Control fraud in America: Are we structurally encouraging control fraud?

Emmanuel J. Connell
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Abstract
Control fraud, defined as a criminal in control of a company using it as a weapon and shield to defraud others and makes it difficult to detect and punish the fraud, has become a social epidemic (Black, 2005, 1); (Wheeler & Rothman, 1982, 1403). Since the savings and loans scandal of the 1980’s, control frauds have been looting and manipulating others virtually unchallenged by any government regulatory agencies. White collar control frauds cause billions of dollars in damage to the public annually, while that of street crime causes far less damage in the range of millions. Despite the disparity in damage, control fraud seems to be on the back burner in terms of priority for government regulatory agencies. In a day and age of a prison driven nation, petty street offenders are being incarcerated with regularity while white collar control frauds continue to fraud unquestioned which creates a clear social class bias favoring white collar criminals.

White collar control frauds are able to persist in fraud and looting due to several factors which structurally create a criminogenic environment that encourages fraud. Specifically, control frauds are able to continue looting because of laxity in sanctioning, deregulated markets, and the maintaining of the capitalist status quo in a greed driven economy. To combat these factors, we must create a greater awareness of control fraud followed by effective and tough sanctioning for control frauds regardless of social class. Further, a serious need for intense regulation is necessary to confront control frauds, coupled with providing adequate funding and resources to regulatory agencies to effectively combat control fraud. If these changes can be made, a final elimination of white collar crime, specifically control fraud, can be attained.

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Control Fraud in America
Are We Structurally Encouraging Control Fraud?

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CONTROL FRAUD IN AMERICA

CONTROL FRAUD IN AMERICA: ARE WE STRUCTURALLY ENCOURAGING CONTROL FRAUD?

By

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ABSTRACT

Control fraud, defined as a criminal in control of a company using it as a weapon and shield to defraud others and makes it difficult to detect and punish the fraud, has become a social epidemic (Black, 2005, 1); (Wheeler & Rothman, 1982, 1403). Since the savings and loans scandal of the 1980’s, control frauds have been looting and manipulating others virtually unchallenged by any government regulatory agencies. White collar control frauds cause billions of dollars in damage to the public annually, while that of street crime causes far less damage in the range of millions. Despite the disparity in damage, control fraud seems to be on the back burner in terms of priority for government regulatory agencies. In a day and age of a prison driven nation, petty street offenders are being incarcerated with regularity while white collar control frauds continue to fraud unquestioned which creates a clear social class bias favoring white collar criminals.

White collar control frauds are able to persist in fraud and looting due to several factors which structurally create a criminogenic environment that encourages fraud. Specifically, control frauds are able to continue looting because of laxity in sanctioning, deregulated markets, and the maintaining of the capitalist status quo in a greed driven economy. To combat these factors, we must create a greater awareness of control fraud followed by effective and tough sanctioning for control frauds regardless of social class. Further, a serious need for intense regulation is necessary to confront control frauds, coupled with providing adequate funding and resources to regulatory agencies to effectively combat control fraud. If these changes can be made, a final elimination of white collar crime, specifically control fraud, can be attained.

Key words: control fraud, white collar crime, regulation, fraud, manipulation, capitalism, social class bias, and greed.
Chapter 1

REDEFINING CONTROL FRAUD

It has been highly documented that fraud costs American taxpayers in excess of $486.48 billion annually (Reiman & Leighton, 2010, 125). To better put the gravity of this number into perspective, street crime/property crime, which is defined for our purposes as: burglary, motor vehicle theft, larceny, and robbery, has an estimated modest annual loss of $15.6 million (Federal Bureau of Investigation; Uniform Crime Report, 2011). The numbers behind the crimes should raise concern for many, however it appears that our politicians, law enforcement, and many members of the media seem to only show regard for the fight against petty street crimes that by all accounts has decreased substantially in the last five years (Federal Bureau of Investigation; Uniform Crime Report, 2011). Despite the documented decrease, the media has focused on petty street crimes that draw a larger crowd of viewers in the best interest of higher TV ratings, entertainment revenue and sponsorship. Politicians and law enforcement agencies on the other hand, have focused their agenda towards arbitrary issues for what they assume will get them elected into office instead of the major issue of fraud in our society. The cost of special attention to TV ratings and personal agendas has resulted in a clear lack of awareness of the real threat that plagues American society as a whole.

The real threat of serious concern is one that is often considered unconventional and imaginary by the media’s inclination of severity. This threat has also been belittled by our politicians who may have a stake in seeing that consciousness of threat is minimal at best. The infamous litigator of the savings and loan debacle of the 1980’s that put a stop to the billions of dollars looted from tax payers and the industry, William Black dubbed this threat as “control fraud”. Control fraud is defined as a criminal in control of a company using it as a weapon and
shield to defraud others while making it difficult to detect and punish (Black, 2005, 1); (Wheeler & Rothman, 1982, 1403). Fraud is further derived from deception in that one creates and exploits trust to cheat others (Black, 2005, 1). The very core of fraud must be taken as a legitimate explicit weapon because it diminishes trust that trickles down to a demolishment of relationships, agreements, business markets, and our culture in general. Once trust is lost, risk value increases therefore leading to a decrease in stock prices, business values, and an increase in security cost measures. The gauntlet does not end there, in fact, companies must invest valuable resources into increasing security measures to prevent the risk and fraud from occurring. We the people, the taxpayers, must foot the increased costs by way of companies and bureaucracies passing the expenses onto us through raised product prices and service expenses. Ultimately, the idea of a control fraud results in the disintegration of trust that takes on an evolution into more expenses to counteract the fraud with necessary mechanisms that we the people must pay for whether we are conscious of it or not.

To better explain the effects, Black states the point clearly in terms of unconscious effected parties:

"fraud causes terrible negative externalities because it inflicts injury on those who were not parties to the fraudulent transaction" (Black, 2005, 1).

In making reference to "those who were not parties", Black intends to convey the very idea that the nature of control fraud affects others, you and I, who may be completely unaware of the deceit that will become a vehicle to raised prices and higher taxation due to necessary control fraud measures. The extra expenses trump any other form of criminal actions that result in losses to the consumers, even that of blue collar thievery and petty street crimes. Particularly, control fraud costs taxpayers more financial losses than any and all other property crimes combined,
which should raise enormous concern (Black, 2009). However, we may make the control fraud possible by naïve and uneducated weakness from the deceiving control fraud that often comes in the form of an honest and intelligent CEO. A control fraud will strategically seek individuals who they perceive to have inherent weakness and with the use of manipulation, they will exploit these individuals for their personal gain. Additionally, a criminogenic environment that allows for the control fraud to perpetrate and thrive explains the other half of the problem. A criminogenic environment is one that encourages crime and deceit by the lack of regulation and policies in place to combat fraudulent crimes (Black, 2005, 3). The combination of both a criminogenic environment and that of preying on weak individuals through exploitation provides a better explanation to how control fraud is possible.

Once the criminogenic environment is in place, the stage is set for super predator control fraud artists to do what they do best, exploiting the weak and naïve. Exploitation comes by way of taking advantage of others without any conscious knowing or whereabouts of the control fraud. We know this to be possible when we use the Savings and Loans debacle as a lesson to be learned from that came at a time when regulation was limited and consumer awareness was absent at best. The Savings and Loans scandal of the 1980’s allowed for CEO’s to loot entities into insolvency while pocketing the returns and ultimately indebting the taxpayers of the losses incurred (Calavita & Pontell, 1990, 309). The final estimates of the losses suffered, ranged at a staggering $300 to $400 billion by way of a bailout with taxpayers funding (Calavita et al., 1990, 309). The criminogenic environment in the Savings and Loans scandal was the driving force behind the losses due to the complete lack of regulation by the hands of then president Ronald Reagan, therefore allowing fraudulent criminal activity as the underlying factor (Calavita et al., 1990, 312). The deregulated environment is only made possible by politicians such as President
Reagan who hold a clear interest in seeing the markets free of any rules regardless if fraudulent and unethical means are the very nature of the Savings and Loans tragedy.

A complete realization of control over a corporation or organization is absolutely necessary for events such as the Savings and Loans debacle to occur. As the title of Black’s book states, “The Best Way to Rob a Bank is to Own One”, which captures the essence of the ideal that with complete control comes the power to put the right people in place to use the organization as a vehicle to fraud and theft (Black, 2005, 1). Not only must the control fraud realize his power but it must be recognized and endorsed by others in the organization as legitimate. The control fraud’s power is often endorsed by others who either fear or respect the individual. Those who do not succumb to the control frauds ideals and fraudulent mechanisms are often dismissed or shunned in such a way that the individual will reluctantly accept the control frauds power. Once this happens, the control fraud can put people in place to aid in perpetrating the control fraud, essentially resulting in theft. The control fraud uses the company as the perpetrator as well as the victim, making it very difficult to detect the fraud and theft (Friedrichs, 2010, 234).

In normal circumstances, organizations will have a checks and balance system that acts as a prophylactic to any fraud that may occur. However, the issue with this logic is that the control fraud is the head and CEO of the organization which only follows suit that they can and will control those security measures. To do this, they strategically place specific individuals that are not capable of saying no to fraud but quite the contrary; they will do as the control fraud requests. The individuals are what Black describes as “yes-men”, who either are too afraid to cross the CEO or are of loyal nature no matter the criminal extent (Black, 2005, 2). Additionally, outside yes-men are needed to secure clean opinions when audit measures are enacted in order to defeat fraud controls. The control fraud actively seeks accountants, auditors, lawyers, regulators,
and other outside yes-men who will sign off on clean opinions whether the books or products are fraudulent and lack value or not (Black, 2005, 2). Intuitively, the control fraud becomes unchallenged or checked by the systematic recruitment and placement of individuals who will aid and abet the fraud under the supervision of the super predator control fraud.

The process of establishing an organization built upon control fraud goes much deeper than obtaining the yes-men, in fact the recruitment stage is a preliminary step for the control fraud to acquire the correct mechanisms to loot the organization. The fraudulent accountants will provide a statement for the control fraud that over-values assets, resulting in an increase of stock values of non-existent product. To better convey the issue, the control fraud obtains an optimal asset opinion on the value of their product or assets by a top notch auditing firm, deceitfully allowing shareholders, taxpayers, and legitimate businesses to believe that the organization is valuable and making profit. Additionally, like-minded control frauds will initiate fraudulent transactions with each other as a means to record quarterly value on a transaction that has no actual value, yet the top notch auditing firm will give their blessing. Another trick used by the control fraud is the mechanism of selling a product or initiating a transaction with their own company in an effort to cover up losses from one account and switching funds to another to cover up extreme losses and create fictitious income (Black, 2005, 2) The many mechanisms and enablers make control fraud possible and the existence of these individuals has revolutionized the business markets throughout the American market.

Control frauds have many strategies for fraud and deceit but they hardly act alone in putting others money into their pockets. True control frauds will actively seek environments that are fully conducive to accounting fraud and other deviant mechanisms. States that have the lowest amount of regulation or that are lacking in resources to control fraudulent individuals and
organizations are seemingly ideal for a control fraud to operate. Control frauds will use their power to move the organization to those deregulated states or they will only do business with states operating in a deregulated fashion. However, in the event that the control fraud cannot operate in a deregulated environment, they will use another tactic provided by the resources at their fingertips. The control fraud will bully, threaten, and coarse regulators into giving in to their demands of deregulating the markets in the effort to loot and fraud the company (Black, 2005, 3). In this way, the control fraud will prey on the weak and weary who were methodically chosen as a target of which can be taken advantage of. If intimidation does not work, the control fraud, who is often the CEO, will use the resources of the organization to make political contributions as a last ditch effort to sway politicians into deregulation. In simpler terms, the control fraud will attempt to “buy” politicians by lining their pockets with funding from the organization of the control fraud (Black, 2005, 3). Conclusively, the control fraud cannot act alone without the support of politicians and regulators turning a cheek at the deviant actions of the super predator CEO.

With regulators deep in the pockets of control frauds, the stage is then set for personal theft by what would appear to many outsiders as legitimate means. Specifically, deregulated markets allow the control fraud to hide losses and in fact transform them into record profits that are graced by a big audit firm, making the books seemingly legitimate. The control fraud will continually report inflated numbers over losses, never to be challenged as what appears to be a lucrative and successful organization. The truth of the matter is that no one wants to point fingers at highly profitable companies who are boosting the economy and the marketplace. The control fraud understands this type of fear or respect, as such, and can drive the organization into complete insolvency while maintaining face as a respected CEO. In turn, the organization will
handsomely reward an already over-paid CEO with enormous bonuses, stock options, and other generous incentives. The rewards, while earned through extreme fraudulence, become something of an obsession for the control fraud, a game if you will. At this point, the control fraud believes and convinces them self that the fraudulent means of gaining (false) profit to be legitimate and therefore continues the rampage into complete insolvency of the organization. The control fraud then intuitively, consciously makes the organization a vehicle for looting by deceit and trickery among other things.

