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EACUBO Workshop


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With You Today

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 2
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Goals and Objectives


- Fraud's Impact on Organizations:
 - What happens?
 - Who does It?
 - Why did they do it?
 - What can you do about it?

 3
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Fraud Impact – What Happens


Fraud Headlines

- Iona College Fires 2 Employees After Discovering \$800,000 Fraud, [The Chronicle of Higher Education](#), Oct 10, 2010
- Palm Beach Atlantic University ex-president pleads guilty to fraud, money laundering, By Scott Travis, [Sun Sentinel](#), March 07, 2011
- Probe finds fraud, deception at for-profit colleges, [USA Today](#), Aug 4, 2010
- Wire fraud, money laundering at center of Hardin case (at the University of Central Arkansas), By David McCollum, [Thecabin.com](#), March 7, 2011

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New Economic Realities

- Revenues are down.
- Funding is down.
- Cost-cutting is required or has happened.
- Service delivery is at risk.
- Financial controls are at risk.

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ACFE 2010 Report to the Nation

Summary of Findings

- Survey participants estimated that the typical organization loses 5% of its annual revenue to fraud. Applied to the estimated 2009 Gross World Product, this figure translates to a potential total fraud loss of more than \$2.9 trillion.
- The median loss caused by the occupational fraud cases in our study was \$160,000. Nearly one-quarter of the frauds involved losses of at least \$1 million.
- The frauds lasted a median of 18 months before being detected.

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ACFE 2010 Report to the Nations

- The industries most commonly targeted were the banking/financial services, manufacturing and government/public administration sectors.
- Anti-fraud controls appear to help reduce the cost and duration of occupational fraud schemes. We looked at the effect of 15 common controls on the median loss and duration of the frauds. Victim organizations that had these controls in place had significantly lower losses and time-to-detection than organizations without the controls.

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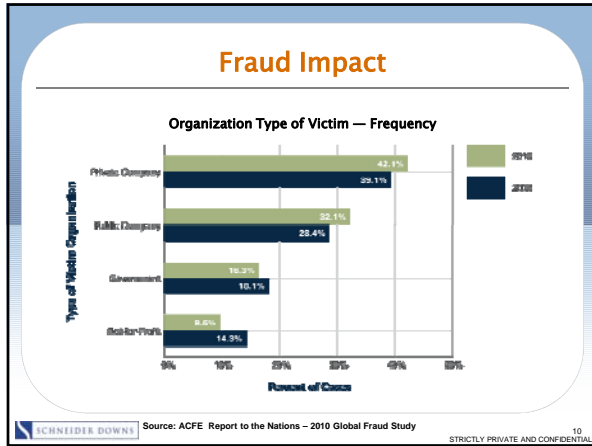
ACFE Study - Impact

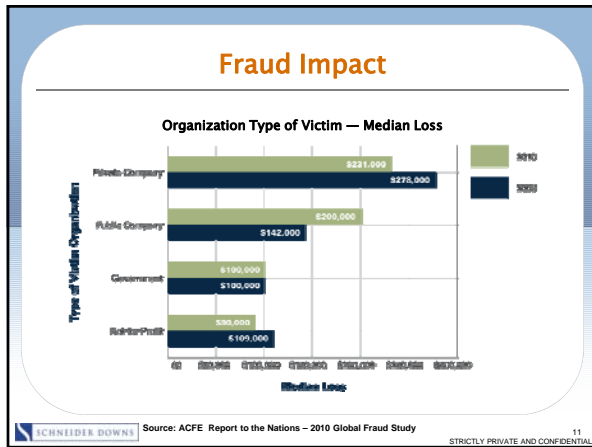


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Source: ACFE Report to the Nations - 2010 Global Fraud Study

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COSO Study – Fraud Impact

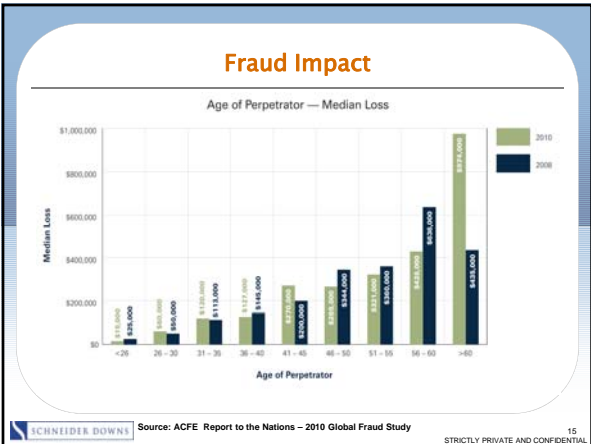
Table 9. Common Financial Statement Fraud Techniques

