

sox  
↑  
The CFO's Perspective

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THE  
BOARDROOM PROJECT

# Your Views on Ethical Behavior

accountability

- If someone wants a day off, is it acceptable for them to call in sick?
- Is it acceptable for employees to conduct personal business on company time?
- How do you feel about accepting gifts?

NO GRAY AREA

# Goals:

Ethics is foundation of business  
(accountability)

- Define Fraud
- SOX and Operations
- Marketing Impact

} becoming  
language of  
business

SOX will be  
mandating language,  
measures of accountability  
• who will get there first?

# Fraud

A deception made for  
personal gain

2005  
38% mgn  
FINED

↓  
not just talking about  
stealing (\$50B/yr issue)  
BUT ABOUT STK PRICE  
& DEC'S & COMMUN IMPACTING  
IT



# Key Elements of Fraud

A *representation*  
about a *material* point  
which is *false*  
and *intentionally* or *recklessly* made  
which is *believed*  
and *acted upon* by a *victim*,  
and the victim suffers *harm*.

DEF MKTG  
SPDG  
~ 20-25% OF REV

LACK OF KNOWLEDGE  
NOT A DEFENSE

LACK OF PUTTING  
MEASURES IN PLACE  
TO KNOW BETTER

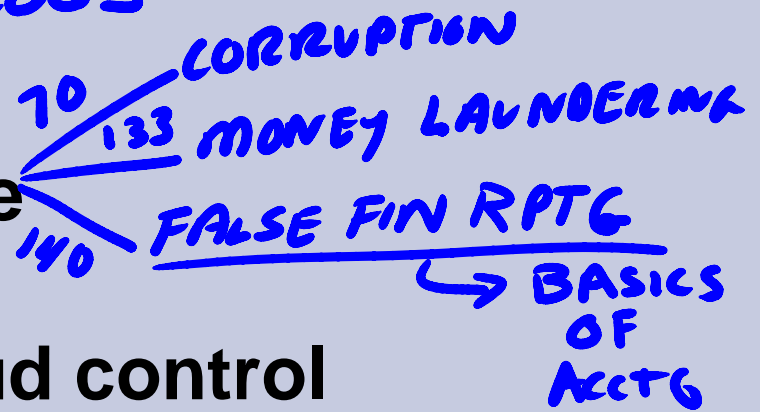
STAKEHOLDERS

# Fraud is a Booming Business...

- Fraud, a significant and growing threat worldwide **45% OF CO'S 2005**

**FOCUS**

- Types of economic crime **WHERE EARLY FOCUS**



- The effectiveness of fraud control **34% CHANCE / 26% I.A.**
- The bigger the company – the harder they fall..... **3X MORE OFTEN**

**WHAT IS ON P&L & BS**

# What Leads to Fraud

ANYWHERE

- Fragmented knowledge
- Divided responsibility
- Ambiguous orders
- Unknown Consequences

