Groupthink and Fraudulent Financial Reporting

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ABSTRACT:
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Findings: The findings indicate that groupthink is very prevalent in business and a contributing factor in some situations to fraudulent financial reporting.
# Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abstract</td>
<td>1</td>
</tr>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Fraud</td>
<td>1</td>
</tr>
<tr>
<td>Fraud Triangle</td>
<td>2</td>
</tr>
<tr>
<td>Groupthink</td>
<td>4</td>
</tr>
<tr>
<td>Literature Review</td>
<td>4</td>
</tr>
<tr>
<td>Hypothesis Development</td>
<td>7</td>
</tr>
<tr>
<td>Methodology</td>
<td>7</td>
</tr>
<tr>
<td>Surveys</td>
<td>7</td>
</tr>
<tr>
<td>AAERs</td>
<td>8</td>
</tr>
<tr>
<td>Results</td>
<td>8</td>
</tr>
<tr>
<td>Surveys</td>
<td>8</td>
</tr>
<tr>
<td>AAERs</td>
<td>10</td>
</tr>
<tr>
<td>Conclusion</td>
<td>13</td>
</tr>
<tr>
<td>Works Cited</td>
<td>15</td>
</tr>
<tr>
<td>Appendix I</td>
<td>16</td>
</tr>
</tbody>
</table>
Groupthink and Fraudulent Financial Reporting

Abstract

Purpose and Methodology: The purpose of this study was to gain an understanding of groupthink and whether or not it impacts fraudulent financial reporting. This study utilizes surveys of practitioners and academics and an analysis of Accounting and Auditing Enforcement Releases (AAERs) to determine whether or not groupthink is a prevalent factor in fraudulent financial reporting.

Findings: The findings indicate that groupthink is very prevalent in business and a contributing factor in some situations to fraudulent financial reporting.

Introduction

Fraud

Fraud can manifest itself in numerous forms, styles and with varying consequences. Fraudsters continuously create new and different ways to commit fraud within different organizations. Fraud, according to Romney et al., is defined as “gaining an unfair advantage over another person” (Romney, et al., 2008). The authors continue by defining legally what must take place for fraud to be present including:

- A false statement, representation or disclosure,
- A material fact, which is something that induces a person to act,
- An intent to deceive,
- A justifiable reliance on the misrepresentation,
- And an injury or loss suffered by a victim (Romney et al., 2008).

Fraud is very prevalent in the business community. According to a 2003 study by KPMG, 75% of organizations dealt with some type of fraud during the past year. In another study by PriceWaterhouseCoopers in 2003, at least 30% of respondents from each industry group had experienced fraud. No industry or organization is immune from fraud and it can strike at anytime and anywhere (Peterson and Zikmund, 2004).

Romney, et al. define fraudsters as white collar criminals. Research has shown that white collar criminals differ greatly in their psychology and demographical information from violent criminals, but share the same psychology and demographics as the general public (Romney et
al., 2008). This shows how difficult it is to detect fraud and fraud perpetrators as they blend in easily with the general population.

SAS 99 defines fraud under two broad categories: misappropriation of assets and fraudulent financial reporting. Misappropriation of assets includes theft of assets such as office supplies or cash. This fraud can take numerous forms and is referred to as employee fraud because this type of theft often comes from within the organization as opposed to an outsider simply robbing the organization. Perpetrators often are trusted within the organization and use this position to trick or mislead others to commit the fraud. They are often caught because of their own arrogance including living an extravagant lifestyle, becoming greedier and taking larger amounts more frequently over time, or becoming careless and overconfident (Romney et al., 2008).

The second type of fraud under SAS 99 is fraudulent financial reporting. SAS 99 defines it as “intentional or reckless conduct, whether by act or omission, that results in materially misleading financial statements.” This type of fraud was seen in the collapse of Enron and WorldCom. Most frequently, as in these cases, this fraud is committed by making financial statements appear more favorable than reality or “cooking the books” (Romney, Marshall and Steinbart, 2008).

