

Lies! Lies! Lies!

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**GENERAL CONFERENCE AUDITING SERVICE
SEMINAR**

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Ethical Lapses

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Circa 1984: Boesky, Milken, Junk Bonds

Circa 1990: Savings & Loans; Demise of “Big 8”
accounting firms

Circa 2001: Enron, WorldCom; Tyco, Adelphia

Circa 2008: AIG, Fannie Mae, Bear Stearns, Lehman
Brothers, Goldman-Sachs

ACFE “Report to the Nations” - 2012

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Occupational Fraud:

The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.....
(these) schemes can be as simple as pilferage of company supplies or manipulation of time sheets, or as complex as sophisticated financial statement frauds.

ACFE “Report to the Nations” - 2012

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Study included 1,388 cases from nearly 100 nations
Frauds lasted 18 months before detection

Typical losses: 5% of organization’s annual revenue

Most common scheme: Asset misappropriation

87% of cases

Small organizations most at risk

ACFE “Report to the Nations” - 2012

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Initial detection happens by the following actions:

- 43% Employee tips (if a hotline is used)
- 15% Management review
- 15% Internal audit
- 13% Accounting control activities
- 12% By accident, police notification, confession
- 3% External audit

ACFE “Report to the Nations” - 2012

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81% of the perpetrators have never before been charged or convicted

Warning signs that a perpetrator exhibits:

Living beyond their means (36%)

Experiencing financial difficulties (27%)

Close association with vendors (19%)

Excessive control issues (18%)

ACFE “Report to the Nations” - 2012

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“Occupational fraud is a global problem. Though some of our findings differ slightly from region to region, most of the trends in fraud schemes, perpetrator characteristics, and anti-fraud controls are similar regardless of where the fraud occurred.”

www.acfe.com/rtn/rtn.asp

Signs of Crimes

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Good Internal Control:

Organizations need to implement and enforce strong financial controls. Management and boards of directors need to emphasize the importance of testing the controls and closing all loopholes.

Signs of the Crimes

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To stop these crimes:

Require two-signature checks

Do not allow CPA to be trustee for client's trusts

Take note of dramatic lifestyle upgrades

Signs of the Crimes

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Strong Boards:

Board members, executives, and accountants need to closely scrutinize monthly financial statements and other documents, keeping an eye out for signs of suspicious activity.

Signs of the Crimes

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To stop these crimes:

External auditors should not accept gifts

If gifts are offered, notify the board

If audit is delayed, notify the board

Boards should examine monthly financials

Boards should monitor CFO's other positions

Signs of the Crimes

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Management must possess integrity:

Management should establish a “tone at the top” that encourages ethical conduct and prohibits policies that pressure staff to meet unrealistic financial goals.

Signs of the Crimes

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To stop these crimes:

Watch for signals that encourage fraud
Follow up on all discrepancies

Signs of the Crimes

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Employees must have integrity tools:

Organizations should provide tools for employees to make it easier for them to act as whistle blowers.

Signs of the Crimes

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Audit Team Selection:

Engaging employees who were once employed by the audit firm, especially as CEO, CFO, or controller, may lead to the audit firm's audit plan and testing thresholds being known by the client.

Signs of the Crimes

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To stop these crimes:

Verify cash in bank accounts

Insist on accurate and timely inventories of
fixed assets

Research and verify all estimates

Compare salaries to level of experience

Keep an eye out for suspicious patterns

Signs of the Crimes

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Audit Team Selection:

Auditing fieldwork should be assigned to seasoned auditors who have received formal education into how to prevent and uncover fraud schemes.

Summary

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Note the client's internal control procedures, especially with respect to:

Segregation of duties

Cash and other vulnerable assets

Timely reconciliations

Test the controls; request the loopholes be fixed

Summary

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Ask: Is the client's board functioning and active?

Does the board engage in regular monitoring of the financial statements?

Are there suspicious patterns in the financial records or in the financial reports?

Summary

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Notify the Board if:

Gifts are offered to you as the auditor

The client significantly delays the audit

The client refuses to cooperate in the audit

Watch the tone management sets “at the top”

Summary

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Take note of dramatic life-style changes by employees, especially those who deal with financial matters

Assign audit staff wisely, matching expertise with the organization's complexity

Monitor situations where management may have inside information as to audit procedures or policies

Fraud IQ Number 1?

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Research has shown that the most common reason that CFOs commit financial statement fraud is:

Fraud IQ Number 1?

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- a. To cover up embezzlement of other fraud schemes.
- b. Pressure from CEOs.
- c. To increase the value of their own investments in company stock.
- d. To his their own errors or poor judgments that led to weak financial performance.

