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Fake Accounts Scandal at Wells Fargo: What are the Lessons?

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"Our entire culture is centered on doing what is right for our customers."
—John Stumpf (Wells Fargo CEO)

I. Introduction

Wells Fargo initially agreed to pay a fine of $185 million to Consumer Financial Protection Bureau (CFPB) and others for opening millions of fake accounts without customers' permission (Sandwith, 2016). Employees at Wells Fargo created more than 1.5 million unauthorized deposit accounts and set up roughly 565,000 bogus credit card accounts over five years. This figure was revised upward to $3.5 million bogus deposit/credit card accounts in August 2017 (Keller, 2017). In February 2020, Wells Fargo agreed to pay $3 billion in additional settlement, of which $500 million went to the SEC and $2.5 billion went to the U.S. Treasury. Several other cases of recent alleged bank fraud are generally associated with mortgage lending or other areas of esoteric products such as collateralized debt obligations or fancy derivatives. Wells Fargo staff created fictitious account holders so that they could meet difficult sales targets. Sadly, this fraud lasted more than five years and resulted in Wells Fargo firing about 5,300 workers and managers for cause between Jan. 1, 2011, and March 7, 2016 (Tomkiel, 2017). This fraud took an extremely high toll on the customers and employees associated with it.

Wells Fargo (WFC) stock has dropped approximately 10 percent since the scandal was announced and the then CEO John Stumpf was forced to resign. According to the complaint, managers would constantly "hound, berate, demean and threaten employees to meet these unreachable quotas. Managers often tell employees to do whatever it takes to reach their quotas (Hersh, 2016)" Bankers at Wells Fargo used special internal terms for these fraudulent business practices such as "pinning" and "bundling." Pinning is assigning "a PIN number to customer ATM cards without customer authorization for the intention of impersonating the customers on Wells Fargo computers to enroll in online banking products. Bundling refers to the Wells Fargo practice of incorrectly informing customers that certain products could only be obtained in packages with other products when in fact the product was available individually." (Hersh, 2016).

Toxic Sales Culture

Wells Fargo leadership often referred to its sales goals as "50/50 plans" because the leadership knew only around half the regions would be able to meet the target. However, all employees would feel the pressure of these extreme sales goals. Wells Fargo employees knew that meeting or exceeding these numbers could make or break their careers. In fact, employee incentive compensation was linked to these lofty sales quotas. The extreme focus on making sales lead to promotions for those who could find a way to excel in this pressure induced sales environment (Wells Fargo, 2017).

Up until 2014, employees and managers would receive a "motivator report" daily and/or weekly. This report contained monthly, quarterly and year-to-date sales goals. The report would rank employees and managers against one another in terms of their sales outcomes (Wells Fargo, 2017). This report effectively shamed those with a small number of sales and praised those with high sales numbers. Over time, these practices created a toxic culture that permeated the daily lives of Wells Fargo employees. In fact, many employees turned to the practice of "simulated funding" to get credit for creating a sham account. In this practice, employees would temporarily transfer their own funds, or funds from another customer to the fraudulent account (Wells Fargo, 2017). By creating an environment where selling products was the most

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important thing for employees, Wells Fargo created a landscape that was ripe for unethical behavior. Moreover, Wells Fargo's 2017 investigative report states as a principle finding, "The root cause of sales practice failures was the distortion of the Community Bank's sales culture and performance management system, which, when combined with aggressive sales management, created pressure on employees to sell unwanted or unneeded products to customers and, in some cases, to open unauthorized accounts" (Wells Fargo, 2017).

II. Control Environment

Tone at the top refers to the ethical climate created by the top management. It is management's commitment to honesty, integrity and ethical behavior at all levels of the organization. Incentives on sales goals and objectives are an important part of the culture of any business. However, when management acts unethically, or appears to be more concerned with financial success than doing what is right; employees tend to act in a similar manner. Wells Fargo was unable to realize the degree to which employee business practices were creating extensive reputational risks for the bank. That "hefty" fine paid to CFPB is akin to a slap on the wrist representing "only about 3 percent of the bank's second-quarter profits." (Lewczyk, 2016).

