Fraud Risk Assessment Practices and Corporate Governance

Donald R. Owens, CPA, CFF, CIA, CFSA, CBA, CRMA
Director, Internal Audit and Risk Advisory Services
Schneider Downs & Co., Inc.
This advice is not intended or written to be used for, and it cannot be used for, the purpose of avoiding any federal tax penalties that may be imposed, or for promoting, marketing or recommending to another person, any tax related matter.
“Fraud and stupidity look an awful lot alike.”

Alan Bachman, CFE, MBA,
Education Manager at ACFE
Escalation Fraud Theory
Ethics and Fraud are so inter-connected. Without a strong ethical culture, fraud risk exponentially increases.

In most fraud cases uncovered, indicators that a fraud was occurring were evident to others. However, human nature is to continue to trust those around us even when faced with evidence to the contrary.

**Misplaced Trust is a Great Facilitator of Fraud**
Fraud Detection

Initial Detection of Occupational Frauds

- Tip: 40.2%
- Management Review: 15.4%
- Internal Audit: 13.9%
- By Accident: 8.3%
- Account Reconciliation: 6.1%
- Document Examination: 5.2%
- External Audit: 4.6%
- Surveillance/Monitoring: 2.6%
- Notified by Police: 1.8%
- Confession: 1.0%
- IT Controls: 0.8%

Percent of Cases

Source: ACFE Report to the Nations – 2010 Global Fraud Study
Fraud Duration

Median Duration of Fraud Based on Scheme Type

- Financial Statement Fraud: 27 months
- Check Tampering: 24 months
- Expense Reimbursements: 24 months
- Payroll: 24 months
- Billing: 24 months
- Corruption: 18 months
- Cash on Hand: 18 months
- Skimming: 18 months
- Larceny: 18 months
- Non-Cash: 15 months
- Register Disbursement: 12 months

Source: ACFE Report to the Nations – 2010 Global Fraud Study
Fraud Controls

Importance of Control in Detecting or Limiting Fraud

<table>
<thead>
<tr>
<th>Control</th>
<th>Percent of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Audit/FE Department</td>
<td>17.9%</td>
</tr>
<tr>
<td>Management Review</td>
<td>25.3%</td>
</tr>
<tr>
<td>Surprise Audits</td>
<td>25.7%</td>
</tr>
<tr>
<td>Job Rotation/Mandatory Vacation</td>
<td>25.3%</td>
</tr>
<tr>
<td>Hotline</td>
<td>19.3%</td>
</tr>
<tr>
<td>Rewards for Whistleblowers</td>
<td>24.5%</td>
</tr>
<tr>
<td>External Audit of ICOFR</td>
<td>24.5%</td>
</tr>
<tr>
<td>External Audit of F/S</td>
<td>23.0%</td>
</tr>
</tbody>
</table>

**KEY:**
- External Audit of F/S = Independent external audits of the organization’s financial statements
- Internal Audit/FE Department = Internal audit department or fraud examination department
- External Audit of ICOFR = Independent audits of the organization’s internal controls over financial reporting
- Management Certification of F/S = Management certification of the organization’s financial statements

Source: ACFE Report to the Nations – 2010 Global Fraud Study
Laws and Regulations to Deter Fraud

- Foreign Corrupt Practices Act
- Sarbanes-Oxley Act of 2002
- Dodd-Frank Act
- U.S. Federal Sentencing Guidelines
- Whistleblowers Protection Act
- American Recovery and Reinvestment Act of 2009 (Stimulus)
- Uniform Prudent Management of Institutional Funds Act (NP)
- Annual Financial Reporting Model Regulation

Is it possible to legislate morality?
Fraud Triangle

The fraud triangle is a common pictorial of the three factors that drive fraud.

Rationalization
(External Influences)

Opportunity
(Process and Controls)

Need/Pressure/
Motivation
(External Influences)
Fraud Risk

An organization **CANNOT** control individuals’

- Needs/pressures/motivations
- Rationalization

However, an organization **CAN** control

- **Opportunities** for fraud to be perpetrated by having the necessary **controls** and **monitoring activities** to effectively limit and/or remove opportunities
Fraud Risk

Would you answer "yes" to any of the following questions:

