

# **INTERNAL CONTROLS IN THE REAL WORLD**

The Good, The Bad and the Scary

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Superior Accounting Conference 2017

# WHO I AM

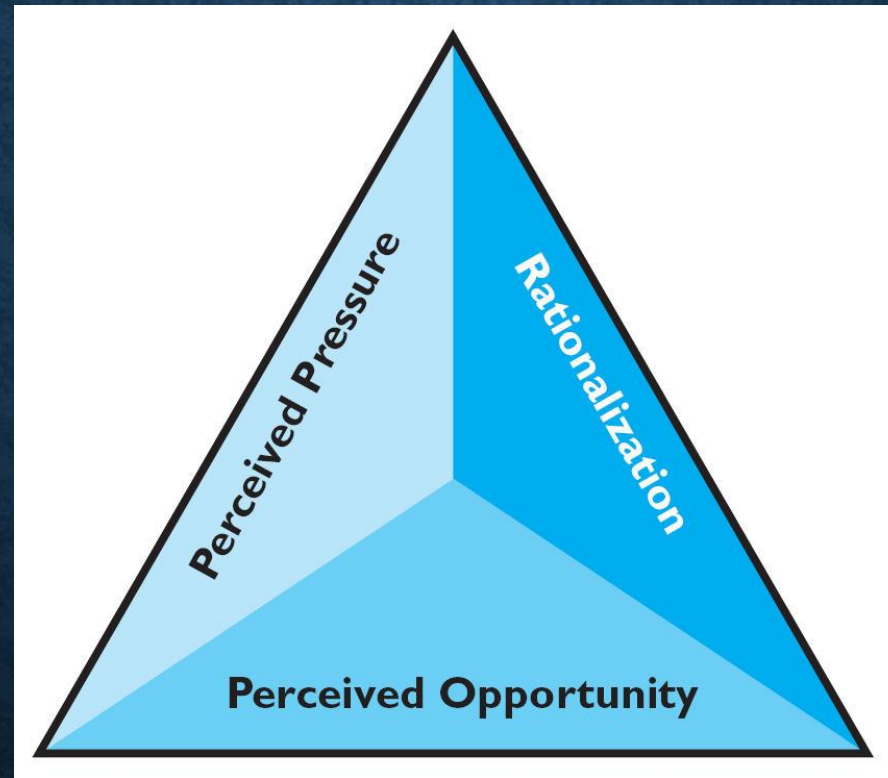
- My Background—
  - Corporate positions as Accounting Department Manager, Controller, CFO
  - Health Care Executive in Insurance and in Physician Practice Management
  - Academic Department Administrator in Medical School (MSU-CHM)
  - Small Business Owner – Retail Flooring and Franchise
  - Fraud Examiner and College Professor



# WHAT WE WILL DISCUSS TODAY

- Creating the culture of honesty and openness
- Eliminating the opportunities for fraud
- What organization (structure) helps to minimize asset misappropriations
- Proactive? Must be!!
- Involve the entire organization in the prevention of fraud

