

# "FIGHTING FRAUD in Smaller Public Companies"

## What are the Top Fraud and Financial Ethics Threats?

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## What are the Top Fraud and Financial Ethics Threats?

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**There will be instructions at the end of this seminar on obtaining CPE credit\* for this webinar.**

**To qualify you must attend at least 50 minutes of this webinar.**

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# Biographies and Introductions

Bob Benoit

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## Lord & Benoit helps “Smaller Public Companies”

Lord & Benoit releases leading edge SOX education and research. For instance, “Impact of SOX on the Manufacturing Industry”.





# Lord & Benoit helps “Smaller Public Companies”

CCH “Financial Restatements” research

RIA Thomson “Investment Research” section

RIA Thomson/Southwest Learning "Checks on Internal Controls Pay Off"

BNA "Sarbanes-Oxley and Small Business"

Counsel of Institutional Investors "Letter to Chairman SEC and Chairman PCAOB"

ADP "HR's Role in Ensuring Compliance and Driving Cultural Change"

Oracle “GRC Strategy”

Oracle: Best Practices for World Class I/T Governance

Oracle: Helping You Compete and Win in a Flat World

SAP "Governance, Risk and Compliance Management"

Top 40 Accounting Firms "The SOX Act"

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# Lord & Benoit helps “Smaller Public Companies”



- [Do You Know the Facts? Latest Section 404\(a\) Requirements for Smaller Public Companies](#)
- [SOX TV: Top Ten Compliance Threats TV interview discussing major areas of compliance for smaller public companies](#)
- [SOX TV: How Do You Conduct a Virtual SOX Assessment?](#)
- [Delay-Detect 10A-Delist: Facts about Section 404\(a\) for Smaller Public Companies](#)
- [Impact of Accounting for Income Taxes on SOX 404](#)
- [ComplianceOnline: 10 Threats to SOX Compliance for Smaller Public Companies](#)
- [Metric Stream Webinar: SOX Essentials for Small Public Companies](#)
- [Leverage Entity-Level Controls and Virtual SOX](#)
- [SME Capital Markets: SEC Guidance on Internal Controls over Financial Reporting \(SOX 404\)-- Impacts CPA's Attorneys, Officers and Directors](#)
- [ComplianceOnline: New SEC Guidance on Sarbanes-Oxley Section 404](#)
- [Helping Foreign Based SB-2 Registrants and 10KSB Filers Achieve SOX Compliance](#)
- [Small Filers Planning for the Transition to 404 Compliance](#)
- [MSCPA Conference: A Sarbanes-Oxley Update](#)
- [SME Capital Markets: Virtual SOX Compliance Frameworks for SB-2 and 10KSB Filers](#)
- [AICPA Web Seminar: Virtual SOX](#)
- [CBI Research: 2nd Annual Pharmaceutical/Biotech Conference on Sarbanes-Oxley and 404 Compliance](#)
- [ComplianceOnline: 10 Pre-SOX Tips for Smaller Public Companies](#)
- [Sarbanes-Oxley Risk Assessment for Pharma/Bio/Life Science Industries](#)
- [ComplianceOnline: Virtual SOX Compliance](#)
- [State Society of CPA's: Arizona, Nevada, New Jersey, Ohio: Cincinnati, Cleveland, Columbus, Texas: Dallas, Houston, Wisconsin](#)

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## Lord & Benoit helps “PCAOB CPAs”

- All Big 4 CPA firms and most second-tier firms’ have referenced Lord & Benoit’s research.
- Almost all PCAOB-registered CPA firms worldwide, use the Lord & Benoit e-newsletter as a source for SOX research information.

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# Webinar Course Outline

## 1. Regulatory Environment, Guidance

1. SEC
2. PCAOB
3. AICPA
4. COSO
5. SOX Sections 404(a) and (b)

## 2. Top Fraud and Financial Ethics Risks

## 3. Questions and Answers

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# Regulatory Environment

- SEC
- PCAOB
- AICPA
- The times (bankruptcies, tight funding, changes in Congress, new President, bank failures, fraud, overall need for governance)
- COSO

# COSO (Committee Of Sponsoring Organizations of the Treadway Commission)



American Accounting  
Association



American Institute of  
Certified Public Accountants



Financial Executives  
International



Institute of  
Management Accountants



The Institute of  
Internal Auditors

[www.COSO.ORG](http://www.COSO.ORG)



# Guidance, Guidance and More Guidance

**COSO**



**SEC Guidance**



**PCAOB Guidance**



**AICPA Standards**



# SOX Section 404(a) Requirements?

The Sarbanes-Oxley Act of 2002, Section 404(a) requires smaller public companies (non-accelerated filers) with fiscal years ending after December 15, 2007 to document a Management Assessment of their Internal Controls over Financial Reporting (ICFR).

