"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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Disclaimer

The literature contained herein is not intended to substitute authoritative literature published by the respective regulatory agencies. Professionals are advised to consult with legal and accounting authorities on all matters before implementing professional standards.

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Biographies and Introductions

Bob Benoit

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Access Code: 671-626-122 Webinar ID: 787-396-607

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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".

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"



- SME Capital Markets: SEC Guidance on Internal Controls over Financial Reporting (SOX 404)-
- 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

- AICPA Web Seminar: Virtual SOX

 CBI Research: 2nd Annual Pharmaceutical/Biotech Conference on Sarbanes-Oxley are

 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 James Pallas, Henrich

- 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)











www.COSO.ORG





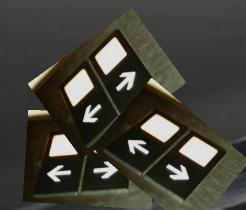
Guidance, Guidance and More Guidance

COSO

G050*****

SEC Guidance





PCAOB Guidance

PCAOB

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 <u>fraudulent</u> 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 checksigning 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

www.Section404.org



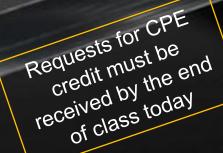
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- 2. Copies of Slides



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Questions

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