# FRAUD TRIANGLE





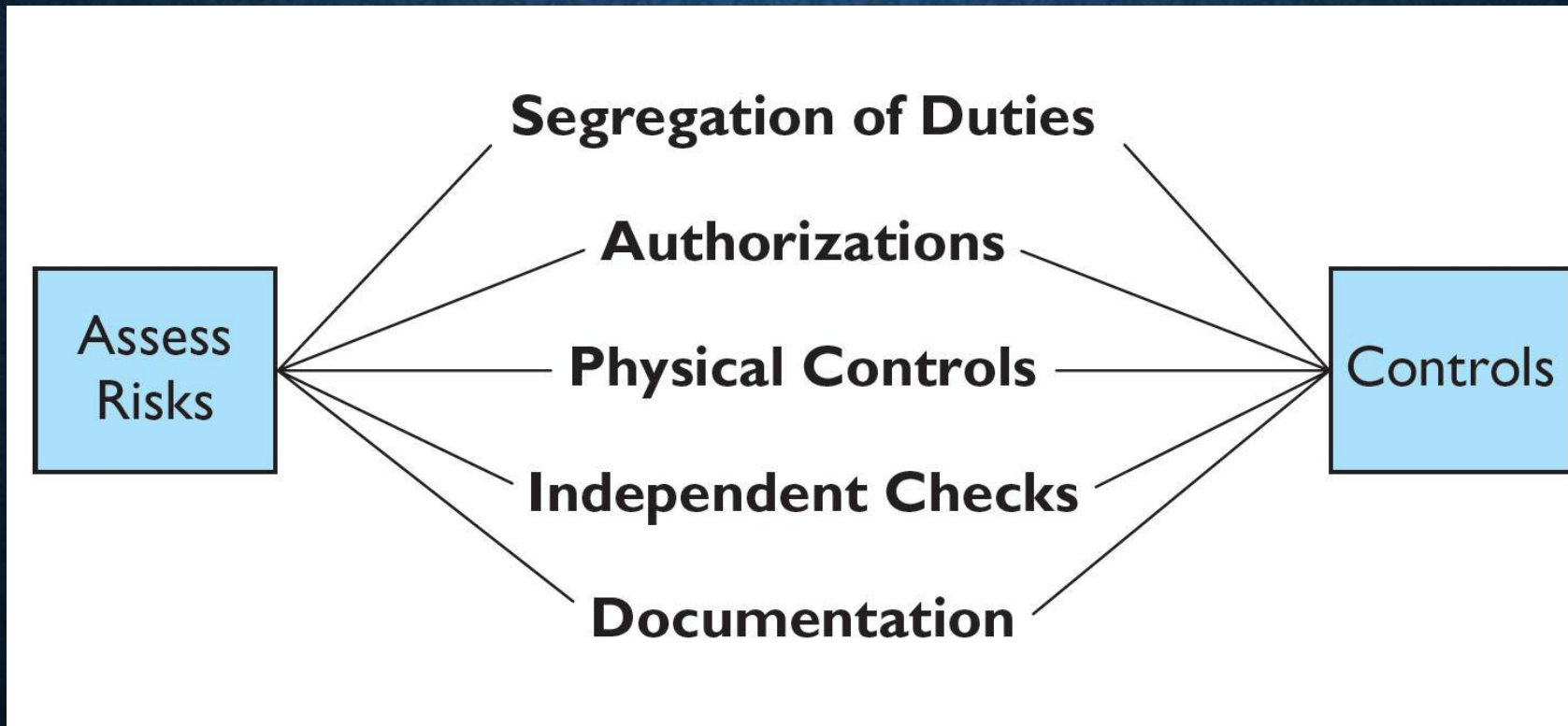
# ELIMINATE OPPORTUNITIES

1. Have good internal controls
2. Discourage collusion
3. Monitor employees and provide a whistle-blowing system
4. Create an expectation of punishment
5. Conduct proactive auditing

# INTERNAL CONTROLS

TYPE OF CONTROL	CONTROL ACTIVITIES
Preventive controls	<ol style="list-style-type: none"><li>1. Segregation of duties</li><li>2. System of authorizations</li><li>3. Physical safeguards</li></ol>
Detective controls	<ol style="list-style-type: none"><li>1. Independent checks</li><li>2. Documents and records</li></ol>

