



**Texas Society of CPAs
Austin Chapter**

**Risk Management and
the Emerging
Profession:
Risks and Rewards**

**Presented by
Duncan Will
CPA/ABV/CFF, CFE**

CAMICO
INTERNAL TOWNSEND COMPANY

Sound Familiar?

The accompanying financial statements for the year ended December 31, 2008, have been prepared assuming that the Corporation will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Corporation's recurring losses from operations, stockholders' deficit, and inability to generate sufficient cash flow to meet its obligations and sustain its operations raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 2 to the consolidated financial statements and do not include any adjustments that might result from the outcome of this uncertainty.

The Current Climate

“It’s the economy, stupid!”

- Bankruptcies
- Unemployment
- Curtailed credit
- Broken supply chains
- Housing market

**The credit/liquidity crunch
permeates everything**

Economic Instability

- Federal fund rate hovering less than .20%
- 1-Year T-Bill rate hovering around .50%
- Jobless claims highest since 1982
 - April 2009 jobless rate reached 8.9%
 - 539,000 jobs lost in April
 - Median time out of work now 12.5 weeks
- Many home mortgages exceed homes’ worth
- 2.45% of corporate mortgages 30 days late
- Rocky market
- Recession began December 2007

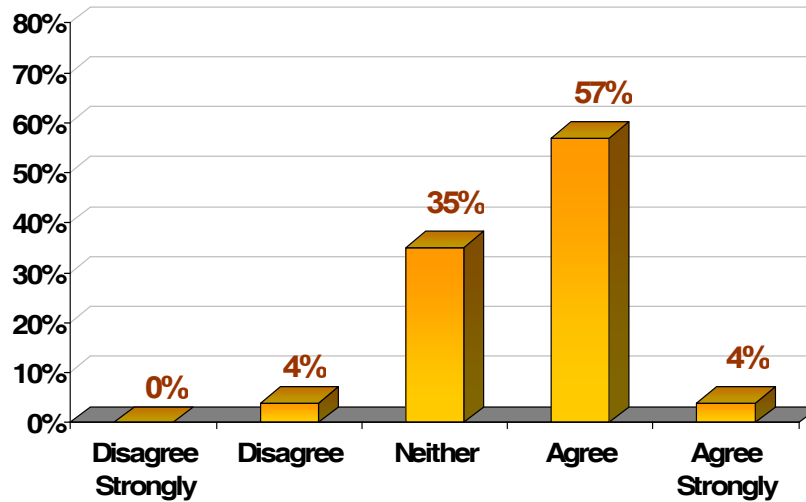
Juries and CPAs

Question

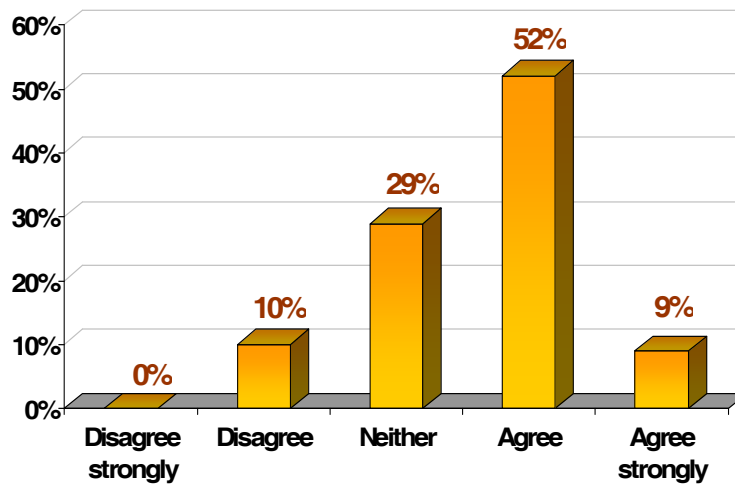
In a recent poll, how did a jury respond to the following statements ...?

- a. Agree Strongly
- b. Agree
- c. Neither
- d. Disagree
- e. Disagree Strongly

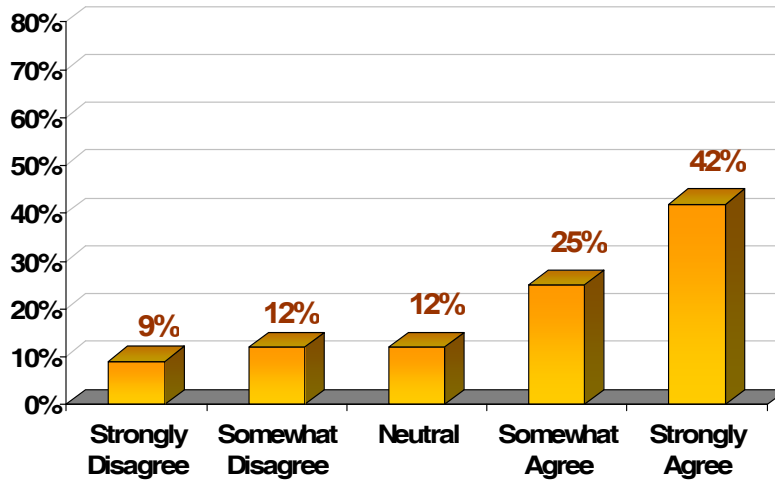
Accountants should be very conservative and should advise their clients to take only those tax deductions which are clearly justifiable



During an audit, auditors are responsible for digging well beneath the surface of financial statements to learn the truth about a company



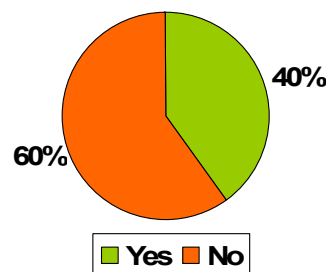
A professional accounting firm that does not catch a company's fraud should pay a severe penalty



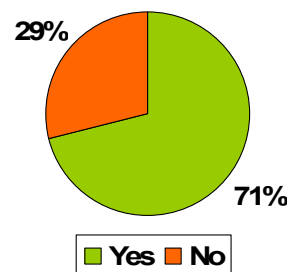
Survey Question

If an accountant is hired by a company to review financial statements, but not retained to do an audit, would you expect the accountant to uncover fraud?

