

Will SAS 99 make a difference?

- ✓ Evaluating how the entity responds to identified fraud risks
- ✓ More emphasis on professional skepticism
- ✓ **Discussions among engagement personnel (brainstorming)**
- ✓ **More inquiries of management and others within the entity**
- ✓ Reorganized and modified fraud risk factors
- ✓ Expanded fraud risk assessment approach
- ✓ Expanded guidance on revenue recognition as a likely risk
- ✓ Linkage between identified risks and the auditor's response
- ✓ Looking at the risk of management override of controls
- ✓ Technology focus (?)

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Let's ...

- ✓ Look at some fraud brainstorming concepts and techniques
- ✓ Look at some fraud inquiry concepts and techniques
- ✓ Apply these concepts and techniques in a fraud case study exercise

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**Fraud
Brainstorming**

Fraud Discussions Among
Engagement Personnel

- ✓ During audit planning
- ✓ Interactive exchange of ideas ... *brainstorming*
- ✓ Insights of more experienced team members
- ✓ How and where the financial statements might be susceptible to fraud within the framework
 - ✓ Motive
 - ✓ Opportunity
 - ✓ Rationalization
- ✓ Emphasize importance of proper state of mind (professional skepticism) during the audit
- ✓ Include the risk of management override of controls

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Fraud Discussions Among
Engagement Personnel

- ✓ Thoroughly probe the issues
- ✓ Consider audit responses to fraud susceptibility
- ✓ Summarize known fraud risks and control strengths and weaknesses
- ✓ Brainstorm ways that fraud might be committed by someone within the entity (by management or employees) or on the entity (by an outsider)
- ✓ Evaluate fraud schemes deemed viable or possible
- ✓ React by modifying planned audit tests to ascertain if fraud is occurring

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The purpose of brainstorming ...

...is to get as many ideas as possible from a group of people in the shortest possible time. Quantity and not quality is the order of the day. It does not matter if the ideas are thought to be unworkable, or crazy, or outlandish by anybody within the group. Sometimes these ideas are the very ones that are adapted into other forms that solve the problem adequately.

--<http://www.mindbloom.net/brain.html>

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The rules for effective brainstorming ...

- 1. There should be no criticism of any idea from any member of the group*
- 2. There should be no evaluation of the ideas generated*
- 3. The more ideas generated, the better*
- 4. Combination or modification of the ideas generated is encouraged*

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The documentation dilemma

- ✓ How much should we document?*
- ✓ Follow audit organization policies ...*
- ✓ Follow SAS 96, Audit Documentation ...*

“the auditor should document findings or issues that in his or her judgment are significant, actions taken to address them”

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Okay ...

Let's apply these skills and see if we can figure out who took what ... when ... why ... where ... and how ...

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***W. I. S. E.
A Case Study in
Fraud***

NOTE:

- ✓ The names of the organizations and characters in this case study have been changed, and are not the real names of the organizations and persons involved in the case from which this story was derived.
- ✓ Any similarity between the organizations, characters, and events depicted in this case study and organizations, persons, and events with which you may be familiar is entirely deliberate.

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NOTE:

- ✓ We will need 7 volunteers to assist in the presentation of this case study.
- ✓ Your assistance, if you volunteer, will not be difficult; it will not be embarrassing.
- ✓ It will be educational, challenging, and hopefully, fun.
- ✓ Trust me; you can count on me; I am an accountant.
- ✓ ***If you volunteer, you will receive the acclaim of your peers!***

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SEIAF Winter Meeting

February 2-4, 2005

Notes

Worldwide Institute for Situational Ethics, a not-for-profit organization

- Susan Purduper, Executive Director
- Robin Plundar, Chief Financial Officer
- Helen Weels, Programs Director
- Otto Krattic, Board Chair
- Salvatore Amander, IT Director
- Lewis Skannon, New Board Member
- Talia Watt, Receptionist

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Worldwide Institute for Situational Ethics, a not-for-profit organization

- ✓ As we learn a little bit about our ~~perpetrators~~ I mean volunteers, see if you can identify any fraud risk factors or vulnerabilities that might indicate a higher risk of fraud.
- ✓ **Fraud Risk Factor:** A characteristic that provides a **motivation** or **opportunity** for fraud to occur; a **rationalization** for fraud; or an **indicator** that fraud may have occurred

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Susan Purduper, Executive Director