Additionally under SAS 99 the auditor has a responsibility to detect fraud. Auditor’s must:

- Understand fraud,
- Discuss the risks of material fraudulent misstatements related to the client,
- Obtain information from client,
- Identify, assess, and respond to risks,
- Evaluate the results of their audit tests,
- Document and communicate findings to appropriate level of management or audit committee, and
- Incorporate a technology focus into their audits (Romney et al., 2008).

**Fraud Triangle**

The fraud triangle is a means of displaying the motivation for fraud. According to Romney et al, for fraud to be prevalent three conditions must be met: pressure, opportunity and rationalization. All three must be present for fraud to exist. These authors further break down each point of the fraud triangle into their own separate triangles and in the case of pressure, two triangles. All of the points on these sub-triangles need not be present for fraud to exist as
on the general fraud triangle, they are simply rationale for how opportunity, rationalization and pressure occur (Romney et al., 2008).

Pressure is the motivation for committing fraud. The two triangles for pressure are employee pressure and financial statement pressure. The employee pressure triangle includes lifestyle, finances or emotions. The employee may have a gambling problem or other addiction; the employee may be living beyond his/her means; or the employee may be motivated by greed or dissatisfaction. The other sub-triangle of pressure is financial statement pressure and this occurs often when executives attempt to “cook the books”. This could occur because of financial considerations, industry conditions or management characteristics. The company may be having a bad year, the overall industry or economy could be depressed or management may just be ethically questionable or place an unusually high reliance on meeting analyst’s expectations (Romney, et al., 2008).

Opportunity is “the condition or situation that allows a person or organization to do three things” which are included on the opportunity triangle:

- Commit the fraud,
- Conceal the fraud, and
- Convert the theft/misrepresentation to personal gain.

Opportunities include poor internal controls or an organization having poor ethical standards (Romney et al, 2008). Organizations can best mitigate fraud by reducing the opportunity. As Free et al., discuss in Management Controls, the collapse of Enron occurred due to an opportunity provided by Jeff Skilling, CEO. Skilling demanded the company meet analyst’s projections, demanded short-term results and created a cut throat culture within the organization to achieve these goals. This culture created an opportunity for rampant fraud or at least questionable acts at all levels in the organization (Free et al., 2007).

The final point on the fraud triangle is rationalization. Rationalization “allows the perpetrator to justify illegal behavior.” This is what the perpetrator says to themselves to justify their actions. The three sides of the rationalization triangle are attitude, justification and a lack of personal integrity. A perpetrator’s attitude would allow them to justify a fraudulent act. By having a lack of personal integrity a perpetrator is able to continue on living as if nothing had happened (Romney et al., 2008).

Ramamoorti (2008) re-interprets the fraud triangle and takes on a view of it based more on psychology and sociology and their application to fraud. There are numerous factors that do not fall neatly into the triangle’s three sides such as revenge and greed. Ramamoorti suggests a modified triangle to explain fraud: the act, the concealment and the conversion. This allows outsiders to “reconstruct how the fraudulent act was committed, what actions were taken by
the fraudster to hide the audit trail or conceal his/her tracks, and eventually how s/he (as well as potential others) unlawfully benefited from the act" (Ramamoorti, 2008).

**Groupthink**

Audit Committees are an extremely important element of oversight to an organization especially with collusion and groupthink on boards and within the management team (Ramamoorti, 2008). Ramamoorti defines groupthink as “many heads, one mind.” He continues by saying that groupthink “discount[s] contrarian opinions or tends to sway the group into making a feels good decision because maintaining group cohesiveness and solidarity is seen as more important than realistic appraisal of the facts at hand” (Ramamoorti, 2008).

Scharff (2005) explains that groupthink is prevalent in real world business cases including the fraud committed by WorldCom and its CEO Bernie Ebbers. He defines groupthink as “a mode of thinking that people engage in when they are deeply involved in a cohesive in-group when the members’s strivings from unanimity override their motivation to realistically appraise alternative courses of actions” (Scharff, 2005).