• Is there risk of management over-ride of controls?
• Has your external auditor found fraud control deficiencies?
• Do you conduct business in higher risk industry or geographic markets?
• Are there remote subsidiaries, joint ventures, etc.?
• Have you recently undergone significant changes in size, management or structure?
• Has anybody on the board or in senior management been the subject of or been affiliated with a company that has been under investigation?
Fraud Risk Management Program Overview

| Principle 1 | As part of an organization’s governance structure, a fraud risk management program should be in place, including a written policy (or policies) to convey the expectations of the Board of Directors and senior management regarding managing fraud risk. |
| Principle 2 | Fraud risk exposure should be assessed periodically by the organization to identify specific potential schemes and events that the organization needs to mitigate. |
| Principle 3 | Prevention techniques to avoid potential key fraud risk events should be established, where feasible, to mitigate possible impacts on the organization. |
| Principle 4 | Detection techniques should be established to uncover fraud events when preventive measures fail or unmitigated risks are realized. |
| Principle 5 | A reporting process should be in place to solicit input on potential fraud, and a coordinated approach to investigation and corrective action should be used to help ensure potential fraud is addressed appropriately and timely. |

Principle 1 - Fraud Risk Program

Key Components of a Fraud Risk Program*

- Board ownership of agendas and information flow.
- Access to multiple layers of management and effective control of a whistleblower hotline.
- Independent nomination processes.
- Effective senior management team (including chief executive officer (CEO), chief financial officer, and chief operating officer) evaluations, performance management, compensation, and succession planning.
- A code of conduct specific for senior management, in addition to the organization’s code of conduct.
- Strong emphasis on the board’s own independent effectiveness and process through board evaluations, executive sessions, and active participation in oversight of strategic and risk mitigation efforts.

Principle 2 - Fraud Risk Assessment

Three Key Elements of a Fraud Risk Assessment*

- Identify inherent fraud risk — Gather information to obtain the population of fraud risks that could apply to the organization.

- Assess likelihood and significance of inherent fraud risk — Assess the relative likelihood and potential significance of identified fraud risks based on historical information, known fraud schemes, and interviews with staff, including business process owners.

- Respond to reasonably likely and significant inherent and residual fraud risks

- Perform a cost-benefit analysis to decide what the response should be to address the identified risks and.

## Fraud Types

<table>
<thead>
<tr>
<th>Fraudulent Financial Reporting</th>
<th>Theft of Sensitive Data</th>
<th>Defrauding Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>Customer and Employee Personal Information</td>
<td>Intentionally misrepresenting products and services</td>
</tr>
<tr>
<td>Expenses</td>
<td>Proprietary Information/Trade Secrets</td>
<td>Inflating invoices/ duplicate billings</td>
</tr>
<tr>
<td>Improper Valuation or Misclassification</td>
<td>Patents, Copyrights, Other Legally Protected Intellectual Property</td>
<td>Shorting Orders/product</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Almost always material – directly impacts the financials</th>
<th>May or may not be material /measurable – indirectly impacts the financials</th>
<th>May or may not be material - directly impacts financials</th>
</tr>
</thead>
<tbody>
<tr>
<td>Almost always involves senior management</td>
<td>Can involve any level of employee</td>
<td>Controls can be difficult and expensive to implement</td>
<td>Controls can be effective, particularly with regard to those below top management</td>
</tr>
<tr>
<td>Controls are less effective in preventing and detecting fraud</td>
<td>Controls can be difficult and expensive to implement</td>
<td>Controls can be effective, particularly with regard to those below top management</td>
<td>Controls can be effective, particularly with regard to those below top management</td>
</tr>
</tbody>
</table>
## Fraud Types

<table>
<thead>
<tr>
<th>Misappropriation of Assets</th>
<th>Corruption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Theft</td>
<td>Bribery</td>
</tr>
<tr>
<td>Fraudulent Disbursements</td>
<td>Bid Rigging</td>
</tr>
<tr>
<td>Payroll Fraud</td>
<td>Kickbacks</td>
</tr>
<tr>
<td>Expense Reimbursement</td>
<td>Illegal Payments</td>
</tr>
<tr>
<td>Capital Assets/Inventory</td>
<td>Conflicts of Interest</td>
</tr>
<tr>
<td></td>
<td>Aiding and Abetting Fraud</td>
</tr>
</tbody>
</table>

May or may not be material  - **directly impacts** financials

May or may not be material  – **indirectly impacts** the financials

Can involve any level of employee

Can involve any level of employee

Controls can be effective, particularly with regard to those below top management

