The Role of Internal Controls in the Fight Against Fraud

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A Bad Influence

Learning Objectives

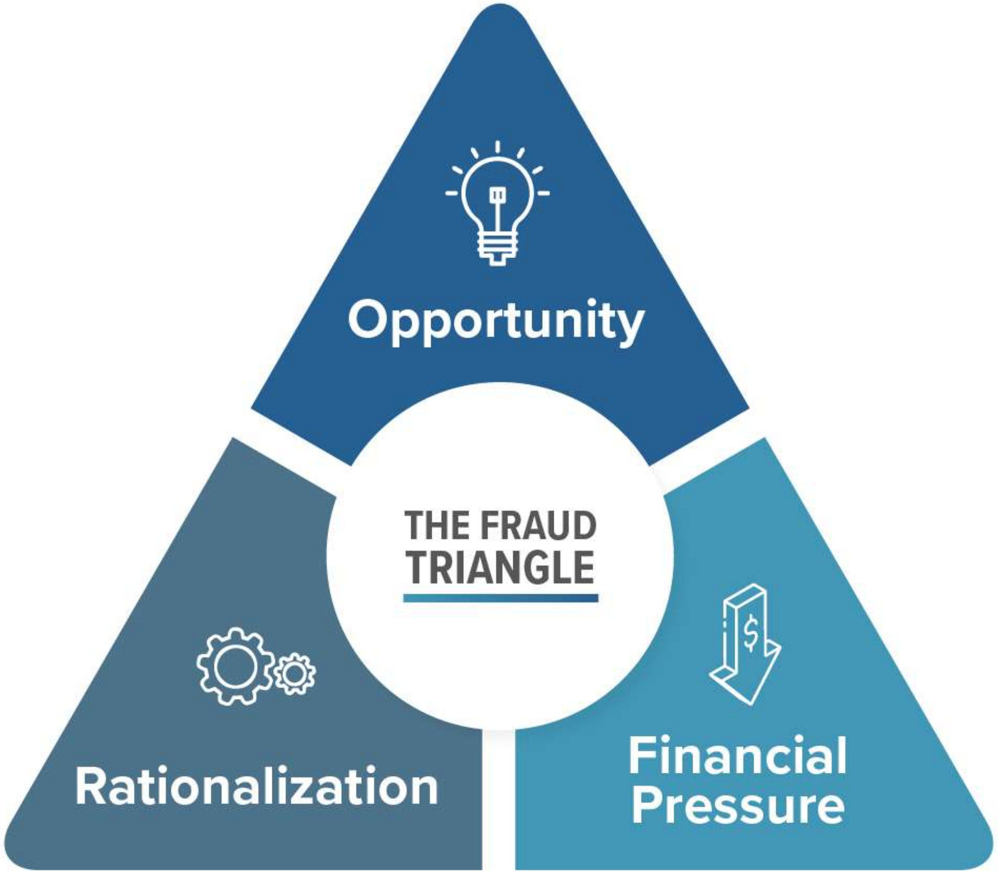
- Recognize the control weaknesses that commonly lead to fraud, including the "Terminal Two"
- Apply your knowledge of internal controls to sharpen the focus of fraud investigations and make them more productive
- Explore the state of internal controls in today's business environment and learn why they so often fail
- Identify ways to improve fraud prevention and detect it sooner when it happens

Question #1

What is your role?