The decentralized operations used by Wells Fargo allowed for management in banks to run them "like they owned them." (Wells Fargo, 2017). Under this type of business model, management was able to impose unrealistic sales quotas and adopt policies that drove its employees to engage in fraudulent behavior to meet those unattainable goals (Hersh, 2016). Wells Fargo's internal investigation points out, "Corporate control functions were constrained by the decentralized organizational structure and a culture of substantial deference to the business units. In addition, a transactional approach to problem-solving obscured their view of the broader context. As a result, they missed opportunities to analyze, size and escalate sales practice issues." (Wells Fargo, 2017).

Internal Control Failures

According to Musngi: "While the issue seems to have limited financial impact (currently), it has a significant impact on operations, internal controls, and compliance, given the scale of the issue which involved 5000+ employees, the duration which spanned multiple years, and the inability of management to remedy the issue despite their efforts." He fears financial restatements and disclosures of material internal control weaknesses by Wells Fargo. Internal audit, line management, and the corporate risk-management—all appear to have broken down resulting in massive employee terminations and record fines (Musngi, 2016).

Signs of inappropriate sales techniques started to show up in the early 2000's. In 2004, internal Wells Fargo investigators developed a task force to examine "gaming" sales techniques (Wells Fargo, 2017). In the August 2004 report the group stated, "it is the conclusion by Corporate Security Internal Investigations that whether real or perceived, team members on the current Corporate Sales Incentive Plan feel they cannot make sales goals without gaming the system. The incentive to cheat is based on the fear of losing their jobs for not meeting performance expectations." (Wells Fargo, 2017). The 2004 report raised alarm bells by noting, "[i]f customers believe that Wells Fargo team members are not conducting business in an appropriate and ethical manner, it will result in loss of business and can lead to diminished reputation in the community." (Wells Fargo, 2017). However, this report failed to make an impact on senior managers. Additionally, internal auditors failed to continue to press this issue for the next several years as the fraud ran rampant.

There are no indications that internal audit department at Wells Fargo looked "at the setting of compensation targets, the culture of the organization, the design and operation of controls over the opening of customer accounts, the design and operation of controls around customer complaints." (Wells Fargo, 2017). The decentralized governing body at Wells Fargo had all the information relating to employee terminations, turnover, incentive compensation, performance reviews and the work atmosphere; but similar to risk management, the Chief Administrative Officer had no coordinated practice in place to comprehensively track sales problems (Wells Fargo, 2017).

Internal Audit Failures

Internal auditors assumed that other parts of the bank were responsible for mitigating sales practice integrity issues (Wells Fargo, 2017). However, they did not verify if that was the case. According to Tomkiel (2017): "Internal auditors issued report after report rating as effective various controls designed to prevent, detect and remediate sales integrity violations and "sales practice-related risks." Internal audit even reviewed the bank's compensation plans and opined that the plans' designs did not promote unethical behavior." The internal auditors focused narrowly on the individual controls

and processes that were operating to detect individual incidents of misconduct. They unfortunately did not assess the "overall risk environment" as it impacted the bank and its customers. Internal audit departments everywhere need to operationalize the suggestions of the recent research publication of IIA on auditing "culture." (Tomkiel, 2017). In addition, internal auditors should exhibit more professional skepticism than others such as risk management personnel at the bank.

Whether or not risk management or internal audit could have prevented this type of fraud is questionable. There are procedures that should have been performed or at least monitored, that would have allowed the activities to be identified as a risk. For example, the audit plan or risk assessment should have included monitoring consumer complaints or customer satisfaction as well as the responses to each of these. The organizational culture should have been assessed by walking around and listening to employees and observing them perform daily tasks.

