

REMA
Financial Managers Conference
Ethics and Integrity in the
Fraud Equation

Presenter
Paul Rosol
Jefferson Wells Risk Advisory Services Director
and Fraud Subject Matter Expert

April 14, 2011

Agenda

- What is Ethics, Integrity
- What is fraud and who is committing
- The importance of ethics and control in preventing fraud – a focus on the opportunities

What are Ethics and Integrity?

Fraud - Definition

Any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain

The environment is right for fraud when there is:

- A supply of motivated offenders
- The availability of suitable targets
- The absence of capable control system “checks and balances”

Ethics and Integrity

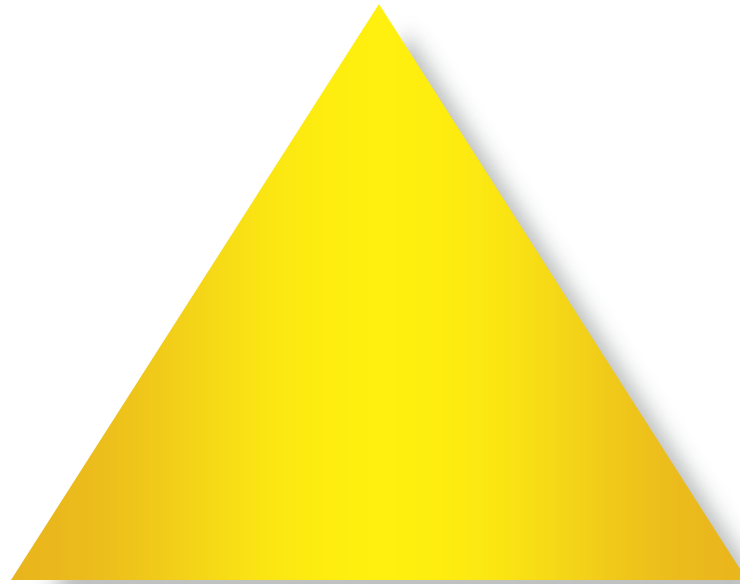
- The behaviors that a business adheres to in its daily dealing with others.
 - Internally
 - Externally
- Good business ethics should be a part of every business
 - Ongoing – A part of the culture
- Brand does not equal ethical culture

Ethics and Integrity

- Gender, race, job characteristics, responsibilities.....can all create ethical dilemmas

Situational Elements of Fraud

Motive / Pressure



Opportunity

Rationalization

Profile of the white-collar criminal

Generally,

- Older (30+ years)
- 53% male, 47% female
- Long-time employee
- Stable family situation
- Above-average education
- Less likely to have a criminal record
- Good psychological health
- Position of trust
- Works overtime
- Rarely takes vacation
- Detailed knowledge of the accounting systems and **their weaknesses**
- Change in personal circumstances
- Lifestyle inconsistencies

Direct and indirect effects of fraud

- Financial loss
- Damage to reputation
- Loss of customer base

Non-occupational /external fraud

- Securities fraud
- Money laundering
- Consumer fraud
- Computer and Internet fraud
- Governmental fraud
- Tax fraud
- Financial institution fraud
- Check and credit card fraud
- Insurance fraud
- Healthcare fraud
- Bankruptcy fraud

Occupational /internal fraud

- Fraudulent statements
 - Financial
 - Non-Financial
- Asset misappropriation (theft)
 - Cash, Receivables, Inventory, Other Assets
 - Payables, Payroll, Personal Purchases
- Bribery and corruption
 - Kickbacks, bid rigging, conflicts of interest

Examples of employee fraud

- P-Card/corporate credit card
 - Plant Manager
 - Worked his way up through the organization to Plant Manager
 - Was given a P-Card when promoted
 - Was promised a relocation within a one- to two-year timeframe when promoted
 - Panicked about the condition of his residence
 - Started with a small purchase — when it went undetected, purchases grew quickly
 - Expense reports weren't carefully reviewed, the few "detected" red flags weren't followed-up on by his manager
 - Eventually caught through a budget review by other employees who then called the company's whistleblower hotline

Examples of employee fraud (Continued)

- P-Card/corporate credit card
 - Event planner
 - Responsible for the organization’s event planning
 - Position required a P-card for all of the related expenses
 - Was also having personal financial problems
 - Justified the purchase of clothing — felt she “needed nicer clothes when visiting hotels,” etc.
 - Couldn’t afford luggage for traveling and felt the company should provide
 - Took family members along on trips
 - Initially, expense reports weren’t carefully reviewed and the few “detected” red flags weren’t followed-up on by her manager