On the other end of control fraud is the credit reporting agencies that act as auditors and approval institutions for large corporations that assist the conniving CEO with perpetration of the fraud. The rating companies willingly live and die by a “don’t ask, don’t tell” practice that ultimately boils down to a conscious overlooking of records as a means to give a AAA stamp of approval to an insolvent and risky institution (Black, 2009). The control fraud would essentially buy a AAA rating from credit rating companies that would tell lenders they have a zero risk chance of default. The credit rating companies would purposely bypass the necessary files to be examined to prove profitability and clean books, necessarily aiding and abetting in the control fraud scheme (Black, 2009). The practice of overlooking the books has proved to make many credit agencies into extremely lucrative businesses and in turn, fueled the nonprime mortgage derivative industry that became the collapse of the 2008 housing debacle.

One of the most infamous control fraud schemes known to the American society was named after early super predator Carlo Ponzi, who in 1919 claimed he could reach astronomical returns on investment through low postage rates and a self-developed system of investing (Friedrichs, 2010, 204). Carlo Ponzi, or “Charles” as he is often known, would take funds from investors and pay off old investors with new investors funding, which appeared to the old
investors as huge residual gains. He would then have to continually gain new investors in order to pay the old investors and keep the scheme moving. The remaining funding would be pocketed by Ponzi and used for his own personal agenda. Ponzi’s control fraud scheme became known as the “Ponzi scheme” or “Pyramid scheme” that jump started the fraud revolution in America. The Ponzi scheme is a vehicle for control fraud; however a better understanding of why the control fraud actually exists is crucial to identifying the measures needed to eliminate the fraudulent practice.

A theory developed by Charles’s Tittle known as control balance further explains why control fraud exists and is highly emergent. Tittle believed that crime is a function of the amount of control one exercises relative to the amount of control imposed upon one (Friedrichs, 2010, 234). In this way, control fraud was intuitively a derivative of control balance by the idea of a surplus of control that allows control frauds to engage in exploitative and fraudulent transactions. The surplus of power relishes the extent to which fraud can be perpetrated by the control fraud but to make fraud possible, the control fraud must have an abundance of power, only through absolute control of the organization from which he/she seeks to extort and commit thievery. Control balance theory then becomes necessary to afford the opportunity for transition to control fraud through power differentials within an organization or corporation. Although control balance helps explain control fraud, many other factors are central to the theory and etiology of control fraud.

Factors aiding in control fraud are exclusive to regulation or the lack thereof, criminogenic environment, the psychosis personality of greed and power, and the lack of a deterrent effect. However, an argument can be made that inherent criminal tendency is the central theorem to any deviant act whether of fraud or other deviance. The factors leading to
control fraud will be progressively explored as a means to create greater awareness of the endemic in our society. The aims of the research on control fraud are increasingly intricate in developing an understanding and conceptualization of the many reasons that control fraud exists and the factors that are central to its existence. More so than the factors, are the resolutions to the problem that seemingly plague American corporations, organizations, and enterprises. Gaining a greater awareness of control fraud as an effort to create systematic solution is necessary to combat the problem at its core. Taking a closer look into the research will allow the opportunity to create the resolutions and tools needed, ultimately resulting in scholarly work to be disseminated for use and further research to be built upon.

Taken as a secondary analysis, it is critical to understand William Black’s theory of control fraud to have a complete understanding of the issue. Particularly, a closer look at Black’s book, *The Best Way to Rob A Bank Is to Own One* (2005), will provide the basis for the argument and resolution of this research. In addition, the theoretical framework to follow will encapsulate research from Jeffrey Reiman & Paul Leighton on their work in *The Rich Get Richer and the Poor get Prison* (2010) as well as David Friedrichs writing in his book *Trusted Criminals: White Collar Crime in Contemporary Society* (2010). Utilizing the many scholarly research works, the theory of control fraud will be dissected, covering the etiology of the issue, its effects, and the resolutions to such effects.
Chapter 2

PERPETRATORS AND VICTIMS; WHO WINS?

Perpetrators

Control frauds and white collar criminals are often thought to have deviant features that would stand out due to their innate conniving tendencies, however, the truth of the matter is that control frauds resemble normal everyday people, such as fathers, brothers, cousins, and people just like you and I. In fact, the very idea that they can blend in and deceive others makes the control fraud that much more dangerous. Individuals who commit control fraud tend to have a personality that is built upon greed and hunger for more no matter the cost. Control frauds seek weakness in individuals and organizations as prey in order to extract and use everything they possibly can for personal gain (Black, 2005, 3). Individuals who do not buy into the control frauds threatening demeanor will then be met with tactics to cause tension and unease as a means to control defiant individuals into either succumbing to their demands or being dismissed. Controls frauds encapsulate the very essence of their title, they use control as a mechanism to bully others into aiding in their fraud.

In addition to controlling mechanisms, control frauds generally operate in two different and distinct variations. In specific, control frauds will either act as opportunists or in a reactive manner, to perpetrate fraud. The opportunist control fraud actively hunts for open opportunities while the reactive control fraud makes a move when a business is falling to insolvency (Black, 2005, 5). Opportunists tend to be more aggressive and risky in that they will continually perpetrate control fraud whether their organization is legitimately profitable or turning to insolvency. Conversely, a reactive control fraud will be seemingly honest for many years until
the organization or business takes a turn for the worst, then engaging in fraudulent mechanisms for fear of failure and saving face (Black, 2005, 5). Control frauds are motivated by greed turned fraud and not by bad economies or insolvent markets despite reactive control fraud motivations. An underlying innate intention to gain more and more is an ideal that is critical to understanding what and who a control fraud really is.

Excessive risk-taking and above-the-law mentality further deciphers the control fraud ideal which leads to moral hazard, a term that explains the control fraud persona. Moral hazard is the temptation to seek gain by engaging in abusive, destructive behavior, either fraud or excessive risk-taking (Black, 2005, 6). Control frauds use this mentality to drive companies into insolvency without any concern for its shareholders, employees, or other indirect parties that will be affected. Limited liability makes this lack of concern possible when it is understood that shareholders can only lose up to the total value of their stock. The control fraud is then no longer responsible for failure or debt incurred yet the creditors must pay the price of the insolvency. However, if the large risk committed by the control fraud gains massive profits, the control fraud and shareholders are handsomely rewarded. The incentive for the control fraud to take huge risks and make poor decisions is therefore enhanced with the weight of failure being exclusively on the creditors as oppose to the greedy risk-taking CEO (Black, 2005, 6). The risk factor then makes reactive control fraud more appealing to potential deviant white collar criminals.

Opportunist control frauds, on the other hand, operate and are defined by four distinct characteristics. The four characteristics are used to create and find optimal avenues for control fraud. For this to be possible, opportunist control frauds consider characteristics such as: ease of obtaining control, weak regulation, ample accounting abuses, and the ability to grow rapidly (Black, 2005, 7). The opportunist control fraud thrives in unregulated environments that make
the criminogenic environment necessary as a tool in the fraud’s repertoire. While the opportunist control fraud is highly deceitful, the use of deceit becomes unnecessary with a deregulated market. A deregulated market allows for control fraud to operate without detection or the means to combat the fraud. Conclusively, the opportunist control fraud is an active, control seeking individual who pursues ideal deregulated markets to loot the industry for personal gain.

The control frauds are erroneously perceived as acting alone in looting organizations yet their perpetration of accounting fraud and other such fraud is accessed through other cohorts who make the deception possible. Lawyers, creditors, auditors, and regulators directly and indirectly allow avenues for fraud to persist, working hand-in-hand with the control fraud. Control frauds will obtain “yes-men” such as attorneys who will provide counsel that is oriented towards finding every intricate legal and illegal loophole for fraudulent financial gains. Many times, the attorney will act as both lawyer and CEO, creating a conflict of interest in itself. Additionally, while there is an obligation to report any potential bodily harm of the client, there remain no ethical obligatory laws that require a break in attorney-client privilege for reasons of financial fraud or other associated white collar criminal behavior (Friedrichs, 2010, 300). Control frauds understand such privilege and as such use particular attorneys to progress their fraud and deception.

Creditors and auditors may be the single most active contributors in the fraud committed by the deceitful CEO. In the case of accounting fraud, which comprises the majority of control fraud cases, control frauds will recruit and pay for big auditing and credit firms to render flawless ratings and opinions on non-existent fraudulent transactions and risk assessments. The blessing from an audit firm tells lenders that the corporations are safe and risk-free from substantial default and loss. The issue here lies in the idea that audit firms who are threatened by
loss of profit and contract from the control fraud will sign off on an impeccable rating without
even a quick glance at auditing books to verify profitability and lack of risk. Corrupt auditors, on
the other hand, will knowingly overlook financial statements and auditing reports further aiding
in fraud (Friedrichs, 2010, 302). The auditing firm or individual accountant then becomes a party
to the control fraud whether of conscious or unconscious nature. Although accountants and audit
firms have an ethical responsibility to report misrepresentations with financial statements to
corporate management, they are not however required to personally come forward with
allegations of fraud or misrepresentation to outside authorities (Friedrichs, 2010, 302).
Nonetheless, auditors, creditors, and accountants aid in the control frauds vehicle for looting and
fraudulent deception.

Apart from accountants and attorneys who work directly for the corporation or
organization under the control frauds command, the outside regulator creates the criminogenic
environment that supports the control frauds deviant endeavors. In a normal and healthy
corporation, compliance officers would provide policing of fraud internally as a defense
mechanism protecting the corporation, however the control fraud strategically selects individuals
to act as compliance officers that will not only allow fraudulent activity but also aid in the fraud
(Friedrichs, 2010, 306). In this way, the control fraud creates loop holes that will benefit their
deceit in looting the corporation. Conversely, outside regulating officials who are far too often
underpaid and overworked have a greater incentive to aid the control fraud in looting.
Government regulators have a budget in the millions of dollars to police fraudulent corporations
who are looting in the billions of dollars, lending to the idea that resources are few and far for
combating control fraud (Friedrichs, 2010, 289). Additionally, large corporations ran by control
fraud CEOs have an upper hand in that they have the resources to bribe, offer prospective
lucrative government jobs, and heavy government influence (Friedrichs, 2010, 289). Regulators also have the weight of political leaders on their back that use pressure to sway regulators into laxity on regulation in the interest of their corporate ties. Corporations are able to accomplish laxity in regulation by intense lobbying and enormous political contributions that force government officials to halt any and all regulation of their fraudulent business practices (Friedrichs, 2010, 290). This causes the regulator to become a necessary component who aids in the control fraud’s looting consciously or unconsciously, by use of bribes, political pressure, or lack of resources to combat fraud.

Victims

The costs of control fraud and other forms of white collar crime, while estimated in the trillions of dollars annually, cannot begin to explain the extent of damage committed against the victims (Friedrichs, 2010, 50) nor can any number explain who the victims are, how it affects them, and if any compensation can reconcile the damage committed against them. However, victims of control fraud come in many forms and very often are unknown to the general public due to the indirect nature of the control frauds deviant behavior. Additionally, control fraud crimes are hardly ever reported, and those that are reported receive little to no attention in retrospect. Many businesses that are victims of control fraud will make every attempt to cover up their losses due in large part to the ridicule and embarrassment that they believe they will receive from peers in the industry (Friedrichs, 2010, 49); (Levi, 1987, 1992, 169). The non-reported nature of control fraud then enhances the idea that this type of crime is minimal and unproblematic which leads to little to no deterrence and forgotten victims that pay the price. Even when control fraud cases are reported it becomes very difficult to assess and capture the
extent of damage in terms of finances and psychological losses therefore, victims are often unknown, forgotten, and hardly ever compensated for their losses.