Wells Fargo Auditors

KPMG issued a clean ICFR opinion in the Wells Fargo 2015 annual report. Many people speculated and questioned why a clean report was issued when there were obvious sales abuse schemes occurring. KPMG stated that it was aware of the unethical sales practices at Wells Fargo occurring as far back as 2013. However, the firm seemed content with the knowledge that management had of the practices. KPMG responded to Senators Elizabeth Warren and others when asked about their procedures to deduct fraud and duty to inform investors, by stating that "not every illegal act has a meaningful impact on a company's financial statements or its system of internal controls over financial reporting. From the facts developed to date, including those set out in the CFPB settlement, the misconduct described did not implicate any key control over financial reporting and the amounts reportedly involved did not significantly impact the bank's financial statements." (McKenna and Riquier, 2017)

Wells Fargo's board decided to keep their long-term auditors, KPMG, despite their inability to detect fraudulent sales practices that occurred in the bank between 2012 and 2016. Wells Fargo defended its decision based on the independent auditor's professionalism, knowledge of the industry and business practices (Wack, 2017).

Law Department Failures

Employment lawyers within Wells Fargo saw, to their chagrin, termination after termination resulting from the same unethical conduct: employees "gaming" the system to meet sales performance goals. These lawyers reported this trend to their superiors after a while but not in time. Wells Fargo's sales practices investigation report points out, "beginning around 2011, a recurrence of sales integrity events led employment lawyers to recognize sales pressure in the Community Bank environment as a root cause of gaming cases. Lawyers in the Employment Law Section and the Deputy General Counsel responsible for the Section also began to recognize the existence of significant reputational risk to Wells Fargo arising out of sales integrity issues, particularly mass gaming cases." (Wells Fargo, 2017). They argued in their internal memos that the root cause for this ethical lapse may be structural—their compensation bonus schemes may be seriously flawed. The lawyers initially believed that customers may not be harmed by these unethical sales practices. When the lawyers finally realized what was going on was illegal, they reluctantly spoke up but their internal warnings were feeble.

Even after detecting a worrisome trend, the internal investigations department did not do enough to highlight the issue. The internal investigations department also did not analyze the datasets that were available to it. They did not make any attempt to quantify the trends nor did they attempt to detect problem areas.

Epilogue

As part of a federal case brought by the Office of the Comptroller of the Currency, the former CEO of Wells Fargo John Stumpf can never work at Wells Fargo again and must pay a fine of $17.5 million (Bomey, 2020). The case against Stumpf points out that he repeatedly dismissed allegations of fraud when they were clearly presented to him. Additionally, the Head of Community Banking, Community Bank Group Risk Officer, General Counsel, Chief Auditor, and Executive Audit Director are all facing person sanctions for their actions in the scandal (OCC, 2020). For its part, Wells Fargo is attempting to put the bank on a better footing. The current Chief Financial officer John Shrewsberry said the employees have "really adopted more of a compliance mindset and a customer experience rather than a convert customer and expand business mindset" (Armstrong and Noonan, 2019).

In total, the bank faced tremendous monetary penalties for its fake account practices. The table below lists the state and federal fines levied against the bank. However, this table does not include several additional civil lawsuits the bank has had to contend with.

Table 1: Wells Fargo Fines

Wells Fargo Sales Practice Matters Fine Distribution		
Date	**Amount of Fine**	**Fine Distribution**
Sep 16	$185 million	$100 million CFPB Civil Penalty Fund $35 million OCC $50 million City of Los Angeles
Oct 18	$65 million	New York Attorney General
Apr 18	$1 billion	OCC and CFPB
Dec 18	$575 million	All 50 states and District of Columbia
Feb 20	$3 billion	$500 million to SEC to distribute to investors and $2.5 billion to U.S. Treasury

(Wells Fargo: Violation Tracker, 2020)

Case Questions

1) Define and discuss the three ethical theories: 1) Utilitarianism; 2) Justice; and 3) Rights.

2) Who were all affected by the fake accounts that were created Wells Fargo employees? How were they affected? Please analyze the ethical theories mentioned in question one to the Wells Fargo scenario.

3) What are the internal control weaknesses in Wells Fargo Bank? (Please categorize the internal control weaknesses according to COSO.)

4) Describe red flags (under fraud triangle: incentives, opportunities, or attitudes) that are present in this Wells Fargo case study.

5) Please read the Wells Fargo Internal Report at https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf and summarize the substance within two pages.

6) Investors, audit committee, management, internal auditors, law department, OCC, and others should all exhibit "professional skepticism." Please describe what "professional skepticism" is and how important it is for auditors.