Examples of employee fraud (Continued)

- P-Card/corporate credit card
 - Hospital Administrator's Administrative Assistant
 - Had P-Card to buy department supplies
 - Was delegated the responsibility of approving all of the "team's" expense reports – including her own
 - Was also having personal financial problems
 - Recognized the opportunity to gain some additional income by partnering with her husband
 - Purchased generators and air compressors from a well-known home improvement chain and sold them at busy intersections every Saturday
 - A co-worker stopped to purchase a generator, and noticed the Administrative Assistant and that all boxes came from one retailer
 - Co-worker contacted the company's whistleblower hotline

Examples of employee fraud (Continued)

- Unauthorized Sale of Merchandise / Inventory
 - Salesman for Company
 - Collusion with warehouse manager
 - Product transferred to Salesman without paperwork
 - Product transferred to Salesman as “Demo’s”
 - Company doing periodic verification of distributors found their product on an unknown website and did not recognize vendor as a customer
 - We worked with client to arrange purchases from the website in unique colors to identify warehouse and salesman, etc.

Examples of employee fraud (Continued)

- Irregular accounting transactions
 - Chief Accounting Officer and associates
 - Used accounting transactions to conceal the misappropriation of funds
 - Used associates to assist in concealing the transactions
 - Misrepresented accounting statements to management
 - Transactions enabled by the absence of segregation of duties and span of control
 - Minimal controls in place/complete confidence in individual
 - Discovered through an outside call

Examples of employee fraud (Continued)

- Fraudulent CD's Issued
 - Personal Banker
 - Used accounting transactions to conceal the misappropriation of funds
 - Opened accounts in deceased individuals names
 - Fraudulent CD maturity notices and statements
 - Transactions enabled by the absence of segregation of duties and span of control

Examples of external fraud

- Irregular accounting transactions/data hack
 - Unknown perpetrators
 - Obtained company's payroll checking account number, and the routing and transfer number
 - Committed a series of transactions over five years
 - Enabled due to the organization's lack of communication regarding completion of account reconciliations
 - "Reconciliations" performed by an area not trained in the proper way to complete an account reconciliation
 - Detected by analysis and centralization

Examples of external fraud (Continued)

- Fraudulent Loan Scheme
 - Commercial customer of bank
 - Presented fraudulent broker statement as collateral
 - Potential kiting / wiring of funds

Examples of external fraud (Continued)

- Data hack
 - Unknown perpetrators
 - Obtained access to the company's IT systems
 - Committed a series of transactions over a one-year period
 - Enabled by lack of controls around the company's firewalls and applications
 - Eventually detected through account reconciliation

What's behind the recent spike in fraud?

- State of fraud
 - Significant increase in the level of fraud since the financial crisis began in 2008
 - Has seen plateau in 2009
- Most recent survey shows a slight increase in average loss per company to fraud
 - \$8.8 million – 2009
 - \$8.2 million – 2008

Has your organization suffered from fraud?

	2009 Survey	2008 Survey
At least one fraud	85%	86%
Theft of physical asset or stock	38%	37%
Information theft, loss or attack	25%	27%
Management conflict of interest	23%	26%
Financial mismanagement	21%	22%
Regulatory or compliance breach	21%	25%
Vendor, supplier or procurement fraud	20%	18%
Corruption and bribery	19%	20%