- ✓ Sue has been WISE's executive director for 4 years.
- ✓ She was selected for the position by WISE's founder, Otto Krattic, who is now chairman of the board. Sue and Otto work well together and confer frequently about policy.
- ✓ During Sue's tenure
 - ✓ membership has risen over 220%
 - ✓ revenue from fundraising and grants is up over 350%
 - ✓ administrative costs have dropped from 20% to 8% of the annual budget
 - ✓ total staffing has increased by 150% while administrative staffing has only increased by 15%

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Susan Purduper, Executive Director

- ✓ Sue is responsible for all hiring and firing decisions including all purchasing and contracting; but she delegates most of what she considers “administrative minutia tasks.”
- ✓ Everyone—particularly the board of directors—agrees that Sue has done an outstanding job of meeting the organization’s mission goals and objectives.

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Robin Plundar, Chief Financial Officer

- ✓ Robin is a retired senior manager from a CPA firm, Hay, Wood, Jubusoff & Company.
- ✓ WISE’s executive director, Susan Purduper, hired Robin shortly after she joined WISE 4 years ago.
- ✓ When Robin started, the books and the accounting systems were a mess; he quickly brought order to what had been chaos.
- ✓ As WISE grew, Robin helped Sue manage the growth, and became a trusted and key advisor to her.
- ✓ Robin helped Sue keep administrative staff levels and costs low by expanding his duties as WISE grew. Robin does essentially all of the accounting work; and Sue delegated to him the authority to serve as WISE’s purchasing and contracting officer.

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Robin Plundar, Chief Financial Officer

- ✓ Robin works long hours during the week and on most weekends, he is always cheerful; a true team player.
- ✓ Robin has always been very satisfied with the modest annual pay increases Sue has recommended for him over the years.
- ✓ Everyone agrees that Robin does a terrific job; Sue always gives him a great deal of the credit for WISE’s success; Robin is very happy working for WISE and has, in fact, turned down offers to work for larger organizations for substantial pay increases

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Helen Weels, Programs Director

- ✓Helen Joined WISE three years ago, after the executive director, Susan Purduper, met her at a national conference put on by her then employer, the National Association of Association Conference Planners and Directors.
- ✓Helen immediately implemented a plan to increase WISE's conference attendance and publications sales.
- ✓Helen did an analysis that revealed that the country's two most popular conference locations are Las Vegas and Atlantic City. After she moved WISE's 4 major conferences to these locations, conference attendance increased by 30%, although on-site registration stayed about the same, even declining slightly.

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Helen Weels, Programs Director

- ✓Publication sales at conferences initially increased along with the increased attendance, but then leveled off and started declining slightly.
- ✓Helen even added two more conferences to WISE's annual schedule.
- ✓Helen's success in expanding WISE's conference programs has been recognized by both the board and the executive director.

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Otto Krattic, Board Chair

- ✓Otto is a former senior Federal executive and gained prominence for his groundbreaking work in advanced situational ethics applications.
- ✓Otto founded WISE eight years ago and initially served as both executive director and board chair.
- ✓Otto hired Susan Purduper as executive director 4 years ago so that he could spend more time speaking at conferences and consulting on political campaigns.

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Otto Krattic, Board Chair

✓Otto has semi-annual Board meetings at which the executive director and the programs director give updates on operational and programmatic activities and achievements, and the CFO gives updates on financial matters, primarily focusing on the annual budget and tracking actual-to-budget performance.

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Salvatore Amander, IT Director

✓Sal joined WISE three years ago. His previous job was as a senior IT manager for Hay, Wood, Jubusoff & Company, a CPA firm.

✓When Sal arrived, the WISE IT structure was a mess. Most of the organization’s computers were obsolete, the network was slow and inefficient, and WISE was not even using a broadband internet connection. WISE did not even have any sort of virus protection system; Sal found all of the entity’s PCs infected with multiple viruses.

✓Within the first six months, Sal upgraded all of WISE’s systems to state-of-the-art hardware and software, installed appropriate firewalls and virus protection, and arranged for a high-speed T-1 connection.

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Salvatore Amander, IT Director

✓Sal also implemented several linked databases that integrate accounting, fundraising, membership, and conference registration information.

✓Sal prepared a report that estimated that the cost savings from the more efficient systems more than offset the additional IT budget costs.

✓The executive director, Susan Purduper, has been very pleased with Sal’s work, and WISE has given Sal generous performance bonuses the past two years.