A. Accountant
B. Attorney
C. Auditor
D. Ethics/Compliance
E. Management
F. C-Level Executive
G. Law Enforcement
H. Other

The Fraud Triangle



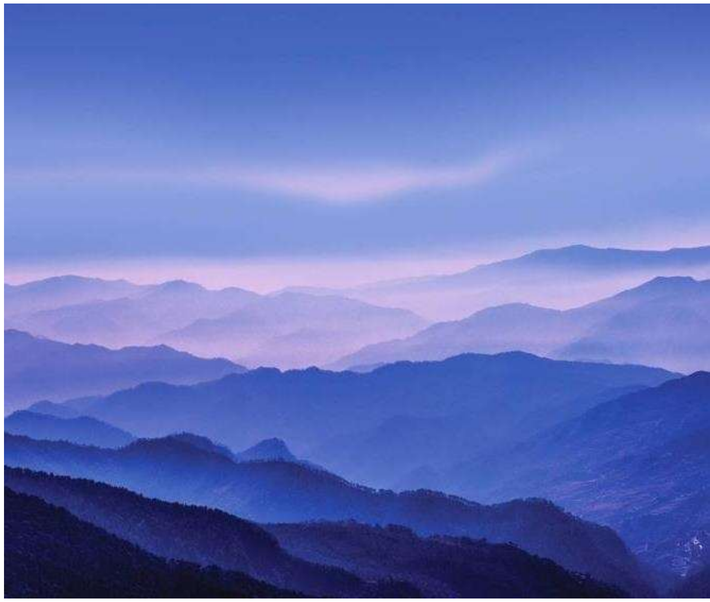
The Open Door

The Terminal Two

Segregation of Duties

Meaningless Approvals

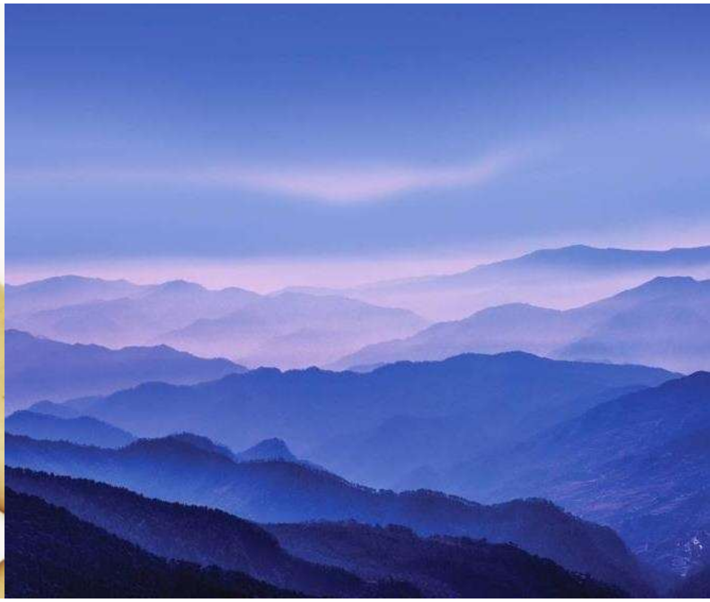
The Ambitious Payroll Manager



Agricultural Industry

Internal Controls

- Replaced Staff/Moved Payroll to HR
- Sole Authority Over Payroll Master File
- Initiated Transactions
- Posted General Ledger
- Reconciled Payroll Bank Account



Red Flags

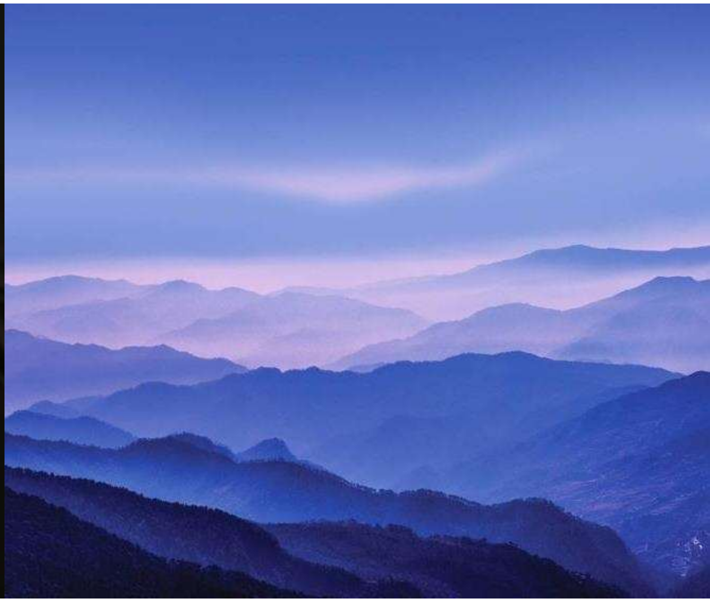
- Spouse
- Home
- Cars
- Clothing and Jewelry
- Private Schools
- Horses

Sharpen Investigation Focus

Unreliable Internal Records

Third-Party Documentation

Sleight of Hand and Misdirection



- Deleted payroll register entries
- Altered payroll master file
- Created fraudulent journal entries