Controls can be difficult and expensive to implement. Requires close scrutiny of employee activities and cost to do business
Principle 3-4 - Prevention and Detection

Fraud Controls Types

Preventive – Intended to reduce the risk of fraud occurring to an acceptable level

Detective – Intended to flag potential risk that a fraud occurred in a timely manner

Persuasive – Tone and culture of the organization, its belief system

Competence - Requires knowledge of expected outcomes and incentive to report (if it has the characteristics of a fraud, report it)
Principle 5 - Investigation and Corrective Action

Key Components of Investigation and Response*

- Categorizing issues.
- Confirming the validity of the allegation.
- Defining the severity of the allegation.
- Escalating the issue or investigation when appropriate.
- Referring issues outside the scope of the program.
- Conducting the investigation and fact-finding.
- Resolving or closing the investigation.
- Listing types of information that should be kept confidential.
- Defining how the investigation will be documented.
- Managing and retaining documents and information.

Other Fraud Oversight Support

Independent Board

HR – take serious the concerns of all associates

- Institute a 360 feedback program
- Establish and monitor open-door policy
- Conduct town-hall meetings across the organization
- Re-enforce core values through internal publications

Internal Audit – EWRM, FRA, Internal audit plan execution

Legal Department

External Audit

Third Parties (examiners, regulators, compliance auditors, etc.)

Investment Bankers and Analysts
Fraud Risk Assessment
Fraud Risk Assessment

Develop a FRA Framework
Populate fraud risks
Rate likelihood and significance
Identify controls and assess alignment
Identify gaps
Remediation
Fraud Risk Assessment
Identify the Opportunities to Commit Fraud

• Create a profile that includes a list of the different areas in which fraud may occur and the types of fraud that are possible in each area (brainstorming, analysis of prior frauds, public information/Google alerts)

• Consider the various types of schemes and scenarios that could occur within an organization

• Don’t overlook information technology impact (enabler or deterrent)
Capturing Fraud Risks and Controls

Entity Level Controls
(Code of Conduct, Hiring Practices, Whistleblower Procedures)

Institutional Approach

Fraud Risks
Susceptible Processes and Apps
Risk Probability and Severity
Controls/Deterrents
Control Gaps
Remediation

Financial Statement Approach

Chart of Accounts
Fraud Risks
Risk Probability and Severity
Susceptible Processes and Apps
Controls/Deterrents
Control Gaps
Remediation
### Fraud Risk Tolerance Measurement Criteria

#### Probability/Likelihood

Prior instances, prevalence, and other factors, including volume of transactions and complexity, and number of people involved in the process should be considered

- Remote
- Reasonably possible
- Probable

#### Severity/Impact

Should include financial, monetary, operational, reputational as well as criminal, civil and regulatory liability considerations

- High
- Moderate
- Low
Factors of Probability

- Companies are downsizing
- Budgets are decreasing
- Companies are doing more with less
- Increased government regulation
- Stressed and disaffected employees
- Stock pressure

Organizational Levels:
Consideration of fraud risks at the company-wide, business unit, process, and significant account levels should all be demonstrated.
Fraud Risk Assessment Simplified Heat Map

**Severity / Impact**
- **High**
- **Moderate**
- **Low**

**Inherent Risk**
- High
- Moderate
- Low

**Probability/Likelihood**
- Remote
- Reasonably Possible
- Probable

<table>
<thead>
<tr>
<th>Threat</th>
<th>Level</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Moderate</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>Low</td>
<td>5</td>
<td></td>
</tr>
</tbody>
</table>
Importance of Controls in Detecting or Limiting Fraud

Internal Controls Modified or Implemented in Response to Fraud

- Increased Segregation of Duties: 61.2%
- Management Review: 50.6%
- Surprise Audits: 22.5%
- Fraud Training for Employees: 16.4%
- Fraud Training for Managers/Executives: 14.8%
- Job Rotation/Mandatory Vacation: 13.5%
- Internal Audit/FE Department: 12.3%
- Anti-Fraud Policy: 11.7%
- Code of Conduct: 8.7%
- External Audit of F/S: 8.7%
- Hotline: 7.9%
- External Audit of ICOFR: 7.8%
- Independent Audit Committee: 6.0%
- Management Certification of F/S: 5.9%
- Rewards for Whistleblowers: 4.0%
- Employee Support Programs: 1.8%

Source: ACFE Report to the Nations – 2010 Global Fraud Study
Controls Alignment

Control Design

- Aligned with relevant fraud risks
- Executed by competent and objective individuals

Control Effectiveness

- Evidence available to support whether control is operating as intended
- Control executed at a frequency appropriate to the fraud risk
Fraud Control Types

**Preventive** - control identifies the exception/unexpected condition prior to completion of the activity (e.g., posting of a journal entry, receipt of inventory, tracking AR/AP)

- Most proactive measure – “before the horse is out of the barn”
- Minimizes the chance that fraud can occur

**Detective** - control identifies the exception/unexpected condition post completion of the activity (e.g., reconciliations, loan file review, financial statement analysis, budget to actual comparisons).