# BASICS OF INTERNAL CONTROLS





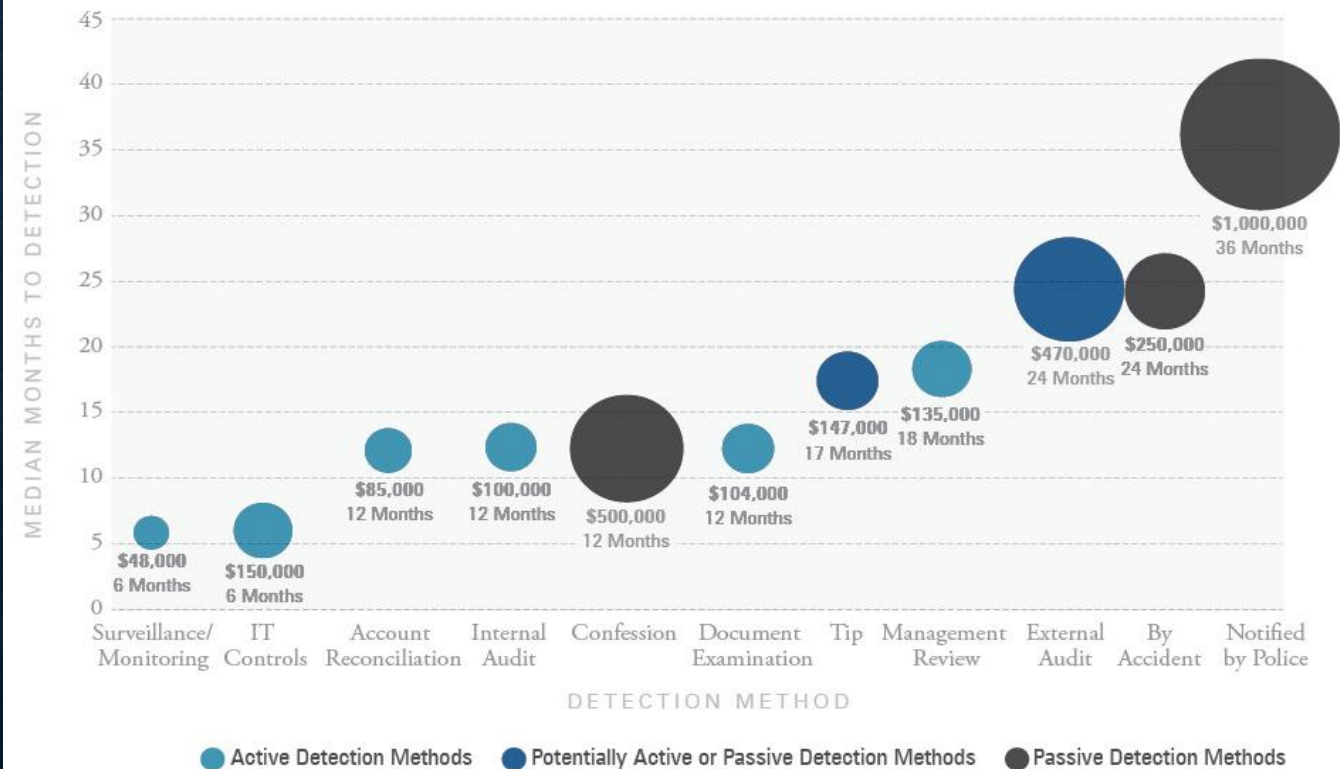
# STANDARDIZED FRAMEWORK

- COSO's Internal Control Framework
  1. A good control environment
  2. A good accounting system
  3. Good control activities
  4. Monitoring
  5. Good communication and information



# MEDIAN LOSS AND MEDIAN DURATION BY DETECTION METHOD

Figure 32: Median Loss and Median Duration by Detection Method



# EMPLOYEES ARE OUR WEAKEST LINK

- Collusive frauds have increased probably because of...
  - Increased complexity of business
  - Increased frequency of supplier alliances
- Suggested method of discouraging collusion:
  - Have a “right-to-audit” clause on the back of all purchase invoices



# WHISTLE-BLOWER/HOT LINE SYSTEMS

- Effective systems have the following:
  1. Anonymity
  2. Independence
  3. Accessibility
  4. Follow-up

# **FEAR IS A MOTIVATOR!!**

- One of the greatest deterrents to dishonesty is fear of punishment.
- Real punishment involves having to tell family members and friends about the dishonest behavior.
- A strong prosecution policy that is well publicized lets employees know that dishonest acts will be harshly punished.