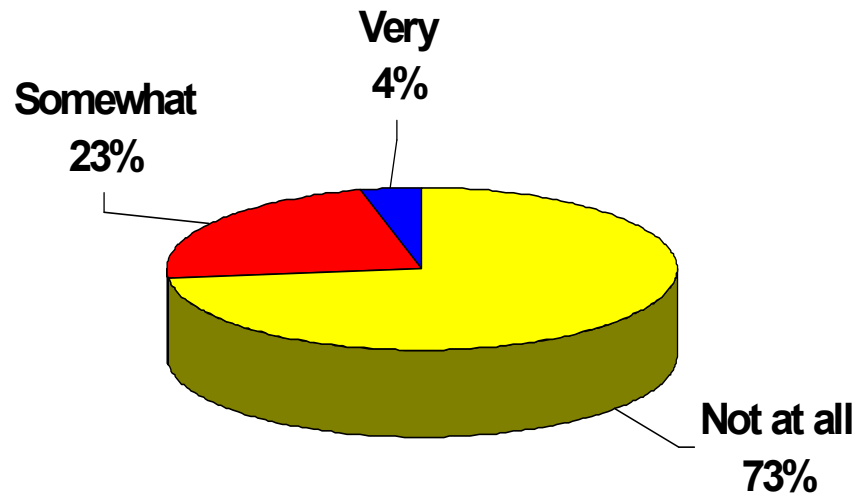
Pre-Enron



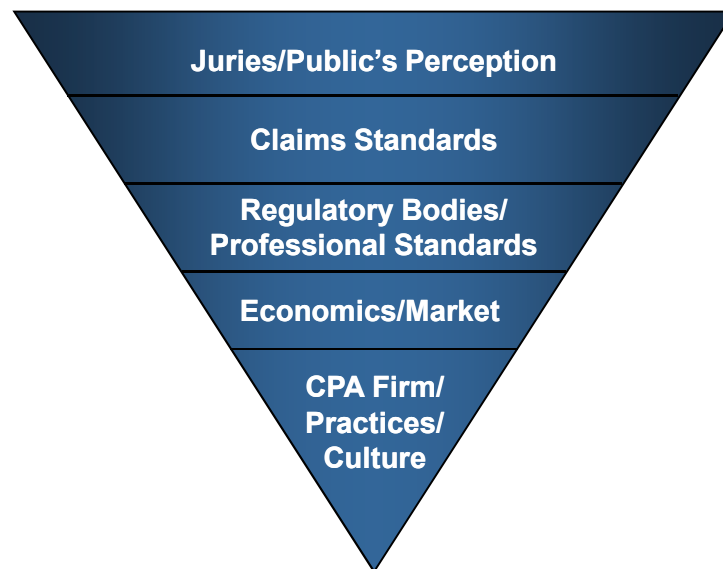
Post-Enron



How familiar are you with how an accountant audits a company?



The World We Live In...



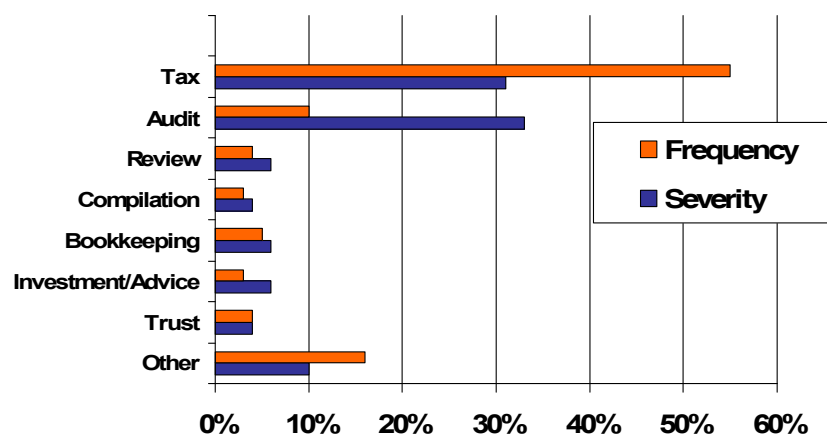
The World According to CAMICO

Average Claim Size

	<u>From Inception</u>	<u>Three-Year Avg.</u>
Audit	\$ 303,000	\$ 288,000
Review	\$ 184,000	\$ 208,000
Compilation	\$ 131,000	\$ 238,000
Investment Advice/PFP	\$ 182,000	\$ 197,000
Business Valuations	\$ 113,000	\$ 146,000
Trust	\$ 105,000	\$ 96,000
Bookkeeping	\$ 116,000	\$ 89,000
Tax	\$ 52,000	\$ 51,000
All Scopes of Practice	\$ 95,000	\$ 96,000