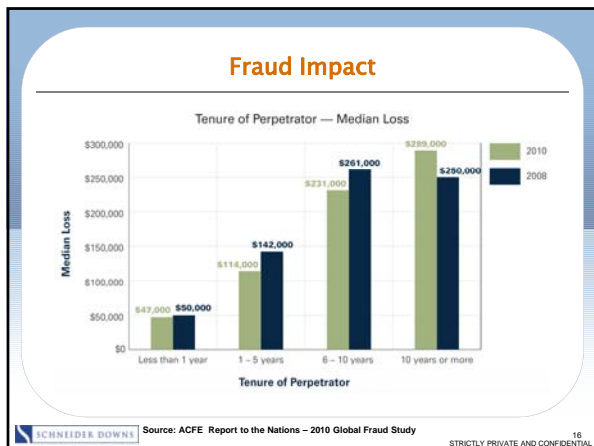
Methods Used to Misstate Financial Statements	Percentage of the 347 Fraud Companies Using Fraud Method *
Improper revenue recognition:	61%
Recording fictitious revenues - 48%	
Recording revenues prematurely - 35%	
No description/"overstated" - 2%	
Overstatement of assets (excluding accounts receivable overstatements due to revenue fraud):	51%
Overstating existing assets or capitalizing expenses - 46%	
Recording fictitious assets or assets not owned - 5%	
Understatement of expenses/liabilities	31%
Misappropriation of assets	14%
Inappropriate disclosure (with no financial statement line item effects)	7%
Other miscellaneous techniques (acquisitions, joint ventures, netting of amounts, etc.)	20%
Disguised through use of related party transactions	19%
Insider trading also cited	24%

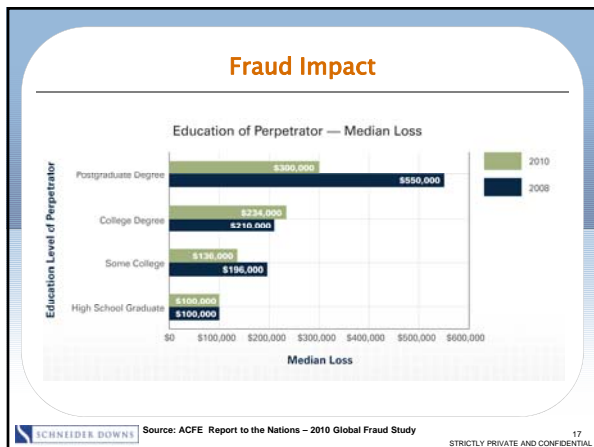
* The subcategories such as premature revenues or fictitious revenues and assets do not sum to the category totals due to multiple types of fraud employed at a single company. Also, because the financial statement frauds at the sample companies often involved more than one fraud technique, the sum of the percentages reported exceeds 100 percent.

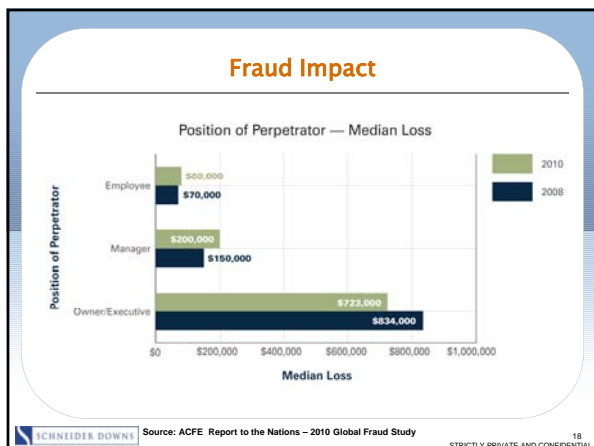


Who Does It?