7) Describe the governance structure at Wells Fargo Bank. Give detailed comments on the "control environment" at Wells Fargo.

8) Did the company culture at Wells Fargo encourage incentive gaming by employees? Discuss in detail.

9) Why did this illegal activity continue for more than five years at Wells Fargo? What specific steps Wells Fargo could have taken to control this early on?

10) What is the optimum level of incentives? Were lower-level employees over-incentivized which led them to commit fraud? What is the role of managers in this? Discuss.

11) Suggest several new internal control procedures to overcome the weaknesses in the ICS at Wells Fargo.

Part II: Case Learning Objectives and Implementation Guidance:

We developed a case based on an actual events and occurrences at Wells Fargo Bank. No fictitious information (bells and whistles) was added to enhance the learning objectives. Cases provide students with an opportunity to apply judgement and skepticism in courses such as auditing, systems, and law. The case will give the students a background in the situation, but they are also able to find outside sources to work through these issues. Developing these skills can prepare accounting majors as they enter the workforce. This case provides an opportunity to study the details of the fraud that occurred at a major U.S. Bank and has captured the public's attention in recent years.

Learning Objectives:

This case can be used in an auditing, accounting information systems, internal audit, forensic accounting, and/or an accounting ethics course. It was developed to increase students' skills in analysis, synthesis, and evaluation of real-world information.

The specific learning objectives for this case project are as follows:

- Evaluate fraud risk factors
- Apply Utilitarian ethical reasoning
- Understand COSO Internal Control Principles
- Evaluate the internal control system
- Design new internal controls
- Governance in a large financial institution
- Apply SAS 99, PCAOB AS5, and AU 240

Implementation Suggestions:

This case was used in undergraduate auditing, systems, and law classes. It is recommended that students be familiar with the following topics prior to completing the case: fraud, Code of Professional Ethics, generally accepted auditing standards, professional skepticism, COSO framework, and internal controls. The case is typically scheduled after covering the ethics chapter and internal controls in the revenue cycle in the systems class. All six questions were not assigned in any one class. Rather, systems classes were assigned questions three and four, whereas auditing and ethics students were assigned questions several other questions.

The case was presented to students via email and/or posted in the content section of a web-based software program. The instructor selected team members in an effort to more closely match the work environment. Groups of two to three members seemed to work best in offering participation by everyone. Students were required to read the case and answer questions with the lessons they learned in their groups outside of class time. Students were allowed ten days to two weeks to work through the case and submit their work to the instructor.

Literature Review:

The following case studies on the Wells Fargo scandal are publicly available. Each case takes different approaches and focuses on different issues of fraud that occurred at Wells Fargo. Elson and Ingram (2018) provide information about the fraudulent activities that occurred at Wells Fargo but focus more on the corporate governance structure and management's responsibility. It provides detailed information about communication occurring between employees and management, the use of the company's ethics hotline and management's response; or lack thereof. Due to the corporate governance focus, a majority of the discussion questions focus on the "tone at the top," the effectiveness of the processes, and management's responsibilities. The Wells Fargo cross-selling case by Tayan (2019) briefly reviews the history of Wells Fargo and the development of the scandal through its culture, its values, and its management. The independent investigation report revealed an organizational structure with dispersed leadership and a sales culture that feared losing their jobs for not attaining goals as the main reasons for the cross-selling scandal. Wells Fargo continues to examine its business practices. Most recently, in 2018, it identified violations occurring in both its auto and mortgage lending divisions. The case presents questions that focus on the cross-selling incentive systems and how they were structured. It reviews the company's culture and asks how performance systems can achieve company objectives without sacrificing culture. Ethics Unwrapped (2020)

case provides a 41 second YouTube video showing how their salespeople created fake accounts to meet unrealistic quotas set by management. It depicts managers and those meeting the quotas getting paid large sums of money. The discussion questions inquire about conflict of interest, incentive gaming, and the reasons why fraudulent practices were occurring. Heitger, Heitger, and Heitger (2021) focus on managerial control systems and the three elements that make up a control system which are strategy, performance measures, and incentives. Using the W.T. Grand and Wells Fargo cases, they look at how each of these elements played a role in the dysfunctional control systems for each company. This case asks students to identify the management control systems used by W.T. Grant as well as designing a system that would fix the existing weak system. The second set of questions focuses on Wells Fargo and asks one would improve it. The case asks students to assume the role of management at Wells Fargo and how would they handle it if they knew about the fake accounts before it was public knowledge. Lastly, it asks students to compare the two situations at W.T. Grant and Wells Fargo and why do they think such challenges continue to occur in businesses to this day.