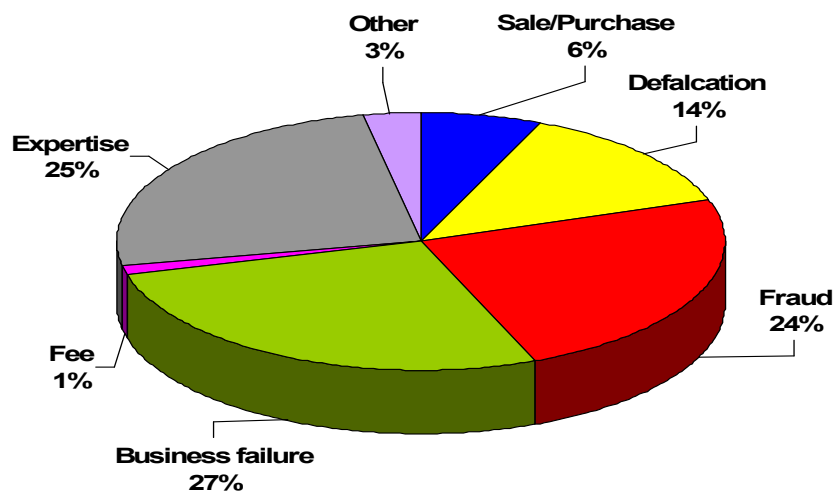
Frequency vs. Severity

All Claims by Scope from Inception



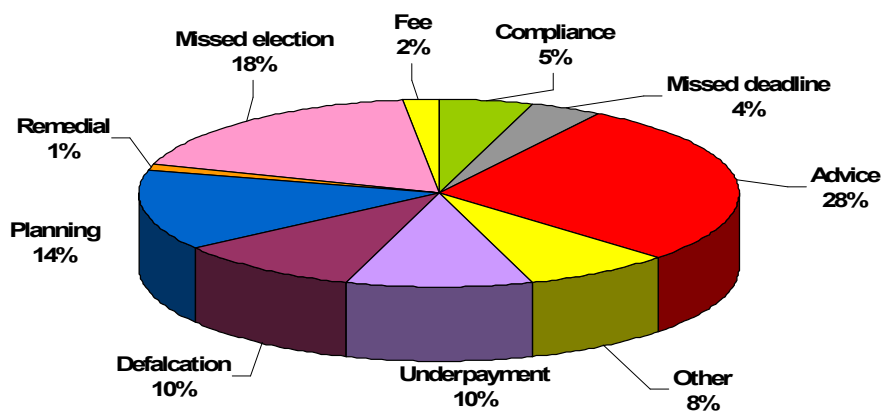
Audit Claims

3-Year Average



Tax Claims

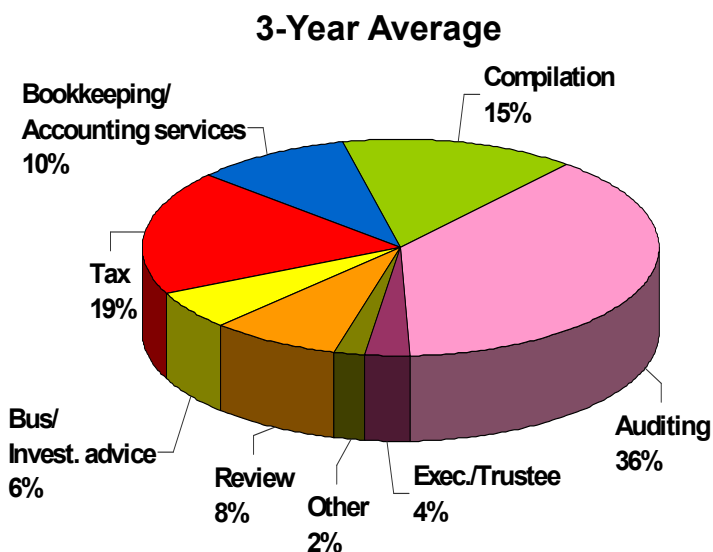
3-Year Average



High-Risk Tax Areas

- Estate tax
- International tax
- Multi-state returns

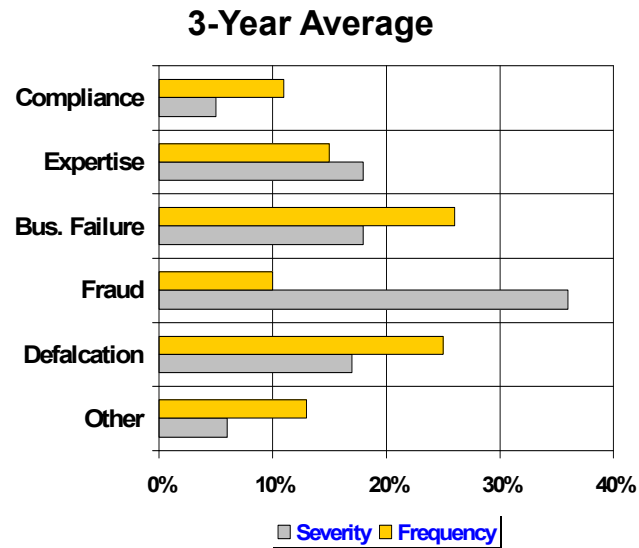
Fraud Claims by Engagement



Some **Unpleasant** Facts About Fraud

- Most frauds don't involve audits
- When fraud is involved, lawsuits follow
- A lot of emotion involved
- Creates perception that the CPA is a crook
- Often guilt by association
- Reputations are damaged
- Fraud lawsuits often go to trial

What Causes the Big Claims? Significant Claims (Over \$150,000) by Error

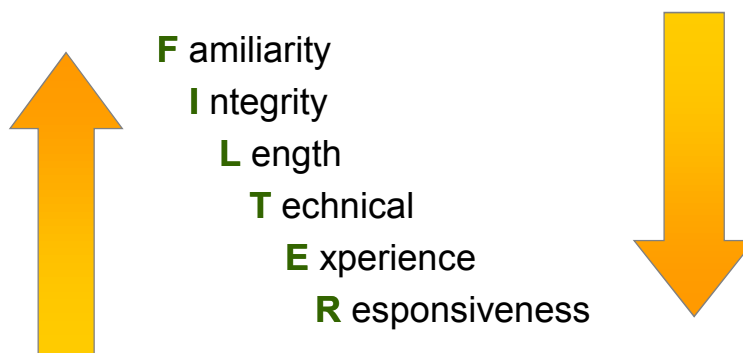


Loss Prevention Tips and Techniques

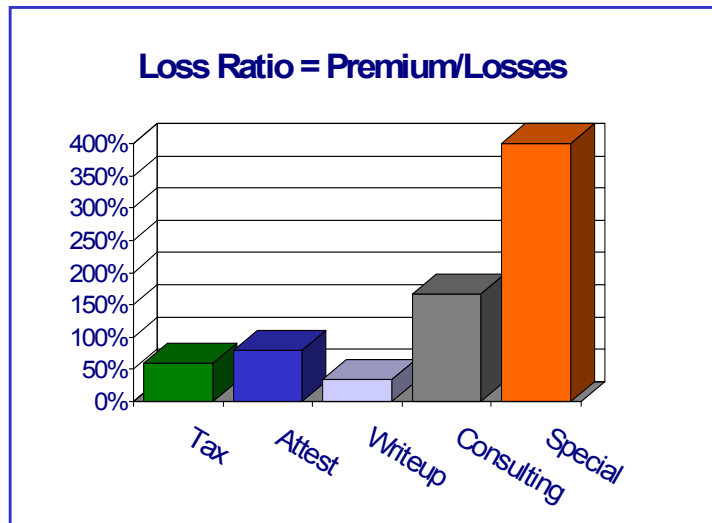
Top Six Reasons CPAs Say They Won't Be Sued

- I only do tax work
- My clients are friends
- I've known my clients for years
- Everyone in my firm has national accounting firm experience
- I don't make mistakes
- I've never been sued before

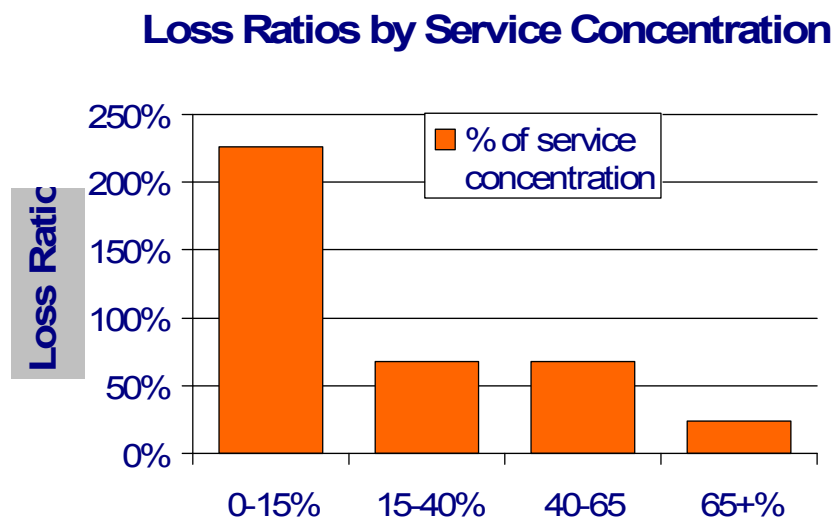
LP Filter → Risk Impact



New Services = Extra Risk



Risk Is High for Beginners!



Engagement Letters

Engagement Letters Should ...

- Be customized
- Be in “plain English”
- Be separate letters for each service
- Specify the SCOPE and LIMITS
- Indicate client assistance expectations
- Indicate your record retention policy
- Include a stop work clause
- Include binding arbitration language for fee disputes
- Clearly indicate billing terms
- Consider retainers
- SAS 114 dates
- Consider privacy statement and outsourcing
- Implement SSARS 17 now

Engagement Letter Pitfalls

- Marketing information
- Evergreen letters
- Unilateral letters
- All-encompassing language
- Unsigned engagement letters
- Interest charges

Disengaging

Disengagement Hot Areas

- Timing of disengagement
- Opportunity cost of relationship
- Clients' changing needs
- Clients' failing environment



Items to Address When Disengaging

- **Disengage in writing**
- Communicate verbally first
- State the last day of service
- Work status
- Pending due dates
- Account balance status
- Encourage retaining new CPA ASAP
- Cooperation with successor
- Disposition of all client records
- **Keep letter professional, not emotional!**

“Drop Dead” Letter

- Detail factors necessitating letter
- Indicate consequences of non-responsiveness
- Typical requirements:
 - Responsiveness
 - Payment in full
 - Retainer

Non-Engagement

Non-Engagement Letter

- Thank clients for their interest
- Indicate CPA firm was never engaged
- Indicate CPA firm has not agreed to provide services
- Discussions were never finalized and should NOT be relied upon

Documentation

- Follow up oral advice with written documentation
- Indicate the limitations of oral tax advice
- Be factual
- Avoid subjective comments
- Document ASAP
- Document advice not taken
- Use tax organizers

Client Records and Third Parties

- Responding is optional
- Consider:
 - Why documents are being requested
 - Risks of complying
 - Client relationship
- Client consent
- Redact SSN/EIN