Damage

$2.25 million

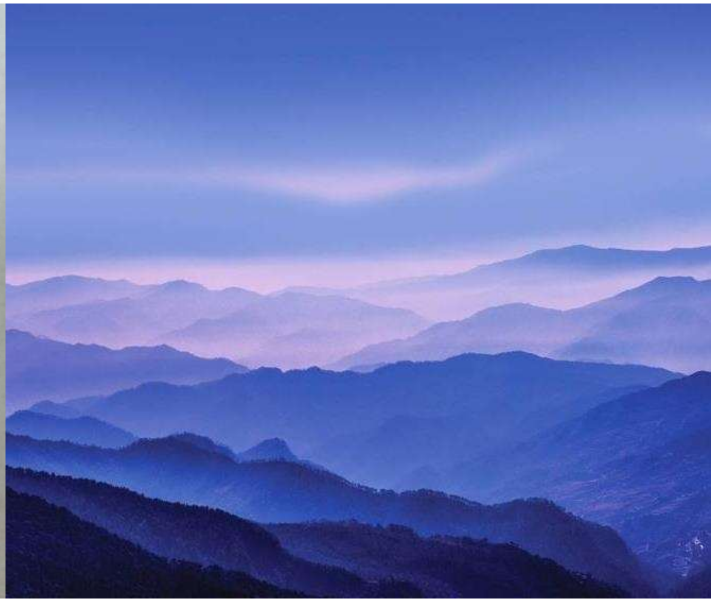
- **Fictitious payroll disbursements**
- **Tax refunds**

Question #2

In your experience, have most perpetrators been:

A. Disciplined
B. Terminated
C. Civil Action
D. Criminal Prosecution
E. No Action

A Charity's Uncharitable Controller



Regional Chapter

International Humanitarian Organization

Red Flags

- Modest Income
- Boat
- New Cars
- Season Tickets
- Vacations
- Gambling

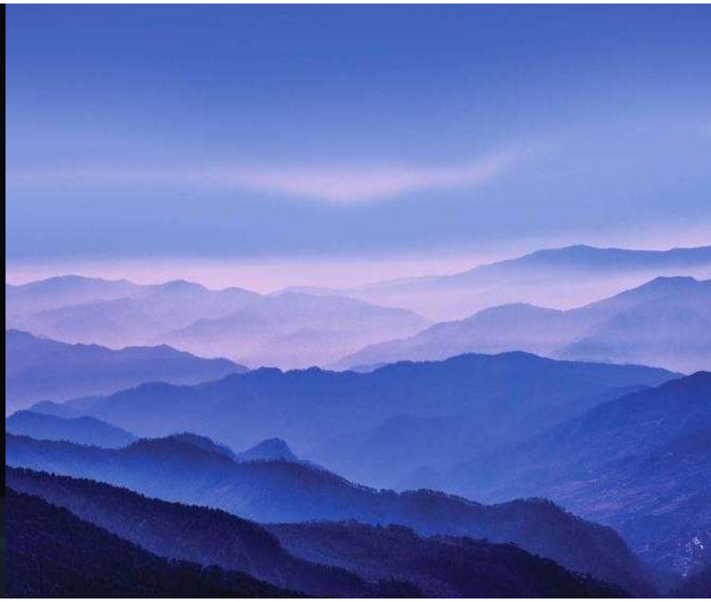
Internal Controls

- Received Cash
- Made Bank Deposits
- Received and Approved Vendor Invoices
- Signed and Issued Checks
- Payroll
- Posted the General Ledger
- Reconciled Bank Accounts

