand acknowledges that such industries also may exhibit more fraud because the incentives to commit fraud are greater or because it is easier to commit it.

As further evidence, the researchers examined firm and individual characteristics to gauge the effect of overconfidence on fraud. To observe trends, the study compared firms that had been identified by the SEC as experiencing fraud to a matching sample of firms of similar size and in the same industries that had not been sanctioned by the SEC.

Premeditated vs. Accidental

In reviewing the SEC data, the researchers identified two types of fraud. One is outright, premeditated or "opportunistic" fraud. The other is naïve, almost accidental fraud that fits with the authors' idea that executives who find themselves in a jam are inclined to turn to fraud to cover up minor earnings management in prior periods.

Schrand acknowledges that many executives in the same position steer clear of trouble. "Clearly there are some executives who choose not to go down the fraud path," she explains. These managers make a rational decision and fully understand that if they mask poor earnings, they are committing fraud and that could lead to heavy penalties. Schrand says fraud may have occurred at some of the matched firms, but never reached the level that it was detected by the SEC, perhaps because managers' overconfidence paid off and a temporary problem worked itself out.

To better understand these companies, Schrand is currently examining earnings restatements. These companies, like the fraud firms, may have managed earnings briefly, but they did not continue the pattern. When the executive was in the position of requiring egregious behavior to cover up prior "gray areas" of earnings management, or earnings management in minor amounts, he didn't do it. Instead, he admitted to the earlier earnings management and then restated earnings. The behavior never escalated to fraud. "This is where we still need to do more data analysis. It may be that some executives choose to 'fess up' to minor amounts of [earnings management] rather than committing fraud and the SEC chooses not to penalize the firms that admit to minor transgressions with an official enforcement action."

On the firm level, she says, the research focuses on looking at other decisions made by firms exhibiting fraud – including dividend policy, capital structure and tax strategy – that also are correlated with executive overconfidence. If overconfidence is the explanation for fraud, then firms at which fraud occurred should make other decisions that reflect overconfidence. Schrand notes as an example that these firms also tend to pay lower dividends, or no dividends, compared to matching firms. "This finding is consistent with survey evidence about overconfident executives and dividend policy. The idea is that overconfident executives think they have something better to do with the money than pay it out in dividends," says Schrand.

When it comes to looking at the individual characteristics of executives likely to commit fraud, the analysis is not that statistically compelling, Schrand cautions. The psychology literature identifies individual characteristics that are related to overconfidence – such as commitment to a project – and characteristics of the decision maker based on his experience, such as past successes, education or military service, and even fundamental traits, such as gender. (All but one accused executive in the researchers' sample is male.) The authors note that psychological studies find men are more overconfident than women, but it is unclear whether that is because of a biological link or their experience. Measuring these types of attributes of individual executives is difficult. As the paper notes, the results are only descriptive.

The authors also looked into the role of corporate governance as a device to alter the relationship between overconfidence and fraud. They found no significant differences between the fraudulent firms and the matching sample on commonly studied governance features such as block ownership, board size and board composition. The paper says this result suggests executives at fraudulent firms were more overconfident than those at firms where fraud did not occur, and that better governance was not in place to counteract their tendency to commit fraud. Schrand adds that this result is consistent with the conclusion that the fraud firm executives are different. It is inconsistent with the idea that all executives are equally overconfident and that the non-fraud firms simply had better controls in place to contain their executives.

Just because overconfidence might lead to bad decisions in particular circumstances, it should not be the only, or even primary, consideration when evaluating executives, Schrand says, adding that a growing body of literature indicates that confident and optimistic leaders might make what would be viewed as bad decisions in certain circumstances, but overall, they also have assets that any firm needs to succeed. "Given that the firm has to hire the whole person, you might actually want somebody who exhibits this bias. But, you should recognize that the overconfidence, which has its positive aspects, can also have a downside."

Video Transcript

1. Crossing the Line: White Collar Crime (Part 1)

QUINLAN: As our viewers certainly realize, no one makes it to the top ranks of corporate management without a healthy dose of self-assurance. After all, confidence typically underlies decisive, strong leadership. But to what extent does overconfidence lead managers to cross the line and commit fraud?

An ongoing documentary film project at DePaul University is titled, "Crossing the Line." And it is an exploration, led by Dr. Kelly Richmond Pope, assistant professor of accounting in the University's college of commerce, of why – and what happens when – ordinary people commit extraordinary crimes.

SURRAN: With us is Walter Pavlo, Jr., a former MCI executive as well a convicted fraudster. He authored "Stolen without a Gun" about his fraud, and now lectures about financial fraud and blogs on white-collar crime for Forbes.

Thanks for joining us this month, Walt.

PAVLO: Thank you. It is a pleasure being here.