Groupthink is easy to define but more difficult to find and analyze in practice. Scharff proposes several criteria that could indicate groupthink. The more prevalent these factors and the larger their numbers, the more likely groupthink has influenced the organization. The components are a feeling of invulnerability within the group, rationalization of the decision by the group, morality within the group, pressure from within or outside the group, stereotypes of those outside of the group, self-censorship when one does not agree with the group and unanimity during most or all decisions.

**Literature Review**

Fraud has been studied from numerous perspectives in an attempt to break down why and how it occurs. The fraud triangle often provides for an explanation as to why fraud occurs. By discovering the incentives/pressures, opportunities and rationalization of fraud one can often make some sense of fraud. Ramamoorti discusses how the three sides of the triangle can explain fraud but goes on to suggest that not every crime can fit easily into this summary (2008). The author continues by analyzing Sam Antar of CrazyEddie. Antar committed fraud simply for the sake of committing fraud and used human characteristics such as empathy and compassion to trick those around him (Ramamoorti, 2008). Ramamoorti argues that these
characteristics fit in at some level into the fraud triangle. These characteristics may only fit into a certain area arguably or may fit into multiple areas though (2008).

The audit committee is one of the most important safeguards against fraud. Obvious, evident signs of fraud are often missed. This may be due to selective perception or “seeing only what one wants to see” and the confirmation bias or “seeking confirmation of one’s beliefs” and ignoring evidence to the contrary. These failures to detect fraud can occur at the auditor, management or the Board of Director level (Ramamoorti, 2008).

Ramamoorti (2008) addresses groupthink as being prevalent within audit committees and boards of directors thus allowing for an environment where fraud can take place. This point is not expanded upon greatly and deserves much more attention at the audit team, management and board level (Ramamoorti, 2008).

A study done for the Institute for Fraud Prevention determined that it takes seven individuals to commit fraud (Tillman & Indergaard, 2007). This study analyzed financial statement restatements from January 1, 1997 to June 30, 2002. From there the restatements were narrowed down to ones that had lawsuits brought against them as these would be more likely to indicate fraud. From these cases the researchers identified that multiple individuals were listed as defendants. Often these individuals work together to commit the fraud or act that brought the complaint against them and their organization. This study showed that group dynamics are certainly an issue when it comes to commitment of fraud. This study fails to link this group’s actions to groupthink or to any groupthink signs.

Steinberg (2009) describes his experiences with groupthink and the impact it can have on new board members and even experienced boards. Steinberg witnessed numerous new board members fail to voice their opinions because they were not fully conversant in how the board worked. His experiences show that groupthink can emerge in many forms and may impact decisions and stifle dissent when a consensus starts to appear.

Steinberg (2009) relays another story from a major financial services company and its CEO. The CEO presented a direction and was ready to move the discussion forward. Steinberg noticed that the body language indicated not everyone was convinced of the direction. Steinberg forced more discussion and eventually the group moved in a new direction. Groupthink nearly prevailed in this situation had it not been for more thoughtful discussion. Steinberg’s anecdotes fail to address the issue of groupthink but these anecdotes can be related to situations where a board or CEO may want to be deceitful and no one will attempt to stop it because they do not want to dissent.

In one study researchers found that nearly all participants going into a group decision making scenario believed they knew what the outcome would be and were cognizant during the
decision making process of others emotions and feelings about the process (Ladbury & Hinsz, 2009). This shows that many scenarios exist where groupthink can thrive and cause groups to come to a decision, whether good or bad, with little to no debate or discussion. Because this study was done with psychology students, fraud was not discussed in this study.