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Lewis Skannon, New Board Member

- ✓ Lew is considered to be a rising star in the field of situational ethics, having gotten his start working as campaign manager for Camelia Eon, who ran for the senate seat in New York (after Hillary resigned to run as Ralph Nader's vice presidential candidate in 2004).
- ✓ Lew met Otto Krattic, WISE's founder, at a conference where Lew had delivered a talk entitled "*If It Sounds Good, Say It!*"
- ✓ After Otto asked Lew to join the WISE board six months ago, Lew quickly immersed himself in WISE details.

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Lewis Skannon, New Board Member

- ✓ Lew has asked many questions about WISE operations:
 - ✓ Why are we spending so much on information technology?
 - ✓ Why is publications expense rising faster than publications revenue?
 - ✓ Why have on-site conference registrations decreased so drastically in the past two years?
 - ✓ Why can't the programs director or the IT director or the CFO give me straight answers to any of my questions?
 - ✓ Why doesn't the board meet monthly?
 - ✓ ... and so forth ...

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Lewis Skannon, New Board Member

- ✓ Otto, who was initially supportive, seemed to become impatient with Lew. At Lew's first board meeting three months ago, Otto said to Lew "Maybe you should take a few months to get to know the organization better." Everyone laughed.
- ✓ Susan, however, has been very patient with Lew's questions. At the board meeting, she directed staff to get answers to each of Lew's questions "immediately, if not sooner."

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Talia Watt, Receptionist

- ✓ Talia is outgoing, talkative, effervescent, and pleasant at all times.
- ✓ Callers and visitors often comment to the executive director, Susan Purduper, about Talia's cheery attitude, pleasant manner, and helpfulness.
- ✓ Talia was hired by the WISE founder, Otto Krattic, not long after WISE started.
- ✓ In addition to answering the phones and greeting visitors, Talia manages office supplies, and coordinates deliveries.
- ✓ Talia also opens and sorts the mail, including invoices from vendors. She also keeps a log of accounts payable and, when she mails out checks, she notes accounts as "paid."

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WISE Selected Financial Information

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Members	55,295	61,899	91,756	109,873	121,985
Dues Revenues	\$30,412,250	\$34,044,450	\$50,465,800	\$60,430,150	\$67,091,750
Program & Grant Revenue	239,075	256,098	635,987	724,589	843,575
Conferences Revenues					
Pre-registrations	7,208,734	7,307,543	8,102,355	8,765,419	9,359,887
On-site Registrations	764,097	865,322	871,098	880,981	859,031
Publications	2,543,009	2,759,080	2,657,087	2,875,018	2,810,876
Total Revenue	\$41,167,165	\$45,232,493	\$62,732,327	\$73,676,157	\$80,965,119

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WISE Selected Financial Information

Fundraising Costs	\$7,603,063	\$8,511,113	\$12,616,450	\$15,107,538	\$16,772,938
Program & Grant Expenses	255,810	266,342	648,707	731,835	818,268
Research Costs	17,713,312	20,104,208	31,699,722	40,799,324	46,588,278
Publications Costs	1,986,543	2,155,333	2,338,464	2,537,156	2,752,730
Conferences Costs	5,320,987	6,032,642	6,649,415	7,153,519	7,583,493
Administrative Costs					
Salaries	985,609	1,024,541	1,063,472	1,102,404	1,141,335
Expenses	6,848,948	6,246,310	6,733,733	5,167,589	4,137,348
IT Costs	398,876	870,998	985,321	1,097,623	1,198,526
Total Expenses	\$41,113,148	\$45,211,486	\$62,735,284	\$73,696,987	\$80,992,915
Surplus/(Deficit)	\$54,017	\$21,007	(\$2,957)	(\$20,830)	(\$27,796)

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Brainstorming to Find Fraud

- ✓ Divide into groups of 4-6 people
- ✓ Select a scribe
- ✓ Using the information you know about this case so far, brainstorming ways that fraud might be happening at WISE
- ✓ Following the rules for effective brainstorming
- ✓ Take 10 minutes
- ✓ Following the brainstorming session, use 10 minutes to decide on questions to ask our panelists. Each team is limited to asking only 5 questions, so select your questions and targets for those questions wisely (no pun intended)

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Fraud Discussions Among
Engagement Personnel

- ✓ Thoroughly probe the issues
- ✓ Consider audit responses to fraud susceptibility
- ✓ Summarize known fraud risks and control strengths and weaknesses
- ✓ **Brainstorm** ways that fraud might be committed by someone within the entity (by management or employees) or on the entity (by an outsider)
- ✓ **Evaluate** fraud schemes deemed viable or possible
- ✓ **React** by modifying planned audit tests to ascertain if fraud is occurring

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Fraud Inquiries

Case Study

The Case of the Perplexed Payroll Clerk

Note: This case is currently under an ongoing criminal investigation. The names of the entities and characters have been changed.