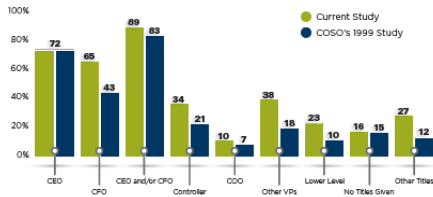
Perpetrators by Department

Number of Cases Based on Perpetrator's Department				Median Loss Based on Perpetrator's Department			
Department	# of Cases	Pct. of Cases	Median Loss	Department	# of Cases	Pct. of Cases	Median Loss
Accounting	231	28.9%	\$200,000	Legal	8	1.0%	\$1,100,000
Executive / Upper Management	142	17.8%	\$853,000	Executive / Upper Management	142	17.8%	\$853,000
Operations	129	16.1%	\$80,000	Purchasing	22	2.8%	\$600,000
Sales	93	11.6%	\$106,000	Research and Development	7	0.9%	\$542,000
Customer Service	49	6.1%	\$45,000	Human Resources	7	0.9%	\$325,000
Finance	31	3.9%	\$252,000	Finance	31	3.9%	\$252,000
Warehousing / Inventory	24	3.0%	\$100,000	Accounting	231	28.9%	\$200,000
Purchasing	22	2.8%	\$600,000	Sales	93	11.6%	\$106,000
Manufacturing and Production	19	2.4%	\$100,000	Warehousing / Inventory	24	3.0%	\$100,000
Information Technology	16	2.0%	\$93,000	Manufacturing and Production	19	2.4%	\$100,000
Marketing / Public Relations	8	1.0%	\$80,000	Information Technology	16	2.0%	\$93,000
Legal	8	1.0%	\$1,100,000	Board of Directors	8	1.0%	\$93,000
Board of Directors	8	1.0%	\$93,000	Internal Audit	6	0.8%	\$93,000
Human Resources	7	0.9%	\$325,000	Operations	129	16.1%	\$80,000
Research and Development	7	0.9%	\$542,000	Marketing / Public Relations	8	1.0%	\$80,000
Internal Audit	6	0.8%	\$93,000	Customer Service	49	6.1%	\$45,000

SCHNEIDER DOWNS Source: ACFE Report to the Nations – 2010 Global Fraud Study 19 STRICTLY PRIVATE AND CONFIDENTIAL

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Types and Frequencies of Individuals Named in AAERs

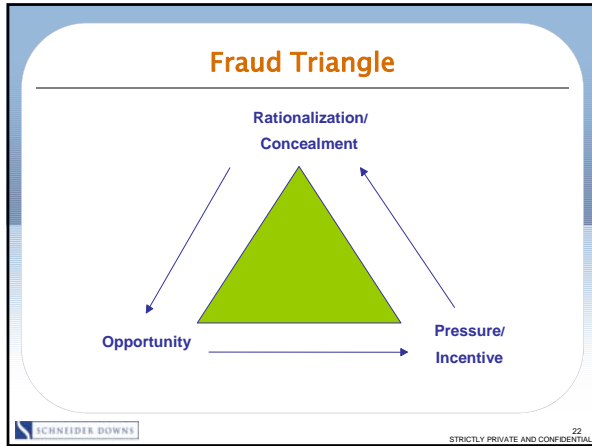


Note: In many cases the AAERs cited board members for their involvement in the fraud. The vast majority of these individuals appeared to be company managers serving on the board, including CEOs serving as Board Chair.

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Drivers of Fraud – Why It Happens



- ### Quantitative Red Flags
- Inadequate working capital / undercapitalized
 - Analyze:
 - Quick/Current Ratios
 - Aging Accounts Receivable
 - Related-Party Transactions
 - Compensation tied to financial goals
 - Example: CFO/upper management bonuses tied to financial performance
 - Incentive: Cook the books to make bonus
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- ### Quantitative Red Flags
- Disconnect between earnings and cash flow
 - Maximized lines of credit
 - Late financial statements or compliance reporting
 - Weak internal controls over hard and soft assets
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Qualitative Red Flags

- Failure to set the proper tone at the top
 - Entity viewed as personal asset/piggybank
- Financial control vested into too few individuals
 - Owner(s) not as informed as they should be
 - Failure to review
- Failure to communicate unacceptable behavior

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Qualitative Red Flags

- Failure to review separation of duties
- Failure to review favored relationships

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What Can You Do About it?