Peterson et al., (2003) studied the affect of the CEO's personality on top management teams. The study was intended to discover a linkage between a good CEO and success of the organization, but in reaching these results the study showed that the CEO has a great deal of influence on the management team. This influence can be positive and allow for positive, forward-looking discussion or can be negative and stifle discussion and only allow the CEO to be correct. This clearly can be applicable to groupthink.

Sharff (2005) discusses groupthink in depth and its impact on the fraud at WorldCom. This study analyzes the specific psychological concept within a real world business case. Scharff lays out different components of groupthink that may raise a red flag as to whether or not groupthink is prevalent within an organization. They are as follows:

- Invulnerability-cohesive groups can build an aura of invulnerability and this provides reassurance to the group and its decisions.
- Rationalizations-groups can develop outrageous fabrications and rationalizations to justify their behavior. This can display itself by the group misjudging relevant warnings, inventing new arguments for the same tired position, etc.
- Morality-groups judge morality in different ways within the group. Morality could be judged based upon actual ethical standards or one's loyalty to the group.
- Pressure-groups exert pressure on all the members to agree with the group and not express a dissenting opinion.
- Stereotypes-groups that fall victim to groupthink begin to develop a stereotype for those outside the group. The group may view those not in the "inner circle" as "inept, incompetent and incapable of countering effectively any action by the group, no matter how risky."
- Self-censorship-individuals either may not state an opinion or may state an opinion they do not necessarily believe in to help keep the group cohesive.
- Unanimity-groups may take a position to keep everything positive and all members may simply fall in line to not break this silent pact (Sharff, 2005).

Even with these numerous components it is still difficult to detect groupthink in practice. It is difficult to see these components from the outside of an organization without being involved at some deeper level. According to Scharff many of these components were seen in WorldCom and, unfortunately, it took Cynthia Cooper, head of internal audit and ultimate whistle blower, quite some time to finally discover this major fraud (2005). These components, however, allow an outsider to determine if groupthink in a particular situation (such as when fraud is committed) is prevalent and lead to the fraud.

~ 6 ~
The top management team at WorldCom fell victim to groupthink when committing financial reporting fraud. The examination of the fraud at WorldCom by Scharff (2005) is the only major study that links fraud and groupthink together. Scharff utilizes a list of factors in group dynamics that can lead to groupthink and examines each individually to determine if groupthink is prevalent within WorldCom's top management team that committed fraud. The fraud at WorldCom shows that top management teams can fall victim to groupthink in committing and rationalizing fraudulent financial reporting. It is possible that other management teams have also succumbed to groupthink in committing fraud.

**Hypothesis Development**

Groupthink is a psychological condition in which a group comes to a consensus because the individuals do not want to create discontent within the group, do not want to harm the progress of the group or disrupt the group in anyway although the individual may disagree and see a better course of action. Fraud and groupthink have been studied extensively but there is a lack of study on the implications of groupthink on fraud. Groupthink can lead management teams to make poor decisions in the course of their business or give them an avenue to commit fraud specifically with their financial reporting.

A detailed examination of whether or not groupthink can contribute to fraudulent financial reporting is warranted. This paper investigates how groupthink provides rationalization for committing fraudulent financial reporting. By examining groupthink from different perspectives it is possible to determine whether or not groupthink is a likely contributor to fraud. Therefore, my hypothesis is:

\[ H_1: \text{Groupthink in top management teams leads to fraudulent financial reporting.} \]

**Methodology**

**Surveys**

Surveys were sent out via e-mail to gain an understanding of groupthink in the real world. Three groups were contacted: psychologists, professors and practitioners. First, psychologists were surveyed to gain a general understanding of groupthink. Then, professors were surveyed to understand the implications of groupthink in a theoretical sense, and depending upon
background, implications of groupthink in the real world. Finally, professionals and practitioners completed surveys to find real world situations in which groupthink has had implications.

Appendix I provides the questions used for each group surveyed.

The questions were open-ended to receive a broad range of responses in order to gain a broad perspective of groupthink in the business world.