The indirect victims are those who were affected the greatest by control fraud that had nothing to do with the criminal deviance, yet were subjected to the consequences for the actions of others. In particular, increased expenses must be allocated to fraud prevention mechanisms and risk management devices, which are similar to the idea that conventional crimes result in increased expenditures on locks, cameras, and other security measures (Friedrichs, 2010, 51). Not only must corporations spend extra finances on fraud mechanisms but they must hire more employees to conduct investigations, screen individuals, and maintain surveillance (Friedrichs, 2010, 51). The additional expenses are then added onto product prices, cost of services, and associated fees that we the consumers must endure in the wake of control fraud activity. The consumer then becomes the unconscious victim of the control fraud without any inclination of the wrong doing. Conversely, investors suffer when confidence and trust is lost after a control fraud scandal surfaces, ultimately resulting in decreasing stock prices and an increase in interest rates in the market (Friedrichs, 2010, 52). Once again, the consumer bares the brunt of the control frauds criminal behavior through negative stock market adjustments. In short, the indirect victims are those who suffer consequences of the control fraud that were not a party to the criminal actions, very often the American consumer.

In addition to consumer victims, control fraud causes mistrust, depletion of confidence in markets, superiors, and corporations as well. Deterioration of trust then takes a toll on employee confidence and working relationships with those who have violated trust within the corporation or organization. Once the onset of loss of confidence sets, a prophylactic divide between the consumer and retailer, employee and management, and investor and corporate CEO create a
market that is determined to decrease profits, and ultimately, assault the economy as a whole. Weary markets cause consumers to re-think their purchases and investors alike to consider who they invest funds with, for good reason. Simply put, investors and potential buyers become victim to the fraud by mistrust that creates a psychological effect, which causes a freeze on allocating resources back into the market and economy.

Control frauds prey on a broad spectrum of victims, but government entities are often looked over as too big to become victimized. Quite the contrary, government entities often fall victim to control frauds by defense contract firms who overbill beyond the scope of what has been set forth between the two parties (Friedrichs, 2010, 54). Defense contractors ran by control frauds will find ways to manipulate government contracts by downright looting the tax dollars from government funding. Particularly, control frauds understand that regulation and oversight by government compliance entities is slim to none, making theft by exaggerated charges and unaccounted for billing an easy ride to looting American tax dollars. The trickledown effect transitions to loss of tax payers’ dollars that could have been allocated to much needed programs and social services that will now become losses due to control fraud. Victimization therefore is not limited to consumers and investment firms but also government entities.

Victimization by control frauds has minimal awareness by the public and government agencies that make the control frauds become untouchable. Compliance agencies and regulators generally approach control fraud victimization with less than significant concern of the damage due to the idea that most victims of control fraud are of a wealthy status to begin with and cannot be compared with victims of street crime, then becoming stigmatized (Friedrichs, 2010, 56). Additionally, it is thought that wealthier subjects should be even more so conscious of control fraud behavior and white collar criminality than the average individual. However there is a
serious issue with the logic in this type of thinking in that crime and deviance is the same whether perpetrated by an armed assailant or a white collared crook with a pen. Adding on, many argue that street crime has a more serious nature in that offenders use deviant and corrupt measures unlike that of a desk, tie and suit criminal. White collar control frauds use thievery, deceit, power, manipulation, and fraud which are attributes and tactics found in every property street crime that is known. Collectively, the control fraud victimization should not be overlooked due to stigmatization of the character and wealth of the victim or the makeup of the criminal.

Despite the common notion of control fraud victims being of a wealthy status, as a whole, victims are not of affluence in retrospect (Shichor, Sechrest, & Doocy, 2001, 81). Low level control fraud investors prey on individuals who may invest their life savings, retirement funds, and other sorts of savings accounts. These individuals can be blue collar workers, hourly employees and other low wage workers who are not considered affluent. Victims of this sort face the most dramatic consequences when control fraud investor’s loot or misuse their entire life savings for personal expenses and inappropriate allocations of funds. When this happens, many victims have no resolve and no clue where to turn or who to report it to. Lack of awareness and attention to control fraud and white collar crime maybe the root of the inability to find correct agencies to handle these crimes. The losses suffered by the victims of investment control fraud, leave a sense of betrayal and desperation followed by realization that some cannot afford medical insurance, mortgage payments or other necessities anymore. Victimization of blue collared middle class individuals should be of serious concern within the issue of control fraud predators.

There is no secret that victims of control fraud perpetration have no typical profile or association from which to label, yet they all share a common thread in that they have been deceived and cheated of their finances and most importantly their trust. Indirectly or directly,
victims suffered losses ranging from arbitrary to insurmountable devastation of all assets and even nationally economic effects from the consumer standpoint. What remains clear is the level of victimization of investor, creditors, common consumers, employees, and retired individuals resulted in psychological detriment from loss of trust and financial ruin. The effects of the victimization need to be called upon for further investigation and a raised level of awareness as a means to a remedy to the epidemic of control fraud.

**Wins and losses, Landmark cases**

Control fraud is a complex and intricate form of criminal deviance, one that requires immense conceptualization to develop the necessary tactics of combatting and preventing future economic disasters. While there have been many landmark control fraud cases in the past, a shortage of investigation and research has been dedicated to defeating the fraud. In addition, the academic research that has been conducted has been served to closed ears from government regulatory boards and political machines that have an agenda to serve and corporate crooks to appease. Further, the media has added to the continuation of control fraud by focusing on crime that captures audiences as oppose to white collar control fraud that the public may perceive does not affect them. A combination of watered down public awareness and laxity in regulation and compliance efforts has supported the control fraud endemic. Deeper review of historical control fraud cases and a wide range of public dissemination of findings is the key to ending the repeating cycle of looting and deceit that is control fraud.

For starters, the 1980’s encompassed the majority of the control fraud cases that received the most notable media attention. The savings and loans debacle was a direct example of what can happen if control frauds receive little attention and regulation. Savings and Loans cases
CONTROL FRAUD IN AMERICA

resulted in an excess of $500 billion, with control frauds being the epicenter of the criminality (Reiman & Leighton, 2010, 138). Savings and loans provided federally backed loans that were financially insured by the federal government from the entity Federal Savings and Loan Insurance Corporation (FSLIC). Once the federal government deregulated the markets under the supervision of then President Reagan, investors would make extremely risky investments. When the investments became insolvent and massive failure set in, control frauds knew that the FSLIC insured them, meaning they could take advantage of the system by shooting for broke with risky investments being covered by taxpayer dollars (Reiman & Leighton, 2010, 139). Essentially, control fraud investors would only take the riskiest investments knowing that they will not have to foot the bill whether insolvency defined the investment loan or not.

Of the convicted control frauds involved in the Savings and Loans debacle, the most notable were Michael Hellerman, Charles Bazarian, and Mario Renda along with a sleuth of other criminal control frauds. Michael Hellerman was convicted of fraud of a Savings and Loan in New York in which he defrauded $8.4 million and $7.5 million from Florida Center Bank (Reiman & Leighton, 2010, 141). Consequently, Hellerman was sentenced to 47 years and $1.75 million fine as a combination of both frauds, however after appeals he concluded a 5.5 year sentence and a requirement to pay $100,000 fine, which he has yet to pay (Reiman & Leighton, 2010, 141). Bazarian on the other hand, managed to extract $20 million from a couple Savings and Loans investments and an additional $100k from a government H.U.D. project (Reiman & Leighton, 2010, 141). Not surprisingly, Bazarian was found to be complicit in the Florida Center Bank fraud case along with fellow control fraud Michael Hellerman. Similar to Hellerman’s sentencing, Bazarian ended up with a disparate sanction of 4 years in prison, three years probation and $110k in restitution and fines for his actions between the Savings and Loans
swindles and the Florida Center Bank fraud (Reiman & Leighton, 2010, 141). All said and done, Bazarian served a measly sentence of less than two years in prison for collaboration with authorities and has paid back no more than $18k in fines and restitution (Reiman & Leighton, 2010, 141). Needless to say, birds of a feather serve time together. Lastly, Mario Renda, president of First United Fund, a brokerage firm in Garden City, and a financial consultant, looted $16 million from two union pensions and welfare funds (Buder, 1987). The brokerage claimed a net worth of over $170 million, a number that would have made their firm one of the largest profiting firms in the country. The number could not be further from the truth and, in fact, the firm was falling to insolvency yet looting others of millions of dollars for personal expenses (Buder, 1987). Following criminal conviction, Renda was sent to prison and required to pay over $10 million between restitution and fines yet only served 21 months of hard prison time (Reiman & Leighton, 2010, 141). Although Renda served a minuscule amount of prison time for his deceitful crimes, he was ordered to pay a substantial amount in fines. Whether he actually pays the entirety of the amount owed remains to be seen but if history is our guide, like the control frauds before him, he will not pay the full amount. As in the case of Renda and the other control frauds, swiftness and severity, or the lack thereof, was the theme of the 1980’s Savings and Loans debacle.

In more recent times, control fraud scandals reached epic proportions beginning with the infamous Enron and Arthur Andersen cases in the 2000’s. Enron, a nationally recognized energy trading corporation led the charge of control fraud cohorts who were covering up massive debts, recording losses and loans as profit, using fraudulent accounting practices, and attaining enormous bonuses and stock options by cheating the market (Reiman & Leighton, 2010, 140). Along with many other criminal control fraud corporations, Enron helped jump start the
recession crisis of the 2000's that many would argue, we Americans are still recovering from. The control fraud perpetrated by corrupt CEOs and CFOs further resulted in loss of confidence in the market that transgressed into decreases in stock value and a drought in the American economy. Intuitively, the control fraud of this era is pivotal that it be learned from and evaluated, a lesson that cannot be overstressed.

In the case of the accounting firm Arthur Andersen, the firm was convicted for fixing financial statements that were audited in an effort to cover up corporation wide insolvency for many large corporations (Reiman & Leighton, 2010, 144). In addition to fraudulent bookkeeping, Andersen carried out a massive shredding of financial documents that would have linked the auditing firm’s corrupt bookkeeping practices to the energy giant Enron’s implosion of fraud in accounting practices and outright deception. A reported 32 boxes full of financial documents regarding Enron’s insolvency and cover-up were ordered to be destroyed to hide the collusion that took place between Andersen and Enron (Kher, 2002). Following the aftermath of the debacle, Andersen’s big name accounts such as Freddie Mac and Delta Airlines immediately cancelled their existing contracts with the auditing firm, sealing their demise as a fully functional auditing firm (Kher, 2002). Andersen’s control fraud amounted to the fining and settlement of $217 million to Sunbeam, $90 million to Colonial Realty, $7 million to end a Waste Management Case, $229 million dollar shareholder settlement, and a SEC cease and desist order for deceptive accounting (Reiman & Leighton, 2010, 145). Finally, the Supreme Court ordered Andersen to no longer operate as any type of entity for charges of obstruction of justice in relation to the Enron scandal. However, after appeals, Andersen was lifted from the disbarment for reasons of failing to demonstrate conscious wrong-doing but since time elapsed since the original disbarment, Andersen’s employees had already left, contracts were cancelled, and the
firm no longer had the resources to rejuvenate back into a profitable auditing firm (Reiman & Leighton, 2010, 145).

Arthur Andersen’s counterpart Enron, while colluding in much of the very same manner that found the auditing firm disbarred, had many more intricate elements of fraud in their demise. Particularly, Enron’s control fraud CEOs hid financial losses and debt with the aid of Andersen knowing full well that the corporation was billions of dollars into insolvency. The corporation was losing massive amounts of revenue and in fact had no profit margin to show, hence the diabolical cover-up of losses. Control frauds engaged in conflicts of interest within contracts, deceitful accounting transactions, and criminally deviant manipulation of employees and consumers of power in California (Reiman & Leighton, 2010, 145). The most disturbing of Enron’s control fraud behavior lies in that top CEO’s Jeffrey Skilling, Ken Lay, and CFO Andrew Fastow were fast selling their shares as the ship was increasingly sinking (Reiman & Leighton, 2010, 145). In total, between the men, $1 billion of shares were sold off in the last few years of Enron’s existence, as employees were locked out of selling their shares for what CEO’s dubbed administrative changes (Reiman & Leighton, 145). Enron employees were told not to sell and that the company has never been in better financial condition, however after the lockout, bankruptcy was declared which ended over 4,000 jobs and life savings’ emptied (Bragg, 2002).

The control fraud scandal at Enron, the largest of it’s time, left several thousands unemployed, and financial markets in disrepair.