- Can be a strong deterrent
- Puts those within the organization on notice
- Serves to mitigate damage that otherwise could have occurred
Fraud Control Types

**Persuasive** - control attempts to persuade good governance and business morality throughout the company. Regardless of the circumstances, it’s a “do the right thing” company mindset.

- Control attempts to persuade good governance and institutional morality throughout the company
- It’s a “do the right thing” company mindset
- “Tone at the top” that overlays the company
  (Internal Audit, Risk Management, Penalty of Law)

**Competence** – possessing expertise, activities do not have separate and distinct controls embedded within them

- Understanding of the environment
- Recognizing odd or unusual activities
- Willingness to challenge and report concerns
Preventive

Human Resources procedures
• recruiting/hiring – smart, honest, ethical
• background investigations
• anti-fraud training
• exit interviews

Restricted Access

Segregation of duties (limit keys to the kingdom)

Authority limits – can minimize potential damage

Transaction-level controls – approvals, reviews, etc.
Detective

Necessary when preventive controls don’t make sense from a cost/benefit perspective

Operate in the background

Such techniques include:

• variance analysis
• comparison of internal data to external sources
• “surprise” audits
• communicate identified deficiencies or items outside of thresholds to appropriate managers
• whistleblower hotline
• exit interviews (HR)
Detective, continued

Account reconciliations

Independent reviews

Physical inspections and counts

Special audits – (e.g., expense reports, P-card activity)

Journal entry review
Persuasive

Formal code of ethics/conduct
Management setting appropriate example
Positive workplace environment

• Honest and constructive feedback and recognition
• Eliminate fear of delivering “bad news”
• Treat employees with fairness
• Organizational responsibilities clearly defined
• Strong communication practices and methods
• Direct communication vs. innuendo
• Competitive compensation
Competence

Willingness to challenge the actions of others when such actions appear to be suspicious in nature or in direct violation of policy and procedures.

Trust Your Instincts – Avoid the Compulsion to Ignore/Deny the Obvious
Fraud Risk Assessment
Control Remediation/Risk Acceptance

Link Between Antifraud Controls and Control Activities

• 70 — 80% cross-over (safeguarding, authorization, etc.)

• Cost-Benefit analysis of controlling a risk versus the benefits of mitigating or eliminating that risk

• Must consider how the controls can be circumvented or overridden by management and others.
Critical Controls

Segregation of Duties

• Ensure all significant balance sheet accounts are reconciled by someone independent of the activities associated with the accounts.

• Designated individual must understand the purpose of the accounts and be in a position to evaluate the underlying account support to conclude that the accounts are properly stated and underlying transactions are appropriate.

• Evaluate business practices and identify those activities that would enable concealment of inappropriate or fraudulent behavior and segregate the practices between parties.
Critical Controls

Delegation of Authorities

• A “Delegation of Authority” policy is established to define the limits of authority designated to specified positions of responsibility within an organization and to establish the types and maximum amount of obligations that may be approved by individuals and title

• Failure to strictly adhere to the policy should subject the violator to disciplinary action

• To be effective, establish monitoring and reporting practices to ensure such limits are adhered to
Fraud Opportunity

When an organization’s primary focus is on cost reduction and speed/convenience of conducting business, an environment conducive for fraud many times arises due to the combining of sensitive responsibilities and authorities within job functions.