The responses to these survey questions were analyzed by placing participants into categories based upon their current and past positions. These categories include Big Four public accounting firms, mid-sized public accounting firms, small public accounting firms, internal audit functions, private industry accountants, human resources professionals, governmental accountants, academics and psychologists. The responses would also show certain key terms that are generally used to identify groupthink which would be used to analyze the AAERs.

AAERs

Accounting and Auditing Enforcement Releases (AAERs) outline the case brought against an individual or company by the Securities and Exchange Commission (SEC). The SEC often brings these cases against individuals or organizations that have committed fraud. They outline the details of the case brought against the individual or organization and provide all details necessary in the proceedings.

AAERs were selected from January 1, 2008, through September 26, 2010. Any corporation listed that had an SEC Complaint PDF file available was selected. This did not include complaints filed against individuals (e.g.: CPAs) or Big Four public accounting firms (e.g.: Ernst & Young). The AAERs were then analyzed and put through filters to reduce the number for final analysis. These filters were reading of the introductory section to determine its relevance, key-word searches to find signs of groupthink and finally a detailed analysis of any remaining AAERs to analyze groupthink on a deeper level. The knowledge gained from the surveys and research will be applied to determine if it is likely that groupthink played a role in these fraud cases.

Results

Surveys

I was unable to obtain any responses from psychologists. Of the 34 e-mails sent out to professionals and professors, I received 11 professional responses and 3 academic responses. I

~ 8 ~
grouped the professionals into different categories. One professional may fall into multiple categories because they represent different areas of accounting. The categories selected are Big Four Public Accounting Firms (Big4), Mid-sized Public Firms (Mid-sized), Small/Local Public Firms (Small), Private Industry Accounting (Private), Internal Auditing Function (Internal), Governmental Accounting (Government), Human Resources Professionals (HR) and Not-For-Profit Experience (NFP). Table 1 summarizes the response data.

<table>
<thead>
<tr>
<th>TABLE 1: Categories-Professionals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big4</td>
</tr>
<tr>
<td>Mid-Size</td>
</tr>
<tr>
<td>Small</td>
</tr>
<tr>
<td>Private</td>
</tr>
<tr>
<td>Internal</td>
</tr>
<tr>
<td>Government</td>
</tr>
<tr>
<td>HR</td>
</tr>
<tr>
<td>NFP</td>
</tr>
</tbody>
</table>

It is important to survey a diverse group of individuals to see fraud and groupthink from numerous viewpoints. Because fraud is not limited to only private industry or public accounting, the study must analyze groupthink from the same perspective. By analyzing information about groupthink from different angles including public accounting, private industry and not-for-profit organizations we can see whether or not groupthink is prevalent across multiple areas within business.

<table>
<thead>
<tr>
<th>TABLE 2: General Data-Professionals and Professors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seen fraud in business</td>
</tr>
<tr>
<td>Believe groupthink occurs in business</td>
</tr>
<tr>
<td>Seen groupthink in business</td>
</tr>
<tr>
<td>Intervened due to groupthink</td>
</tr>
<tr>
<td>Saw poor decisions made because of groupthink</td>
</tr>
<tr>
<td>Served in leadership roles</td>
</tr>
</tbody>
</table>

Table 2 shows that fraud and groupthink commonly occur in business settings. A vast majority have seen fraud, seen groupthink that in some cases led to fraud and have intervened due to groupthink. Eleven respondents believed groupthink led to poor decisions, although numerous respondents commented that this is extremely difficult to measure unless it quickly resulted in a loss. In some cases, as mentioned by some respondents, a group may not even realize groupthink occurred until long after a decision has been made. Many respondents mentioned that after a decision had been made, group members mentioned in confidence that they would have preferred an alternative course of action. This response was seen amongst several members of the group, but none of them voiced their opinion. Twelve of the respondents had
served in some sort of leadership role which I defined as having headed a committee, been a partner in a firm or been the head of a department such as human resources.