The control frauds that caused the Enron disaster were finally convicted as Jeffrey Skilling was found guilty on a combination of 19 counts of insider trading, fraud, conspiracy and false statements which he received 24 years of prison time for these actions (Reiman & Leighton, 2010, 145). Kenneth Lay was convicted of 6 counts of conspiracy and fraud however he suffered
a major heart attack before he could be sentenced, therefore ending any current and pending cases against him (Reiman & Leighton, 2010, 147). As in the case of CFO Andrew Fastow, who had 109 felonies pending against him, he decided to help the prosecution in testifying against his superiors, ultimately reducing his sentence to a maximum of a 10-year prison sentence that could be significantly reduced with good behavior (Reiman & Leighton, 2010, 147). The CEOs penalties in this case may stand out as one that was delivered with adequate sanctioning, however in the grand scheme of things, the billions looted and retirement pensions lost were insurmountable compared to the minor prison time sentenced.

Overall, whether victim or perpetrator, can there be a distinct winner when control fraud is unchecked? An argument can be made that of the few cases mentioned that went through prosecution stages, the control frauds received minimal prison sentences and paid very little in terms of restitution and fines. Control frauds that looted billions of dollars and received fines of less than a few million can view this as nothing short of a business decision, if you will. In this logic there can be no deterrence for the conniving looters, meaning that many more consumers, investors and employees will continue to be exploited and deceived. Winners? Yes, if you consider control frauds giving a few million dollars to make several billion fraudulent dollars. Losers? Absolutely, the consumers and American taxpayers must carry on the bill to finance the prosecutions, pay for increased security control stops, and fall victim to an untrusting marketplace full of unchecked wolves, control frauds that is. The question remains, why haven’t government compliance agencies strictly enforced tough penalties and laws to deter future disasters of this magnitude? The answer lies in regulation policies, effective sanctioning practices, and feeding the status quo of the American Political agenda, topics to be further explored.
Chapter 3

WHY DOES CONTROL FRAUD PERSIST?

Lack of Regulation

A control fraud has many attributes such as power, deceit, and manipulative behavior that allows looting and fraud to exist, however, control frauds require other additional variables to create successful fraud. Defeating regulation for one example, is paramount to providing a criminogenic environment that is ideal for criminally deviant fraud. Almost every single control fraud case beginning with the Savings and Loans debacle of the 1980's was made possible by deregulation or limited resources to actively police these frauds. Much like the Savings and Loans debacle, the president has an explicit role in the regulation processes and oversight of Wall Street corporations (Black, 2005, 262). Depending on the agenda of the president and whether his hands are buried in the pockets of Wall Street, regulation can be hit or miss from one presidency to the next. Such was the case with President Reagan who deregulated the markets, accepted contributions from known control frauds (Charles Keating from the Keating Five scandal), provided no support or resources for regulatory agencies, and in fact, cut the number of regulatory examiners which made oversight impossible (Black, 2005, 262). Additionally, the president has the power to put personnel in regulatory roles that favor his agenda who will either become a control fraud’s nightmare or closest ally. The president is therefore a critical element to the regulation/deregulation processes that either aids or combats control fraud.

Markets that are in fact deregulated, give control frauds the necessary ingredients to establish fraudulent mechanisms for large scale looting. Criminologist William Black (2005) explored the four ways in which deregulation lends a hand to control frauds when he writes:
"It can radically change the environment because we are poor at predicting untested dynamic events. For example, in the S&L debacle, even though an economic theory predicted "competition in laxity," Pratt did not anticipate California's reaction to the Garn-St. Germain Act of 1982. He did not anticipate how his dozens of regulatory changes interacted to create a perfect environment for control fraud. Second, deregulation may increase system-capacity problems. ADC loans were often over 100 times more time-consuming to review than single-family home loans. Third, deregulation may allow investment in assets that lack a readily ascertainable market value. One of the keys to accounting fraud is to find such assets, like the large commercial ADC projects in Dallas. They may create guaranteed (through fictitious) income and hide true losses. Fourth, deregulation may provide the authority to enter into reciprocal (fraudulent) transactions used to transmute bad investments into good ones. It may also provide the authority to create an entity that will be used as a straw party.” (264).

Intuitively, Black conveys the idea that deregulation allows for unseen negative changes resulting in active fraud, system capacity problems that make regulatory review of loans impossible, investment in artificial assets, and fraudulent transformation of losses to profits. Not only does deregulation provide ideal environments (criminogenic) for control frauds but it can also limit the amount of oversight available due to a lack of resources for compliance agencies. The Securities and Exchange Commission (SEC) for example, is depleted of the necessary funding needed to carry out compliance of federal regulatory laws. Control frauds fully understand this apparent lack of resources that are committed to federal compliance agencies, in turn allowing control frauds to act completely undetected. Further, deregulation dispels funding that is needed to hire adequate examiners, accountants, regulators, and compliance officers to prevent and detect fraudulent accounting abuses. Collectively, deregulation poses serious concern for compliance efforts and allows an ideal environment for control frauds to excel in looting, a concept needing further refinement.

Regulative concepts have been developed over the years that characterize the control of fraudulent practices against people, corporations, organizations, and entities. One view in particular understands regulation as a mechanism for protecting the public, yet on the other hand,
the highly political concept acknowledges regulation as a vehicle for aristocrats to control power and resources (Friedrichs, 2010, 283). The latter concept of regulation sees compliance agencies as being controlled by Wall Street and elitist corporations who are the very cronies that they are charged with regulating (Friedrichs, 2010, 283). Although these concepts of regulation charge some form of protection for the public, or in the case of corporate cronies interest, protecting profits whether fraudulent or not, it seems that the United States government has adopted a laissez faire policy on regulating control frauds. In reluctantly regulating corporate abuses of accounting fraud and other associated control fraud, the government has actually benefited Wall Street interests and cronyism, or as it is defined for our purposes, the “good ol’ boys club” (Friedrichs, 2010, 284). Despite government creations of regulatory agencies such as the Securities and Exchange Commission (SEC), Federal Home Loan Bank Board (FHLBB), and the Federal Deposit Insurance Corporation (FDIC), there has been no change in regulatory efforts due to political pressure from lobbying by corporate giants and big business interests (Friedrichs, 2010, 284). We can credit the status quo to the 1980’s and the deregulated efforts of the Reagan Administration, although we would like to think that things have changed, sadly they have continued with greater intensity. In fact, the Bush Administration took deregulation to a whole new level beginning with deregulation patterns that allowed the Enron frauds as well as the collapse of 2008 to occur. President Obama, on the other hand, has taken the bull by the horns and rerouted regulation policies to combat current control frauds from spiraling out of control. Despite these efforts, it is clear that regulation consists of a compliance as oppose to deterrence philosophy, enabling control frauds to halt their fraudulent behavior yet receiving minimal sanctions as long as they comply, a problematic cycle. Considerably deregulation has an astounding effect on aiding control frauds to continue deceitful practices.
The age old argument between compliance and deterrence has reached new levels of debate both in Congress and in academia. Four types of regulatory policing styles were developed to explain regulatory behavior from the many agencies that are employed to police control frauds. Particularly, Frank (1984) describes these styles as: legalistic and free agent style, which is prosecutorial and can be informal, and watchmen and service styles that are reactive in nature (Frank, 235). Regardless of the regulatory policing style that each agency employs, the bigger issue is in the idea that while agencies maintain some semblance of autonomy, they are influenced by political pressures and elitist corporatism. Many agencies have, in fact, been ridiculed for pursuing extreme political agendas and neglected their explicit regulatory duties. Others have been accused of taking their power too far in pursuing big business entities and have been ordered to back off due to political lobbying. What can be certain is that equilibrium is necessary to establishing a clear explicit balance between the utilization of power in compliance and deterrence.

Regulating control fraud is much more than finding the equilibrium of compliance and deterrence, in fact, it should be argued that equilibrium cannot be found due to the insufficient funding of agencies who can, at best, recruit unqualified regulators who are easily misled and manipulated by high priced attorneys and large corporations that have the necessary means to litigate through any wrong doing that may have occurred (Friedrichs, 2010, 289). Additionally, modest budgets of millions of dollars are allocated to regulatory agencies that are charged with oversight of billions of dollars of accounting fraud cases throughout Wall Street (Freidrichs, 2010, 289). The lack of reasonable funding also correlates with the level of inspectors that can be contracted; reducing the amount of coverage regulatory agencies can have success with (Freidrichs, 2010, 289). Given the shortage of inspectors, regulatory agencies are reduced to
other less successful means of preventing and discovering control fraud corruptions, such as computer technology which also raises the issue of intrusion (Freidrichs, 2010, 289). Due to minimal salaries and overworked regulatory agents, regulation becomes very ineffective and can actually harm detection of fraud efforts. Low-paying regulatory salaries pose a problem in itself in terms of potential bribery and promises of lucrative positions in corporate roles. In addition, intense lobbying has resulted in limiting regulatory agency powers as well as budgets (Conklin, 1977). Conclusively, these limitations provide the essential components for control fraud to thrive in a deregulated economy, a trend that is seemingly unstoppable.

Regulatory agencies also face a bias that reflects more respect for large corporations than of small businesses. It is often erroneously thought that larger corporations will commit more frauds than that of the smaller corporations, lending to the idea that agencies will focus what little resources they have on large corporations. The other issue lies in the idea that with larger corporations comes bigger more intricate frauds, requiring many more countless hours and resources into investigations. Not only is there more time spent investigating larger frauds but also big businesses have more resources to fight off any litigation than that of smaller businesses. This theory creates a bias of class and economic power with wealthier corporate control frauds controlling the gamut of regulatory power and oversight. Adding on further, larger corporations are able to devote bigger sums of money to political contributions as a means to pressure politicians into deregulating the system as well as backing off regulators. Such was the case of Enron with the Bush Administration accepting large contributions in exchange for deregulation to continue looting and accounting fraud practices. This raises, a significant issue between the lack of regulation, political corruption, lack of regulatory resources, and the criminogenic environment that is created from these variables. The question remains, is the government
structurally encouraging control frauds to loot America out of billions of dollars without any resistance whatsoever? I have made a case however, it is now up to the many white collar criminologists and political advocates to begin taking a serious look at the corruption and control fraud that has made our country into a fraud nation. In doing so, effective sanctioning and consequences should be the epicenter to finding resolutions to the control fraud endemic.

**Arbitrary and Ineffective Sanctioning**

One of the contentions surrounding sanctioning and sentencing of white collar criminals, particularly that of control frauds, is the idea that this class of offenders are extremely disparate in sentencing compared to those of street crime. Disparate in the sense that those white collar criminals (control frauds) receive more lenient sentences compared to street offenders. The rationale behind the discrepancy is intricate due to the complexity of these cases, which calls for increased cooperation in exchange for lenient sentences and sometimes complete immunity (Friedrichs, 201, 329). In many cases, providing leniency in sentencing to catch bigger actors in control fraud cases is absolutely necessary in the grand scheme of things. However, other factors contribute to minimal sentences for control frauds, such as sympathizing with offenders for the belief that they are good people who intended to make good decisions but were swayed by structural motives. Additionally, judges are less apt to deliver harsh sentences for individuals who have impeccable records of serving in the community, old age, poor health, and who can remain in the community to work and pay restitution to victims of the fraud (Friedrichs, 2010, 329). Judges often believe that the criminal process itself is stigmatizing enough to shame the control fraud, creating punishment in itself. Other factors also inspire lenient sentencing, such as harshness of the crime, how many victims, and what the gravity of the crime entailed (Frierichs, 2010, 329). Judges may also sympathize with the control fraud in the belief that they
were pawned off by the corporation who may have more complicity than the offender. Regardless of the reasoning behind the disparity in sentencing, a social class bias is evident in the lenient sentences that have been historically imposed on control frauds as a class.

As there remains a push for harsher sentencing for lower social class offenders who commit petty street crime in an incarceration driven, mass prison building nation, it appears that wealthier, more affluent offenders receive the better end of the stick, so to speak. Corporate crooks who have looted billions of dollars from the American taxpayers find themselves out of the harm of iron prison bars while the poor minority offenders who have taken far less can almost guarantee a visit to the iron gates (Reiman & Leighton, 2010, 125). This disparity in effective sanctioning has provided control frauds with the necessary incentives to become repeat offenders, knowing that they will likely receive probation and ill-proportionate fines per their crime. Additionally, studies have found that many white collar offenders have in fact become repeat offenders which may very well be due to warnings to comply with regulation as oppose to an effective deterrence driven sanction (Reiman & Leighton, 2010, 126). Adding on further, control frauds that misappropriated funds, often for personal gain, have a mediocre chance of being arrested as oppose to petty property offenders who have 72 times greater number of arrests than that of wealthier control frauds (Reiman & Leighton, 2010, 127). In this way, Reiman & Leighton (2010) report that for every $10,926 lost from a property crime, one arrest is made yet for every $773,423 looted from misappropriations, only one arrest is made (127). Conclusively, any and all deterrent effect for white collar control frauds is absent making looting and fraud an extremely lucrative business, one that has yet to be confronted by any significant measure.