**The World According to
Certified Fraud
Examiners**

Fraud Is a BIG Problem

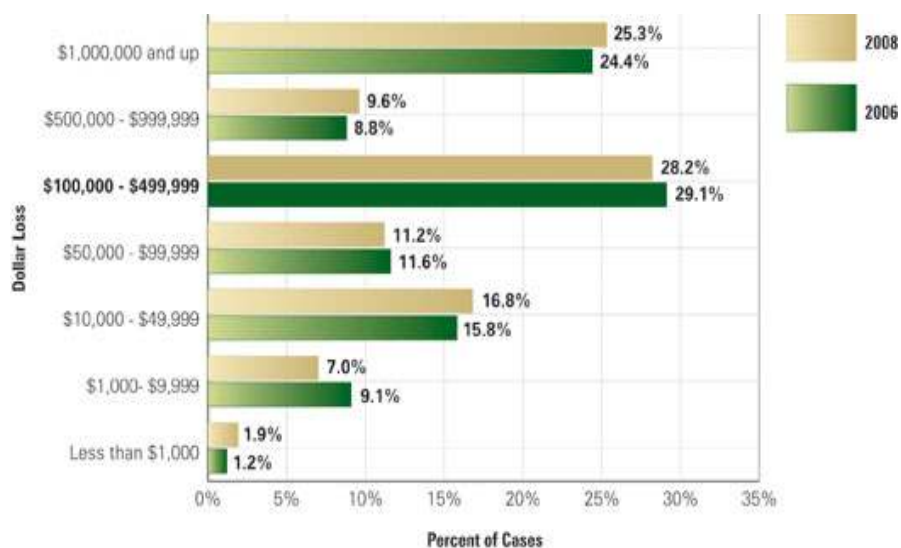
Fraud is increasing
U.S. organizations lose
7% of their annual
revenue to fraud.

\$994 BILLION!



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Distribution of Dollar Loss



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Fraud Affects All **TYPES** of Organizations

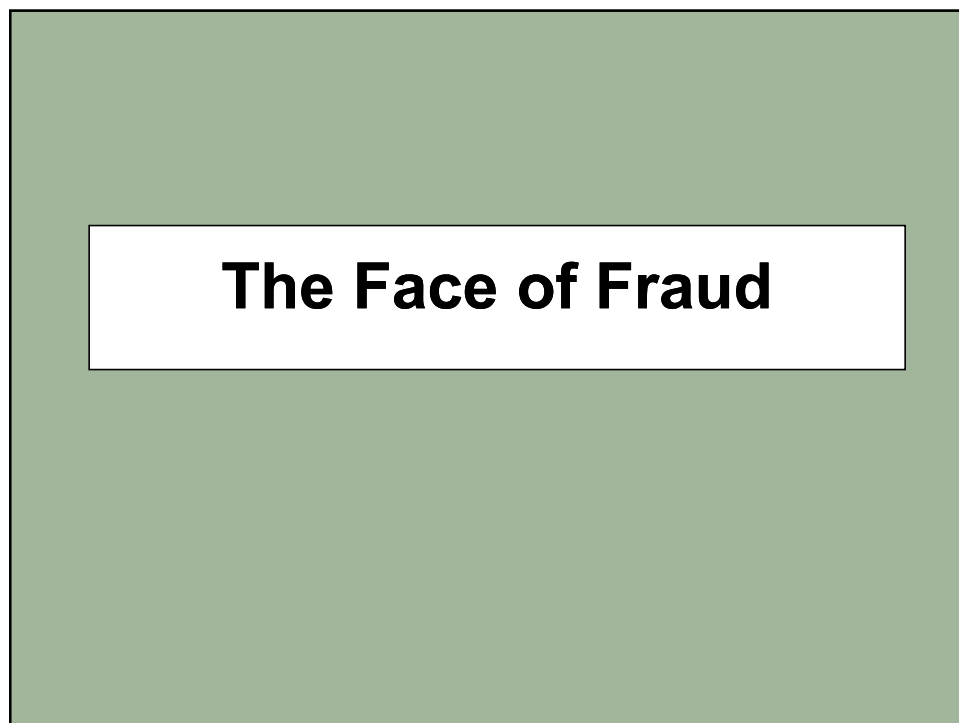
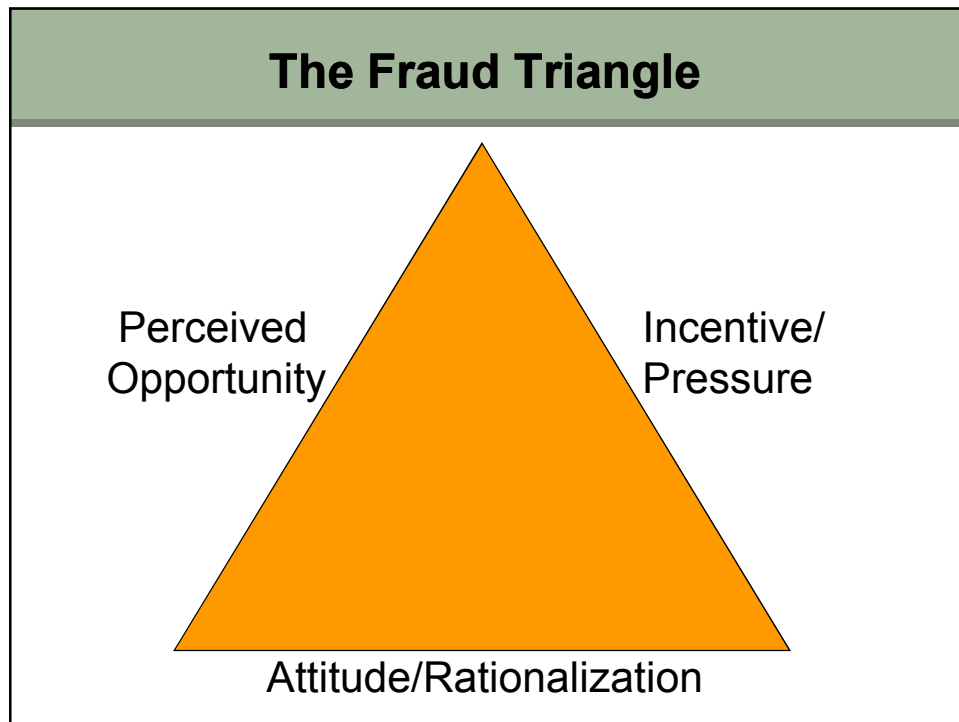
<i>Organization</i>	<i>Size of Loss</i> 2008 2006	<i>Distribution</i> 2008 2006
Private Company	\$278,000 \$210,000	39.1% 36.8%
Public Company	\$142,000 \$200,000	28.4% 31.7%
Government	\$100,000 \$100,000	18.1% 17.6%
Not-for-Profit	\$109,000 \$100,000	14.3% 13.9%