Sharpen Investigation Focus

Unreliable Internal Records

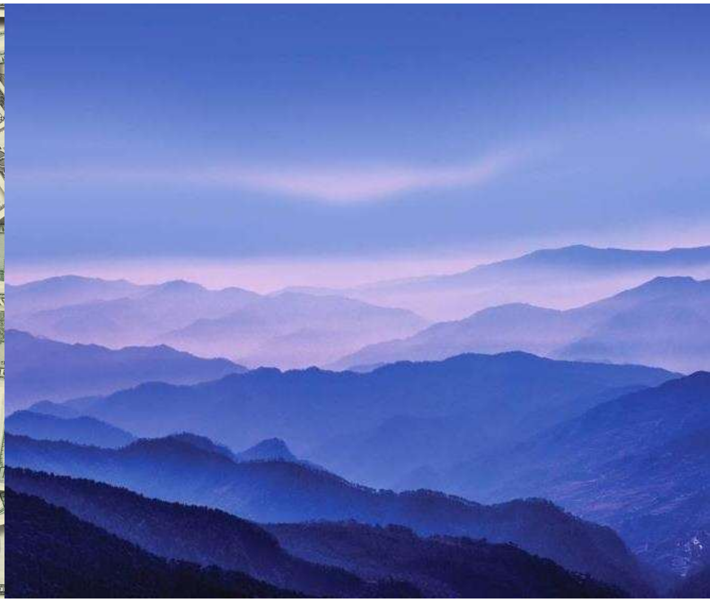
Third-Party Documentation



Sleight of Hand and Misdirection

- **Traveler's Checks**
- **Cash Receipts**
- **Credit Card**

Damage



$565K in two years

The Greedy Superstar

Technology Company

Internal Controls

- ERP with Expense Reporting Module
- Corporate Amex Card
- Cash or Personal Credit Card Permitted in Some Cases
- No Receipt for Expenditures Under $25
- Supervisor Reviews/Approves

Question #3

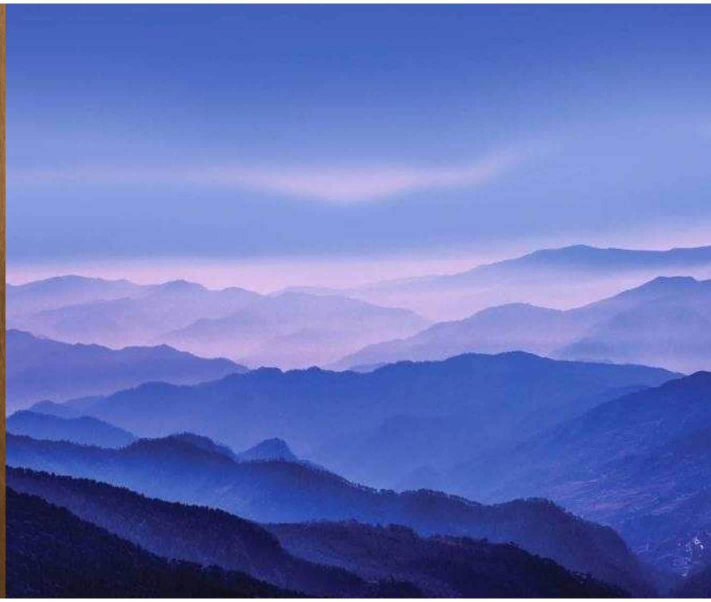
How would you assess these controls?

A. Adequate
B. Improvement Needed
C. Inadequate

Sharpen Investigation Focus

Cash and Personal Credit Card Transactions of $25 or Less

Third-Party Documentation/Email



Red Flags

- **Numerous cash expenditures without receipts**
- **Excessive use of personal credit card**