Effective Sanctioning for control frauds remains to be an ever increasing issue in criminal justice policy, yet other factors such as wealth and the ability to secure credentialed counsel
make the issue even more problematic. Specifically, control frauds tend to be of a more affluent status which allows for effective litigators who have the necessary resources to outgun the miniscule resources of government regulators and prosecutors. A cost as well as time weighing analysis is often used to decide whether to go forth with prosecution of white collar control frauds. This dichotomy over whether the resources needed to prosecute big corporate control frauds are worth pursuing lend to the idea that wealthier offenders who fraudulently loot others will face less formal punishment and lenient sentences (Reiman & Leighton, 2010, 130). As was the case with the prosecutions of control frauds in the Enron and Arthur Andersen cases who fought vigorously to delay any punitive sanctioning. While a few perpetrators received mild prison time and modest fines in both cases, the amount of damage conflicted and the level of looting committed were inconsistent with the sanctioning that was delivered. Intuitively, prosecution and effective sanctioning become a bias of social economic status as oppose to equal justice for all people and all crimes regardless of wealth.

Aside from the serious issue of social economic status affecting the level of punishment that one will face, the issue of lenient sentencing of white collar control frauds in general, poses much concern. How is it possible to expect a convicted control fraud that loots enormous amounts of money and manipulates accounting practices to discontinue their behavior with petty sanctioning? Case in point, the Chief Financial Officer of Enron, Andrew Fastow, was facing 109 felony counts for securities fraud, conspiracy, obstruction of justice and a sleuth of other fraud related charges, yet through plea agreements he only ended up facing a maximum of up to ten years in prison (Reiman & Leighton, 2010, 152). Additionally, Fastow’s corrupt counterparts at Enron, Kenneth Lay and Jeffrey Skilling, locked their employees and shareholders out of $60 billion in shares while Enron was seemingly sinking, many losing their life savings as well as
benefits. However, these offenders received petty prison terms while they caused mass financial devastation to thousands of employees and their families for a lifetime to come. Adding on further, many have argued that white collar offenses aren’t as detrimental to society as that of armed robbery or theft hence they do not merit harsh punishment. However, quite the contrary, just as a petty thief steals from a home or an armed robber takes from others, control frauds loot from everyday taxpayers and do so under the cover of a suit and tie. Many of the negative attributes seen in petty street criminals are also possessed in white collar control frauds such as that of deceit, trickery, fraud, and corruption. Further, the claim that control frauds are receiving harsh sentencing is absolutely erroneous when a closer look is taken at the extent of damage committed to the economy, shareholders, and often employees who are direct victims of the fraud. The victims of these frauds are not accidental; in fact, most of the frauds were strategically planned, coordinated, and carried out on such a large scale level that it would be ignoring the obvious to consider the control frauds, victims of a bad economy or any other reason other than ill-intentioned corruption. For this reason, lenient sentencing of control frauds needs to be widely questioned and contributed to one of the many reasons control frauds continue as repeat offenders.

Touching further on lenient sentencing, it is only fair to adequately argue that frauds receive minor punishment compared to all other crimes with statistical backing. Particularly, the U.S. Sentencing Commission (2006) reported that perpetrators of fraud who were convicted federally in 2005 only received a minuscule sentence of 23.6 months in prison while the average for offenders who committed murder was 228.4 months in prison (Source Book of Federal Sentencing Statistics. See Appendix C). Additionally, since 1995 there has only been a marginal increase of sentencing of these offenders by a meager swing since the average in 1995 was a
head scratching 18.3 months of imprisonment, hardly leading to any belief of intensity in sentencing control frauds (Source Book of Federal Sentencing Statistics, 1996. See Appendix A). In addition, control frauds that embezzled and looted others money received an average prison term of only 7.6 months in 1995 with an increase to only 13 months by 2005 (Source Book of Federal Sentencing Statistics, 1996. See Appendix B); (Source Book of Federal Sentencing Statistics, 2006. See Appendix C). The injustice does not end there; in fact, it only gets worse with the average prison term for control frauds who were convicted of anti-trust offenses receiving only 9.2 months in prison in 1995 and only 10.3 months in 2005, as well as money laundering control frauds who were subjected to minor prison time of 40 months in 1995 to only 46 months in 2005 (Source Book of Federal Sentencing Statistics, 1996. See Appendix A); (Source Book of Federal Sentencing Statistics, 2006. See Appendix C). This injustice has allowed absolutely zero deterrent effect for control fraud perpetrators and had been a staple for control frauds to persevere into increased looting as captured in an article in the Yale Law Journal:

"Moreover, civil penalties and criminal sanctions (at least before Enron) did not apparently deter many white-collar offenders. The rampant white-collar crime seen at Enron and the litany of corporate crime exposed thereafter is testament to the fact that the old sentencing regime was an insufficient deterrent. By the same token, as long as we are dealing in generalizations, one could credibly argue that steeper penalties should be imposed for white-collar defendants because there are typically certain aggravating factors that are associated with much white-collar crime. White-collar offenses are not generally crimes of passion. CEOs who receive top Guideline sentences may often be motivated by greed, not by economic need or drug addiction. To the extent that a white-collar defendant is surrounded by a stable and affluent social group, he or she has less ability to attribute some blame to upbringing or social environment." (Weissmann & Block, 2007).

The essence of the disparity in fraud crimes of control fraud perpetrators comes down to lack of awareness and the unmerited leniency for those who the justice system perceives as good people who made poor decisions. However, decades of providing leniency towards control frauds has
enhanced the social class bias and increased fraud corruption of white collar offenders, an ideal that has continued the enticement to commit more frauds with no indication of any deterrence in a nation that prides itself on punishment and corrections.

**Maintaining the Capitalist Status Quo**

Crony Capitalism has added to the problem with control frauds excessively committing accounting frauds and manipulation of finances which tend to mislead investors from the actual financial state of a corporation. The capitalistic ideal is firmly embedded in the structural factors that lead to looting when it is understood that there is an intense pressure to gain more profit and take more risk no matter the cost (Shutt, 1998, 168). Consequently, control frauds feel this pressure from corporations that flaunt enormous bonuses for recording profit whether that means using fraudulent mechanisms to show profit or not. The capitalistic pressure creates a criminogenic environment that thrives on greed and a sense of being on top of the world where enough can never be enough in a “sink or swim” corporate world. The control fraud, who may be an honest person to begin with, due to the circumstances, feels they can only compete with others by partaking in the same fraud methods being used by other deviant white collar criminals. Additionally, when the market becomes saturated with individuals using these deviant mechanisms who appear to be gaining huge bonuses, it forces honest people to either resign or become involved. In this very way, the capitalist credo of gaining more and more profit and the pressures that are associated create a criminogenic environment that encourages fraud and manipulation, therefore continuing the cycle of control fraud.

Widely recognized is the idea that the capitalistic society we live in should not have bearing on the morale and good intent that we conduct ourselves with. The truth of the matter is
that despite what we want to believe, there is a drastic influence on gaining more profit that does, in fact, weigh heavy on our decision to use honest methods or fall to control fraud. Shutt (1998) captures this idea prophetically when he writes:

“As is now widely recognized, this environment is one in which financial institutions are under strong pressure to offer fabulous incentives to those who can make huge short term profits by gambling with other people’s money, such that the temptation to manipulate markets- or simply to cook the books- is all too irresistible. What few of these critics have felt able to confront is the disturbing reality that this tendency is only accentuated by a climate of competitive deregulation in which different financial centers are effectively encouraged by their national authorities to compete for business by not asking too many question” (168).

Several questions are raised regarding this influence of capitalism, but in particular, it is not one of whether when is enough, enough but more specifically, why do we continue the capitalist credo of needing more and more without any contention of satisfaction. Do we contend that control frauds only are motivated by capitalist ideals? Absolutely not, however, there is a corollary effect that is extremely significant in the relation to choosing to fraud others for personal gain. To this effect, there is much needed support to sway these ideals in an effort to prevent any enticement or incentive to use fraudulent mechanisms for the pursuit of profit. The government should be at the front of the line in terms of leading a charge to act as a prophylactic in building corporations that discourage fraud and manipulation. The notion of eliminating the corporate status quo seems like a simple resolution and very much has the potential to be the answer, but the problem is that the government thrives on a capitalist nature and for as long as we have been an industrial nation, has used capitalism as their bread and butter. Conclusively, there lies a serious problem with the way in which we value profit and money over good will and honest business.
In the idea of maintaining a capitalist status quo, there are remedies that can eliminate fraud incentives without the use of a complete transformation to socialism. There is a necessary need for a nationalization of minor democratic socialism that has the potential to limit economic exploitation and fraud which also enhances the opportunity to create a sense of sharing and community with all social economic strata. However, absent of such ideals, capitalism reverts to corporate executives and Wall Street cronies turning to manipulative forms of fraud in every facet of business. Adding on, a structural transformation can divert control frauds from relying heavy on deregulated markets and an emphasis for huge profits that are often illegitimately gained. Not only is a large scale transformation necessary but it also has the potential to provide cooperation vs. conflict in terms of abolishing the capitalist need. With an enhancement of progressive social policies in place, higher yields of production through cooperation can be attainable. Furthermore, until we the people can create greater awareness of the issue with capitalism along with the help and endorsement of our politicians, we cannot expect to see a decrease in frauds and manipulation of markets by control frauds.

In addition to the problem of capitalism, it remains clear that in conglomeration with a significant lack of regulation and the arbitrariness of minimal and selective sanctioning, control frauds continue to thrive in looting and financial manipulation. As long as there is competitive lobbying for deregulation by large corporate giants, absent of strong regulative ideals, there is no need for compliance officers to monitor fraud. Additionally, we have learned, even with minimal regulation, sanctioning and prison time is selective favoring the rich and control frauds rarely will ever see serious prison time for their manipulative crimes. Further, the capitalist structure of our nation, which begs for more profit, creates a criminogenic environment that encourages fraud and other deceitful tactics to create more profit for illegitimately earned multi-million dollar
bonuses at the expense of the American taxpayers, who historically have paid for the bailout of
the control fraud corporations. Comprehensively, control fraud will continue to persist un­
attested until these barriers can be broken with a semblance of permanence.

Chapter 4

SOLUTIONS TO A CONTROL FRAUD DRIVEN NATION

Legitimization of tough sanctioning

If we learned anything from the Enron control fraud scandal and other past mass frauds,
surely we obtained a greater understanding that tougher prison sentences, in maximum iron bar
facilities are the lifeline of deterrence for deceitful white collar control frauds (Black, 2005, 265).
However, while this rationale makes sense, it can only be possible if control frauds truly believe
that they will in fact face serious time behind bars. Conversely, perpetrators who are under the
assumption that their crimes will be kicked under the rug in terms of sentencing, or the lack
thereof, will continue to thoughtlessly loot and fraud. How can we blame them? The government
has not established one ounce of consistent record of punishment that fits these crimes therefore
leading to the idea that white collar control frauds are untouchable. It then is made apparent that
there must be a consistency in punishment to thwart control frauds from deviant behavior.

Taking things a step further, we can take a look at the issue from the classical
criminologist Cesare Beccaria’s theory of deterrence. Beccaria believed that celerity, severity,
and certainty were key to deterring criminals from committing crime. Specifically, certainty
meant that there would be no doubt the offender would be punished, celerity meant that the
offender would in fact be punished immediately, and severity premised the idea that the
punishment would be tough yet fitting the crime (Brown & Esbensen, 1988, 223). For our
purposes, this theory meant that by punishing control frauds using mandatory sentencing without any chance of getting off through high priced counsel, they would in fact think twice before committing fraud. Not only would the control fraud assuredly be punished, they would also be handled immediately, leaving little room for delays that could lead to furthering punishment and justice as our current justice system is flawed. Lastly, control frauds who are found to be guilty would not receive probation or community service, they would however be severely punished enough to fit the severity of their crimes that often effect millions of people with insurmountable losses. It is then firmly recommended that in lieu of focusing on the crime committed, deterrence emphasizes preventing the crime by utilizing celerity, certainty, and severity. Intuitively, tough and swift sentencing is a necessary solution that changes the status quo from biased arbitrary and ineffective sanctioning to a system that strikes fear in the heart of anyone conceiving the utilization of fraud and manipulative mechanisms.