# SAS 99 AND PROACTIVE AUDITING

➤ Good fraud auditing involves four steps:

1. Identify fraud risk exposures
2. Identify the fraud symptoms of each exposure
3. Build audit programs to proactively look for symptoms and exposures
4. Investigate fraud symptoms identified

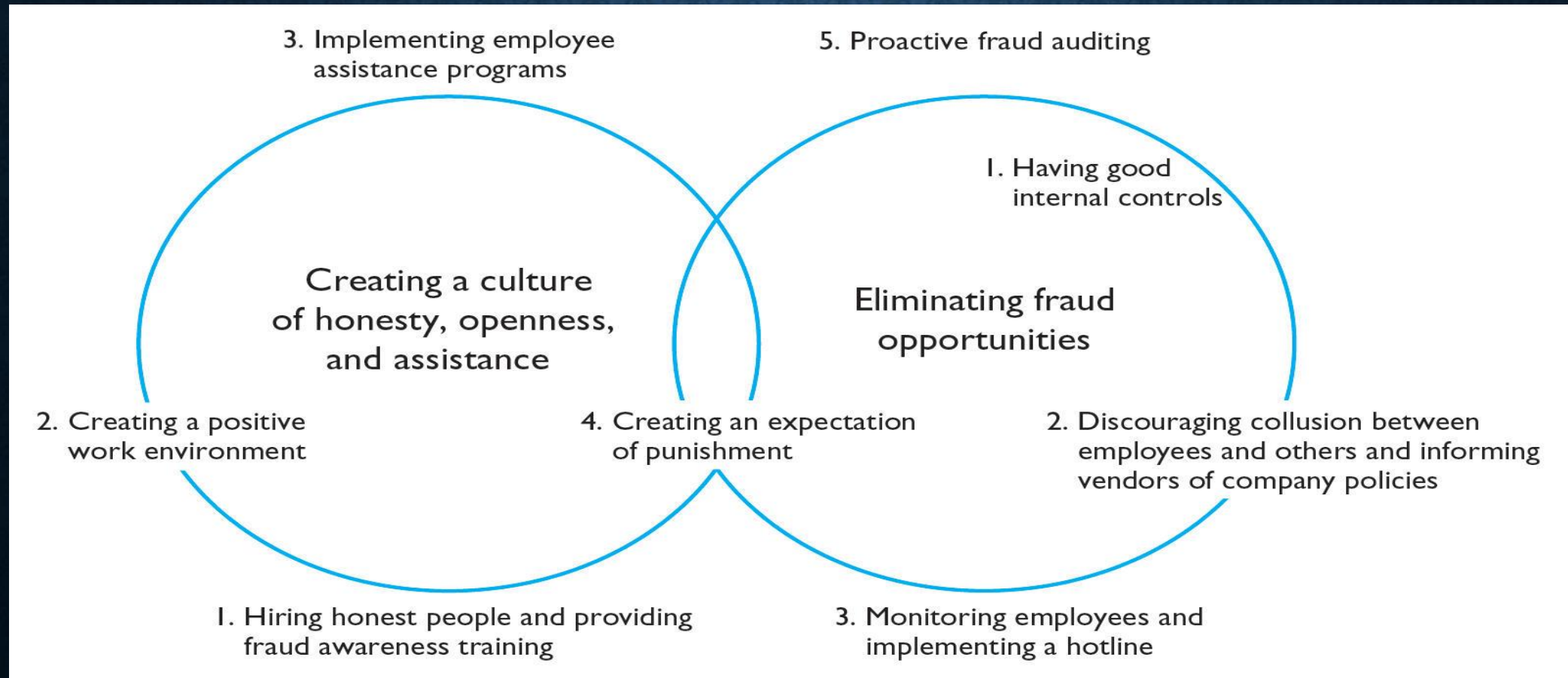