An important question for this study was to analyze what signs led to groupthink in order to provide a basis for analysis of the AAERs. This question was asked of those surveyed and the following were important indicators of groupthink as mentioned by respondents:

- Individuals expressing a dissenting opinion after a decision was made
- General discontent in the meeting without any vocal dissent
- Inexperienced team members who were unsure of themselves and others making decisions
- Powerful or unethical group leader
- Quickly making a decision
- Pressure placed on an individual or a group
- Lack of individual ideas amongst group members
- Culture where failure is not allowed

These signs of groupthink are mirrored in the fraud triangle and Sharff’s (2005) analysis of groupthink’s effects at WorldCom. When bringing all of these factors together one is able to gain a deep understanding of groupthink and is better able to analyze whether or not it is likely that groupthink is occurring in a given situation.

AAERs

The fifty AAERs that involved fraud within public organizations were identified. The introductory sections of these fifty AAERs were read to determine whether or not fraud that had financial reporting implications was involved in the case. All 50 met this criterion after this reading.

From this grouping of 50 AAERs a keyword search and reading of the introduction of each AAER narrowed down the grouping to 27 AAERs that showed signs of groupthink. The keyword search consisted of the following words: group, committee, collaboration, collaborate, collaborating, together, team, teamwork, partnership and department. By reading around the keywords that were found, I analyzed whether or not the word was relevant and whether or not the description of events around the word pointed toward groupthink. I also looked for multiple individual defendants listed in the file and for evidence of groupthink in the introduction. Each of the AAERs found in this grouping of 27 revealed one of the keywords searched for, multiple
defendants listed, some indication of groupthink in the introductory material or some combination of the three.

Six categories emerged from the original group of 50 AAERs. They are bribery, expenses, internal control, misrepresentation, revenues and stock. These categories can be described as the following:

- bribery includes any illegal gift giving
- expenses is related to categorizing expenses incorrectly
- internal control relates to poor internal controls within the organization
- misrepresentation includes inflating performance, GAAP departures, misleading documentation for IPO and improper disclosure
- revenues relates to overstating revenues
- stock involves unregistered sale of stock, backdated stock options and illegal stock options

Table 3 summarizes the breakdown by category:

<table>
<thead>
<tr>
<th>TABLE 3: Categories of AAERs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bribery</td>
</tr>
<tr>
<td>Expenses</td>
</tr>
<tr>
<td>Revenues</td>
</tr>
<tr>
<td>Internal Control</td>
</tr>
<tr>
<td>Misrepresentation</td>
</tr>
<tr>
<td>Stock</td>
</tr>
</tbody>
</table>

Table 4 summarizes by category the prevalence of the keywords in each of the categories:

<table>
<thead>
<tr>
<th>TABLE 4: Categories</th>
<th>Multiple Individual Defendants</th>
<th>Group</th>
<th>Committee</th>
<th>Collaborate</th>
<th>Together</th>
<th>Team</th>
<th>Partnership</th>
<th>Department</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bribery</td>
<td>2</td>
<td>1</td>
<td>5</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Expenses</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Revenues</td>
<td>4</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Internal Control</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Misrepresentation</td>
<td>4</td>
<td>3</td>
<td>9</td>
<td>0</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Stock</td>
<td>7</td>
<td>1</td>
<td>12</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>5</td>
</tr>
</tbody>
</table>

*Because the words collaboration, collaborating and teamwork produced no relevant results, they are not included in the above table.*
Table 5 shows based upon the key-word analysis above whether or not it is possible that groupthink was a factor in committing the fraud reported in the AAER:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bribery</td>
<td>4</td>
</tr>
<tr>
<td>Expenses</td>
<td>0</td>
</tr>
<tr>
<td>Internal Control</td>
<td>0</td>
</tr>
<tr>
<td>Misrepresentation</td>
<td>8</td>
</tr>
<tr>
<td>Revenues</td>
<td>4</td>
</tr>
<tr>
<td>Stock</td>
<td>10</td>
</tr>
</tbody>
</table>