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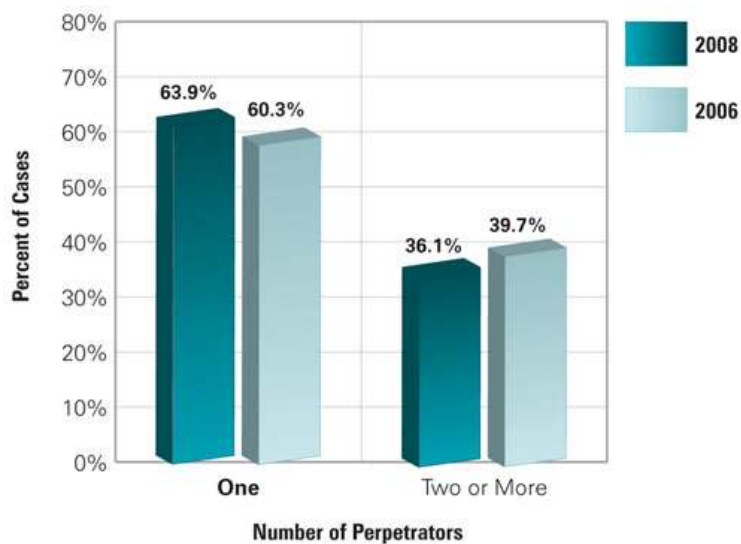
Fraud Affects All **SIZES** of Organizations

# of Employees	Median Loss 2008	Median Loss 2006
< 100	\$200,000	\$190,000
100 to 199	\$176,000	\$179,000
1,000 to 9,999	\$116,000	\$120,000
10,000 +	\$147,000	\$150,000

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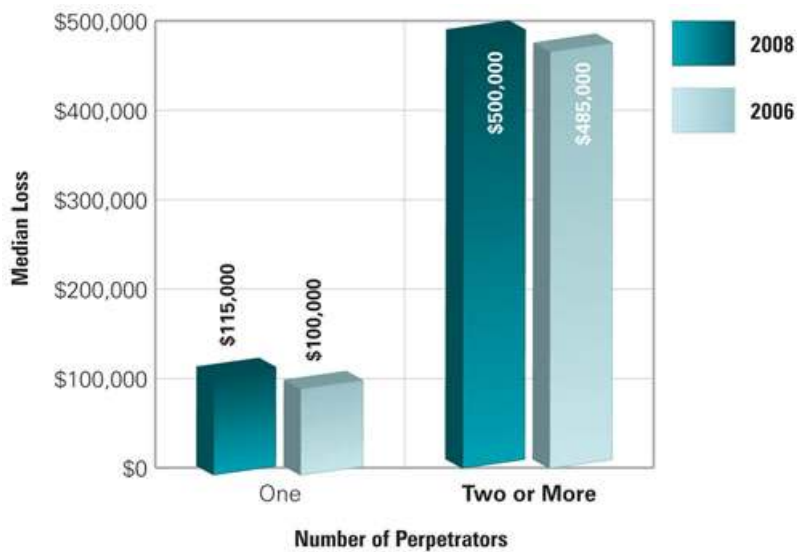


Number of Perpetrators



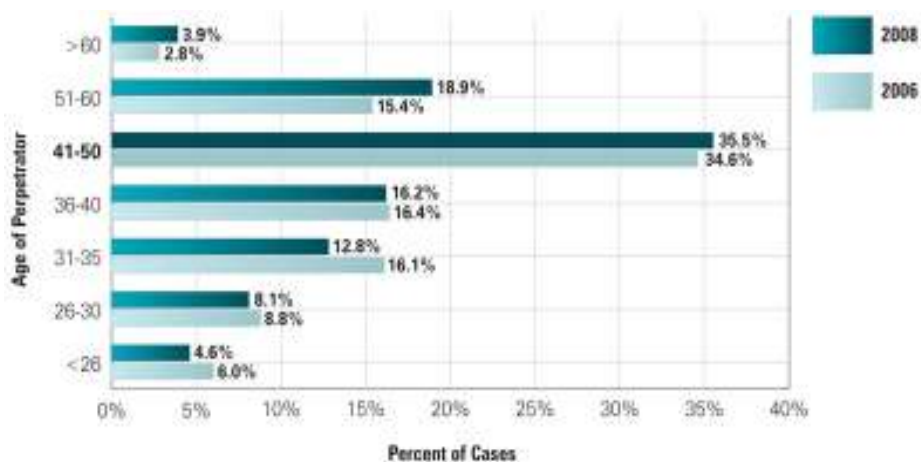
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Number of Perpetrators — Median Loss



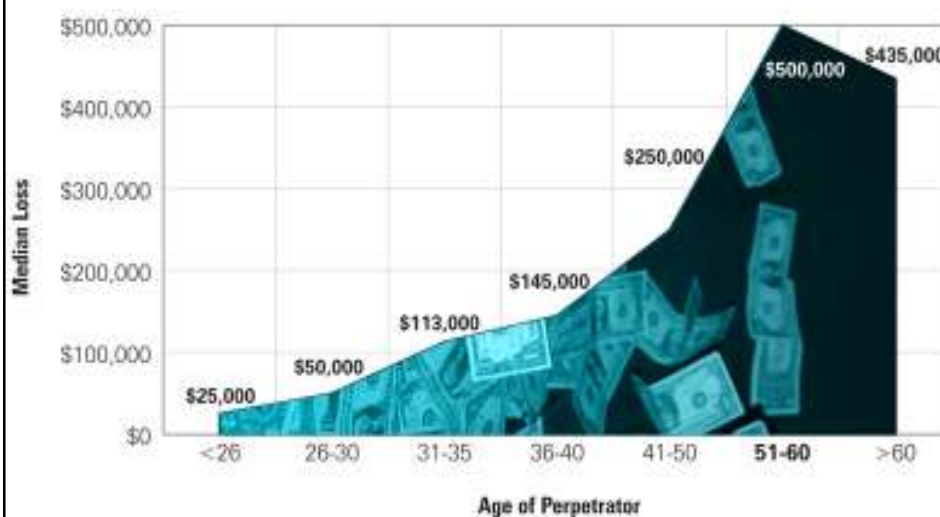
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Age of Perpetrators



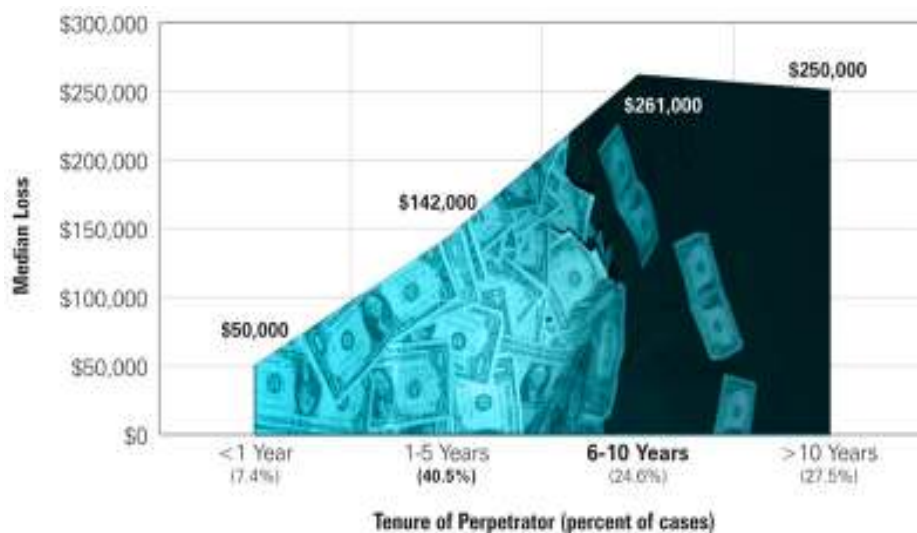
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Age of Perpetrator — Median Loss