Employee’s years of service

x

Number of key responsibilities residing with the employee

x

Organization’s complacency level with respect to validating controls and monitoring activities

= 

Potential for fraud to be committed
<table>
<thead>
<tr>
<th>Activity Name</th>
<th>Examples</th>
<th>Susceptible Process</th>
<th>Fraud Type</th>
<th>Potential Impact/Severity (H,M,L)</th>
<th>Probability of Fraud Occurrence (H,M,L)</th>
<th>Inherent Fraud Risk (H,M,L)</th>
<th>Controls to Mitigate Inherent Risk</th>
<th>WP REF</th>
<th>Residual Fraud Risk (H,M,L)</th>
<th>Comment / Control Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improper application of GAAP</td>
<td>Secure credit based upon improper accounting (falsify meeting the debt)</td>
<td>Financial Reporting</td>
<td>Fraudulent Financial Reporting</td>
<td>H</td>
<td>M</td>
<td>H</td>
<td>Insert Control 1</td>
<td></td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Inappropriate top-sided journal entries</td>
<td>Manipulation of financial performance</td>
<td>Financial Reporting</td>
<td>Fraudulent Financial Reporting</td>
<td>H</td>
<td>H</td>
<td>H</td>
<td>Insert Control 1</td>
<td></td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Willfully miscalculating tax liabilities</td>
<td>Understating tax liabilities</td>
<td>Financial Reporting/Procurement/Tax</td>
<td>Fraudulent Financial Reporting/Corruption</td>
<td>H</td>
<td>L</td>
<td>L</td>
<td>Insert Control 1</td>
<td></td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Theft fixed assets</td>
<td>Taking of inventory without authorization, improper disposal of fixed assets</td>
<td>Fixed Asset Management/Financial Reporting</td>
<td>Fraudulent Financial Reporting/ Misappropriation of Assets</td>
<td>H</td>
<td>L</td>
<td>L</td>
<td>Insert Control 1</td>
<td></td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Embezzlement</td>
<td>Check kiting; forgery</td>
<td>Procurement</td>
<td>Misappropriation of Assets</td>
<td>M</td>
<td>M</td>
<td>M</td>
<td>Insert Control 1</td>
<td></td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Vendor abuse</td>
<td>Bribery, related-party collusion, extortion, kickbacks, preferential treatment, skimming, fictitious vendor billings</td>
<td>Procurement/Legal</td>
<td>Corruption/Misappropriation of Assets</td>
<td>H</td>
<td>L</td>
<td>M</td>
<td>Insert Control 1</td>
<td></td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Related party transactions</td>
<td>Transactions not at “arms-length”</td>
<td>Procurement/Legal</td>
<td>Corruption</td>
<td>H</td>
<td>L</td>
<td>L</td>
<td>Insert Control 1</td>
<td></td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Theft of proprietary confidential information</td>
<td>Trade secrets and customer lists sold to a competitor</td>
<td>Sales Management, Production</td>
<td>Theft of Sensitive Data</td>
<td>M</td>
<td>H</td>
<td>M</td>
<td>Insert Control 1</td>
<td></td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Use of company assets for personal gain</td>
<td>Using company vehicles at side-business</td>
<td>Fixed Asset Management</td>
<td>Misappropriation of Assets</td>
<td>M</td>
<td>L</td>
<td>L</td>
<td>Insert Control 1</td>
<td></td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Theft from company’s operating account</td>
<td>Fraudulent disbursements to fictitious vendors</td>
<td>Cash and Treasury Management/Accounts Payable</td>
<td>Fraudulent Financial Reporting</td>
<td>H</td>
<td>H</td>
<td>H</td>
<td>Insert Control 1</td>
<td></td>
<td>M</td>
<td></td>
</tr>
<tr>
<td>Intentional manipulation, corruption and/or destruction of data</td>
<td>Destruction of customer records</td>
<td>Data Processing</td>
<td>Theft of Sensitive Data</td>
<td>H</td>
<td>M</td>
<td>H</td>
<td>Insert Control 1</td>
<td></td>
<td>M</td>
<td></td>
</tr>
</tbody>
</table>
Fraud Risk Assessment - Results

- Types of fraud that have a chance of occurring
- Inherent risk of fraud considering the assets, morale, turnover, history of fraud, business indicators
- Adequacy of existing anti-fraud programs, monitoring activities, and fraud controls
- Potential gaps in fraud controls
- Actions required to address gaps
Role of Corporate Governance
Principles of Good Governance

Hiring Practices
Realistically define positions
  • Clearly delineate roles, responsibilities and expectations of all positions
Perform pre-employment screenings
  • Criminal background investigation
  • Education verification
  • Drug screening
  • Credit Checks
  • Personal and prior employer reference checks
Workforce cultural fit
  • Behavioral assessment
  • Scenario screening
  • Aptitude testing
Board established well-defined criteria for C-suite
  • Experience expectations and education requirements - solicit assistance from executive search firms
  • Perform comprehensive background checks similar to those above
  • Design incentive plans that promote ethical behavior
**Principles of Good Governance**