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Table 11. Board of Director Composition (Means)

	Full Sample				1991-1999 Sample				2001-2004 Sample			
	# of Firms	Fraud Sample	No-Fraud Sample	p-value	# of Firms	Fraud Sample	No-Fraud Sample	p-value	# of Firms	Fraud Sample	No-Fraud Sample	p-value
Number of board members	203	7.7	8.0	-0.3	113	7.4	7.8	-0.4	52	7.9	8.0	-0.1
Type of board member:												
Inside director	203	30%	25%	5% .010	113	32%	28%	4% .069	52	25%	23%	2%
Grey director	203	10%	12%	-2%	113	12%	13%	-1%	52	8%	11%	-3%
Outside director	203	60%	63%	-3%	113	56%	59%	-3%	52	67%	66%	1%
Type of grey director:												
Former company officer	63	45%	57%	-12%	41	38%	52%	-14%	13	62%	54%	8%
Relative of management	63	7%	8%	-1% .086	41	9%	27%	-12%	13	4%	15%	-11%
Consultant to company	63	25%	16%	9%	41	32%	14%	18% .054	13	8%	8%	0%
Outside legal counsel	63	15%	10%	5%	41	15%	10%	5%	13	19%	15%	4%
Interlocking director	63	4%	4%	0%	41	5%	6%	-1%	13	4%	0%	4%
Banker	63	0%	0%	0%	41	0%	0%	0%	13	0%	0%	0%
Non-bank creditor	63	0%	0%	0%	41	0%	0%	0%	13	0%	0%	0%
Officer of significant supplier or customer	63	2%	0%	2%	41	2%	0%	2%	13	4%	0%	4%

Note: A p-value that is less than 0.10 indicates that the difference between fraud and no-fraud firms was statistically significant (two-tailed).

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Table 13. Stock Ownership by Directors and Officers; Board Chair and CEO Traits (Means)

	Full Sample				1991-1999 Sample				2001-2004 Sample			
	# of Firms	Fraud Sample	No-Fraud Sample	p-value	# of Firms	Fraud Sample	No-Fraud Sample	p-value	# of Firms	Fraud Sample	No-Fraud Sample	p-value
Stock owned by directors and officers	196	23%	22%	1%	107	24%	23%	1%	52	18%	21%	-3%
Stock owned by the highest-ranking officer	196	9%	9%	0%	107	11%	10%	1%	52	7%	7%	0%
Stock owned by the largest holder among officers and directors	196	15%	13%	2%	107	17%	14%	3%	52	12%	13%	-1%
Type of board chair:												
Inside director	182	75%	70%	5%	99	80%	76%	4%	48	64%	56%	8%
Grey director	182	11%	19%	-8% .039	99	7%	16%	-9% .046	48	17%	25%	-8%
Outside director	182	14%	11%	3%	99	13%	8%	5%	48	19%	19%	0%
CEO age (in years)	203	50.7	51.4	-0.7	113	51.7	50.6	1.1	52	49.9	53.2	-3.3 .001
CEO tenure (in years)	203	9.4	10.2	-0.8	113	10.1	10.2	-0.1	52	8.5	11.1	-2.8 .098

Note: A p-value that is less than 0.10 indicates that the difference between fraud and no-fraud firms was statistically significant (two-tailed).

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Table 14. Other Full Board and Governance Characteristics (Means)

	Full Sample				1991-1999 Sample				2001-2004 Sample			
	# of Firms	Fraud Sample	No-Fraud Sample	p-value	# of Firms	Fraud Sample	No-Fraud Sample	p-value	# of Firms	Fraud Sample	No-Fraud Sample	p-value
Number of board meetings per year	183	7.7	6.6	1.1 .001	99	7.6	6.6	1.0	49	8.0	6.2	1.8 .005
Number of directors who left the board during the first fraud year	203	0.2	0.4	-0.2 .045	113	0.2	0.4	-0.2	52	0.4	0.3	0.1
Percentage of companies that had a director leave during the first fraud year	203	15%	25%	-10% .018	113	13%	23%	-10% .058	52	25%	25%	0%
Percentage of companies w/ an outside blockholder who was not a director	196	67%	74%	-7%	107	58%	75%	-17% .009	52	77%	77%	0%
Percentage of companies w/ an outside blockholder who was a director	196	23%	24%	-1%	107	21%	19%	2%	52	21%	29%	-8%
Percentage of companies disclosing existence of an internal audit function	203	32%	29%	3%	113	19%	19%	1%	52	50%	48%	2%


Note: A p-value that is less than 0.10 indicates that the difference between fraud and no-fraud firms was statistically significant (two-tailed).