→ SME'S  
DEC MAKING ALT'S  
PROCESS

→ NOT WELL UNDERSTOOD  
HOW LINKS TO  
FIN'L PERFORMANCE

① WHERE FIN IS DOING NEXT DRILL DOWN

# AICPA Auditing Standards Board

## October 2002, SAS 99

NOT SUBJECT TO PERSONAL INTERPRETATION

STMT OF ACCTG STDS

- Describes fraud as it relates to Financial Statements

e.g. labor → invty - B.S. → REV

→ MKTG

GAAP

CASH MATCHING PRINCIPLE

- Requires training & brainstorming sessions → EVERY YR ≠ SAME, SAME

DRILL DOWN

- Identify risks

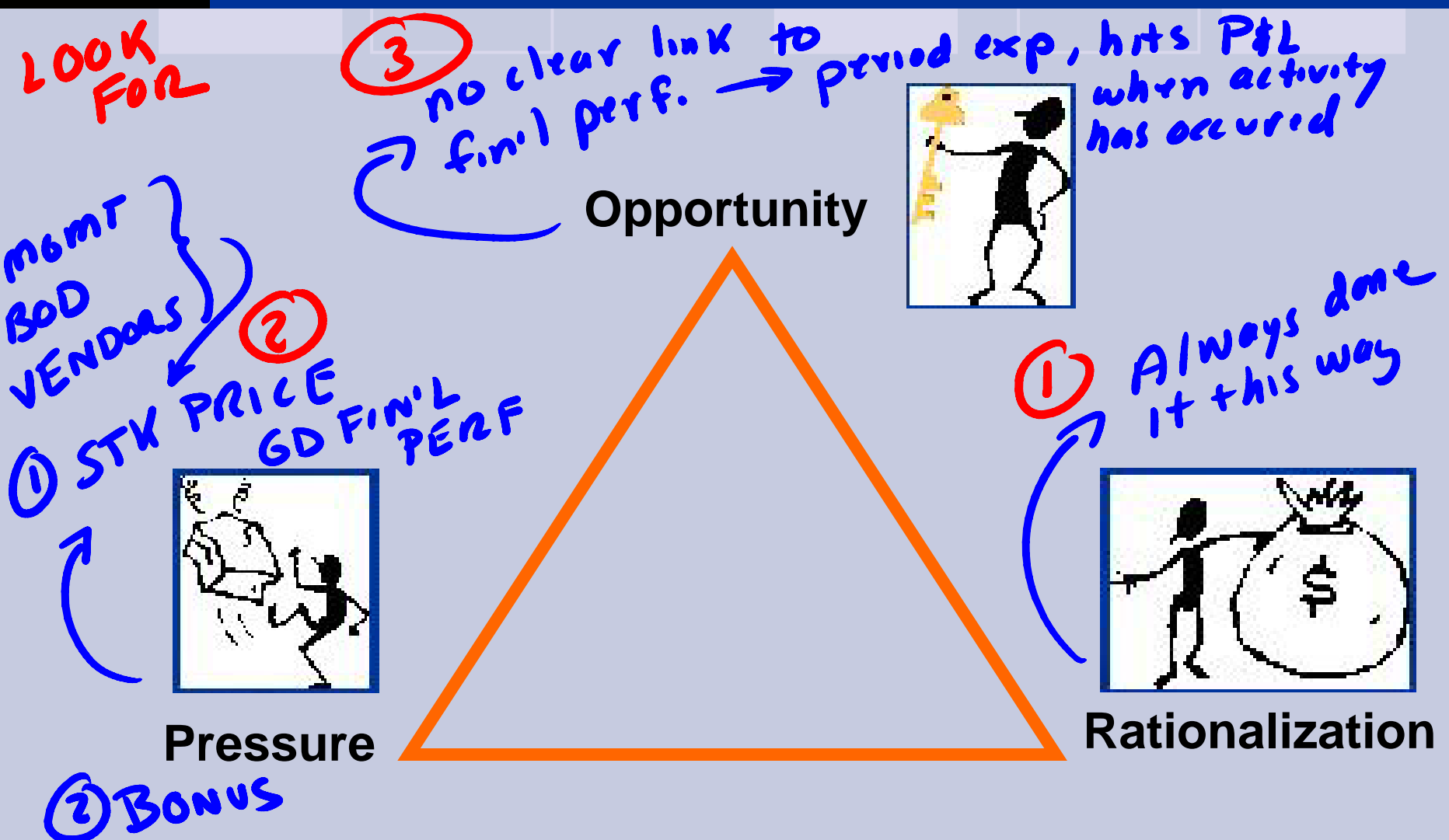
→ Significant

- Assess risks

→ AUDIT COMM  
OUTSIDE BOD MBRs

- Communication to management

# Why Do People Commit Fraud?



# SOX Section 404

Assess the effectiveness  
(accountability)  
of the organization's

Internal Control

NOT JUST P&P, BUT FUNCTIONS & PEOPLE  
AT EVERY LEVEL OF ORGANIZATION!

# The SOX team who is liable

- Company Management
- Board of Directors
- Independent Auditors

→ AT ALL LEVELS  
→ 10 HAVE  
→ 18  
EXECS  
JAIL  
↓  
LEGAL



Is there a process to reasonably assure the achievement of BUS objectives? → ext'l & intl rpts  
(mgmt rpts)

# Why Conduct a

## Fraud Risk Assessment ?

- It's the Law ! *NO LONGER JUST A SHAREHOLDER LAWSUIT → NOW SCARED*

- Heighten / strengthen fraud awareness

*↳ MUST DOC WHAT DOING*

- Provide a framework for continuous detection & prevention of fraud

*DIFF EVERY YR*

*↓ measurements & language*

*↓ EXT AUD SIGN OFF*

**It's the right thing to do !**

*↓ drilling down*

*for users of FIN'L INFO & OWNERS*

*LV'G FOR RISKS: % OF \$ SPEND IMPACT TO P&L*

*MKT'G DISCR ?*



A SOX FIN PERSON IS TAUGHT:

# A Manager's Stages of Moral Development

## Act because of:

- Ethical principles
- It is what is expected
- It is in best interest to avoid punishment

20% are naturally accountable

30%

50%

REST HAVE TO BE MANDATED  
TO GET RESULTS

# AICPA, SAS 99

more language

- Descriptions & characteristics of Fraud

- Emphasis on professional skepticism  
*DO NOT ACCEPT SIGNATURES ALONE OR SOMEONE'S WORD*