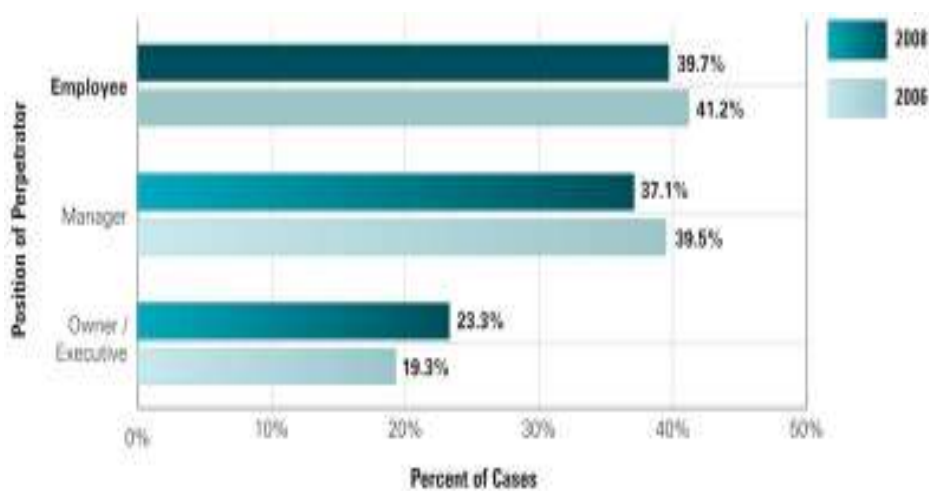
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“Newbie” vs. “Veteran”



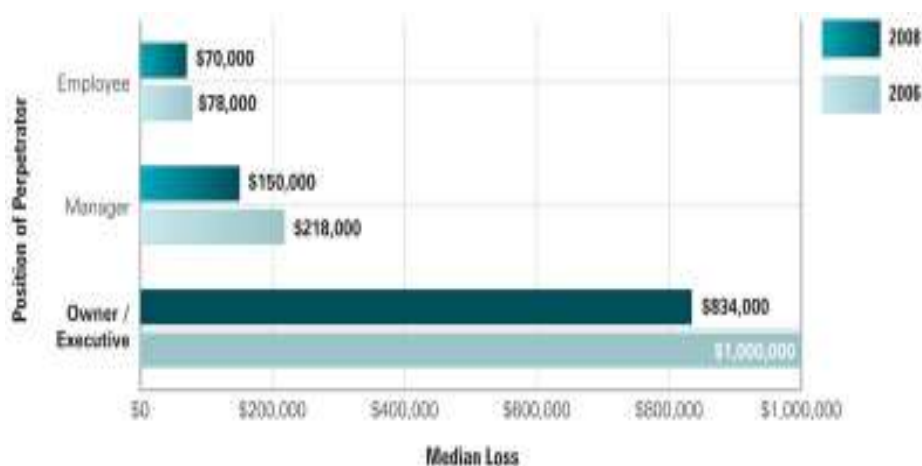
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Employee vs. Manager vs. Owner — Frequency



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Employee vs. Manager vs. Owner — Median Loss



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Duration to Detection

Position	Median # of Months to Detection
Employee	12
Manager/Supervisor	24
Owner/Executive/Officer	24

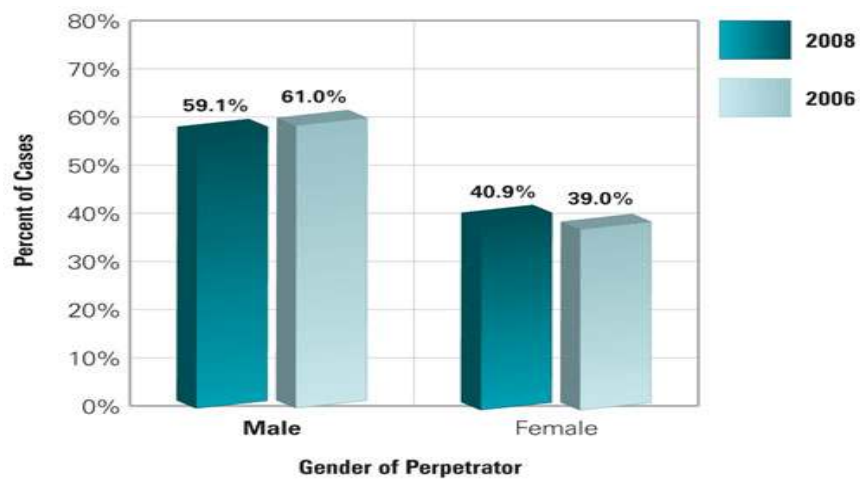
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Median Loss Based on Perpetrator's Annual Income



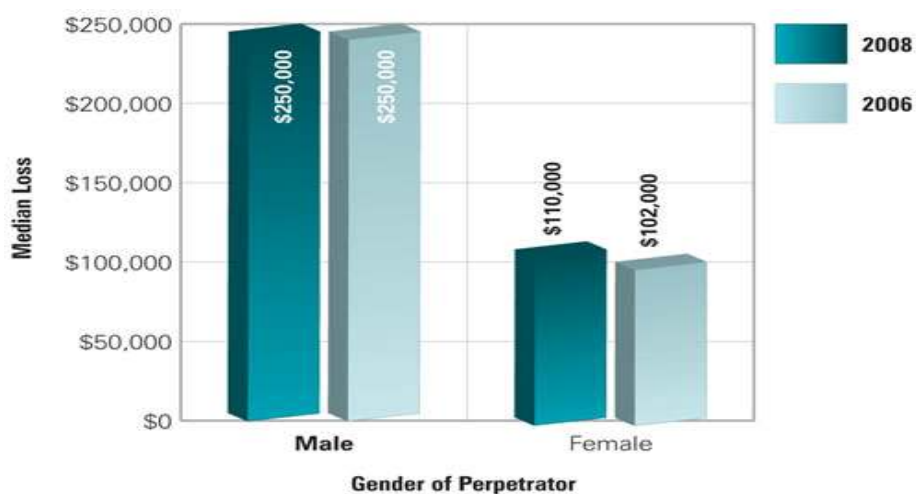
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Gender of Perpetrator — Frequency



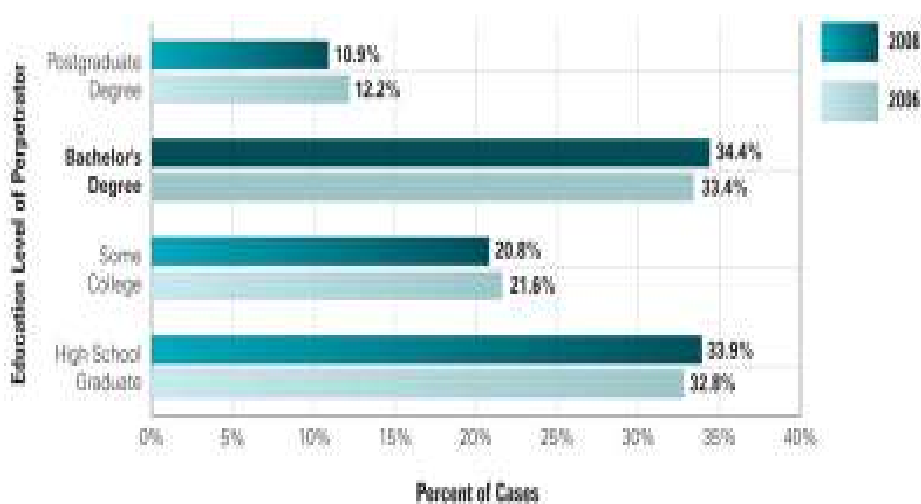
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Gender of Perpetrator — Median Loss



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How Educated Are Fraudsters?