# STATEMENT ON AUDITING STANDARDS NO 99

## ➤ *Consideration of Fraud in a Financial Statement Audit*

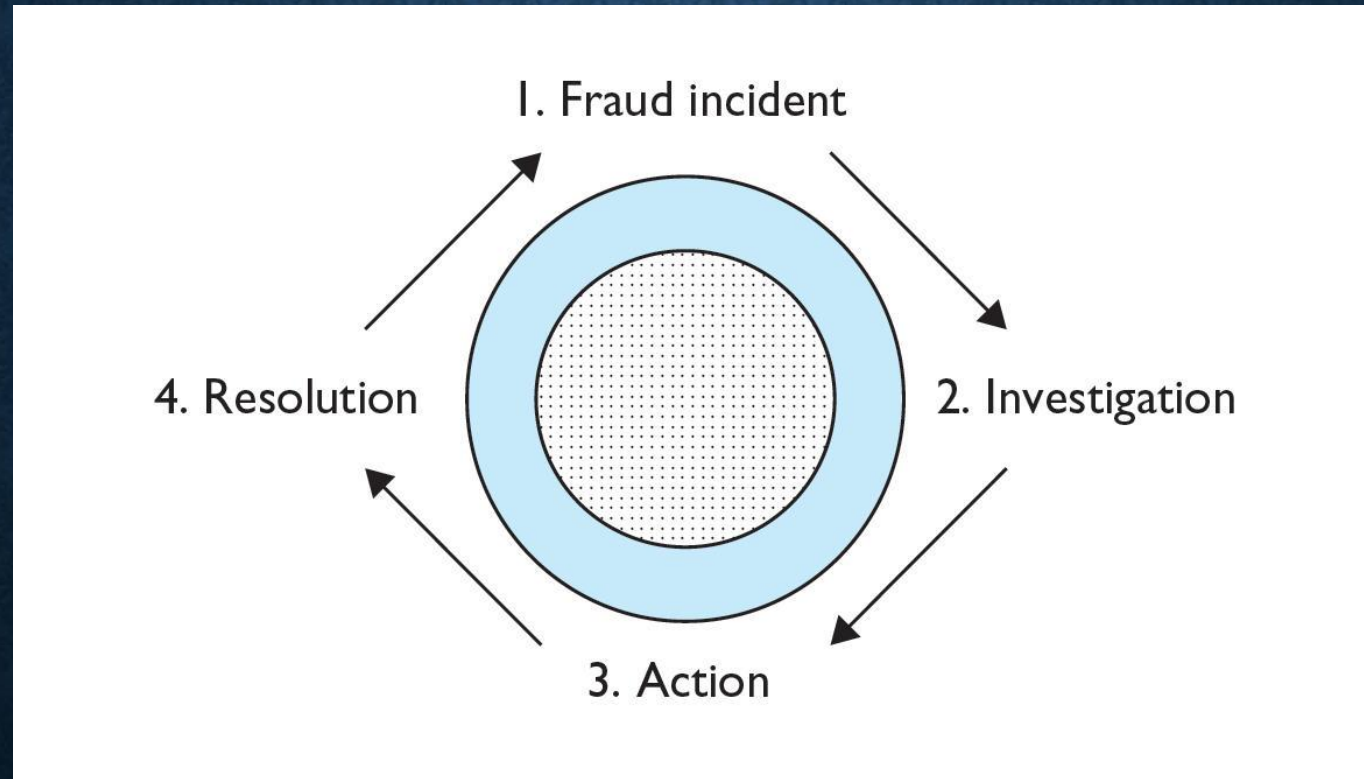
- Brainstorming the risks of fraud
- Discussing with management about awareness of fraud
- Using unpredictable audit tests
- Requiring on every audit procedures responsive to detecting management override