Fraud IQ Number 2?

24

Melissa, a full-time retail store manager, is pursuing a college degree. Because of her work demands, she limits her school schedule to two night courses per semester. At this rate, she anticipates it will take her seven years to graduate.

Fraud IQ Number 2?

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While closing the store one night during a shift that caused her to miss one of her classes, Melissa grew particularly frustrated with her situation. She began a scheme that involved skimming portions of the store's cash sales and processing refunds to her own credit card, intending to use the stolen funds to quit working and finish school faster.

Fraud IQ Number 2?

26

In turning to fraud, Melissa demonstrated which of the following thought patterns common among fraudsters?

- a. Entitlement
- b. Inadequate fear of punishment
- c. Instant gratification
- d. Egoism

Fraud IQ Number 3?

27

In the 1960s, Stanley Milgram, an American social psychologist, conducted a study to understand why millions of Germans followed the orders of their Nazi leaders. His research produced interesting findings about why people engage in acts that seem to conflict with their morals, values, and ethics.

Fraud IQ Number 3?

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Specifically, Milgram's experiment demonstrated which of the following?

- a. The more authority an individual has, the more likely he is to abandon his morals and engage in unethical actions.
- b. Most people will follow orders from authority figures to perform acts that conflict with their personal morals, values, and ethics.

Fraud IQ Number 3?

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- c. People are most likely to engage in unethical actions when they do not fear the expected punishment.

- d. An individual's propensity for engaging in unethical actions is genetically predisposed.

Fraud IQ Number 4?

30

Which of the following is true regarding the behavioral traits and characteristics displayed by fraudsters?

- a. The majority of fraudsters have a history of legal problems.
- b. There are no observable patterns to the behavioral traits displayed by fraudsters.

Fraud IQ Number 4?

31

c. The most common behavioral red flag among fraudsters is the tendency to live beyond their financial means.

d. Staff-level fraudsters are more likely to exhibit control issues, such as being unwilling to allow people to review their work, than executives who engage in fraudulent activity.

Fraud IQ Number 5?

32

Which of the following individuals most fits the statistical profile of an occupational fraudster?

a. Kathryn is a 22-year-old customer service representative. She has been employed by the company for approximately 5 months. She has a high school diploma, and her criminal record shows a misdemeanor petty theft conviction when she was 19.

Fraud IQ Number 5?

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b. Charlie, a 38-year-old college graduate, works as a senior accountant. He has been employed by the company for approximately 35 years and has no criminal background.

Fraud IQ Number 5?

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c. Patricia is 53 years old and is the company's vice president of marketing. She has an MBA and has been employed by the company for 25 years, having worked her way up from an entry-level marketing position. She was charged with passing two bad checks seven years ago but was cleared of wrongdoing, and she has an otherwise clean criminal record.

Fraud IQ Number 5?

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d. David is a 57-year-old warehouse foreman. He is a high-school dropout, and his criminal record shows two prior convictions for assault, one of which resulted in jail time. He has been employed by the company for almost 10 years.

Fraud IQ Number 6?

36

According to research conducted by Robert Feldman, how many times does the average person lie during a 10-minute conversation?

- a. None
- b. One time
- c. Three times
- d. Ten times

Fraud IQ Number 7?

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How often can the average person correctly identify when someone is lying to him or her?

- a. Approximately 10% of the time?
- b. Approximately 50% of the time?
- c. Approximately 75% of the time?
- d. Approximately 95% of the time?

Fraud IQ Number 8?

38

Which of the following statements is the most accurate regarding the behavior of a deceptive person (that is, a person trying to conceal something) during an interview?

Fraud IQ Number 8?

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a. When asked about hypothetical fraudulent conduct (e.g., “What do you think should be done to someone who steals from his employer?”), a deceptive person typically will display a disproportionately intolerant attitude.

Fraud IQ Number 8?

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- b. A deceptive person will generally be more willing to terminate an interview than an honest person.

- c. A deceptive person is more likely to engage in outright denials of an event or action than an honest person.

Fraud IQ Number 8?

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d. A deceptive person will frequently use phrases such as “to tell you the truth” or “honestly” to add credibility to his statement.

Fraud IQ Number 9?

42

Rodney, CPA, is meeting with Amelia, the accounting manager, to discuss some anomalies within the company's cash disbursements system. Rodney asks Amelia a series of general questions about the cash disbursements process, and then moves to the topic of several checks with out-of-sequence check numbers that cleared the company bank account.

Fraud IQ Number 9?

43

Which of the following behaviors is most likely to be a clue that Amelia is being dishonest in her responses?