This group of 27 was analyzed further to look for signs that make groupthink likely. By reading the introductory material and the case facts in each AAER, certain signs began to appear that made it likely that groupthink was a factor in the fraud. Because of the way the AAERs are written, very few signs of groupthink appeared within them. The following signs were ones within AAERs that pointed toward groupthink as a likely factor:

- Strong leader or leadership possibly from an executive team that can exert influence over major decisions or over employees at lower levels to commit fraud on their behalf (Strong Leader).
- Strong committee, group or executive team within the organization that is given a great deal of power and ability to execute fraud (Powerful Group).
- Poor culture or “tone at the top” from executives that makes fraud more likely (Culture).
- Pressure from internal or external forces to meet projections, increase revenues/profits, etc. (Pressure).
- Committees or groups that are too trusting or are ‘puppets’ of executives of the company (Trusting Groups).
- Newer employees within departments or in executive roles (Inexperienced Employees).

All of the above factors according to preliminary research and the surveys conducted are signs that indicate groupthink. Strong leaders and powerful groups have a lot of influence and weight within the organization. They can force others to do almost anything they want for fear of losing their jobs; or they can think that they can do no wrong and make no bad decisions. These groups and leaders can also set a poor “tone at the top” and create a culture of poor ethics or of high pressure that can make groupthink more likely. Pressure to meet projections both internally and externally can cause groups to make decisions that may not be legal or the best long-term decision and can lead to groupthink. If a committee or group is too trusting of an officer, that officer can have the ability to push their agenda through an approval process with little to no questioning and that decision will have fallen victim to groupthink. Finally, newer or inexperienced employees may not want to speak up because they do not yet know or
understand the way things work in an organization and this may prevent them from speaking their mind.

Of the 27 AAERs left after the first filter, 20 showed one or more of the above signs of groupthink. The seven that did not show signs were inconclusive or misinterpreted upon going through the first filters. The following table summarizes the signs of groupthink listed above that the AAERs showed. Each AAER may fit into multiple categories.

**TABLE 6: AAER Groupthink Signs**

<table>
<thead>
<tr>
<th>Strong Leader</th>
<th>16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Powerful Group</td>
<td>8</td>
</tr>
<tr>
<td>Culture</td>
<td>4</td>
</tr>
<tr>
<td>Pressure</td>
<td>6</td>
</tr>
<tr>
<td>Trusting Groups</td>
<td>1</td>
</tr>
<tr>
<td>Inexperienced Employees</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 7 shows which groupthink signs were prevalent in each category of fraud of the AAERs:

**TABLE 7: Fraud Categories vs. Groupthink Signs**

<table>
<thead>
<tr>
<th></th>
<th>Strong Leader</th>
<th>Powerful Group</th>
<th>Culture</th>
<th>Pressure</th>
<th>Trusting Groups</th>
<th>Inexperienced Employees</th>
</tr>
</thead>
<tbody>
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<td>Bribery</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td></td>
<td></td>
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<tr>
<td>Expenses</td>
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<td></td>
<td></td>
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<tr>
<td>Internal Control</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Misrepresentation</td>
<td>5</td>
<td>2</td>
<td></td>
<td>3</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Revenues</td>
<td>2</td>
<td></td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock</td>
<td>7</td>
<td>5</td>
<td>2</td>
<td></td>
<td></td>
<td>1</td>
</tr>
</tbody>
</table>

While it is difficult to analyze AAERs for the signs of groupthink, 20 of the 50 AAERs analyzed showed strong signs that groupthink was a possible contributing factors to the fraud that occurred. Within the AAERs, strong leadership was the easiest sign to pick out especially when the SEC prosecuted the CEO or CFO who was involved in the fraudulent activity.