Assessment of Student Learning:

We assessed the impact of the case on student learning through an eight-question concept quiz (Appendix A) during Fall 2020. A six-question concept quiz was used in Spring 2020. The quiz was first administered after the textbook chapters on fraud and internal control were covered in the auditing class but before assigning the Wells Fargo case (pre-test). The same quiz was administered again after the students turned in their write case answers (post-test). There was about a six-week lag between the pre and post-test quizzes. Students did not receive any grades on these pre and post-test quizzes.

Student scores for both quizzes, pre-test and post-test, for the undergraduate auditing students are presented in Table 2. Each question on the quiz was worth one point. Mean total scores on quizzes are presented in Table 2. The statistical results for Fall 2020 student cohort indicate a significant improvement ($t = -3.270$) in students' understanding of fraud and internal control concepts. Mean difference for Spring 2020 student cohort is not statically significant ($t = 0.294$). Student learning could have been adversely impacted by the sudden switch to remote learning for the last seven weeks of the spring semester due to the coronavirus pandemic.

Table 2: Assessment of Learning

	Pre-WF	**Post-WF**	**T-score**
Fall 2020: Average score (maximum 8)	4.67	6.44	-3.270**
Spring 2020: Average score (maximum 6)	4.59	4.53	0.294

[**significant at $p < 0.01$ for a one-tailed test]

An assessment quiz on fraud and internal control was administered before and after covering the Wells Fargo case. There were 22/17 students who answered pre and post quiz questions in spring 2020 and 12/9 students who answered pre and post quiz questions in Fall 2020, respectively.

Additional Case Assessment:

This case was assigned during the Fall of 2017 and Spring of 2018 to students in auditing and a systems class, Spring 2019 to the ethics students, Spring and Fall of 2020 to auditing students. Only two to three questions were used at a time. Table 1 summarizes student's view and feedback to the case. A total of 90 students completed the case assessment survey (Enrollment was higher: 24 auditing students in Fall 2017, 11 undergraduate students in systems in the Fall 2017, 16 auditing students in the Spring 2018, 17 undergraduate students in systems in the Spring of 2018, and 18 graduate accounting ethics students in Spring 2019) and results are reported in table. An additional 24 auditing students completed the case in Spring 2020 and 26 students (two sections) completed it in Fall 2020. Two of these three sections completed the pre and post-test assessments in 2020 spring and fall. One evening section with older students that met once a week did not participate in the pre and post-test Quiz. Another instructor (non-coauthor) administered the case during Fall 2020 to 19 students in a banking class and student survey results in that are discussed below.

Table 3 indicates that in general students responded favorably to the use of the case as a class assignment. A significant majority of students either agreed or strongly agreed that completing the case helped them better understand the following concepts: red flags related to fraud, ethics, and internal control procedures to prevent theft, COSO framework, and SAS No. 99 (AU 316). A high percentage of students judged the level of difficulty associated with the case to be appropriate for a senior-level auditing course, a junior level systems course, and/or a graduate level ethics course. A strong

majority opined that it was a useful learning tool. A strong majority of the students who completed the case were ready to recommend this case for use in future auditing or systems classes. Table 3 presents information as to how AICPA core competencies are addressed in this case study.