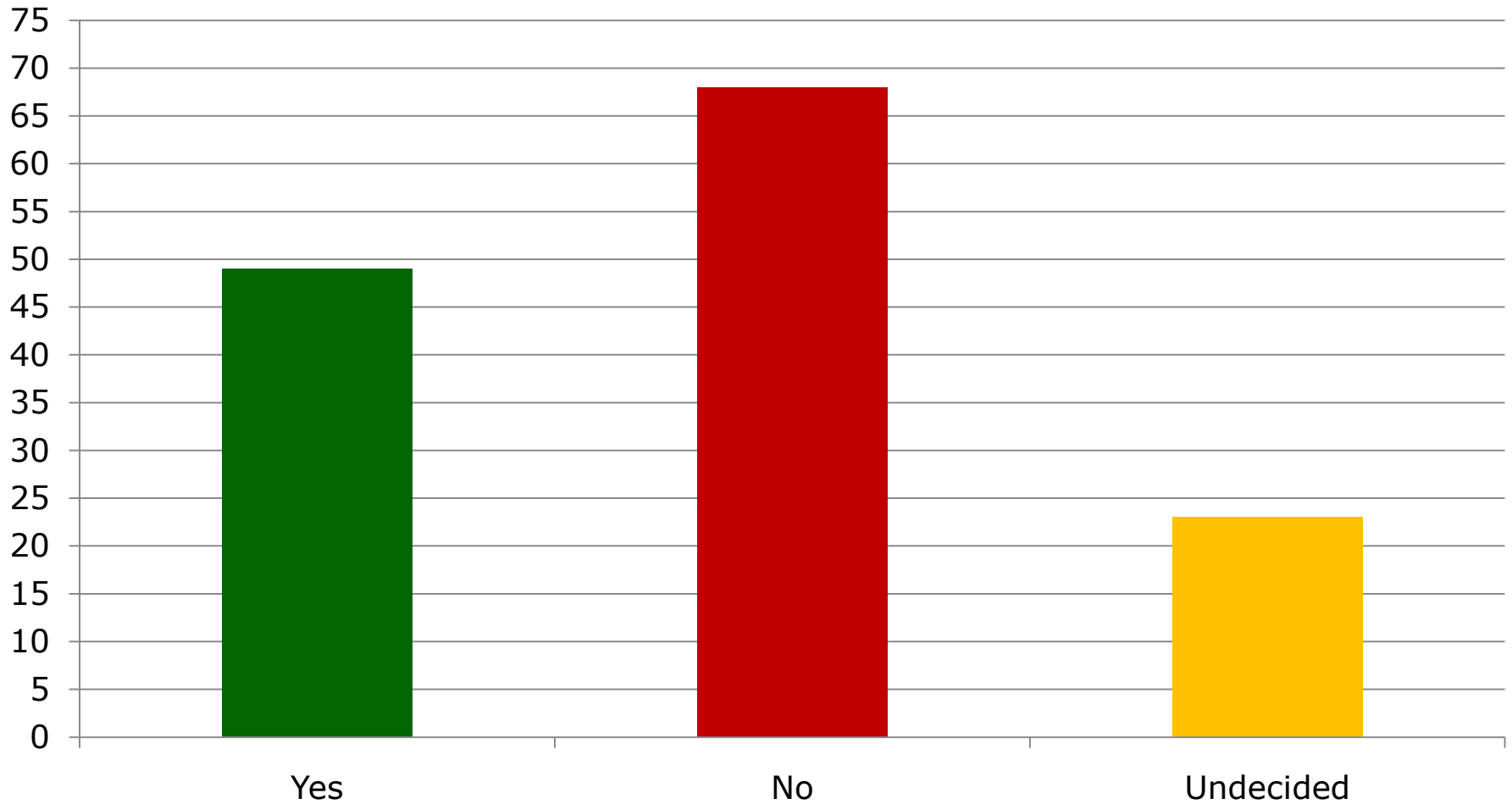
Kroll Global Fraud Survey 2009-2010

Has your organization suffered from fraud? (Continued)