**Conclusion**

Based upon the surveys, with input from those in the profession and the analysis of the AAERs, it appears that groupthink is prevalent in the business world and has an influence on decision makers who are committing fraud. Many signs brought forward by Scharaff (2005) in his analysis of WorldCom were discussed by the professionals and professors surveyed. Several of these factors also appeared in the fraud cases presented in the AAERs.
Because groupthink is clearly an issue in all different types of organizations and at different levels, practitioners need to pay particular attention to groupthink and understand its implications. As shown through the surveys and AAER analysis, groupthink can manifest itself in many different ways and affects each situation differently.

Management and the Board of Directors can reduce the likelihood of groupthink by providing a culture that not only tolerates failure, but encourages it. This will ensure that all ideas, no matter how ridiculous or poorly thought out, are heard. These ideas may lead the group to arrive at different and possibly better decision. Management and the Board of Directors can also put people into positions of power who think differently and see the world differently. This will again allow for better decision making because discussion will be more likely to occur.

Audit teams during an audit can watch for signs of groupthink in the culture of the organization or in the minutes of the Board of Directors meetings. By providing feedback to the client, groupthink can be reduced in the future, thereby reducing the likelihood of poor decision making which may lead to fraudulent financial reporting.

This study has several limitations that merit discussion. Within the surveys, it is extremely difficult to capture groupthink. Some of the respondents even admitted to not always being able to identify groupthink in real-time situations. Others did not complete the survey due to the implications of groupthink in a legal sense. As seen in the AAER analysis, groupthink can have extremely negative implications and this may incriminate those who were involved in it. Although this study is meant to analyze the problems associated with groupthink so that others may utilize the information to reduce groupthink in the future, the legal implications make it difficult to study. AAERs include certain details that are specifically relevant to their case against the organization. This provides a limited view of what is actually occurring within the organization. It is difficult to perform an analysis to determine with certainty that groupthink was a contributing factor to the fraud committed.

Further research may be to continue analyzing groupthink and its real world implications. By talking to more practitioners one can develop a clearer understanding of groupthink and its implications. To fully understand groupthink and its impact on fraud, one would need to understand everyone in an organization involved in decisions and further analyze the decisions being made. A follow up study could take the information provided here to analyze groupthink’s impact on fraud on one organization similar to the analysis done on WorldCom by Ramamoorti in 2008. The framework provided could be applied to other organizations that have committed fraud to allow the researcher to deeply analyze groupthink and develop a means of preventing it in the future.
Works Cited


~ 15 ~
Appendix I
Questions asked of survey groups

Practitioners:

- In what positions have you served as an officer/executive/leader? Were they for profit or not-for-profit?
- Have you seen fraud in a business setting? How?
- Do you believe groupthink occurs in business settings?
- Have you seen groupthink in a business setting?
- What signs contributed to your understanding of the situation? What led you to believe that groupthink was occurring?
- What were the implications of groupthink? Were poor decisions made?
- Have you ever had to intervene due to the implications of Groupthink?
- How can you change the group composition to discourage Groupthink?
- What kind of people can be put in positions of power to make sure it doesn't happen?
  - Demographic Information:
    - Companies
    - Time Served
    - Positions

Professors:

- In what positions have you served as an officer? Were they for profit or non profit?
- Have you seen fraud in a business setting? How?
- Do you think groupthink occurs in business settings?
- Have you seen groupthink in a business setting?
- How has groupthink impacted decision making in these instances?
- How can a group avoid Groupthink?
- Demographic Information:
  - Companies
  - Time Served
  - Positions
  - Current Research Focus
Psychologist:

- In what positions have you served as an officer? Were they for profit or non-profit?
- What is Groupthink?
- Have you done any studies that have been relevant to groupthink?
- How does this concept occur in the real world?
- What types of situations can groupthink occur in?
- What are the results of Groupthink?
- What examples of groupthink have you seen in practice?
- How can a group avoid Groupthink?
- What kind of people can be put in positions of power to make sure it doesn’t happen

Demographic Information:
- Companies
- Time Served
- Positions
- Current Research Focus