- Emphasis on discussions with management  
*AT ALL LEVELS*

used to be okay

- Prescribes unpredictable audits tests  
*SURPRISE*

- Management override of controls

- Obtaining information

*NEED TO REVIEW RISKS IN OP'L DEC MK'G*

*SEE FUNCTION DETAILS*

*SEEK OUT MTL POINTS - MKTG*



# Fraud Categories

- Howard Schilit Ph.D, CPA

*In the 1990's*

**Financial Shenanigans:**

***How to detect Accounting Gimmicks & Fraud***

# Tricks - Sox initial mktg impact s/b

@ fundamental level

1. Record Revenue too soon

2. Bogus Revenue

3. Boost income with one time gain

4. Shifting expenses

5. Failing to record liabilities

6. Shifting current revenue to another period

7. Shifting future expenses to current

8. Bogus assets

then should come how exp to rev → ? link

(GAAP)

? link

IST CUT PAID FOR ENSURE GET WHAT did ads run - who says, what proof

# To Summarize:

Fraud falls into 4 basic categories

- Fraudulent Financial Reporting
  - ② matching exp with Rev
  - ③ cash flow
- Misappropriation of Assets

■ Improper Expenditures or Liabilities

① ■ Avoidance of Expenses

→ controls, msmts, processes

# Fraudulent Financial Reporting

MKT EVAL  
\$28 B 2 MO'S  
BEFORE

## Enron

- Nobody understood how it made money **OR HOW IT WORKED** (FIN S/UNDERSTD HOW EVERY MIL)
- Fortune Magazine: “Most innovative Company of the year.” ASPECT OF BUS IS LINKED TO P&L
- “Deal machine”
- Financials & accounts obscure } hidden or didn't exist
- Off balance sheet entities
- BOD and outside auditors condoned now involved of truly perf

# Misappropriation of Assets

## Parmalat

- Network of false bank accounts
- Offshore investments
- Siphoned off cash to founder
- 18 Corporate executives → don't go by themselves
- \$ 12 Billion ↓ ignorance was not effective defense
- 32,000 investors lost money — suicides

how \$  
Being  
Spent  
↓  
Results  
Spending  
from  
not  
Quantifiable

# Improper Expenditures or Liabilities

*Caught by chance*

## WalMart

- Executive VP & BOD member
- \$500,000
- Gift cards, false invoices, travel & expense reports
- Accidentally discovered by sales clerk

*FIN colluded, took V.P. signature or word*

*don't let it happen to you*



# Avoidance of Expenses

## Rite Aid

- Manipulated earnings

*mgmt of vendors  
damaged gds (35-50%)  
rebates ? hello  
where*

Largest restatement of income ever recorded **\$2B+**

## WorldCom **\$11B**

- Classified billions in Routine Expenses as capital investments

*you should understand how accty is handled in your co. for your activities*

# Fraud in the News

low hanging fruit

↓  
BASICS

- Adelphia Comm.
- HealthSouth \$2.7 B
- Cendant \$3 B
- Tyco \$567 M
- Quest Comm. Intl.
- Bristol-Myers Squibb \$1.5 B
- Westar \$53 M
- Xerox \$1.5 B
- KPMG \$2.5 B
- Merrill Lynch (Enron)
- Nortel
- AOL \$49 M
- China \$399 million
- Peregrine Sys. \$100 M
- Royal Ahold \$820 M
- Hyundai Motor \$106 M
- China Const Bank \$15 M

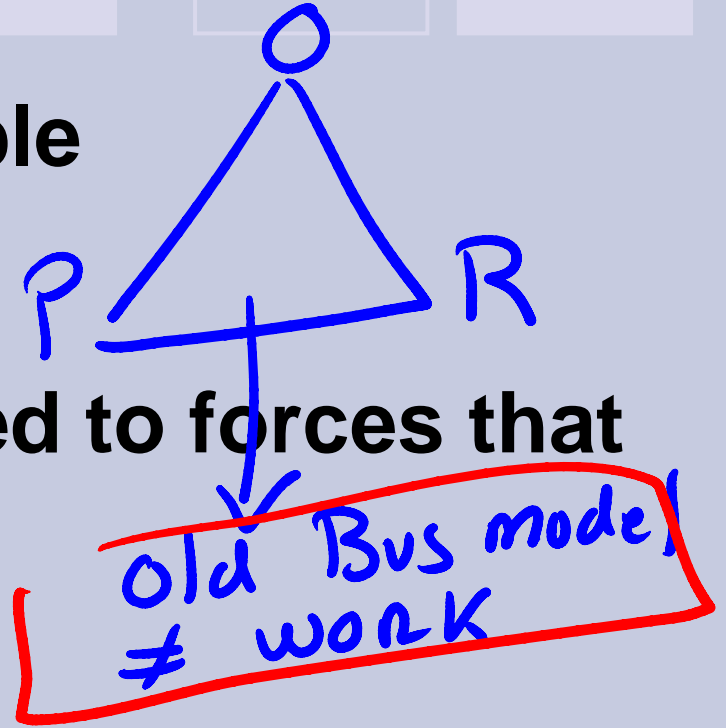
# Fraud -- Summary

- Not crooks or bad people

- Honest people subjected to forces that they don't understand

- Deming's 85/15 rule → TQM major principle

SOX FIN NOW gets it  
85% of workers perf. determined  
by the system (stds/msmts) they  
work within