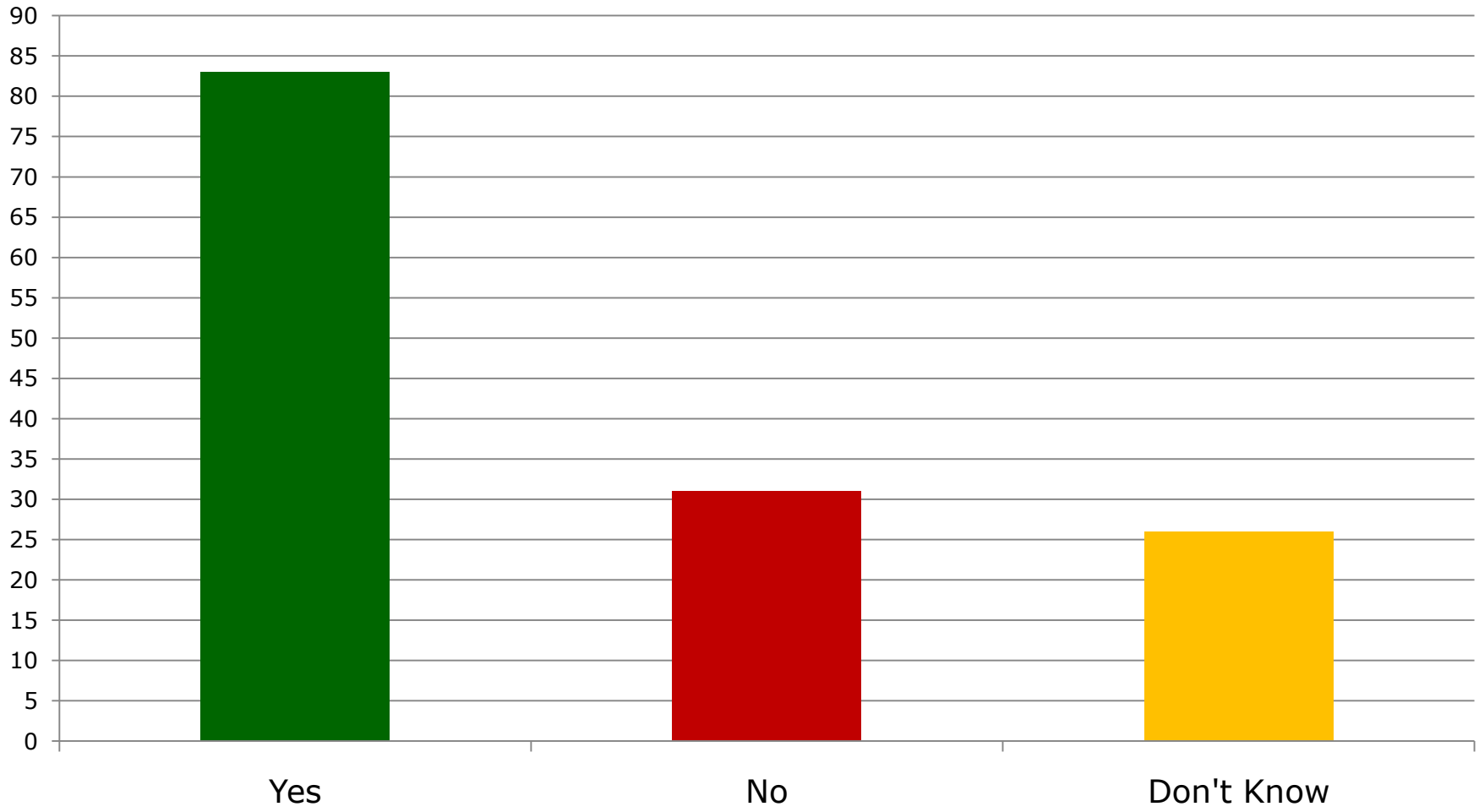
	2009 Survey	2008 Survey
Internal financial fraud or theft	18%	19%
IP theft, piracy or counterfeiting	14%	16%
Money laundering	5%	4%