**Strategy, Mission, and Core Values** - measurable and promote an ethical work environment and aid in achieving business goals and objectives

**Code of Ethics and Related Party/Conflict of Interest Policy** – re-enforce continuously throughout the organization

**Independent Board** - monitor and evaluate actions of executive management

**Financial Oversight** – internal control and monitoring activities to prevent financial misstatement and/or fraud

**Expense Reimbursement and Gift Acceptance** – polices to deter potential abuses

**Whistleblower Hotline** – key element to an effective governance program

**Control Environment** – COSO provides a framework
Fundamental Building Blocks

**Strategy**

- Formal planned scope and direction of an organization
- way in which the various operations of an organization work together to achieve particular mission and goals.

**Mission Statement**

- Mission Statement must clearly define the “purpose” of the organization (What is our business? Why do we exist? What are we trying to accomplish? How will we accomplish it?)
- The Mission is not the company slogan
- Organization’s goals, objectives and activities should align directly to the Mission
Fundamental Building Blocks

Core Values

The guiding principles of an organization, espoused by senior management, and accepted by employees, often reflected in the mission statement of the organization. Core values often influence the culture of an organization and are normally long-standing beliefs. Core values are an increasingly important component in strategic planning because they drive the intent and direction of the organization’s leadership.

Example - U.S. Air Force Core Values:

- Integrity First
- Service Before Self
- Excellence in All We Do
Fundamental Building Blocks

Code of Ethics

- Adopt a written Code of Ethics
  - Designed to deter wrongdoing and to promote honest and ethical conduct
  - Outlines the activities that are appropriate and inappropriate and the consequences for violation
- Directors, trustees, and staff should be familiar and abide by the Code and periodically educated as to the importance of compliance
- Obtain written acknowledgement of adherence to code annually

Related Party/Conflict of Interest

- Establish strict policies on approving and conducting business with related parties (family members, business affiliations, etc.)
- Relationships should be at arms-length
- All conflicts or the appearance of conflicts should be reviewed and approved independent of the employee involved
Fundamental Building Blocks

Independent Board

- Responsible for reviewing and approving the organization’s mission and strategic direction, annual budget and key financial transactions, compensation practices and policies, and fiscal and governance policies

- Membership should include qualified financial expert(s) that reviews and understands the financial statements

- Oversees the hiring and annually evaluates the performance of the CEO and other executive management prior to any change in the officers compensation
Fundamental Building Blocks

Board Education

- Establish an effective, systematic process for educating and communicating to board members their legal and ethical responsibilities and ensure they are knowledgeable about the programs and activities of the organization and can carry out their oversight functions effectively and responsibly.

Board Self-Assessments

- Board members should evaluate their performance as a group and as individuals.
- Clear procedures for removing board members who are unable to fulfill their responsibilities should be in place.
Fundamental Building Blocks

Financial Oversight

• Board/committee with financial expertise to review financials
• Comprehensive budgeting and forecasting model
• Key Performance Metrics – Primary measures used by management to monitor the success of a business or process which provide early warning to potential issues within a process
• Investment Policies
• Capital Allocation Policies
• Controls to Monitor Management Overrides/Top-sided Entries
• Reconciliation of all key accounts
• Document Retention policies
• Independent Annual Audit
Fundamental Building Blocks

Expense Reimbursement Policy

• Should establish clear, written policies for reimbursing expenses incurred by anyone conducting business or traveling on behalf of the organization, including the types of expenses that can be reimbursed and the supporting documentation required

• Such policies should require that travel on behalf of the organization be undertaken in a cost effective manner

• Organizations should neither pay for nor reimburse travel expenditures for spouses, dependents, or others who are accompanying them unless they to are conducting such business
Fundamental Building Blocks

Gift Acceptance Policy

- Adopt restrictions on accepting gifts of a nature that could compromise ethics, influence decisions or be perceived to influence
- All gifts should be reported
Fundamental Building Blocks

Whistleblower Hotline

• Documented procedures for the receipt, retention and treatment of complaints in a confidential nature, anonymous submission of concerns by employees or external third parties is critical
Importance of a Whistleblower Program

Better a company promote and encourage employees to report matters through an internal whistleblower hotline than to face the uncertainty associated with inquires from the SEC, IRS or other agency responding to anonymous complaints received through the agency’s hotline.
Importance of a Whistleblower Program

According to the AICPA recommendation, here are the important attributes that should be part of a whistleblower program:

• The solution should be operated by an independent third party. Employees and others that might want to submit a complaint are more inclined to do so if it is publicly known that the system is operated independently.