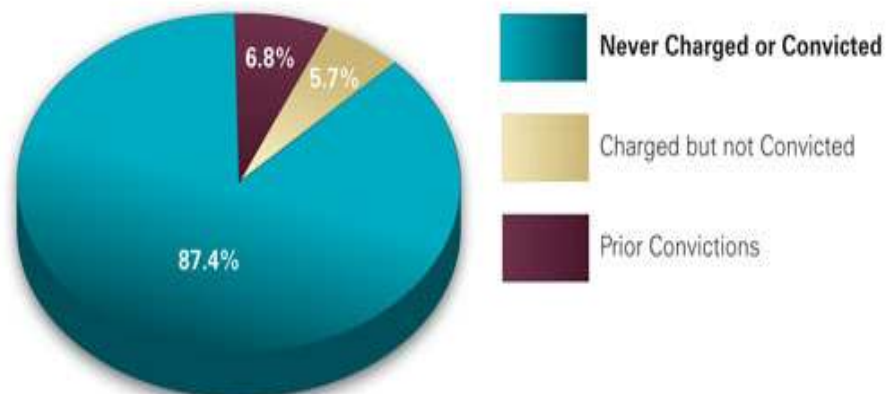
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“Scholastic Fraud Aptitude Test” — Median Loss



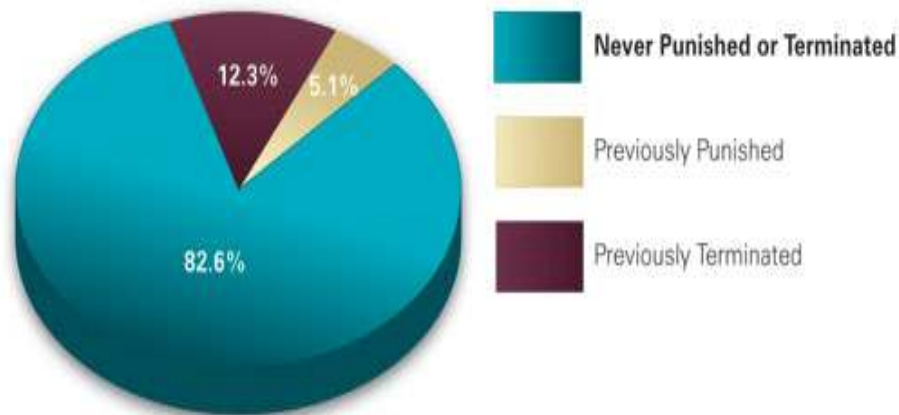
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Prior Convictions?



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Previously Punished or Terminated?

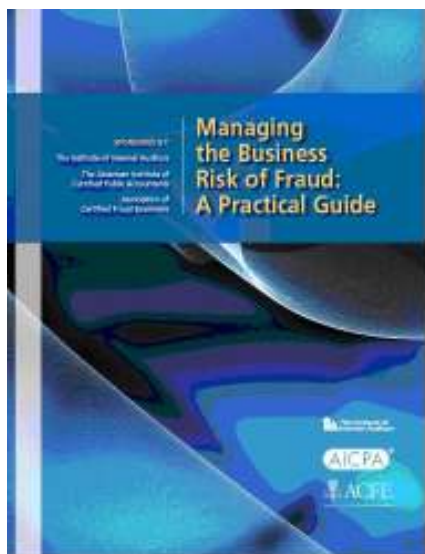


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So... A Typical Fraudster:

- Is male
- Has a college degree
- Has worked for the company a long time
- Is in management
- Is well paid
- Has never been charged

Principles of Managing Fraud Risk



- Fraud risk governance
- Assess fraud risk
- Fraud prevention techniques
- Fraud detection techniques
- Fraud investigation, reporting and corrective action

ACFE Fraud Risk Assessment Tool

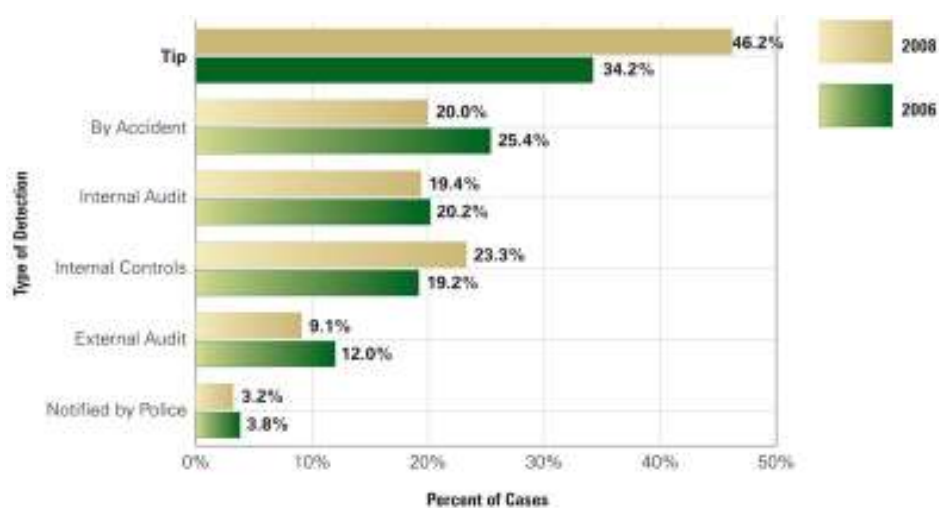
Module	Description	Questions
1	Employee Assessment	34
2	Management/Key Employee Assessment	41
3	Physical Controls to Deter Employee Theft and Fraud	12
4	Skimming Schemes	28
5	Cash Larceny Schemes	21
6	Check Tampering Schemes	22
7	Cash Register Schemes	20
8	Purchasing and Billing Schemes	24
9	Payroll Schemes	21
10	Expense Schemes	7
11	Theft of Inventory and Equipment	33
12	Theft of Proprietary Information	12
13	Corruption	13
14	Conflicts of Interest	6
15	Fraudulent Financial Reports	32

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Simple “Segregation of Duties”

- Send bank statement to external address
- Separate custody from recording functions
- Separate authorizing from recording functions
- Review cancelled checks
- Approve reconciliations
- Account for numerical sequence
- Approve vendors

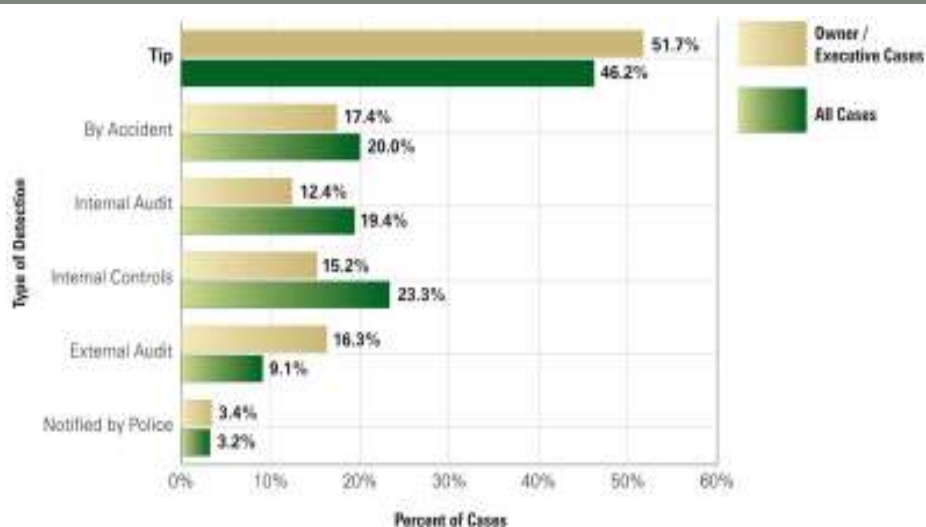
Initial Detection of Occupational Frauds All Entities



The sum of percentages in this chart exceeds 100 percent because in some cases respondents identified more than one detection method.