SURRAN: You won't be surprised, Walt, but our audience identifies with you: an engineering degree, an MBA, a position in corporate finance, and a desire to get ahead in the corporate world. Your story – and your saga – is not uncommon, is it?

PAVLO: I can just tell you from my own experience. I was convicted of a fraud a number of years ago and spent time in Federal prison. The people that I talked to had similar backgrounds.

I was asking them the same thing: "Why you? Why are you here?"

It turned out to be very similar things: an ever-increasing amount of risk, or things that they thought that they could undo at a later time. It just got out-of-control, and they just were not able to bring it back, reel it back in, and it related to my own story.

I think that my biggest fault in corporate America was this desire to please and the desire to make someone appreciate the work that I do – whether it is those who work for me or those above me. For a while there, I seemed to be making everyone happy, even though, in many ways, I was not doing the right thing.

So, there are a lot of different motivations that people have. But I can tell you a constant theme that I see among people that I cover now for Forbes, people that I met in prison, and in my own experience, is the desire to please management and to meet expectations that they set on you.

SURRAN: It's difficult now, but tell me, Walt: what was your motivation for "crossing the line"? Was it the excitement of achieving better results than less-performing colleagues? Or was it the allure of buying new cars and expensive suits that drove you into your fraud?

PAVLO: I will not deny that a nice car and a nice suit did not feel good as some sort of reward that was there. But I never got up in the morning, saying, "I need a nice car," and "I need a nice suit." But I did get up every morning thinking that I have to do the best that I can.

Again, I wanted people to appreciate the work that I was doing. Not just appreciate it, but to look at me as somebody special. And, more than anything, I feel that that was my biggest downfall.

PAVLO: Now, other people that I have covered, particularly when I write for Forbes on white-collar crime, are looking to get an edge or to get in. I covered some of the insider trading cases, and people who were passing information on to hedge fund managers.

Some of those people actually wanted to work in the hedge fund industry, and they were crossing the line. They were making a small amount of money – $50-, $60-, $70,000 – but they knew people in the hedge fund industry who were making millions and millions a year.

Were they passing information to make a few bucks? Yes, but their ultimate goal was to be something much more: to be appreciated. And I can tell you: insider trading hedge fund managers greatly appreciated the information that they were getting, and rewarded them with money. But they also rewarded them with accolades as well as inside, special information.

SURRAN: I read your book. I saw that, like me, you were raised a good Catholic. So, I shouldn't be surprised: you confessed everything and made a full and frank admission. On one hand, it must have made you feel better. Even redeemed. But on the other hand, I can't imagine: what's it like having your kids visit you in prison?

PAVLO: Well, let me just say, often I am asked: am I sorry because I did what I did, or am I sorry because I got caught? I can tell you that my life, leading up to being caught, was certainly not glamorous. I am not saying that I was looking to be caught and could not wait to go into prison. But I can tell you that my life was a disaster. I was nervous. I could not sleep.

There were addictions related to sleeping pills and alcohol.

It was not a good life. So, being caught, my life actually got better, even with the prospect that prison was in front of me, at least now there was an end in sight. At least, there was a way to talk to somebody about deep secrets that I had kept, even from my own family about what I had been doing.

Just the ability to talk and say, "I don't have control over this anymore." Somebody else can tell me what they think of the information that I have and what I've done wrong.

So, it was a bit of a confession. But at the same time, it was therapeutic for me to be able to just come clean with it. I will say that the prospect of prison was something that terrified me – whether it was for my family or for myself. Selfishly, I was afraid. I did not know much about prison and I did not know what it would be like for my kids to know that I was in prison. Were they going to be made fun of?

But it turns out after a while, by just facing these things that again, just like coming clean, you end up having a much better life and a much more transparent life.

I think that that's a better way to live it.

SURRAN: What you're telling me, I think, Walt, is that this tale could happen to anyone, couldn't it? Even someone who was brought up with values and always played it straight, right?

PAVLO: Well, I think that there is a disconnect sometimes between when we look at how we would react in a situation before it is presented to us, and how we actually react in the situation – which can be different. I am not saying that everybody can do this, or will do what I did to commit a fraud.

But I can say that it has been proven that people think that they are going to act ethically, or in the right way, or make the right decision, when presented with the fact outside of the situation. But once, in the situation, they do something completely different.

How does that apply when you're looking at white-collar crime? Well, white-collar crime does not present itself as something devious, or mean, or bad, or even covert. "We're trying to help the company. We're trying to do what's best for the company." Do you understand? White-collar crime and fraud is often presented as a nice package. It is going to benefit people. It is going to help people.

It is not presented as like, "Hey! Let's go cook the books today. Let's go do something illegal that could land us in prison." So it is quite the opposite. It is wrapped up very nicely, so many more people than you would think would be susceptible to that.

SURRAN: Also with us is Dr. Kelly Richmond Pope, an accounting professor at DePaul University who researches white-collar crime and forensic accounting. Thanks for joining us this month, Kelly.