- a. The tone and pitch of Amelia's voice remains extremely consistent with each of her answers, revealing almost no emotion.

Fraud IQ Number 9?

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- b. As Rodney begins asking questions about the out-of-sequence checks, Amelia leans toward him slightly.

- c. Amelia is sitting with her head and the trunk of her body facing Rodney, but her feet and legs are angled toward the door.

Fraud IQ Number 9?

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d. When Rodney hands her documentation of the checks in question, Amelia accepts the documents and looks closely at them for quite some time.

Fraud IQ Number 10?

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As a frequent business traveler, Horace spends much time in airports working on his laptop, which contains large amounts of confidential client data. The airports he frequents are public wireless hotspots. Although Horace appreciates the convenience of these hotspots, he has concerns about their security.

Fraud IQ Number 10?

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Which of the following is NOT a step Horace should take to minimize his exposure to the dangers of public wireless networks?

- a. Avoid connecting to an unknown public wireless network.

Fraud IQ Number 10?

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- b. Disable his laptop's wireless network capabilities when he is not using them.
- c. Allow his computer to automatically select the wireless network to which to connect.
- d. Ensure that his anti-spyware software is up-to-date.

Fraud IQ Number 11?

49

Buford, the controller of Bait Taker Company, received an unexpected yet seemingly legitimate email from the company's bank prompting him to renew his security token. Following the renewal instructions in the email, he clicked on an embedded link to log in to the company's online banking site and renew the token.

Fraud IQ Number 11?

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Buford should enter his logon credentials only under which of the following conditions?

- a. The web address in his browser matches that of the bank.

- b. The term “https” precedes the web address, indicating a secure web session.

Fraud IQ Number 11?

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- c. A secure lock icon appears in the status bar at the bottom of the browser window.

- d. None of the above.

Recent Ethical Lapses

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The land sales

The “lemon”

Recarpet the house

The missing church treasurer

The Fraud Triangle

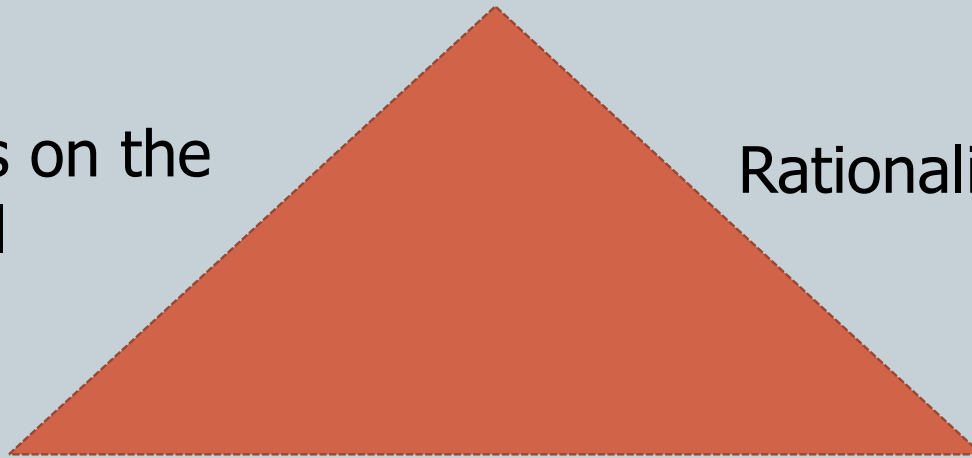
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Control Pressure Points:

Pressures on the
individual

Rationalization

Perceived Opportunity



When Good People Do Bad Things

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Not all misdeeds are done by bad people.

Unethical acts can result from failings rather than selfishness and greed.

Good people can inadvertently make unethical decisions.

Ethical actions require more than just good intentions.

Ethical Judgment Traps

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1. Scripts

“When I was dealing with the first trickling-in of field reports that might have suggested a significant problem with the Pinto, the reports were essentially similar to many others that I was dealing with (and dismissing) all the time...I was making this kind of decision automatically every day. I had trained myself to respond to prototypical cues, and these didn't fit the relevant prototype for crisis cases.”

Dennis Gioia
Ford Company Recall Coordinator

Ethical Judgment Traps

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2. Busyness and Distractions

“After the data was weighed and the variables analyzed, only one variable could be used to predict who would stop to help and who wouldn’t. The important factor was not personality type or whether a student’s career or the parable of the Good Samaritan was foremost in his mind. It was whether or not he was in a hurry...The study made it hard not to conclude that ethics becomes a luxury as the speed of our daily lives increases.”

John Darley and Daniel Batson

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