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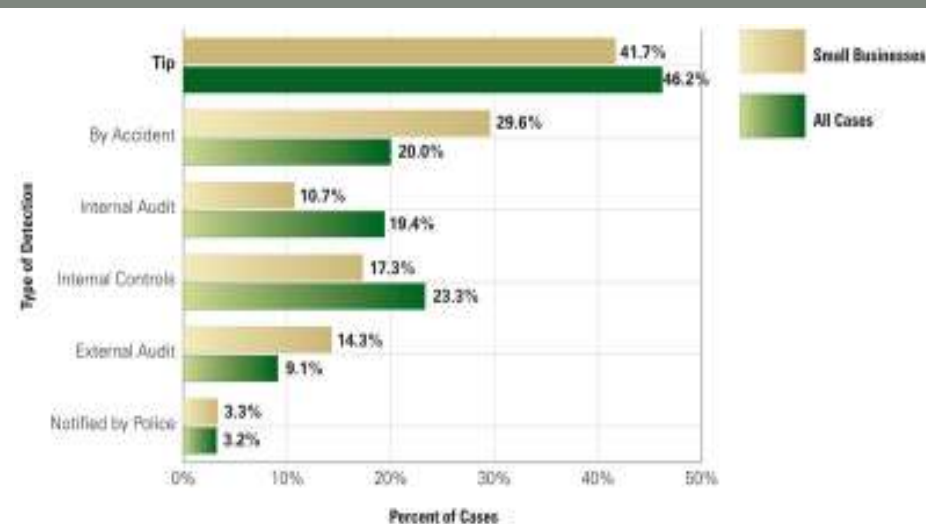
Initial Detection of Occupational Frauds by Owners/Executives



The sum of percentages in this chart exceeds 100 percent because in some cases respondents identified more than one detection method.

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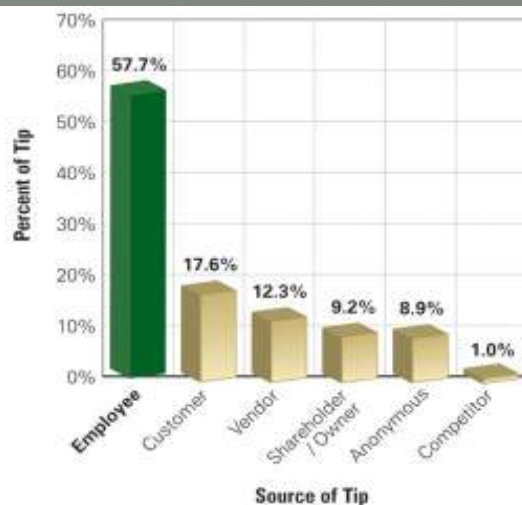
Initial Detection Method of Frauds in Small Businesses



The sum of percentages in this chart exceeds 100 percent because in some cases respondents identified more than one detection method.

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Percent of Tips by Source



The sum of percentages in this chart exceeds 100 percent because in some cases respondents identified more than one source of the initial tip.

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Hotlines Are Effective

	Frequency	Median Loss	Months to Detect
Hotline	20.6%	\$115,000	12 Months
No Hotline	79.4%	\$350,000	24 Months

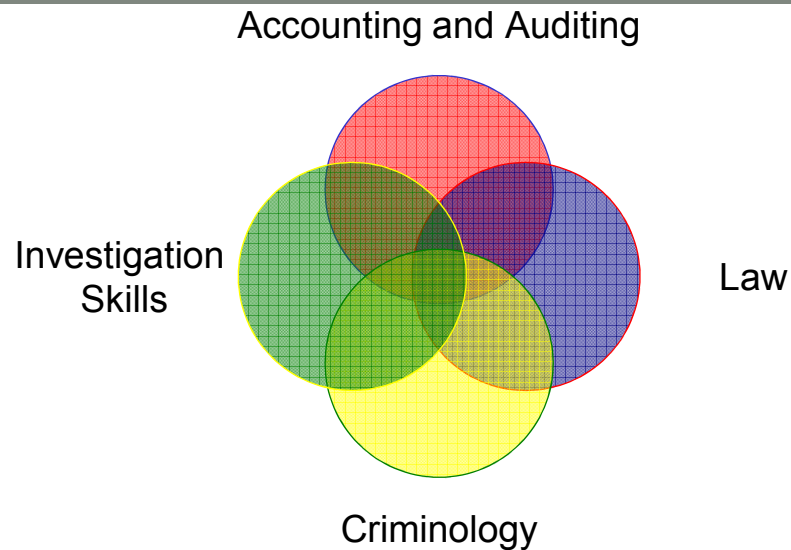
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Forensic Examinations, aka Fraud Examinations

Forensic Exam v. Audit: What's the Difference?

Traditional Audit	Forensic Investigation
Expression of an opinion	Resolve an issue
GAAS	SSCS
Audit program	No program
Materiality	Materiality not as important
Sampling	Detailed analysis
Expensive	Very expensive

Forensic Accountant Skill Set



Ethics and Fraud

Ethics is the best defense against fraud

- Embrace an ethical culture
- Seek ethical clients

Fraud is a crime

- Report it to law enforcement
- Reporting may save the next victim

Which Would You Recommend?



What's Coming?

The Playing Field Is Changing

- FASB Codification (<http://asc.fasb.org/home>)
- International Convergence (ifrs.com)
- AICPA's Economic Resource Crisis Center (aicpa.org/economy)
- Reliability Framework — New Exposure Drafts (aicpa.org/download/auditstd/ED_Reliability_SSARS.pdf)

Final Comments

Best Practices

- Don't dabble
- Don't ask "can I?" → ask "should I?"
- Ask "what can go wrong?"
- Communicate with predecessor
- Document
- Engagement letters should clearly define the scope and limits
- Obtain clients' consent
- Stay on the side of the angels
- Get it right!

Practical Loss Prevention Tips

- Warn of embezzlement risk
- Offer internal control assistance
- Offer two-tiered bank reconciliation services
- Recognize potential independence and objectivity impairment
- Require vacations
- Job/task rotation
- Emphasize and reward
 - Ethics
 - Loss prevention
 - Skepticism
 - Education

Remember...

- CPAs are held to high standards
- CPAs should be conservative
- CPAs should be experts at documentation
- CPAs are expected to **uncover fraud** (regardless of scope of service!)

BE CAREFUL OUT THERE!

Thank You