POPE: Thank you for having me.

SURRAN: As corporate financial executives, our viewers have had to "right-size" their own organizations. And as you know, Kelly, there may even be situations where they've had to cut back on the monitoring of internal controls or on compliance activities. I suppose that could actually lead to increased fraud activity, couldn't it?

POPE: I think the way you presented the question: "yes." I think, if companies are cutting back on internal controls, then yes, we could see more fraud. But I do not know if I totally agree with the statement that you made.

I think that companies are less likely to cut back on internal controls, especially when we see the economic times and the business environment that we are in right now. Paying attention to internal controls is very important, and I think that is going to be the way that we catch fraud. So, companies cutting back on internal controls would probably be a bad thing. But the question that you originally asked me: Sure, if we see a cut back on internal controls, then yes, that can lead to more fraud.

SURRAN: Let's make sure I understand what you mean, Kelly, by "fraud." On one hand, there is fraud that involves asset misappropriation and corruption. On the other hand, there is what is often termed "financial reporting" fraud. To what extent do you make a distinction between these types of fraud?

POPE: So, I think when we think about fraud, we often think about it in terms of two main categories.

The Association for Certified Fraud Examiners really educates the community on these different categories of fraud. So, when I think about financial manipulation, I think about a CFO or an accountant manipulating the books. But when I think about corruption, I think about embezzlement. I think about a person stealing cash or stealing money from a company. I think of fraud in the category of a person having a direct personal gain and a person having an indirect personal gain.

I think about financial statement manipulation as a person that receives an indirect financial gain. I think about embezzlement or corruption – but, under corruption, embezzlement – as a person that is receiving a direct financial gain.

Something that I have seen in my research in doing the documentary – "Crossing the Line: Ordinary People Committing Extraordinary Crimes" – is those two categories. People that committed financial statement manipulation received an indirect gain, whether that be a bonus. Then we see the embezzlers – people that just stole cash from the company and just pocketed it.

I categorize fraud that way because there is a different motivation for each type.

SURRAN: Let me return to your story, Walt. Your fraud was a big deal and you'll be paying restitution for another two decades. But it was a moment in history, too, wasn't it? I mean, it was no coincidence you're your employer – MCI WorldCom – had a historic accounting fraud and collapse, was it?

PAVLO: Well, it is major history. It is major history because – as a result of the downfall of MCI WorldCom, of which I was a part of earlier on – it led to new legislation, the Sarbanes-Oxley Act, which we still have today. It is also the groundwork for new legislation that keeps coming out, as far as regulation on how we hold executives accountable.

Looking at the different aspects that people could have in how they might justify their actions, I want to try to provide some warning for that. White-collar felons are kind of like the rest of the population out there. By telling more stories – that white-collar felons are normal people who made a terrible mistake – is going to lend a lot more result as far as fighting crime than any legislation that is out there. But was it historic? Absolutely.

SURRAN: It's not a bubble today, Walt, but the tough economic times – and the bad jobs market – are similar to what we went through a decade ago. As you go around lecturing about fraud and about ethics, how similar or dissimilar do people seem – and do organizations seem – to what you recall from your MCI days?

PAVLO: Well, white-collar crime happens, and fraud happens, in both good times and bad times. In the boom times, you look at a quote from Warren Buffet who says, "Only when the tide goes out, can you see who was swimming naked," referring to during the boom, there is all sorts of fraud. We see that with mortgage fraud.

Today, different frauds are occurring: insider trading is prevalent, even though the economy is down. The stock market is even down, and yet insider trading is prevalent.

It does not really matter what the economic time is; people are going to find their own rationalization to conduct some fraudulent activity. More than anything, these frauds happen because of the opportunity that exists within corporations where there are very loose standards; there is nobody watching. There is an overabundance of trust without anyone checking everything that goes on in an organization. The rationalization is always going to be there.

But the opportunity is a place where you can protect not only your employees, but the name brand of the corporation from somebody doing something wrong, and I think that is very, very important. As I talk to people, they realize that fraud is prevalent and they realize that there is going to be temptation out there. Do they think that they're going to be the ones to succumb to it? They do not. But I can tell you, neither did I.

SURRAN: Does that make sense to you, too, Kelly, that businesses are once again on the look-out for complex fraud schemes taking place?

POPE: It is not a coincidence that we are starting to see more instances of fraud schemes.

Poor economic times typically mean more fraud schemes. People are being very creative. People are feeling a lot of pressure to make their numbers look a certain way. When you look historically at fraud, we see several periods of schemes, several periods of regulation, several periods of schemes, and several periods of regulation. We are just in one of those periods where we are seeing schemes and then regulation.