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Case Study The Perplexed Payroll Clerk

- ✓ The small town of Budgetary Gap, Florida, has a small accounting staff: a finance director and 4 clerks
- ✓ One clerk, Bud Tuggly, handles all utility transactions: billing utility users, tracking receivables, recording receipts, and making deposits
- ✓ When Bud needs to take some time off (which he rarely does), he asks the town's payroll clerk, Clara Fication, to just put the incoming payments in his desk drawer, so he can "reconcile these transactions" with his utility ledger book
- ✓ In reality,

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Case Study The Perplexed Payroll Clerk

- ✓ Bud has been systematically embezzling funds for several years. He has employed three schemes:
 1. He retypes large utility customer bills and adds a few hundred dollars to the bills. When the payments come in, he holds the check until there is enough cash in the town's cash drawer to cover the overage (he knows about auditor confirmations; so he never does this near yearend)
 2. He sometimes diverts an entire utility payment to his own pocket; records the bill as a zero amount in his records; and posts an adjusting journal entry to balance the customer account

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Case Study The Perplexed Payroll Clerk

3. He sometimes diverts an entire payment to his own pocket; records the bill as paid in his records; and covers the cash shortfall through a convoluted series of adjustments to other accounts

- ✓ So far, investigators have documented more than \$250,000 in misappropriated funds

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Case Study **The Perplexed Payroll Clerk**

Would SAS 99 have prevented/detected Bud's fraud?

- ✓ Evaluating how the entity responds to identified fraud risks
- ✓ More emphasis on professional skepticism
- ✓ Discussions among engagement personnel
- ✓ Expanded inquiries of management and others within the entity
- ✓ Reorganized and modified fraud risk factor examples
- ✓ Expanded fraud risk assessment approach
- ✓ Expanded guidance on revenue recognition as a likely risk
- ✓ Linkage between identified risks and the auditor's response
- ✓ Responses to address the risk of management override of controls

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Inquiries about fraud ...

- ✓ SAS 99 clearly envisions that auditors will develop and maintain some new skills
- ✓ We have always been good at "fact-finding" interviews
- ✓ SAS 99 requires "information-finding" interviews
- ✓ Ideally, "knowledge-finding" inquiries are what we need to be able to make

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Advanced Interviewing Skills

- ✓ Watch for non-verbal reactions
- ✓ Avoid binary questions (calling for 1-word—yes/no—answers)
- ✓ Use open-ended questions designed to get the subject talking freely
 - ✓ "Tell me about"
 - ✓ "What do you think about"
 - ✓ "Give me some suggestions about"
 - ✓ "If someone wanted to steal, how do you think they would do it ..."
 - ✓ "Tell me what else you think I should know"

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Good Interviewer Habits

- ✓ Take minimal notes
- ✓ Do not interrupt the interviewee
- ✓ *Ask open-ended questions (rather than short questions to which one-word answers can be given)*
- ✓ Follow a logical—usually chronological—question sequence

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The documentation dilemma

- ✓ *How much should we document?*
 - ✓ *Follow audit organization policies ...*
 - ✓ *Follow SAS 96, Audit Documentation ...*
- “the auditor should document findings or issues that in his or her judgment are significant, actions taken to address them”*

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Who Did It? (And What Did He or She Do?)

- Susan Purduper, Executive Director
- Robin Plundar, Chief Financial Officer
- Helen Weels, Programs Director
- Otto Krattic, Board Chair
- Salvatore Amander, IT Director
- Lewis Skannon, New Board Member
- Talia Watt, Receptionist

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In this case

- ✓The symptoms (fraud risk factors) were discernible via
 - ✓Careful analysis of internal control weaknesses
 - ✓Careful analytical review
- ✓Brainstorming—focused on these symptoms—should have lead to the potential fraud schemes
- ✓Careful inquiries should have narrowed the focus to our two suspects
- ✓Good audit work from there should have revealed evidence of the frauds

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INTERGOVERNMENTAL AUDIT FORUMS

SEIAF Winter Meeting, Orlando, Florida
February 2-4, 2005

Was It Fraud?
If So, Who Did It?

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