In addition to using a deterrence model, a recommendation is furthered to target executives and CEOs who claim that they had no knowledge of the fraud or wrongdoing that happened under their watch yet these executives who are handsomely paid to run the entire corporation believe they are not responsible. In the case of Enron, executives Skilling and Lay argued that they had no direct knowledge of any accounting fraud, however with the implementation of the Sarbanes-Oxley Act, executives would in fact be responsible due to the requirement that all financial statements be signed off by their CEOs (Reiman & Leighton, 2010, 206). Not only should the CEOs be held responsible but also executives at every level of the corporation from top to bottom should be held liable as they are intertwined within the corporation as holding a title of responsibility, meriting full liability. Executives and compliance officers also should be held liable for poor compliance systems and internal controls within the
corporation that could have acted as a necessary checks and balance system for preventing fraud. Regardless of the idea that an executive had no knowledge of wrong doing, they are responsible for implementation of proper internal fraud systems, which protect the shareholders, employees, and even themselves, therefore they must be held liable for a lack of adequate internal controls.

Once a control fraud is found liable and guilty, especially on federal charges, we must move to mandatory-minimum sentencing to avoid offenders receiving massive reductions of prison time for so-called “drug addiction issues” resulting in time knocked off for completing drug treatment programs, as was the case with Enron’s former CFO, Andrew Fastow, who claimed “dependency” to anxiety-medication (Reinert, 2006). In a mandatory-minimum sentencing system, convicted control frauds would no longer receive petty sentences of community service and fines, they would and should in fact earn tough prison time, adequate fines that require full repayment of losses in addition to added fines for the crime itself from looting and deviant risk taking. Reverting back to the social class bias, it seems that street criminals who cause immensely less harm than the white collar control frauds who steal billions from taxpayers’ pockets are falling victim to a favoring of wealthier classes of criminals. Mandatory-minimum sentencing would provide the solution to this bias and a deterrent effect would combat the mindset of control frauds who believe they can evade the criminal justice system. Conclusively, a recommendation for a transformation to mandatory-minimum sentencing and tough prison time is an implementation that must be established.

Corporations who aid control frauds and allow looting to occur should also become subject to full criminal prosecution without the protection of being a business entity as oppose to an individual. A proposal for full execution and closing of an organization or corporation derives the idea that these entities cannot blame any single individual for criminal acts when sufficient
evidence is provided that a larger scale of perpetrators were involved. Specifically, repeat offenders such as the case of the accounting firm Arthur Andersen who had multiple violations of fraud and misleading financial stating charges would be open for complete extinction as an operating corporation. After all, corporations are considered persons in the concept that they have many of the same rights as natural persons in that they can enter into contracts, therefore they should be subject for wrong doing and corruption in the criminal justice realm. Tough sentencing for these corporate giants should merit not only temporary cease-and-desist orders but they should also have permanent disestablishment sentencing for extreme cases of fraud practices. Further, as in the three strikes laws that render harsh prison time for offenders on their third offense, repeat offender corporations should be subject to dismantlement of the entity from practicing, a disbarment, if you will. Effectively, holding entire corporations responsible for their actions with severe sanctions will instill a sense of “tough on crime” justice and a promoting of ethics as oppose to profit.

Overall, curtailing control fraud whether committed by a corporation or an individual perpetrator should be the result of effective sanctioning that entails tough prison time, adequate fines, and complete permanent disestablishment of a corporation. Deterrence then can only be reached with unbiased sentencing that encapsulates severe penalties for those who break the law and systematically fraud others for personal pursuits of profit. We need to eliminate the idea that white collar crimes are not serious and that they are just part of business practice in general. To do so, the government needs to step in and create mandatory-minimum sentencing for control fraud specific crimes as a testament to a commitment of a zero-tolerance policy for white collar criminal fraud. If tough sanctioning is finally implemented, the incentive to use fraud mechanisms may be once and for all eliminated as a thriving endemic.
Refining control fraud prevention measures

Prevention mechanisms for control fraud have been highly controversial for reasons of ineffectiveness and a lacking in organization. Moving forward in an era needing resuscitation of active fraud prevention mechanisms, it is critical that new and progressive measures be developed. Self-regulation, which is private policing directed at one's own company or professional peers that is a requirement at the most basic of levels in all businesses, is very problematic for a number of reasons (Friedrichs, 2010, 303). Specifically, self-regulation within a business often goes unreported when a control fraud is in a position of power as the CEO because the control fraud has already strategically put personnel in place that will turn a cheek to fraudulent practices. In addition, compliance officers generally are reluctant to tell the CEO that they are conducting fraud or manipulation of finances, which is often looked at as if the compliance officer is not a team player. The compliance officer in any business then takes on an adversarial role that many feel threatened by. A solution to the issues of self-regulation lies in the idea of holding compliance officers legally responsible for aiding or turning a cheek to fraud or corruption of the CEO who is quite often the control fraud. After all, if compliance officers are ignoring deviant practices, they may as well be responsible because they are essentially endorsing the fraud by not reporting the issues. Additionally, compliance officers or any employees for that matter, who report fraud to outside agencies, find it extremely hard to function without threat or harsh treatment back at their jobs. In many cases, those who report wrongdoing, otherwise known as whistleblowers, often must find new jobs and even new careers for the simple reason that many corporations will not hire a whistleblower for fear that they may report their behavior. For these reasons, self-regulation and whistleblowing has very little incentives that address control fraud.
To better combat the flaws in self-regulation, a recommendation for increased sanctioning for those who have been found to have knowledge but failed to report should be undertaken. In combination with increased sanctioning, whistleblowers should receive incentives for reporting wrong doing, which could act as compensation for the whistleblower to find new jobs if necessary. Although many agencies already offer compensation for reporting wrongdoing, it appears that the fact many have to leave their jobs and even careers means that they deserve better compensation in lieu of their potential job relocation in addition to the expenses that come from that. Adding on further, individuals who are found to have harassed whistleblowers following the report of fraudulent practices should receive severe penalties or even elimination from employment. In turn, a better collective effort can be made at detecting fraud internally and essentially rejuvenating self-regulation practices to their full potential.

Accountants and attorneys, even more so than internal compliance officers, should be held liable for withholding evidence or not reporting wrong doing within a corporation. However, accountants who are brought in to certify sound financial statements for corporations who uncover financial misrepresentations quite often intentionally overlook these statements or sometimes even stealthily drop the fraudulent companies account (Freidrichs, 2010, 302). This may be due to the reluctance to be found as an accessory to fraud by the signing of certification of sound financial statements, thus creating an incentive to just overlook or drop the account to avoid any inclusion to begin with. On the other side of the fence, common-law principles do not require accountants and auditors to report wrong doing to outside agencies and regulators while they are in fact required to report misleading statements to internal management (Friedrichs, 2010, 302). The problem with this is that accountants should have the fiduciary responsibility to report all wrong doing to outside regulatory agencies with explicitness. Ideally, a
recommendation for a requirement for all auditors and accountants to report to outside agencies is essential to curtail fraud. In addition, as an elimination of conflict of interest between auditor and corporation by requiring auditing to be conducted only by federal regulators who work for the interest of the government as oppose to the corporation is the necessary action needed to prevent control fraud.

Very much so like the accountants, legal counsel or attorneys also play an integral role in the prevention of control fraud and reporting. Attorneys for major corporations are paid large sums of money to direct CEOs in legal compliance while at the same time, maintaining a semblance of confidentiality with the corporation. When it is found that the corporation is committing fraud or even an individual executive, attorneys are not exactly required to report wrong doing to outside agencies. In fact the American Bar Association (ABA) rules consciously protect attorneys from any liability of reporting fraud of their clients while at the same time neglecting any public protections from corporate wrong doing (Freidrichs, 2010, 301). In this way, attorneys become an essential friend to the corporate control fraud who reserves the right to partake in criminal actions, report the control fraud, or do nothing at all. To refine the prevention of such potential control fraud, a recommendation is made to federally require attorneys to report all misleading actions and fraud to outside regulatory agencies, regardless of attorney-client privilege. Taking this idea a few steps further, attorneys who leave a firm for reasons of fraudulent behavior in a corporation yet fail to report these deviant actions by the corporate control fraud, should be legally liable for the harm committed and should, in fact, bare the same consequences as the control fraud when convicted. When we can make a move toward harsh sentencing and firm liability of attorneys who take on a professional role as an advocate for the corporation as well as a duty to disclose fraud that could harm the public, we will take notice of
an increase in reporting of fraud as well as a decrease in individuals who perpetrate fraud. Therefore based on prior issues with attorney-client privilege in reporting fraud, it is recommended that attorneys be federally subjected to disclose all wrong doing to regulatory authorities, and those who do not shall be subjected to “tough on fraud” sanctioning.

In summary, a serious refinement of control fraud prevention efforts and measures are needed to detect and prevent repeated frauds from looting taxpayers’ dollars. In effect, attorneys, accountants, and auditors alike should own the legal responsibility of fully disclosing all of their client’s wrong doing regardless of client confidentiality. These individuals are professionals and are entrusted with conducting their behavior with ethics as such, any deviation from professional conduct should result in tough prison sentencing, disbarment, and adequate fines. In addition to requiring professional auditors, accountants, and attorneys to fully disclose all wrong doing regardless of client-confidentiality, they have a fiduciary and ethical obligation to protect the public. Another recommendation is to protect whistleblowers who report wrong doing by compensating these individuals to alleviate their financial and psychological losses from any mistreatment they may receive for reporting the wrong doing. Along with whistleblowers, internal compliance officers should be held accountable for withholding pertinent information of wrong doing within the corporation. Compliance officers that are found to have “overlooked” misleading financial statements should be held criminally liable and become subject to harsher sanctioning due to the ethical responsibility that their title encompasses. Finally, by refining these fraud prevention methods, greater accountability is created that works to reduce any incentive to commit fraudulent actions.
Rewiring regulatory agencies

The epidemic of control fraud has devastated business markets, disintegrated trust in the corporate world, and rotted the economy away, however, this has all been possible even with the establishment of many regulatory agencies both federally and on the state level. Regulatory agencies such as the Securities and Exchange Commission have fallen well short of their mandate, which calls for protection of investors, the maintaining of fair, orderly, and efficient markets, in addition to facilitating capital formation (Securities and Exchange Commission, 2012). Failing to make an impact on regulating control frauds has called for a serious need of a rewiring of the regulatory agencies that are currently active. Rewiring of these agencies, requires more financial resources, less conservative rules that constrict deep investigation, and policy makers that have an agenda set purely on protecting the public from fraud and deceptive practices.

Rewiring and restructuring regulatory agencies begins with having adequate funding to pursue investigations of fraud; often times requiring many millions of dollars to begin with. The Securities and Exchange Commission (SEC) in particular, has a minimal budget in the tens of millions of dollars range while they are charged with regulating financial transactions that are in the ballpark of hundreds of billions of dollars (Friedrichs, 2010, 289). Additionally, underfunding correlates to a lack of production due to understaffed agencies with workers who are overworked and grossly underpaid. Absolutely no incentives were involved in working for the SEC and other regulatory agencies as compared with private firms and banking regulatory boards as stated here:

"The systems-capacity problems of the SEC and the Bank Board are parallel. Both were forbidden to pay salaries competitive with those offered by the banking regulatory
agencies (much less private firms). Both experienced rapid turnover and had to staff key operations with inexperienced personnel” (Black, 2005, 257).

The inadequate salaries also result in potential corruption by means of bribery, promise of high paid jobs following conclusion of their regulatory career, and political influence which can sway the effectiveness of the regulatory mandate (Friedrichs, 2010, 289). Lastly, even when regulatory agents are able to survive on their inadequate salaries and apprehend control frauds, they fall very short when it comes to litigation due to high-paid defense counsel that completely outmatch the government attorney resources and expertise, therefore ending fraud cases without any justice.

In an effort to revamp regulatory agencies, a recommendation for significant increase in overall budgeting is ideal to combat the intricate fraud cases that require substantial resources and agents. Adding an increase in funding allows agents to gain an overall satisfaction with their salaries that leads to less incentive for bribery and corruption. In addition, well-compensated regulatory agents who have adequate regulatory investigation budgets can command better results in litigation from acquisition of better attorneys and litigators. The issue of covering the broad spectrum of fraud cases can be further alleviated to some extent with raising the budget to levels that can compete with large corporations who have unlimited funding and resources to combat regulatory efforts. Although there will never be enough funding to prevent and investigate every single fraud case, with an increase in funding, a significant impact can be made that will act as a deterrent to other potential control frauds, resulting in a decrease of looting and fraud.