Non-accelerated filers are companies with public float under \$75 million.

IPO's



# SOX Section 404(b) Requirements?

Section 404(b) for non-accelerated filers (the auditor attestation) was extended until years beginning after December 15, 2008

# SEC Interpretive Guidance

“Management’s evaluation of the risk of misstatement should include consideration of the vulnerability of the entity to fraudulent activity.”

# Top Fraud Risks

# Check Signing

- The number one fraud risk was the ability to sign checks and enter accounting transactions.
- This opens the door to ongoing, perpetual fraud without being caught.
- For example, a bookkeeper who has the freedom to write checks to himself and cover it up by booking a transaction or in the bank reconciliation.

# Wire Transfers

- A similar fraud risk is lack of segregation of duties with electronic fund transfers.
- People who do not even have check-signing authority have EFT or ACH authority.
- EFT and ACH is an even quicker way to embezzle funds than checks.

# Accounting Systems

- Accounting systems that do not have adequate access controls.
- For example, certain off-the-shelf accounting software lets users revise transaction dates and amounts without leaving an audit trail.



# Payroll

- Payroll is not reviewed by anyone other than the person doing it.
- Such personnel can create fictitious employees, give themselves or others raises, make adjustments to payroll and pay people after they've been terminated.
- Having outside payroll services does not insulate companies from this fraud risk.

# Cash Application

- Another top fraud risk was when checks were received by those with access to accounts receivable records.
- In this scenario, personnel can set up commercial enterprises with similar names, and deposit checks in bogus accounts while issuing credits as if the checks were deposited.

# Acctg Application Administrator

- Having accounting people who are also IT administrators is also a high fraud risk.
- Users may delete transactions, give access control to others, gain access to accounting systems outside their assigned responsibilities.

# Journal Entries

- Companies did not have a second person reviewing journal entries, particularly non-recurring journal entries.
- Fraudulent reporting is surfaced through general ledger overrides
- These are caused by incentives, pressures and rationalizations.
- All entries should be proofread.

# Audit Committee Overlooked

- Many audit committees of smaller public companies were not regularly informed about internal control matters, even though these committees have ultimate oversight responsibility.
- Without knowing the facts, these committees lose their corporate governance ability.

# Human Behavior

- Although ethics training was very high on the COSO list of requirements, in practical reality many smaller public companies have no communication or monitoring of ethical values throughout the organization through employee handbooks, codes of conduct, employee sign-offs or quizzes.



# Background Checks

- Many smaller public companies did not bother with background checks, opening themselves up to greater fraud potential and expensive lawsuits.

# No Fail Safe Mechanism

- Many smaller public companies had no whistleblower programs in place.
- One of the first lines of defense against fraud is giving managers and employees a safe method of reporting potential fraud.

# Credit and Debit Cards

- Inadequate follow-up and oversight of company credit cards
- Unlimited use of paypal accounts
- Debit cards

# Table of Authorities

- Board of directors did not define and communicate authorities retained at the board level and those delegated to management, such as by an approval matrix.
- Some transactions, investments or cash accounts were set up without Board approval.

# Lack of Board Participation

- Board of directors did not actively evaluate and monitor risk of management override of internal control and consider risks affecting the reliability of financial reporting?

# Lack of Board Participation

- Audit committee did not actively monitor the effectiveness of internal control over financial reporting and financial statement preparation?

# Lack of Board Participation

- Audit committee did not meet privately with the internal auditors to discuss relevant matters?



# Computer System Event Logs

- Lack of adequate access control over automated records, including controls over and review of computer systems event logs.

# Other Fraud Risks

- Management Incentives and Pressures

# Other Fraud Risks

- Accounting Opportunities

# Other Fraud Risks

- Attitudes/Rationalizations to Misstate Financial Statements and Reporting

# Importance of Ethical Values

- Accountability
- Communication and Respect
- Commitment to Customers
- Fairness and Integrity
- Human Relationship
- Innovation
- Stewardship

# Importance of Ethical Values

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2. Be sure to include your full name in the email
3. You will be asked to complete an Evaluation Form and a Survey Questionnaire

We will send you a

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## Questions

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