Sleight of Hand and Misdirection

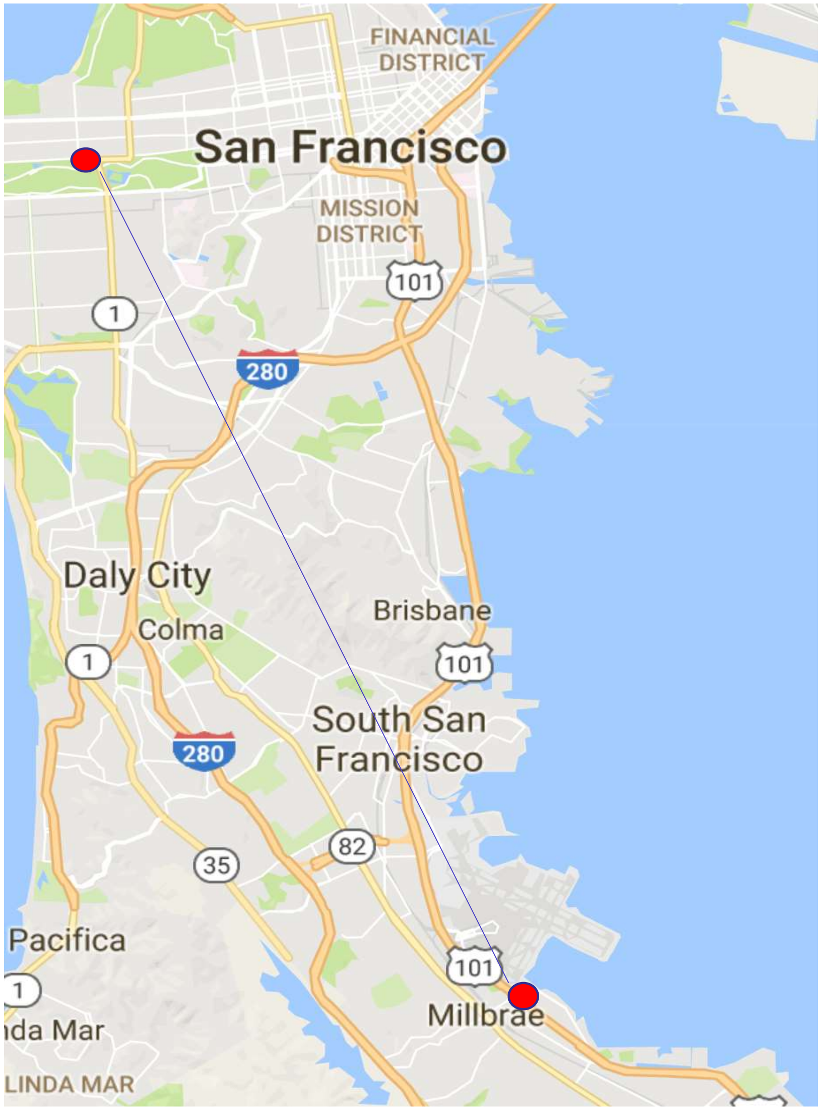
- Personal/fictitious expenditures
- Bogus/altered receipts
- Multiple expense reports

Multiple Expense Reports

Report Date	Expense Date	Description	Amount
• Expense Report 3/6	3/1	Breakfast at McDonalds	$24
• Expense Report 3/6	3/1	Lunch at Subway	$24
• Expense Report 3/6	3/1	Dinner at hotel	$24
• Expense Report 3/6	3/1	Wi-Fi	$18

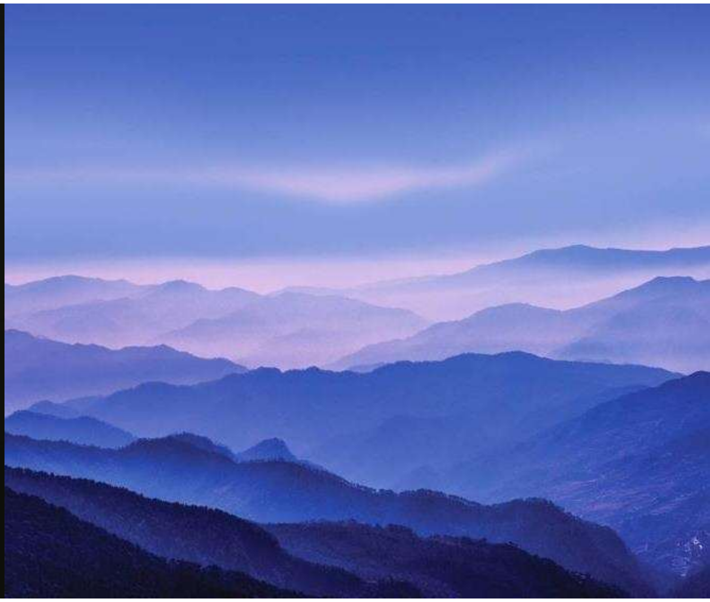
Multiple Expense Reports

Report Date	Expense Date	Description	Amount
• Expense Report 3/6	3/1	Breakfast at McDonalds	$24
• Expense Report 3/13	3/1	Breakfast at Starbucks	$24
• Expense Report 3/20	3/1	Breakfast at hotel	$24
• Expense Report 3/6	3/1	Lunch at Subway	$24
• Expense Report 3/13	3/1	Lunch at Starbucks	$24
• Expense Report 3/20	3/1	Lunch at Local Bistro	$24
• Expense Report 3/6	3/1	Dinner at hotel	$24
• Expense Report 3/13	3/1	Client dinner at Alchemy	$400
• Expense Report 3/20	3/1	Dinner at Local Bistro	$24
• Expense Report 3/6	3/1	Wi-Fi	$18
• Expense Report 3/13	3/1	Wi-Fi	$18
• Expense Report 3/20	3/1	Wi-Fi	$18



