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Lord & Benoit Identifies Top Fraud Risks at Smaller Public Companies

Firm says "there are still major holes in the financial dike."

WORCESTER, Mass.--(BUSINESS WIRE)--Lord & Benoit, a Sarbanes-Oxley (SOX) research and consulting firm, is launching a public awareness campaign to alert CEOs, CFOs, CPAs, audit committees and stockholders to major fraud risks prevalent at smaller public companies. These fraud risks are based on recent in-depth analysis of first-year SOX filers in a variety of industries. The firm is hosting a free, concise one-hour webinar, "Public Primer on Fighting Fraud at Smaller Public Companies," on Thursday, April 2 at 2:00 p.m. EDT for journalists, investors, and business schools.

Gaping Hole in Accounting/IT

According to Bob Benoit, President and Director of SOX Research, the number one fraud risk is ability to sign checks and have access to accounting transactions. "This opens the door to ongoing, perpetual fraud without being caught," he says. For example, a bookkeeper who has the freedom to write checks to himself and cover it up in the bank reconciliation. A similar fraud risk is lack of segregation of duties with electronic fund transfers. "Our research team was amazed to discover," says Benoit, "that people who do not even have check-signing authority have EFT authority. EFT is an even quicker way to embezzle funds than checks."

Next on Lord & Benoit's list of top fraud risks is 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. "The opportunity for manipulation of data is blatant" warns Benoit. Another way to manipulate information is in the area of payroll. In many smaller public companies, payroll is not reviewed by anyone other than the person doing it. Such personnel can create fictitious employees, give themselves or others raises, and pay people after they've been terminated. Having an outside payroll service does not insulate companies from this fraud risk, because payroll services depend on information supplied by the company.

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

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 and wipe them out to cover their tracks. The risk for fraud is also high when companies do not have a second person reviewing journal entries. Many fraudulent reports have surfaced overrides of internal controls from incentives, pressures and rationalizations. And these are likely to increase in these economic times. All entries should be proofread.

Weak Audit Committee Awareness

Lord & Benoit's research team found that many audit committees of smaller public companies were not regularly informed about internal control matters, even though these committees have ultimate oversight responsibility. "Knowledge is power," Benoit says, "and without knowing the facts, these committees lose their corporate governance ability."

Ethical Ambiguity

Human behavior tends to rise to the established standards in the business culture. Although ethics training is 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. This lack of clarity of ethical values leaves room for ambiguity, which in turn can set the stage for fraudulent behavior.

In today's day and age, due diligence with potential employees is not a luxury but a necessity. Lord & Benoit found that many smaller public companies did not bother with background checks, opening themselves up to greater fraud potential and expensive lawsuits.

One of the first lines of defense against fraud is giving managers and employees a safe method of reporting potential fraud. And yet, Lord & Benoit discovered that many smaller public companies have no whistleblower programs in place. Smaller public companies with confusing, chaotic chains of command tend to be more vulnerable to fraud, according to Lord & Benoit's research. "There must be clear authorities who can approve financial actions," advises Benoit, "otherwise, company finances can become free-for-alls."

To register for the free webinar on April 2 at 2:00 p.m., please visit www.Section404.org.

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