Table 3: Wells Fargo Case Assessment

Strongly agree = 1; Agree =2; Neutral =3; Disagree =4; Strongly disagree =5

Item	Fall 2017 Systems	Spring 2018 Systems	Spring 2018 Auditing	Spring 2019 Ethics
1. Completing the WELLS FARGO case study helped me understand red flags (incentives, opportunities, and attitudes) related to fraudulent activities in companies.	1.73	NA	1.76	1.72
2. Completing the WELLS FARGO case study helped me understand internal control weaknesses at WELLS FARGO Technology.	1.55	1.71	1.92	2.11
3. Completing the WELLS FARGO case study helped me understand the importance of "Tone at the Top" in a company.	NA	NA	2.00	1.83
4. Completing the WELLS FARGO case study helped me understand COSO principles regarding internal control systems in companies.	2.09	1.88	2.23	NA
5. I would recommend that this case be part of accounting systems/auditing/ethics classes in future semesters.	1.64	1.47	1.69	1.94
6. The level of difficulty in this case project was appropriate for a systems/ auditing course.	1.91	2.00	2.38	1.78
7. Analyzing this case as a group project was beneficial.	1.55	2.24	2.00	NA
8. Completing Wells Fargo case helped me understand Utilitarian Ethics.	NA	NA	2.23	2.06
9. Completing this case helped me understand that several groups can be affected by unethical acts.	NA	NA	1.54	1.67
10. Overall, this case project was a useful learning tool.	1.45	1.65	1.69	1.78

Conclusions:

Undergraduate auditing, systems, and business law students participated in solving this case. Because it is based on a major fraud that occurred in a well-known financial institution (Wells Fargo), students had access to lots of material on the financial press (e.g., Wells Fargo Board Investigation Report) and other electronic sources. Several of the facts in this case such as the job termination of 5,300 employees and the creation of 3.5 million fake accounts shocked them. Students had the motivation to learn some material outside of their textbook. The participating students learned to apply the fraud auditing standard and AS5 (PCAOB auditing standard on evaluating internal control). Students enhanced their critical thinking and professional judgment, by developing detailed group answers for several key questions on internal control assessment, fraud risk factors (AU 316), ethical reasoning, and the design of new controls. The case was analyzed by students working in groups and as such developed invaluable interpersonal skills as well.

Student Comments: Some student comments about the case are given below**:**

- Well written case study!
- It is a good tool to help me study the red flags and internal control weaknesses. It's really helpful.
- I thought it was a good example and a chance to fresh out COSO attributes.
- Updating market price change and adding a data for reference/comparison to present.
- Thanks.

Appendix A: Pre/Post Test Quiz on Wells Fargo

1) Relating to opportunities, why do most people commit fraud?

A) They need to meet pre-specified business targets.

B) They need to fund an extravagant lifestyle.

C) They feel a sense of superiority.

D) There are weak internal controls.

2) Which of the following is the best reason for management to emphasize fraud prevention and deterrence?

A) The AICPA requires management to implement a fraud prevention program.

B) It is often more effective and economical for companies to focus on fraud prevention and deterrence rather than on fraud detection.

C) Collusion is impossible to detect.

D) All of the above are equally valid reasons.

3) Fraud awareness training should be:

A) extensive and include details for all functional areas.

B) focused on employees understanding the importance of ethics.

C) specifically related to the employee's job responsibility.

D) broad and all-encompassing.

4) Which of the following questions is the auditor not required to ask company management when assessing fraud risk?

A) Is management using all assets effectively?

B) What is the nature of the fraud risks identified by management?

C) What internal controls have been implemented to address the fraud risks?

D) Does management have knowledge of any fraud or suspected fraud within the company?

5) Who is responsible for setting the "tone at the top"?

A) management

B) PCAOB

C) SEC

D) audit committee

6) Without an effective ________, the other components of the COSO framework are unlikely to result in effective internal control, regardless of their quality:

A) monitoring policy

B) risk assessment policy

C) control environment

D) system of control activities

7) Which of the following components of the control environment define the existing lines of responsibility and authority?

A) management philosophy and operating style

B) organizational structure

C) management integrity and ethical values

D) human resource policies and practices

8) Of the following statements about internal controls, which one is least likely to be correct?

A) Control procedures reasonably ensure that collusion among employees cannot occur.

B) No one person should be responsible for the custodial responsibility and the recording responsibility for an asset.

C) Because of the cost-benefit relationship, a client may apply controls on a test basis.

D) Transactions must be properly authorized before such transactions are processed.

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