Saturday Travel for Orlando Conference:

- Cash breakfast at McDonalds - $24
- Cash lunch at Subway - $24
- Cash dinner at Local Bistro - $24
- Car service to SFO - $150
- Flight to Orlando departed 10:55 PM
- Cash for in-flight Wi-Fi - $18



$200–300K per year

Damage


The State of Internal Controls

2022 Survey:

ACCA
IIA
IMA

50% - Lack of Skilled Staff

32% - Lack of Executive Emphasis

41% - Technological Advances Compromise Controls

Source: https://futurecfo.net/the-three-latest-internal-control-challenges/

Question #4

What obstacles do you see in implementing effective internal controls?

A. Lack of skilled staff
B. Lack of executive emphasis
C. Technological advances
D. Other
E. None

Regulatory Response to Crisis

Calamity	U.S. Government Response
Stock Market Crash - 1929	Securities Act - 1933 SEC Act - 1934
Watergate - 1972	Foreign Corrupt Practices Act - 1977
Enron, WorldCom - 2001	Sarbanes-Oxley - 2003
Sub-prime/Wall Street - 2007	TARP - 2008 Dodd-Frank - 2010

Industry Response to Regulation

Early 20th Century

"Internal Checks"

- Prevent errors
- Deter employee theft

1936

American Institute of Accountants (Now the AICPA)

- Measures and methods adopted within the organization to safeguard the cash and other assets of the company as well as to check the clerical accuracy of the bookkeeping

1949

The plan of the organization and all of the coordinated methods and measures adopted within the business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed management policies

The COSO Pyramid

Source: COSO Integrated Framework - 1992

COSO Integrated Framework 1992

Source: COSO Integrated Framework - 1992

COSO Redefined Internal Controls

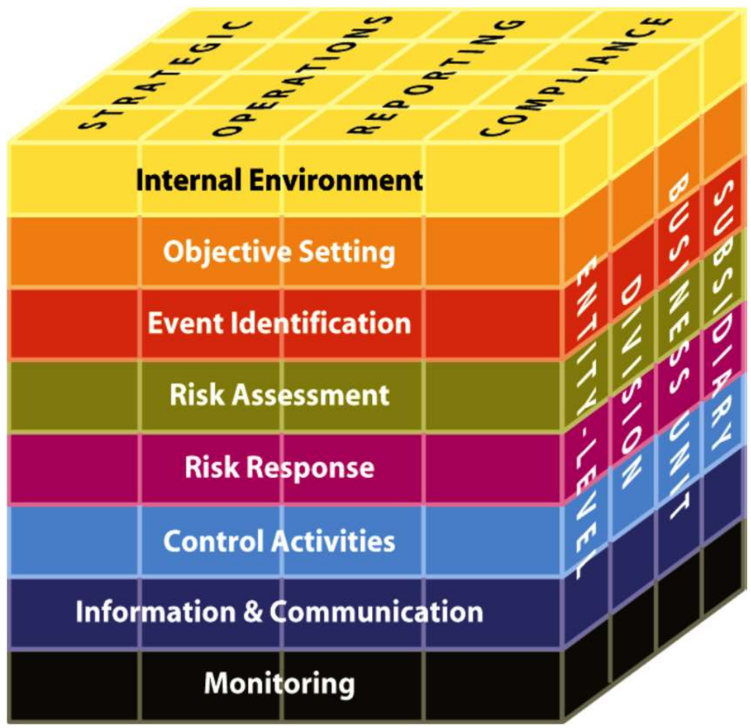
COSO 1992

Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

Source: COSO Integrated Framework - 1992

COSO Enterprise Risk Management 2004



Source: COSO Enterprise Risk Management - 2004

COSO Integrated Framework 2013

Source: COSO Integrated Framework - 2013

COSO Enterprise Risk Management 2017

- Governance & Culture
- Strategy & Objective-Setting
- Performance
- Review & Revision
- Information, Communication, & Reporting

Source: COSO Enterprise Risk Management - 2017

Big Failures

Elizabeth Holmes

Theranos

2018

Marcus Braun

Wirecard

2020

Sam Bankman-Fried

FTX

2022

SVB

2023

What's Changed?

The "Trust Trap"

Takeaways

Education is Essential

Assess Risk

The Terminal Two

- Segregation of Duties
- Meaningful Approvals

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Questions