Kroll Global Fraud Survey 2009-2010

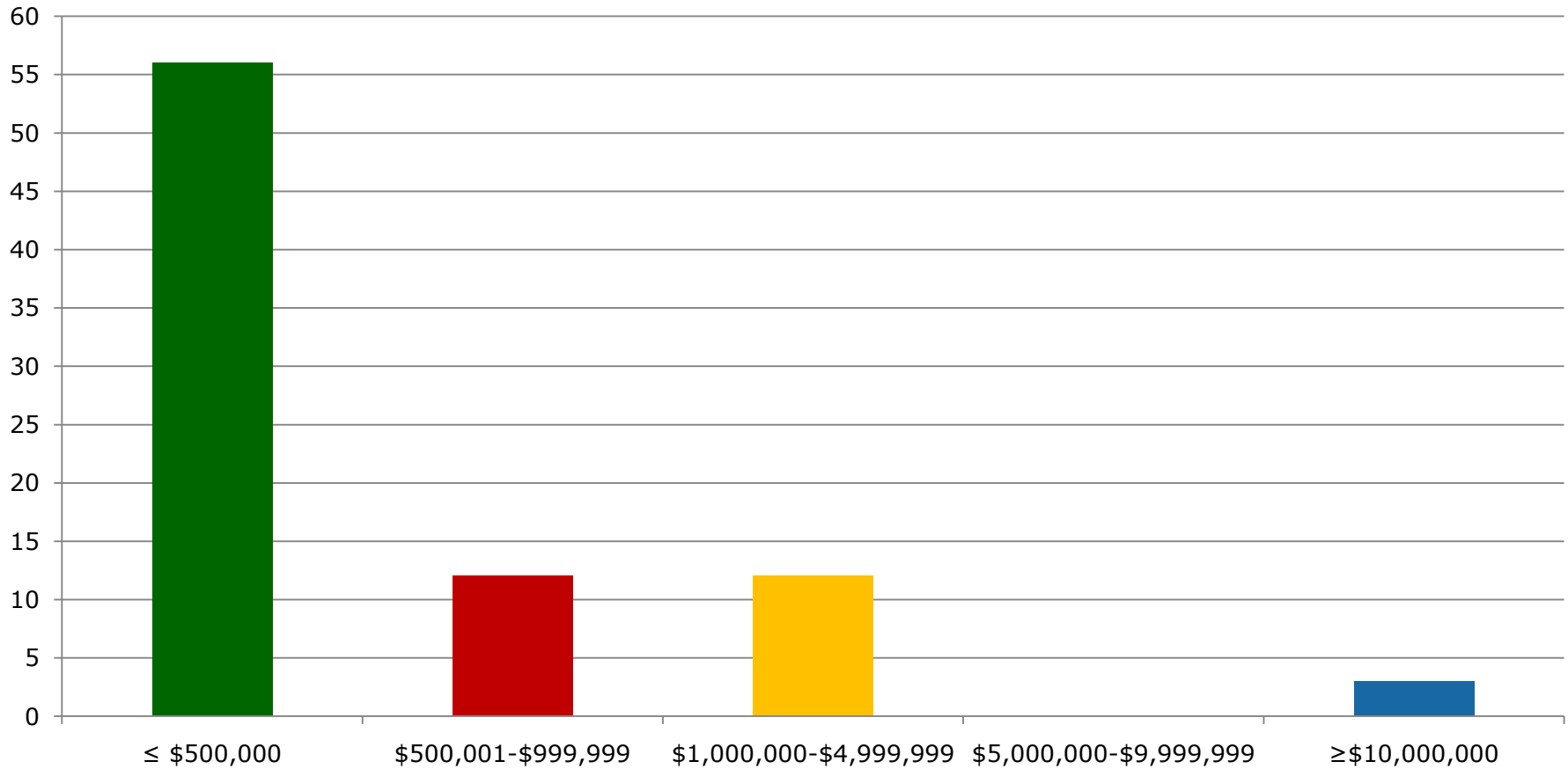
Has the economic crisis caused more fraud to occur?



Has your organization experience fraud in 2009 or YTD in 2010?



Quantified Known Loss for those answering Yes on previous slide



Economic crisis has increased the motive and decreased the opportunity

- Risks have changed
 - Risks associated with growth/expansion (minimized)
 - Less money – closer scrutiny on spending
 - “Key contributors” have gone down:
 - High staff turnover (32 – 26%)
 - Entry into new markets / growth (32 – 24%)
 - Inter-firm collaboration (28 – 20%)
 - Risks associated with expense tightening (grown)
 - “Greater vulnerabilities”
 - Reducing internal controls to save money
 - Pay stringency - increased motive for fraud “justification”
 - Reduced revenues overall

Economic crisis has increased the motive and decreased the opportunity (Continued)

- Employee-related fraud
 - Theft of the organization's property and resources
 - Embezzlement and expense account
 - The organization's information and data
- External fraud
 - The organization's information and data

Top 10 Internal Control Deficiencies

Top 10 internal control deficiencies

1. Absence of management oversight
2. Segregation of duties
3. Lack of communication
4. Absence of reconciling
5. Ineffective or incomplete reconcilements
6. Absence of analytics
7. Weak information security
8. Poor or outdated information systems
9. Absent or weak policies and procedures
10. Review and approval processes

Elements of an Effective Ethics Program

Effective Ethics Program

- Starts with the “Tone at the Top”
- Establish an effective code of ethics
- Designate high-level personnel with direct responsibility for overseeing compliance
- Appoint a compliance officer
- Inform / Educate employees
- Ongoing reporting to Board’s Compliance Committee
- Whistle blower hotline

Effective Ethics Program (continued)

- Implement systems / processes / procedures for investigation
- Consistently enforce the company's policies and procedures with corrective action

Effective Ethics Program (continued)

- Best case scenario, a ethics program will prevent misconduct from occurring at all;
- If criminal conduct does occur, program should facilitate early detection
- Demonstrates a Pro-active approach from a government perspective
- Provides evidence board and executive management are carrying out their fiduciary obligations

Questions?

Paul Rosol

Director, Risk Advisory Services, Midwest

612.851.1643

952.836.7485

paul.rosol@jeffersonwells.com

jeffersonwells.com