

SAS-99

Your Antifraud Program, Will It Pass the Test?

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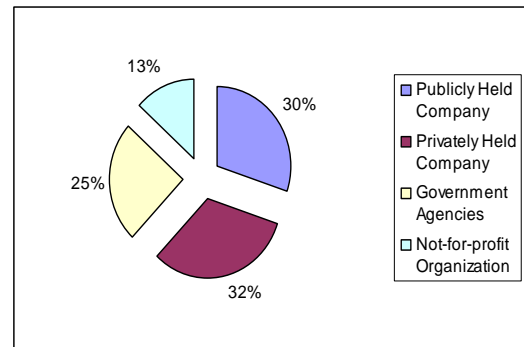
Based on the new auditing standard, *SAS 99-Consideration of Fraud in a Financial Statement Audit*, your auditor is now required to assess your Antifraud program. The new auditing standard, which is part of the AICPA's new antifraud and corporate responsibility program, does a good job of telling the CPA's what they should be doing during an audit to consider the risk of material misstatement to the financial statements due to fraud, but what about management's role? As we all know, management has the ultimate responsibility of establishing controls and procedures to protect the organization's assets, and now the AICPA has heightened that expectation through its issuance of a document that accompanies *SAS 99* entitled, "*Management Antifraud Programs and Controls: Guidance to Help Prevent, Deter, and Detect Fraud*".



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The Fraud Problem

Governmental entities, including public school districts are not immune to fraud. The Association of Certified Fraud Examiners (ACFE) reports in their “2002 Report to the Nation – Occupational Fraud and Abuse” that 25% of frauds reported by Certified Fraud Examiners were in government agencies. This study covered 663



occupational fraud cases that caused over \$7 billion in losses. Occupational fraud is defined by ACFE as “the use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.” As illustrated in this chart, frauds were distributed fairly evenly across these four sectors. The report also states that fraud is estimated to cost an average of \$4,500 per year, per employee.

Although much of the frauds occurring in these entities are not causing material misstatements to the financial statements, they are resulting in lost resources to the organization and hindering the ability of the organization to achieve its goals and mission.

Main Elements of an Antifraud Program

The attachment, “*Management Antifraud Programs and Controls: Guidance to Help Prevent, Deter, and Detect Fraud*” provides a summary of what should be included in an antifraud program and was done as a joint project by the American Institute of Certified Public



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Accountants, Association of Certified Fraud Examiners, Financial Executives International, Information Systems Audit and Control Association, Institute of Internal Auditors, Institute of Management Accountants, and the Society for Human Resource Management. It was the opinion of this committee, and is stated in the preface that “it is only those organizations that seriously consider fraud risks and take proactive steps to create the right kind of climate to reduce its occurrence that have success in preventing fraud.” Preventing fraud will of course protect valuable dollars as well as the immense value of your organization’s reputation.

This document includes three main sections, 1) creating a culture of honesty and high ethics, 2) evaluating antifraud processes and controls, and 3) developing an appropriate oversight process.

Creating a Culture of Honesty

Management should be very deliberate about setting a clear tone at the top for high integrity and ethics. This can be done by establishing codes of conduct, conflict of interest policies, and ethics policies. These codes need to be communicated to personnel in an understandable manner. More importantly, management must behave ethically and create an expectation for ethical behavior throughout the entity.

In assessing culture, consider the following questions. Does the entity create a positive work environment? Are there specific programs and initiatives in place that help provide a positive environment; such as recognition and reward systems, equal employment opportunities, team-oriented approaches, and professional training programs?



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Does the entity have thorough hiring and promoting practices that emphasize values and ethical practices? Are training programs in place for new and existing employees about the entity's values and its code of conduct? This should include training about an employee's duty to communicate certain matters, what these matters might look like, and how to communicate these matters. Your organization should create a method in which employees can safely report suspected wrongdoing, potential violations of the code of conduct, or other matters. The most common approach is to offer a hotline for anonymous reporting.

Evaluating Antifraud Processes and Controls

Neither fraudulent financial reporting nor misappropriation of assets can occur without a perceived opportunity to commit and conceal the act. *SAS 99* requires that the auditor determine whether the entity has identified what their fraud risks are and whether the entity has established compensating controls or procedures to reduce those risks. Management has the primary responsibility to consider the vulnerability of the entity to fraudulent activity and whether any of those exposures could result in a material loss to the organization. Management should evaluate whether appropriate internal controls have been implemented to reduce the risk of fraud.

For example, management may determine that the food service operation has a high risk of theft due to the volume of cash collected on a daily basis. Controls to mitigate that risk may include having locked safes, armored pick up, daily close out, and reconciliation procedures with a proper segregation of duties. Or, there may be a risk of overtime abuse, which is mitigated by procedures including authorization of payroll and good budget controls. Or, it may be necessary



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to have periodic internal audit checks in high areas of risk. This could include running reports that separate regular and overtime pay and investigating any large or unusual payments.

Effective measures will vary between organizations based on size and complexity, but it is crucial that management is *continuously* assessing the risks of fraud, taking steps to mitigate these risks, and implementing and monitoring appropriate internal controls.

Developing an Appropriate Oversight Process

Proper oversight comes in many forms. There should be oversight from an audit committee or board of directors. Many districts do not have an audit committee, and therefore, the governing board becomes the oversight committee. The oversight roles should include evaluating management's identification of fraud risks, implementation of antifraud measures, and creation of the appropriate "tone at the top". In addition, the board or audit committee should be reviewing the entity's financial information for reasonableness compared to prior years or forecasted results, as well as with industry averages. The board must assure that auditor recommendations are being followed. One of the other oversight responsibilities may be to have at least one board member involved in reviewing any reported concerns about ethical practices or suspected fraud. There should be a financially savvy individual involved in this oversight process.

Others that play a part in the oversight process include management taking its role of setting up controls and an effective anti-fraud program, internal auditors, external auditors, and certified fraud examiners. All of these professionals should be included as needed. It is important to note



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that government code section 1237 suggests that an internal audit function be put in place in all governments with revenues of \$50 million or more. Having an internal audit function may seem expensive, but is certainly a concept that is valued and worth serious consideration.

Importance of Antifraud Program

When your organization puts in place the antifraud procedures outlined in the exhibit, it does much more than protect itself from monetary damage. It also safeguards its reputation, its ability to achieve its purpose or mission and certainly, its value. The guidance in *SAS 99* challenges management of organizations to be proactive in preventing and detecting fraud and sets the auditor up to assure it is happening. Will your antifraud program meet the test?

More information on these subjects can be found at the following websites:

American Institute of Certified Public Accountants	www.aicpa.org
Association of Certified Fraud Examiners	www.cfenet.com
Financial Executives International	www.fei.org
Information Systems Audit and Control Association	www.isaca.org
The Institute of Internal Auditors	www.theiia.org
Institute of Management Accountants	www.imanet.org
National Association of Corporate Directors	www.nacdonline.org
Society for Human Resource Management	www.shrm.org



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