

Agenda

- Definitions
- Finance and Audit Committees' duties per their respective charters
- Common concerns for board members
- Three lines of defense model
- Review of board best practices
- Fraud triangle
- 2014 Global Fraud Study
- Closing thoughts



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Wegner CPAs

Finance and Audit Governance

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For



PART 1



Key Definitions

- “Tone at the Top” is the organization’s commitment towards openness, honesty, integrity, and ethical behavior as led by management and overseen by the board



Key Definitions

- Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the



achievement of objectives relating to operations, reporting, and compliance (per COSO)

- Controls are “*what should be done*”



Difference Between Hard and Soft Controls

Hard Controls

- Policy/procedure
- Organizational structure
- Reconciliations
- Signed approvals
- Verifying numbers
- IT applications
- Segregation of duties
- Written authorization

Soft Controls

- Competence
- Trust
- Shared values
- Strong leadership
- High expectations
- Openness
- High ethical standards
- Transparency



Key Definitions

- Duty of oversight: Responsibility to ensure that the organization has adequate internal controls in place, including those over executive management (*i.e., that people and technology are doing what they are suppose to be doing per policies and procedures*)
- The words “oversight”, “oversee”, and other related words are the most commonly used words in board governance guidelines and committee charters.



Key Definitions

- Risk is the possibility that an event will occur and adversely affect the achievement of objectives. Risks are “*what the board and management fear for the organization*”.
- Opportunity is the possibility that an event will occur and affect the achievement of objectives in a favorable manner.
- Do you agree with this statement?:

Risks and opportunities are inseparable as every decision to excel at your objectives (i.e., opportunities) involves risk.





ICANN is a Unique Organization

- *ICANN is a not-for-profit public-benefit corporation with participants from all over the world dedicated to keeping the Internet secure, stable and interoperable.*
(<https://www.icann.org/get-started>)
- *The mission of ICANN is to coordinate, at the overall level, the global Internet's systems of unique identifiers, and in particular to ensure the stable and secure operation of the Internet's unique identifier systems.*
(www.icann.org/resources/pages/guidelines-2012-05-15-en)



Role of the Board

(www.icann.org/resources/pages/guidelines-2012-05-15-en)

- The fundamental responsibility of Directors is to exercise their business judgment to act in what they reasonably believe to be the best interests of ICANN and in the global public interest, taking account of the interests of the Internet community as a whole rather than any individual group or interest.
- It is the duty of the Board to oversee management's performance to ensure that ICANN operates in an effective, efficient and ethical manner.



Purpose of the Finance Committee

(www.icann.org/resources/pages/charter-c0-2012-02-25-en)

- A. Providing oversight on the annual budget process of the Corporation;
- B. Reviewing and making recommendations on the annual budget submitted by the President;
- C. Developing and recommending short and long-range strategic financial objectives for the corporation; and
- D. Providing strategic oversight on financial matters for the Corporation.



Insufficient data & information versus too much

- Have you ever been asked to make a decision, and then contemplated what would be the basis for your decision?
- Have you ever been inundated with

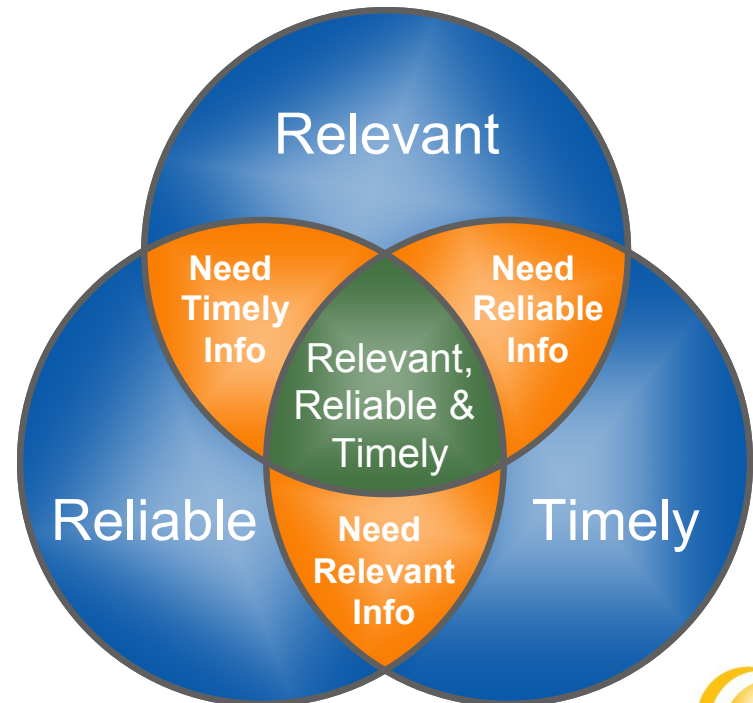


mountains of
information
and numerous
conflicting opinions?



Polling Question #1

- How do you become comfortable with the timeliness, accuracy, completeness, and relevancy of information used for board and committee decisions?