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Table 15. Audit Committee Efficacy, Size, Independence, and Meeting Frequency (1991)

	Full Sample				1991-1999 Sample				2001-2004 Sample			
	N	Mean	SD	t-stat	N	Mean	SD	t-stat	N	Mean	SD	t-stat
Existence of an audit committee	203	98%	98%	-5.2068	93	92%	96%	-4%	52	98%	95%	-2%
Number of individuals on audit committee	889	3.7	3.2	-0.1	500	3.0	3.2	-0.2	93	3.4	3.4	0
Percentage of companies with an audit committee composed of at least 3 members	889	70%	79%	-9%	500	67%	76%	-10%	93	82%	82%	0%
Type of audit committee												
Board member	889	5%	2%	2%	500	8%	2%	3%	93	5%	2%	2%
Officer director	889	1%	1%	0%	500	1%	1%	0%	93	1%	1%	0%
Outside director	889	84%	87%	-3%	500	79%	82%	-3%	93	89%	92%	-3%
Percentage of companies with an audit committee consisting of no outside directors	889	8%	34%	-7%	500	10%	30%	-20%	93	10%	18%	-8%
Percentage of companies with an audit committee consisting entirely of outside directors	889	64%	67%	-3%	500	57%	56%	1%	93	76%	78%	-2%
Number of audit committee meetings per year	170	8.8	8.7	-0.2	89	2.8	2.9	-0.3	47	5.1	4.9	0.2
Percentage of companies with an audit committee that met at least five times per year	170	40%	51%	-6%	89	23%	37%	-14%	47	87%	85%	2%

Note: A p-value that is less than 0.10 indicates that the difference between fraud and no-fraud firms was statistically significant (two-tailed).



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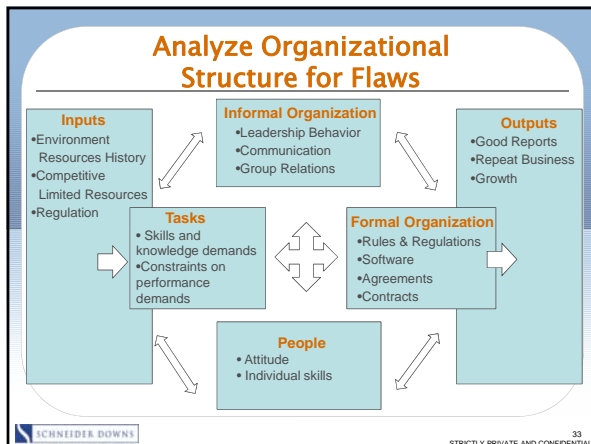
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Table 20. Related Party Transactions (Means)

	Full Sample				1991-1999 Sample				2001-2004 Sample			
	N	Mean	SD	t-stat	N	Mean	SD	t-stat	N	Mean	SD	t-stat
Percentage of companies with related party transactions disclosed in the proxy	203	79%	71%	8%	93	75%	70%	5%	52	87%	77%	10%
Percentage of disclosed related party transactions that involved the founder	117	26%	22%	4%	60	20%	27%	7%	35	14%	11%	3%
Percentage of disclosed related party transactions that involved the CEO	117	51%	54%	-3%	60	58%	53%	5%	35	33%	46%	-15%
Percentage of disclosed related party transactions that involved other senior officers	117	52%	50%	2%	60	47%	47%	0%	35	53%	51%	0%
Percentage of disclosed related party transactions that involved members of the board of directors	117	61%	66%	-5%	60	67%	67%	0%	35	51%	60%	-9%


Note: A p-value that is less than 0.10 indicates that the difference between fraud and no-fraud firms was statistically significant (two-tailed).


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The Winner's Manual for the Game of Life

"There is a culture of passiveness"


The Winner's Manual for the Game of Life
by Jim Tressel (on sale)

"There is a culture of passiveness"
E. Gordon Gee

The Columbus Dispatch, June 12, 2011,
"Terms of Tressel's Exit Nearly Finished"