# Antifraud Activities Framework



# Companies Must

**Document:** EACH SIGNIFICANT CO

- The activity ✓
- Frequency ✓
- Identify who performs the task
- Identify how you measure successful completion of task

↳ did it do what it was suppose to (how measure)

if handle as just  
exp will continue to  
perpetuate fin belief  
mktg IS  
(arms length)  
discretionary



# Companies Must

## Evaluate fraud risk factors:

- *Brainstorm fraud risk schemes.*
- *Rate schemes*
- *Map schemes to existing controls or develop Action Plans*

*explain how  
stds/measures  
prevent fraud*



# Fraud Schemes

- Example
- Detection
- Prevention



EVERY YR  
FIN MUST REVIEW  
& ADJUST DOCUMENTATION  
ON MTL OR SIGNIFICANT  
DRIVERS OF P&L / B.S.

Sees as  
discretionary  
exp

\* IF YOU HAVEN'T SEEN SOX FIN :  
① CO HAS OTHER ISSUES MUST CLEAN 1ST  
② DOESN'T SEE MKTY AS AN IMP. DRIVER  
OF P&L / B.S.

# Detection

- **Trend analysis of expenses to revenue**  
*Significance of discretionary* → *wt so define*
- **Tracking customer / vendor complaints**  
*track record*
- **Statistical sampling**  
*P.O.'s MSMT*
- **Analytic review**
- **Ratio analysis**
- **Surprise counts**
- **Monitoring & questioning**  
*not just one's word*
- **Requesting detailed backup**
- **Compare to what was committed** *accountability*
- **Define vendor / employee relationship (Is it arms length?)**
- **Exception monitoring**



# Prevention

- Segregation of duties
  - Policies & procedures
  - Proper documentation
  - Monitoring
  - Supervisor sign-off not perfunctory
- STDS  
MSMTS  
PROCESS  
accountability*
- Independent verification of success by others
  - Physical safeguards
  - Assignment, rotation & mandatory vacations
  - Surprise audits or counts

# SOX Fraud Schemes

## Brainstorming Topics

### Procurement (Purchase to Payment)

*example  
of drill down  
just in purchasing*

# Fraud Schemes

1. Collusion between buyer and vendor
2. Bid rigging. Employee fraudulently assists a vendor in winning a contract through the competitive bidding process.
3. Sole source justification.
4. Bribery. *} gifts/dinners*
5. Illegal gratuity *}*
6. Conflicts of interest
7. Continuous usage of the same supplier

# Fraud Schemes

8. Are all vendor relationships legitimate and “arms length?”

9. Related party purchases.

10. Phantom vendors.

11. Unclear completion of services.

12. Vague success criteria for evaluating services performed.

13. Split purchases to avoid exceeding delegation of authority. Many purchases made just below the authorized limit.

*how measure  
need quantifiable  
returns*

# Fraud Schemes

14. Duplicate invoices.

15. Unrecorded liabilities. Goods or services are received, but invoices are not processed in a timely manner. Not received from vendors, contingent liabilities discussed, but not recorded. Received from vendors and withheld until a subsequent accounting period.

16. Invoices accepted without supporting documentation to justify payment. Do accounting personnel push back on you for documentation and reasons for expense?

→ WORK DONE NOT ACCOUNTED FOR

# YOUR Obligations (SOX)

## ■ Investigation

MUST ACQUIRE KNOWLEDGE  
LACK  
need to understand your link  
to fin'l process in  
your LO - sit w/  
FIN

## ■ Communication

↳ MUST Report any ethical/wrong doings  
if in position to observe

## ■ Protection

must provide safe environment  
to those questioning (e.g. doc mktg)

## ■ Precaution

must have process, memos,  
STDS TO prevent unethical  
behavior

# The future ....

In some way, each of you will be faced with these obligations in the foreseeable future.

Are you each going to re-invent the wheel or ....

AS AN INFORMED COMMUNITY HAVE STDS ACROSS DOMAINS  
& PROCESSES THAT SUPPORT MKTG  
ACTIVITIES & CONTRIB TO SUCCESS OF CO.

*Thank you*

BENTON

Consulting Services Ltd.

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