So, I do not think it is a coincidence. I think that we will continue to see this. We are all subject to pressure, and we are all subject to human error. Some error and some mistakes, but I do think that we will continue to see this in our future, unfortunately.

SURRAN: I suppose it's inevitable, Kelly, that after any fraud scheme is eventually exposed, people will say, "Where were the auditors?"

POPE: Being a CPA and an accounting professor, and a person who really supports and loves the profession, I think that it is good to ask the question: Where were the auditors?

But you can also say: Where was the CFO? Where was the CEO? Where were the management consultants? Where were the lawyers? Where are the employees?

There is responsibility enough to go around to everyone who is involved in an organization. The auditors are important, and that is a valid question: where were the auditors? But you have to remember that, the way the process works, it is management that gives the information to the auditors. So, if the managers give fraudulent information to the auditors, how can we blame the auditors?

It is the same question that you can ask: which came first, the chicken or the egg, because where were the auditors? I think we should start at the beginning: where was management? Because management provides the information.

The employees are the ones that are either orchestrating or supporting the scheme. When you look at a lot of the cases, including the big cases, there are a lot of people involved in these cases. But where is everybody? Who is paying attention?

You cannot put all of the blame or responsibility on one body or one group. Everyone is to blame; everyone is responsible. It is not just a question of where are the auditors. Again, it is the question of: where are the employees; where are the compliance officers; where are the management consultants; where are the lawyers? Where are the lawyers? Let's ask those questions, too, in addition to where are the auditors.

SURRAN: In a similar vein, Walt, it's also inevitable that some fraud will occur anyway. From your perspective, what can organizations do to minimize or deter fraud?

PAVLO: Well, I think the best thing that organizations can do is to speak candidly – and transparently – with their people about what is going on in the organization. If there is a violation, I believe that organizations have the right to tell the employees, "Hey! This is what happened. Something happened to Joe. Something happened to Sue. Here's what they did. These are the repercussions. This shouldn't have happened. We feel bad that it happened. We're going to change policy so that this doesn't happen again."

You also have to provide an environment where people feel safe to report to management to say, "Hey! I don't feel comfortable doing something," and to provide feedback.

Many times, the quest for results, and financial results inside of a company, often present an intimidating sort of atmosphere, where employees are just trying to please the boss so much, that they find ways to please the boss. Perhaps, that is cutting corners, and perhaps, that, in a way, could lead to their own individual greed taking over, so that they might participate in a fraud.

So I think more than anything, I think just some transparency, and a work environment that feels safe, where people know that they can go to their boss – or to their boss' boss – and get relief from a situation, and that they can speak openly.

SURRAN: Let me wind up by asking you: if our viewers could take one thought away from this program, what would you like that to be?

PAVLO: Well, let me just speak to people that, in general, are faced with a situation: "Should I do this," or "Should I not do this?" I would say that the advice that I would give is: do not give a lot of weight to the consequences of doing the right thing. So often, when we look at a situation, we think "Oh, my goodness. I'm not going to make the results. I'm going to disappoint this person." They are looking at these consequences, that there are going to be consequences if I fail to perform, because I just cannot.

Really, those are not really consequences. Consequences are fraud. Consequences are going to prison. Consequences are being separated from your family. But too often we look at consequences being, "Well, I'm going to disappoint shareholders. I'm going to disappoint my boss. I'm going to disappoint peers that work for me. They're going to think that I'm not doing a good job." Well, sometimes telling the truth, there could be consequences. But I consider those to be much less than anything that you would get if you start lying a little bit, and then it starts catching up with you later.

POPE: If I could leave your viewers with one thought, or one piece of advice, it would be to think about white-collar crimes: white-collar crimes can be committed by anyone. It is not a C-suite incident. It can be committed by any one. That is something that I have learned in the research that I have been involved in for the past three years, working on this documentary that I have developed, entitled, "Crossing the Line: Ordinary People Committing Extraordinary Crimes." What I have learned is that no one is isolated.

After talking to several convicted white-collar felons, I found that I really identify with what they are describing. Not to say that I would make the same choices, but I know people can identify with those stories. That is why talking about fraud and educating people about fraud at all levels is very important. A lot of times in the media and in the research, we focus so much on the C-Suite that we forget about the employees. Those employees are facing the same pressures that the C-Suite's facing.

They are often approached, and often engaged in, fraud as well. So, I think one lasting point is, this can happen to anybody. Anybody can be susceptible to white-collar crimes.

QUINLAN: Our thanks to Walt Pavlo – and to Professor Kelly Richmond Pope – for their insights on why ordinary people commit extraordinary crimes.

As I indicated at the opening of this program, you can view a trailer for the DePaul University documentary film project – "Crossing the Line" – by visiting the computer link on your screen.

In addition, we will continue this program on next month's release when Professor Pope is joined by noted psychiatrist, Dr. Daven Morrison, in an exploration of understanding the unethical executive.