Purpose of the Audit Committee

(www.icann.org/resources/pages/charter-2012-02-25-en)

A. Recommending the selection of independent auditors to the Board;

1. Annual fees
2. Audit plan(s)
3. Performance, qualifications and independence



B. Receiving and reviewing status reports from independent auditors as required and recommended.



Purpose of the Audit Committee

(www.icann.org/resources/pages/charter-2012-02-25-en)

- C. Receiving, reviewing and forwarding to the Board the annual financial report of ICANN's operations and financial position, the related footnotes, and the accompanying independent auditors' report.
- D. Overseeing ICANN's internal financial and accounting controls and procedures, which are designed to promote compliance with accounting standards, and applicable laws and regulations.

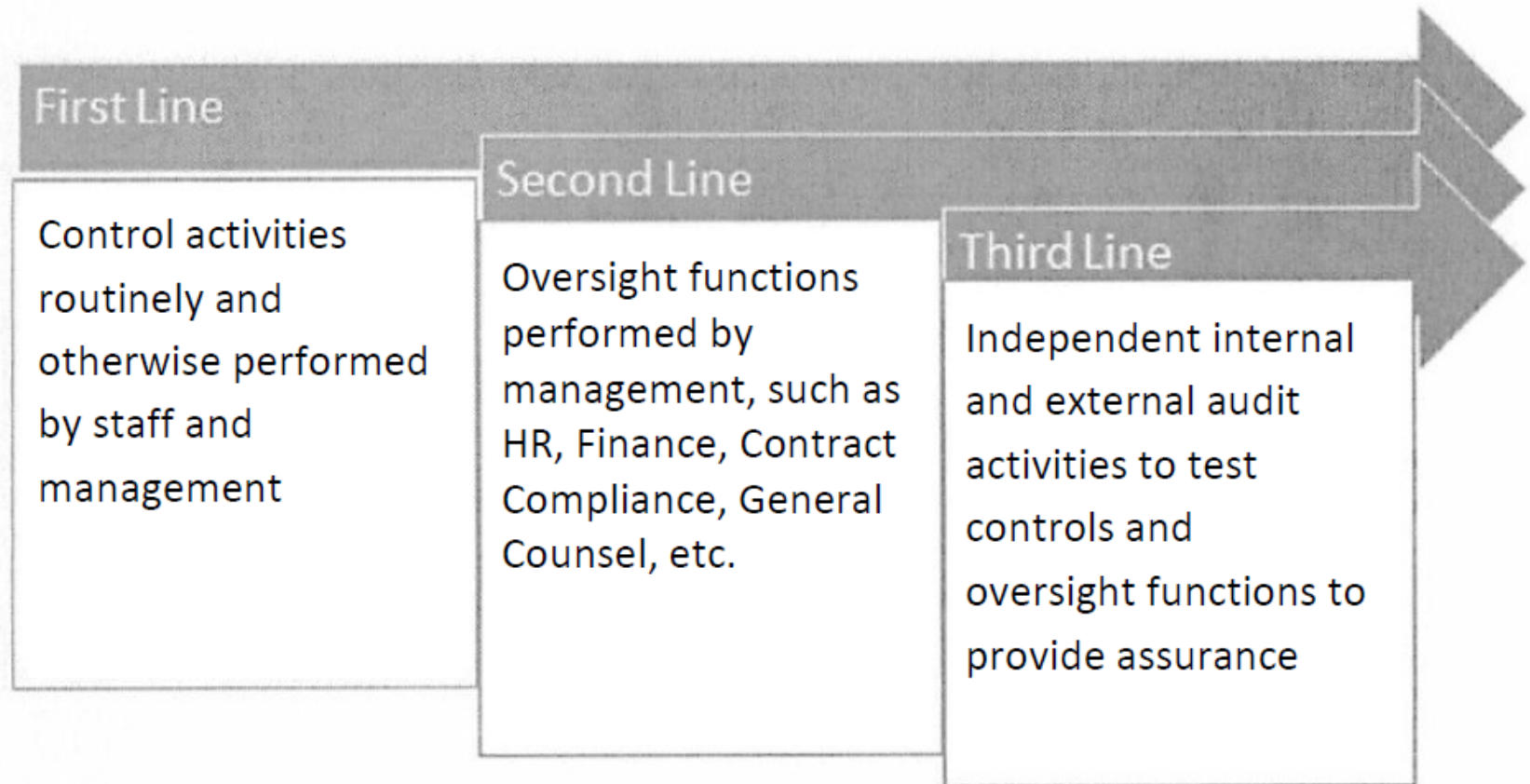


Back to the Concept of Risks and Opportunities: Polling Question #2

- What do you as a board director fear most about your directorship with ICANN?



Three Lines of Defense Model





Board Best Practices

- There is no shortage of “experts” offering board best practices
- Only you (collectively as a board or a committee) can ultimately decide on actions
- Do not overly complicate policies and procedures (i.e., controls)
- It is more dangerous for organizations to have a policy and procedure in place that is not followed than not having that policy and procedure at all



The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control

(Derived from Principle 2 of the COSO-2013 Internal Control – Integrated Framework)

Points of Focus:

- Establishes Oversight Responsibilities
 - Applies Relevant Expertise
 - Operates Independently
 - Provides Oversight for the System of Internal Control
- It is important for the board of directors retains oversight responsibility for management's design, implementation, and conduct of internal control



Controls

The policies, procedures, and actions to help ensure board and management directives are carried out.

