

Committing fraud within the context of the fraud triangle



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Statistics have reported that fraud is the most expensive crime experienced by millions of consumers every year. According to this investigations, there are different ways to commit fraud as criminals continue to expand their imagination and creativity in finding new ways to obtain more gains. A common type of fraud is the financial motivation encouraged by top executives leading them to commit white collar crimes. Companies like Enron and WorldCom are examples of big known corporations tore apart by financial fraud scandals. Until the present, many charges of fraud continue to make headlines, like the example of our company: Valeant Pharmaceuticals. The truth is, undetected fraud, committed for a long time, will lead to enormous losses for many individuals directly and indirectly involved in the company. However, the main question on people's mind is " how have we allowed these large scale of fraud to happen again and go undetected"? Well, the story of Valeant Pharmaceuticals is an example of corporate greed and misconduct, based on a corrupted tone at the top and a dysfunctional corporate culture.

Interviews done to people who have committed fraud have revealed that most people do not originally intent to commit fraud. Many times, they either just took advantage of an opportunity, or they realized nobody noticed an accidently fraudulent act. Therefore, we can agree with Donald Creese, that fraud occurs because of a combination of opportunity, pressure and rationalization. The fraud triangle theory explains the factors that lead to fraud and unethical behavior in addition to understanding how and why people commit fraud.

Beginning with pressure; back in 2008, Michael Pearson was appointed as CEO of Valeant Pharmaceuticals and with his new designation he brought in a new plan. He wanted to create a drug giant that focused on distribution and let someone else do the research (Gandel, 2015). The initial pressure experienced by Mr. Pearson was not wanting to follow the traditional pharmaceutical structure, and instead wanting to avoid lengthy and costly research and development programs. Therefore, in order to make this work, he decided to employ a “ new” strategy in the pharmaceutical industry, which was to implement aggressive acquisitions. “ In Pearson’s view pharmaceutical companies had bloated costs due to years of huge profits, and despite the billions they spent on research and development, they were producing few new F. D. A - approved drugs” (Mclean, 2016). It was for this reason that Pearson (being a man who would see the world in terms of money and earnings), would be very important for him to prove his theory of not betting on science but instead on management. According to him, the “ buy and cut” growth strategy would produce higher returns to investors (Vardi, 2016).

As per the fraud triangle, the pressure, or incentive, to commit fraud is the reason why a person commits fraud. For many years, Valeant Pharmaceuticals was viewed as the role model to other companies but mostly to the pharmaceutical industry. The company’s success was rapid and its growth and rise was strong. In addition, the company’s plan was being praised by everyone and by many corporations and experts, mainly due to its executive unique compensation plan. Pearson had its own theory about improving management based on executives being rewarded for

performance as measured by stock price. This is where again he became a victim to the pressure element within the fraud triangle. Person and other top executives would receive little cash compensation but massive amounts of incentive stock and options. In other words, in addition to investing millions of dollars buying out rival drug companies and drastically impacting the company's financials by piling on debt, executives would receive little cash compensation. But instead, they would do well if Valeant's stock did well and make a fortune if the company's stock went up significantly.

For someone who believes that cancer research is a losing proposition and thinks that pharmaceutical companies has not generated any positive returns on it, it is not complicated to predict that greed was his main force and highest pressure in his life and business decisions. These pressures lead Mr. Pearson to build on smoke and mirrors, instead of focusing on building a strong foundation. He would sell to investors the idea that Valeant's core competencies were its superior approaches to capital allocation and drug pricing (Surowiecki, 2016). Pearson needed to sustain the growth, and the stock price, by whatever means he could.