• The system should have trained interviewers available to handle complaints, instead of only fully automated systems, such as voice mail and internet reporting.
Importance of a Whistleblower Program

- The solution should have a dedicated phone number, and further accept complaints using fax, website, email address, and regular mail. The solution should be available 24 hours a day, 365 days a year.
- The solution should have multilingual capability to support complainants with different ethnic backgrounds, or that are calling from different countries.
- Complainants should have a means that allow them to either call back later, or otherwise provide responses to follow-up questions from investigators.
Importance of a Whistleblower Program

• The solution should have protocols for distribution of each type of complaint to appropriate individuals within the company based on the nature of the complaint. Complaints involving senior management are automatically directed to the Audit Committee without filtering by management or other internal personnel.

• The existence of the system should be made known to employees, vendors, and other stakeholders in public documents, as well as in standard communications to each group.
Legal Implications

Whistleblower Protection (SOX Sections 806 and 1107 and Dodd-Frank Section 922) – i.e., BOUNTY PROGRAM

• On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act). Section 922 of the Act significantly enhances the protections available to whistleblowers. It not only strengthens protections under the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act), it will create an entirely new retaliation-protection regime.

• The Security and Exchanges Commission is authorized by Congress to provide monetary awards to eligible individuals who come forward with high-quality original information that leads to a Commission enforcement action in which over $1,000,000 in sanctions is ordered. The range for awards is between 10% and 30% of the money collected.
Legal Implications

- Feb 24, 2011 – In Van Asdale v. International Game Technology (IGT), a federal jury awarded Sarbanes-Oxley whistleblowers Shawn and Lena Van Asdale $2.2 million in a lawsuit they filed against their former employer International Game Technology (“IGT”).

- During March 2010, the U.S. Department of Labor (DOL) issued awards of $1 million and $600,000 (Tennessee Commerce Bank and e-Smart, respectively) against two separate employers found in violation of the whistleblower protection provisions of the Sarbanes-Oxley Act of 2002 (SOX). The DOL, through its enforcement agency, the Occupational Safety and Health Administration (OSHA), ordered the employers to comply with a litany of measures to remedy their noncompliance of SOX, including reinstatement of the fired whistleblower employees.
Legal Implications

- September 27, 2011 - U.S. Department of Labor awards $75,000 in compensatory damages for emotional pain and suffering to a Sarbanes-Oxley whistleblower under Section 806 of the Sarbanes-Oxley Act which prohibits covered employers from retaliating against employees for providing information or assisting in investigations related to listed categories of fraud or securities violations.
Walk the Talk

To Be Successful:

• Clear Strategy, Mission and Core Values
• Board and Management strict adherence to strategy, mission, values and policies
• Strong Tone Top to Bottom
• Guiding Policies and Procedures
• Adoption and management of formal control framework (COSO)
• Formalized oversight activities – internal audit, external audit, independent board
• Appropriate consequences (termination, demotion, criminal prosecution, etc.) for violators
Donald R. Owens

**Director**
Internal Audit &
Risk Advisory Services
Certified in Financial Forensics
(CFF), CPA, CIA, CFSA, CBA, CRMA

**Contact Information:**
dowens@schneiderdowns.com
Work Phone: 614-586-7257
Cell Phone: 614-271-8551
Fax: 614-586-7657

**Business Address:**
41 S. High Street
Suite 2100
Columbus, OH 43215

The views expressed by the presenter do not necessarily represent the views, positions, or opinions of Schneider Downs & Co., Inc. These materials, and the oral presentation accompanying them, are for educational purposes only and do not constitute accounting, tax or legal advice or create an accountant-client or attorney-client relationship.
As one of the largest certified public accounting and business advisory firms in the region, Schneider Downs serves clients throughout the country and around the world. By integrating high-quality resources, systems and personnel, Schneider Downs has built a reputation of delivering individualized services built on insight, innovation, and experience to meet each client’s specific needs.

For more information, visit us at www.schneiderdowns.com

We Are Committed to Your Success

Schneider Downs