The second recommendation for regulatory rewiring calls for a shorter leash on the level of intrusiveness that an agency can have on fraud investigations. Political lobbying by
corporations who have practiced fraudulent methods of gaining profit, continue to drive a stake in regulatory agencies as to the effect of their power in criminal investigation of white collar frauds. Politicians who have accepted large contributions from big corporations have an implicit loyalty for their interests as oppose to the public protection from deviant business practices. Instead of focusing on political contributions, politicians need to stand their ground and allow for regulation powers that could have a larger scope of fraud protection for the public. In specific, a widening net of power for regulators should encompass the regulation of private stocks and bonds, offerings of limited size, intrastate offerings, and securities of municipal, state, and federal governments, which are areas of investing that the SEC is currently not allowed to regulate (Koba, 2012). Not only is it necessary for other areas of investment to be subject of regulation but it is recommended that all corporations and individuals in any facet in business be subject to regulation because the right to conduct business is a privilege that should always be handled with ethics as oppose to any means necessary to gain profit. Conclusively, a recommendation is then put forth for the government to extend regulatory powers as well as the scope to which regulators can investigate corporate and control fraud; an ideal that serves to further protect the public well-being.

Adding on to the recommendation of additional regulatory powers, it is also crucial that politicians eliminate personal agendas, whether conservative or liberal, when controlling enforcement of regulatory practices. To do so, regulatory officials need to be methodically selected who have the necessary ethics and agenda of tough regulation with concern for the general public. Absent of such leadership, regulatory efforts become arbitrary and ineffective at best, a case that can be made with the current state of regulatory direction. Unbiased leadership
of regulatory agencies, coupled with a broadening of regulatory powers, and increasing resources and funding is the beginning of the end, in the elimination of control fraud.

Creating awareness; centralizing the issue

Since the Enron debacle in 2001 raised awareness of control frauds and white collar crime in general, several policies have been enacted to combat future fraud disasters from occurring. One very important act, the Sarbanes-Oxley Act of 2002 which helps to enforce corporate governance and prevention of accounting fraud has attempted to curtail control frauds from looting and deception (U.S. Securities and Exchange Commission, 2012). However, this act, created with good intent, has minimally contributed towards the prevention of fraud related activities because its main focus has become corporate governance as opposed to control fraud, causing the majority of financial frauds (Black, 2005, 266). It seems that following the creation of the Sarbanes-Oxley Act, the government has ceased all efforts to create more policy to combat control fraud and has yet to even minimally reform current policy to make an impact on the fraud endemic. The media has further added to the fire by playing down the concern with control fraud causing an effect that conveys a message to the public that fraud and other white collar crime are not serious issues, a lie that is so far from the truth. Seemingly, the biggest problem with prevention of control fraud is the lack of public awareness of the seriousness of the endemic and the government’s unwillingness to effectively address the situation.

In order to effectively combat control fraud, conscious awareness of the social endemic must ensue on a national level that includes media, government, social scientists, and a public outcry. As of now, there has yet to be a considerable campaign concerned purely with white collar crime and the prevention of fraud despite the Sarbanes-Oxley Act, which has minimally
contributed. The lack of statistics and records of white collar crimes in official government
databases such as that of the Federal Bureau of Investigation's Uniform Crime Reports (UCR),
speaks for itself in terms of the lack of concern. Additionally, as mentioned earlier, white collar
frauds cause immensely more damage than that of petty street crimes with cost disparities in the
billions of dollars annually (Reiman & Leighton, 2010, 125). Progressing forward, it is firmly
recommended that petitioning and lobbying of congress for better enforcement of fraud policies
is needed. To do so, there must be a dramatic outcry that should not be caused from a devastating
financial crisis, in fact, we should have already learned from past tragedies such as Enron.
Greater awareness of control fraud and a breaking away from the ideal that petty street crime is
the bane in all forms of crime in terms of harm caused will provide the basis for a plan to prevent
and manage control frauds effectively.

Digressing from the recommendation for greater awareness, taken as a whole, the
legitimization of tough sanctioning, refining and tweaking control fraud prevention methods in
an effective manner, rewiring the way in which regulatory agencies operate, in conglomeration
with a greater awareness of the endemic are necessary solutions to tackling control fraud.
Without such measures, perpetrators of fraud will continue to go unnoticed under the radar while
they loot and fraud others, resulting in economic decline. These methods, however, are nothing
more than suggestions and should not be interpreted as a cure-all but at the same time the
utilization of these suggestions should be taken with heavy consideration as a few of many
solutions to fight control fraud. Conclusively, the concept of control fraud is very intricate and
therefore must be handled with in-depth and effective prevention methods that can be utilized in
the corporate world.
Chapter 5

FINAL THOUGHTS

Control fraud has evaporated trust, diminished economic progress, and caused the losses of billions of dollars of tax-payers money yet this endemic remains unchallenged by government entities and can be argued that the structures in place in fact encourage control fraud. Encouragement takes many forms ranging from lenient sentencing to the lack of regulation that becomes a lethal combination creating a criminogenic environment that is ideal for control frauds to operate unquestioned. The Savings and Loans debacle of the 1980’s as well as most all other financial frauds were perpetrated by control frauds, however control frauds were able to do so due to the structures that created a criminogenic environment capable of causing mass harm (Black, 2005, 246). Further, it should be explicitly understood that fraud is serious and poses massive harm on the public, especially when committed by a control fraud who thrives off of looting the system. Control fraud should then not be taken lightly, and further understood for it’s true identity of deceit and fraud, often committed on large scale levels.

Large scale looting and massive frauds are the result of the criminogenic environment largely created by government policy and the capitalist ideals that allow both opportunistic as well as reactive frauds to engage in fraud. Control frauds understand that the lack of regulation creates this environment that in turn, is the very reason why we never see one or two fraud cases. Instead we often see massive amounts of fraud committed simultaneously, such as the Saving and Loans debacle, Enron era collapses, and even the financial bailouts of 2008. In this way, fraud is not random or coincidence so to speak, in fact, it is committed with the intention that regulation is down and policy makers are not concerned, again creating the perfect environment.
for looting (Black, 2005, 247). Fraud should be further conceptualized as crime committed in mass that causes paralyzing harm as oppose to single acts with minimal damage.

The problem with preventing control fraud is that it is hard to detect and even top regulators and economists have insurmountable trouble understanding the many mechanisms used. The fact is, top CEOs and executives are not simply reaching in the till and pulling out loads of cash, instead they are using regulatory restraints and accounting practices in their favor as both a weapon and shield to defraud the very company they work for while deceiving regulators (Black, 2005, 247). Additionally, without proper training in risk and fraud detection, especially that of control fraud, most regulators and compliance officers are just simply unable to detect control fraud because they do not understand its operation. The average regulator receives absolutely little to no ethics and risk management classes in business school, law school, or even with the regulatory agency in which they obtain employment. Quite frankly, there is a real need for better education in both fraud and risk, especially as it relates to control fraud.

In keeping with the theme that regulators have insufficient knowledge of control fraud, this also relates to a lack of the extent of damage both direct and indirect conflicted. As there is blatant direct damage which often affects investors and shareholders, the indirect damage far outweighs the damage that we can see directly (Black, 2005, 248). In fact, control fraud causes inaccuracies within the market that cause stock values to drop and the economy tanks from there. Indirect losses are also seen in terms of corporate employees who are laid off, savings and retirement funds lost, and more importantly the erosion of trust, which was evident in the case of Enron where employees were locked out of their shares and lost their retirement funds. The diminishment of trust devastated markets because it pushed potential investors to think twice about investing in the market causing severe losses in the economy. The indirect damage, often
unseen by regulators who are unaware of this type of damage, has inflicted massive damage to the economy that outweighs the direct first hand harm.

Understanding of control fraud is much more than the idea that control frauds manipulate normal fraud constraints, in fact they not only deceive internal and external compliance officers and regulators who act as outside auditors, they also use regulatory accountants as a weapon to defraud. Specifically, control frauds will become allies with accountants who can serve principally to derive clean audit reports on very flawed books that indicate fictitious profits. Clean audit reports then become the basis for investors to buy into their product (faulty) that in turn is a house of cards made of massive debt and fraud. In addition to deceiving potential investors, control frauds obtain accountants as a weapon to deceive examiners and regulators as to the state of their finances. Therefore, control frauds use accountants and auditors who would normally act as a control restraint, as a weapon to defraud and loot, making accountants their money makers.

The other side of the coin in terms of regulatory manipulation is the idea that regulators do not have the resources to adequately confront control fraud to begin with. Henry Pontell’s theory of systems-capacity describes this problem as:

“the inability of the prosecutorial or regulatory system to cope with crime, or misconduct adequately because of resource limitations, deficient authority, or lack of political will” (Black, 2005, 256).

The federal government and the regulatory agencies that were charged with combating control fraud were grossly understaffed and underpaid in comparison to private firms that had adequate funding and paid their employees satisfactorily. Insufficient resources further resulted into ineffective regulation and poor investigation, making control fraud activities a viable threat. Big corporations also had the funding to give large political contributions to thwart regulatory efforts
that added fuel to the fire of the system’s capacity issue. Control fraud went highly un-pursued by regulators and even when the rarity of judicial action occurred, prosecutors were highly outmatched by high-paid private securities attorneys who had unlimited funding and resources. An increase in funding and resources is imperative to preventing further control fraud and harm to the public.

The presidential elections play a huge role in determining adequacy in funding and resources, but more importantly is the agenda of the President and his administration. As we have seen, former President Ronald Reagan was key in deregulating the markets, allowing fraud mechanisms to be used in the Savings and Loans disaster of the 1980’s (Black, 2005, 262). Reagan’s deregulated plan allowed for poor prediction of fraud, systems-capacity problems, an allowance of fictitious assets to be reported that had no real value, and fraudulent transactions to be unquestioned. To combat this, it is necessary to become a highly regulated economy with the backing of leaders who understand the threat of fraud if deregulation occurs. Regulation further provides rules to abide by that aid in preventing corruption, absent of such rules, control frauds will prey on weak regulation and continue fraud of others. Obtaining presidential leadership that has an agenda concerned with regulation and good business ethics is essential to preventing fraud and a thriving economy.

Digressing from presidential leadership, whistleblowers are pivotal to catching frauds and carry significant weight in the apprehension of white collar frauds. Many factors play into the decision to become a whistleblower such as the threat of loss of job and even harassment which often is reason enough for many employees to turn down the opportunity to turn in their bosses as frauds. However, more so than the threat of losing one’s job is idea that many employees have been with a company for many years and chose to remain loyal to the company and CEO
CONTROL FRAUD IN AMERICA

resulting in closed lips even when fraud is known. To combat this issue, it is critical that ethics be taught earlier in life, during education attainment in business school as well as on the job. In doing so, a decrease in the potential to commit fraud and also to not disclose fraud as to remain loyal to the corporation can occur. It is also necessary to understand that whistleblowers cannot be responsible for preventing all fraud, yet they do play a pivotal role but other structural factors such as increased emphasis on regulation and the criminal justice system should be primary preventers of fraud (Black, 2005, 263). Intuitively, the need for whistleblowers and providing incentives for whistleblowers is a must to enhance efforts of preventing fraud before it results in mass harm.

Another problem lies in the fact that there are absolutely no professional fraud investigators in many of the regulatory agencies, in fact, the majority of these agencies are staffed by lawyers, accountants, and business graduates who do not have the slightest clue as to how fraud is perpetrated (Black, 2005, 264). There remains a need for an executive position as a criminologist or a related field in every regulatory agency for the purpose of expert knowledge in control fraud and one who can think the way a control fraud would in fact think. Regulators should have a critical “don’t trust and always be inquisitive” mindset instead of giving frauds the benefit of the doubt. Without such ideals, control frauds easily can manipulate and turn what would normally be a fraud constraint into an ally, who is essentially a shield for fraud. Lawyers and accountants are not taught to think as a control fraud in their respective education institutions, and further cannot prevent control fraud effectively as would a trained criminologist. I do not intend to advocate that criminologists are the end all to control fraud, however it should absorbed that criminologists and other related professionals often think in such ways that allow
better investigations and preventions of frauds, therefore criminologists should in fact make up the majority of regulatory agency staff for effective prevention of control fraud.