# PREVENTING FRAUD IN ONE HANDY CHART

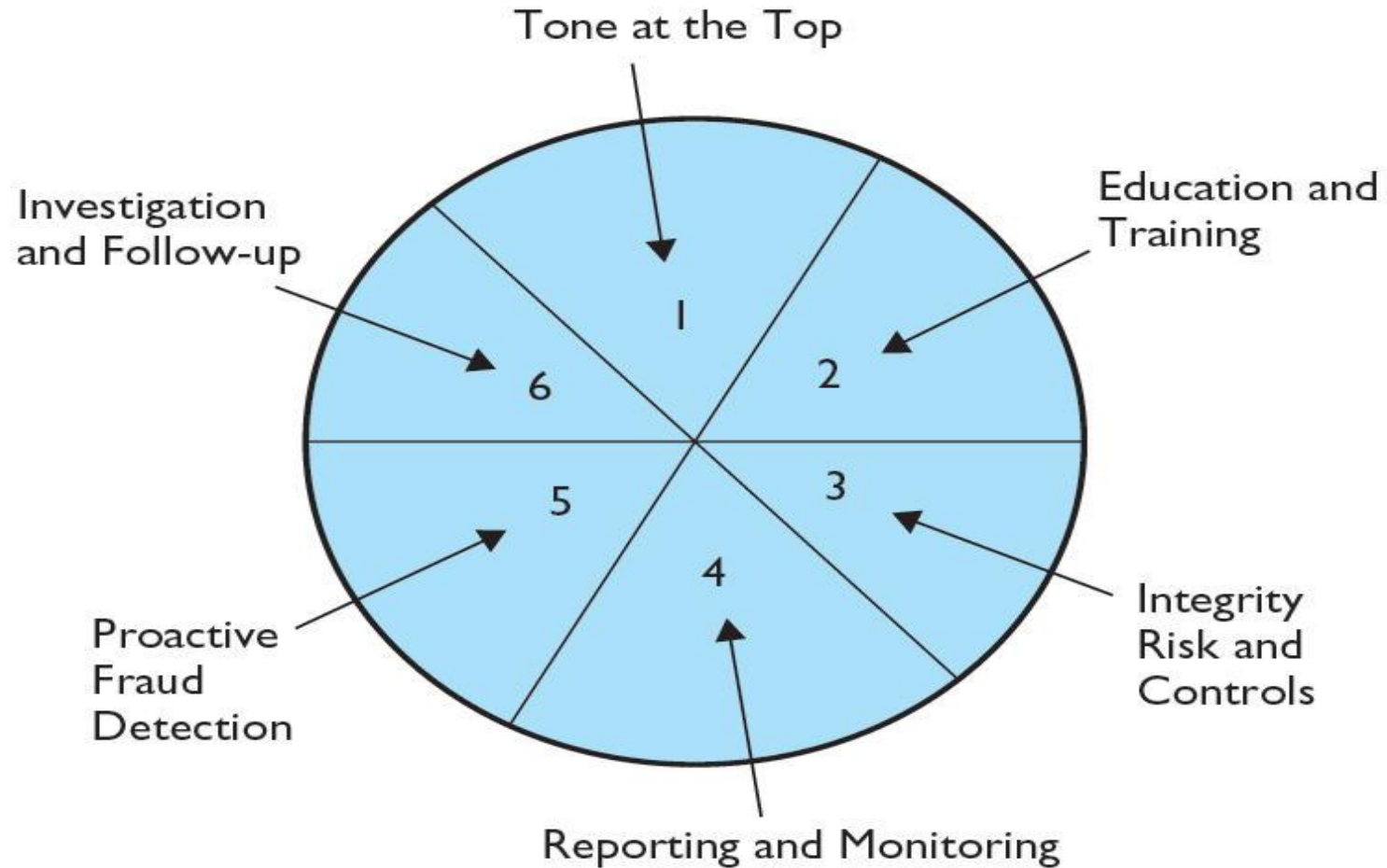


# TODAYS TYPICAL WORK FLOW





# IDEAL SET UP FOR FRAUD PREVENTION

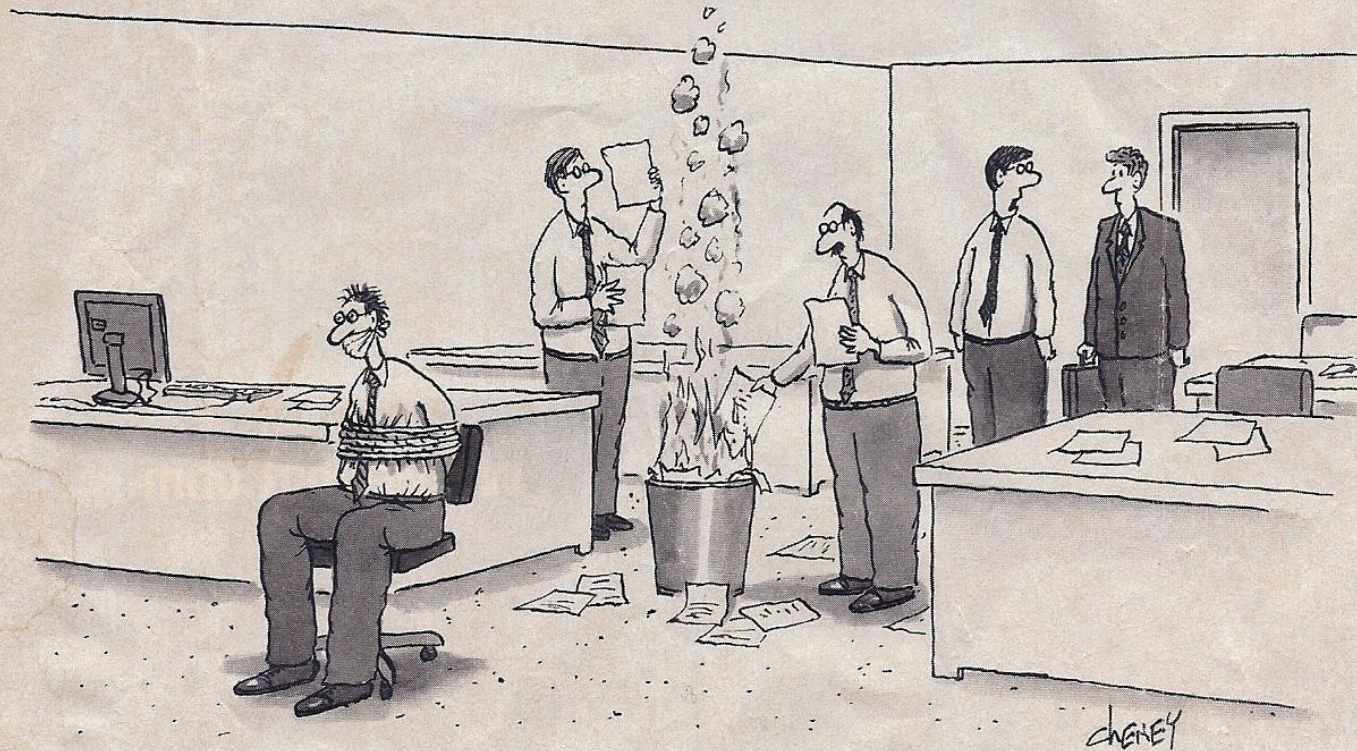


# DISCUSSION

- What have you experienced in your career? Which control would have been most helpful in spotting or pursuing the misappropriation?
- How do we reduce worker stress/schedule jams that lead to compromised systems?
- Is leniency a good solution for a 'good employee' ?
- Does top management care? Of course they do! Do they trust the 'system' to work? Yes, but rarely follow through on concerns...
- Continuous education of all levels of staff will drive the culture to where we all want it to be.



# IF ALL ELSE FAILS...



“First rule — what happens in accounting stays in accounting.”

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