Pearson was able to obtain a financial billionaire status in a very short period of time. In a few years after becoming the company's CEO, Valeant Pharmaceutical was being recognized as one the fastest-growing companies in America, with an equity market value of around \$90 billion (Mclean, 2016). This massive rise was driving by the second factor in the fraud triangle, which is opportunity. As explained by Mr. Cressey, " the opportunity to commit fraud is the circumstances that allow fraud to occur" (Anders CPAs + Advisors, 2015). During 2008 financial crisis, Valeant would sell to investors <https://assignbuster.com/committing-fraud-within-the-context-of-the-fraud-triangle/>

a low-cost pharmaceutical company model, making it attractive to investment bank and allowing them to borrow money at low interest rates. Valeant Pharmaceutical, taking advantage of the opportunity and the circumstances, was able to purchase over 100 companies, including contact-lens-maker Bausch & Lomb (Mclean, 2016). A couple years later, Valeant merged with a Canadian company called Biovail, which was using offshore subsidiaries, allowing them to acquire the lowest tax rate of any pharmaceutical company in the world. In addition, Pearson had told shareholders his goal was to make Valeant one of the five largest pharmaceutical companies. As a strategy, he would talk to shareholders in terms of cash returns and accountability, which allowed him to attract the attention from those investors that did not like the traditional pharmaceutical companies, due to the natural insecurity of drug development.

However, more opportunities were made available to Valeant Pharmaceuticals. The mysterious relationship between Valeant and Philidor RX Services LLC, was another opportunity that helped out Valeant to make hundreds of millions of dollars. Valeant's business strategy was to buy drugs they believed were mispriced and continually increase their prices. Because, insurance companies would not agree to pay those exaggerated prices and instead would approve the less expensive drugs. This is where Philidor would offer the opportunity to Valeant to play and beat the system. Philidor was a specialty pharmacy, whose main business was dispensing Valeant's drugs to consumers and getting insurers to pay for them. Philidor employees were told by management they needed to change the codes on the doctor's prescriptions to Valeant's brand, even when much cheaper generics were

available. They will then re-submit rejected claims by using another pharmacy's identification number.

Philidor allowed Valeant to gain back market share for a lot of their drugs. This new strategy would push the drug's costs through the system and would offer insurance companies big rebates. One example being Solodyn, an acne treatment drug, whose revenue increased by 56% in one quarter, after Valeant started using Philidor to distribute it (Nocera, 2018). In addition, investigations have confirmed there were Valeant employees working at Philidor under false names. Philidor was the target used to abuse the system and increase sales. Gary Tanner, a former executive at Valeant Pharmaceuticals had abused his position of trust and due to weaknesses in the internal control framework of Valeant was able to engage in a multimillion-dollar kickback scheme with Philidor.

But what was the rationalization for this crime? This is the third and final component in the fraud triangle. Cressey's investigation support that many violators do not really feel there are actually criminals. This is what makes the rationalization of committing a fraud the most difficult condition to observe, as this stage involves the mind and thinking of the perpetrator. Based on a letter Mr. Pearson sent out to Valeant's employees he describes the company's business model as being focused on organic growth and execution. The truth is, Valeant was defrauding insurance companies, Medicare and the health-care system by outrageously increasing the price of drugs it had acquired. Pearson would not believe raising prices was a bad thing, he would justify the drugs were underpriced relative to the value they provided in a very expensive operation.

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Valeant's Pharmaceutical fraud investigation includes a list of regulatory and criminal violations. Many of their problems relate to Philidor, currently labeled as their first criminal charge. Other issues and scandals facing the company involves the investigation of the increased drug prices, its financial disclosures, its billing practices and the investor's lawsuits. After examining this case, we can conclude that all three conditions (pressure, opportunity and rationalization) must be present in varying degrees in order for fraud to occur. Neither an employee nor a top executive would be able to commit the fraud if the opportunity is not available, or if the consequences of getting caught are high. In addition, we can conclude that even with a perceived opportunity to commit the fraud, the act is unlikely to occur unless the fraudster can rationalize the fraud. Nevertheless the key question still remains: could Valeant Pharmaceuticals have done anything to prevent it? Valeant executives should not have focused on the short term profit and instead on long-term sustainable growth built on a culture of ethics, hard work and strong business principles.

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