Control frauds are systematic in their looting and intentionally elect executives who will aid in their fraud to bypass corporate governance, a lesson that must be learned from prior disasters. Particularly, normal operating corporations have internal controls who are able to act as a checks and balance system from internal fraud, even that of the CEO. However, to bypass this fraud restraint, control frauds will elect compliance officers and controls that will intentionally aid in their fraud and will not question the control frauds actions, thus eliminating any internal regulation. It is essential that we learn and understand this concept of systematic placement of frauds to grasp the idea of how control frauds beat internal control. The Sarbanes-Oxley Act has been somewhat effective in fighting corporate governance issues relating to fraud in that it has increased accountability expectation of directors, officers, and legal and accounting officers (Peregrine, 2012). Despite positive changes, the act does not however address the issue of systemic placing of internal controls, an issue that allows control frauds to persist. Corporate governance and systematic placement of internal controls is an issue that must be approached from a position of effective policy and regulation.

Touching on systematic placement, control frauds manipulate the way in which stock options are allocated and rewarded because they often are the CEO and have the right to organize stock options in any fashion they desire. In exercising their power, control frauds will organize stock options to short-term economic performance as opposed to longitudinal performance (Black, 2005, 266). Control frauds push for short-term performance stock options because it is easy to manipulate numbers by using fraudulent accounting mechanisms for short periods of time. In addition, when control frauds distort short-term performance numbers, they can loot
stock options and other bonuses into personal gain without any ascertainable legitimate profit value by transferring funds from one account to another, showing false gains. Further, control frauds can also manipulate short-term performance bonuses by taking losses and transferring them into profits in the books and trying to make up the difference the next quarter. The ability for control frauds to organize performance bonuses to their liking is alarming in that it allows fraud and accounting manipulation to go undetected. Future policy must be enacted to combat this ability of control frauds to loot freely and unchallenged.

As we come to a close, the exploration of control fraud and its consequences have been one to learn and find resolution from. Control fraud is the highest form of fraud and white collar crime that Americans are struggling to defeat. Until we can create a national awareness of control fraud that commands resolutions from our politicians with the implementation of intense regulation, the cause may be lost. If we can change the structures that permit the criminogenic environment that allows control fraud to thrive, such as that of deregulation, system-capacity issues, lack of regulatory leadership, and arbitrary sanctioning, we have a shot at decreasing the occurrence of control fraud by creating deterrence. Additionally, this paper and the research derived from it should be further expounded to gain a deeper understanding of control fraud. A recommendation for further exploration of the criminogenic structural elements that provided ideal environments for control fraud should be in order to find solutions to the epidemic. Adding on further, the findings within this paper should be disseminated as a means to use for future prevention of control fraud as well as academic criminology classes within education institutions. The future of the prevention of control fraud is critical and is necessary to permanently eliminate the endemic of fraud that has caused billions of dollars in damage to our nation.
Appendix A: Type of Sentence Imposed By Primary Offense Category

Table 12

<table>
<thead>
<tr>
<th>PRIMARY OFFENSE</th>
<th>TOTAL REQUIRING IMPRISONMENT</th>
<th>Prison</th>
<th>Category Split*</th>
<th>TOTAL REQUIRING PROBATION</th>
<th>Probation and Confinement</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Number</td>
<td>Number</td>
<td>Number</td>
<td>Number</td>
<td>Number</td>
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<tr>
<td>TOTAL</td>
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<td>13,508</td>
<td>33,219</td>
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<td>66</td>
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<td>Manslaughter</td>
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<td>24</td>
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<td>488</td>
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<td>30</td>
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<td>75</td>
<td>71.5</td>
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<td>Drug-Trafficking</td>
<td>16,145</td>
<td>4,818</td>
<td>4,818</td>
<td>11,327</td>
<td>70.3</td>
<td>300</td>
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<td>114</td>
<td>276</td>
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<td>25</td>
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<td>Fraud</td>
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<td>3,556</td>
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<td>320</td>
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<td>508</td>
<td>71.9</td>
<td>43</td>
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<td>12</td>
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<td>Tax</td>
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<td>Blackmail/Extortion</td>
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<td>162</td>
<td>386</td>
<td>70.9</td>
<td>12</td>
</tr>
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<td>Gambling/Obbery</td>
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<td>43</td>
<td>93</td>
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<td>10</td>
</tr>
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<td>Civil Rights</td>
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<td>48</td>
<td>114</td>
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<td>7</td>
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<td>58</td>
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<td>57</td>
<td>57</td>
<td>134</td>
<td>71.6</td>
<td>11</td>
</tr>
<tr>
<td>Prison Offenses</td>
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<td>99</td>
<td>230</td>
<td>71.1</td>
<td>16</td>
</tr>
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<td>Administration of Justice Offenses</td>
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<td>47</td>
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<td>104</td>
<td>71.2</td>
<td>10</td>
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<td>Environmental/WMDs</td>
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<td>37</td>
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<td>85</td>
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<td>Tax Crimes</td>
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<td>Antitrust</td>
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<td>10</td>
<td>76.9</td>
<td>0</td>
</tr>
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<td>Food &amp; Drug</td>
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<td>13</td>
<td>13</td>
<td>29</td>
<td>71.4</td>
<td>4</td>
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<tr>
<td>Other Miscellaneous Offenses</td>
<td>565</td>
<td>162</td>
<td>162</td>
<td>403</td>
<td>71.3</td>
<td>68</td>
</tr>
</tbody>
</table>

*Sentence/Community Split includes all cases in which defendants received prison and conditions of confinement as defined in USSG §5C1.1.

Appendix B: Average Sentence Length By Primary Offense Category

Table 13

AVERAGE SENTENCE LENGTH BY PRIMARY OFFENSE CATEGORY

(October 1, 1995, through September 30, 1996)

<table>
<thead>
<tr>
<th>PRIMARY OFFENSE</th>
<th>Mean Months</th>
<th>Median Months</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td>59.7</td>
<td>34.0</td>
<td>42,925</td>
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<tr>
<td>Murder</td>
<td>253.7</td>
<td>267.0</td>
<td>83</td>
</tr>
<tr>
<td>Moneylaundering</td>
<td>77.3</td>
<td>16.0</td>
<td>53</td>
</tr>
<tr>
<td>Kidnapping/Hostage-Taking</td>
<td>110.2</td>
<td>90.5</td>
<td>84</td>
</tr>
<tr>
<td>Sexual Abuse</td>
<td>67.3</td>
<td>36.0</td>
<td>170</td>
</tr>
<tr>
<td>Arson</td>
<td>33.8</td>
<td>18.0</td>
<td>449</td>
</tr>
<tr>
<td>Robbery</td>
<td>110.9</td>
<td>77.0</td>
<td>1,662</td>
</tr>
<tr>
<td>Arson</td>
<td>95.9</td>
<td>48.0</td>
<td>103</td>
</tr>
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<td>Drugs - Trafficking</td>
<td>82.8</td>
<td>60.0</td>
<td>16,131</td>
</tr>
<tr>
<td>Drugs - Communication Facility</td>
<td>35.2</td>
<td>36.0</td>
<td>394</td>
</tr>
<tr>
<td>Drugs - Simple Possession</td>
<td>6.0</td>
<td>1.0</td>
<td>606</td>
</tr>
<tr>
<td>Firearms</td>
<td>74.7</td>
<td>41.0</td>
<td>2,513</td>
</tr>
<tr>
<td>Burglary/B&amp;F</td>
<td>23.4</td>
<td>18.0</td>
<td>87</td>
</tr>
<tr>
<td>Auto Theft</td>
<td>20.6</td>
<td>15.0</td>
<td>134</td>
</tr>
<tr>
<td>Larceny</td>
<td>6.7</td>
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<tr>
<td>Fraud</td>
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<td>8.0</td>
<td>5,985</td>
</tr>
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<td>Embezzlement</td>
<td>6.2</td>
<td>4.0</td>
<td>710</td>
</tr>
<tr>
<td>Forgery/Counterfeiting</td>
<td>10.3</td>
<td>6.0</td>
<td>723</td>
</tr>
<tr>
<td>Bribery</td>
<td>13.1</td>
<td>6.0</td>
<td>256</td>
</tr>
<tr>
<td>Tax</td>
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<td>3.0</td>
<td>849</td>
</tr>
<tr>
<td>Money Laundering</td>
<td>33.5</td>
<td>31.0</td>
<td>816</td>
</tr>
<tr>
<td>Racketeering/Extortion</td>
<td>90.5</td>
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<td>543</td>
</tr>
<tr>
<td>Gambling/Lottery</td>
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<td>6.0</td>
<td>138</td>
</tr>
<tr>
<td>Civil Rights</td>
<td>37.3</td>
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<td>140</td>
</tr>
<tr>
<td>Immigration</td>
<td>18.6</td>
<td>15.0</td>
<td>4,063</td>
</tr>
<tr>
<td>Prostitution</td>
<td>29.1</td>
<td>25.0</td>
<td>191</td>
</tr>
<tr>
<td>Prison Offenses</td>
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<td>16.0</td>
<td>337</td>
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<td>Administration of Justice Offenses</td>
<td>13.4</td>
<td>9.0</td>
<td>749</td>
</tr>
<tr>
<td>Environmental/Wildlife</td>
<td>4.7</td>
<td>1.0</td>
<td>129</td>
</tr>
<tr>
<td>National Defense</td>
<td>14.1</td>
<td>10.0</td>
<td>23</td>
</tr>
<tr>
<td>Abridgment</td>
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<td>0.0</td>
<td>15</td>
</tr>
<tr>
<td>Food &amp; Drug</td>
<td>3.6</td>
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<td>43</td>
</tr>
<tr>
<td>Other Miscellaneous Offenses</td>
<td>8.7</td>
<td>1.0</td>
<td>367</td>
</tr>
</tbody>
</table>

SOURCE: U.S. Sentencing Commission, 1996 Datafile, MONEFM.
Appendix C: Average Sentence Length In Each Primary Offense Category

### Table 13

**AVERAGE SENTENCE LENGTH IN EACH PRIMARY OFFENSE CATEGORY**

*Fiscal Year 2005, Pre-Booker (October 1, 2004, through January 11, 2005)*

<table>
<thead>
<tr>
<th>PRIMARY OFFENSE</th>
<th>Mean Months</th>
<th>Median Months</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TOTAL</strong></td>
<td>46.3</td>
<td>24.0</td>
<td>15,678</td>
</tr>
<tr>
<td>Murder</td>
<td>189.3</td>
<td>120.0</td>
<td>28</td>
</tr>
<tr>
<td>Manslaughter</td>
<td>25.0</td>
<td>24.0</td>
<td>9</td>
</tr>
<tr>
<td>Kidnapping/Hostage Taking</td>
<td>149.3</td>
<td>114.0</td>
<td>18</td>
</tr>
<tr>
<td>Sexual Abuse</td>
<td>75.4</td>
<td>52.5</td>
<td>92</td>
</tr>
<tr>
<td>Assault</td>
<td>27.7</td>
<td>21.0</td>
<td>143</td>
</tr>
<tr>
<td>Robbery</td>
<td>79.6</td>
<td>65.0</td>
<td>348</td>
</tr>
<tr>
<td>Arson</td>
<td>67.3</td>
<td>60.0</td>
<td>11</td>
</tr>
<tr>
<td>Drug - Trafficking</td>
<td>76.4</td>
<td>54.0</td>
<td>5,652</td>
</tr>
<tr>
<td>Drug - Communication Facility</td>
<td>38.7</td>
<td>48.0</td>
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</tr>
<tr>
<td>Drug - Simple Possession</td>
<td>4.5</td>
<td>2.0</td>
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<td>Firearms</td>
<td>71.8</td>
<td>46.0</td>
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<tr>
<td>Burglary/B&amp;E</td>
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<td>15.0</td>
<td>9</td>
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<tr>
<td>Auto Theft</td>
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<td>Larceny</td>
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<td>Civil Rights</td>
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<td>Immigration</td>
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<td>National Defense</td>
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<td>Antitrust</td>
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<td>4.5</td>
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</tr>
<tr>
<td>Food &amp; Drug</td>
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</table>

1 Of the 18,789 cases, 110 were excluded due to one or both of the following reasons: missing primary offense (50) or missing or indeterminable sentencing information (67). Sentences of probation only are included in this table as zero months of imprisonment. In addition, the information presented in this table includes time of confinement as defined in USSG §7111.1. Descriptions of variables used in this table are provided in Appendix A.

References