Policy: Authority (board or management) establishing what should be done, or not done.

Procedure: Specific protocol and action steps towards accomplishing the policy.

Actions: Manual (human action) or automated (no human action) activities to comply with policies and procedures.

Control activities occur throughout the organization, at all levels & in all functions.

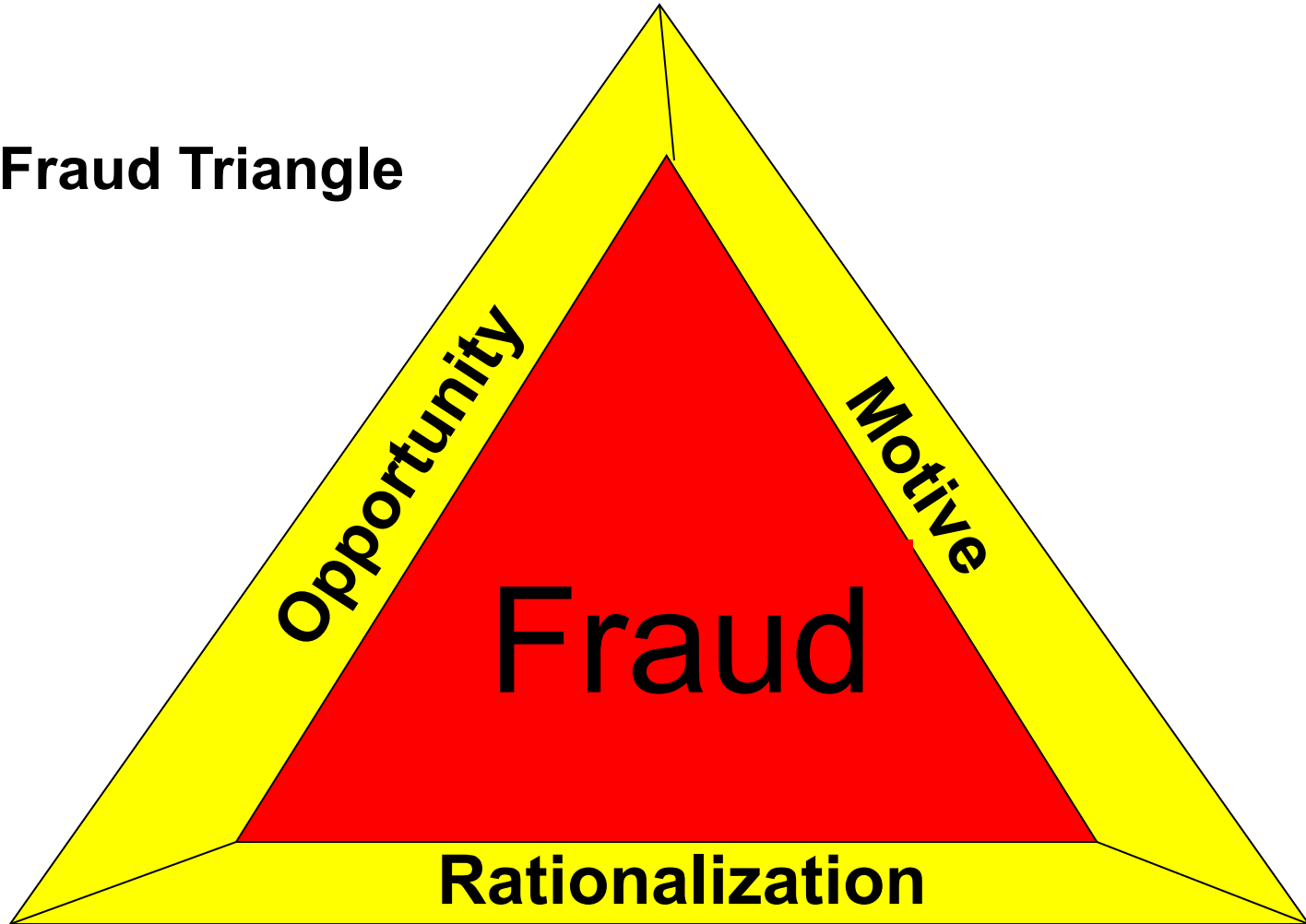


Essential Logic



Key Objective: Prevent & Detect Fraud

Fraud Triangle



Internal Auditing and Fraud, IPPF Practice Guide published by the IIA, December 2009

- **Opportunity** is the ability to commit fraud and not be detected. Since fraudsters do not want to be caught in their actions, they must believe that their activities will not be detected. Opportunity is created by:
 - Weak internal controls
 - Poor management
 - Lack of board-level oversight
 - Ability to use one's position and authority to override controls.



Internal Auditing and Fraud, IPPF Practice Guide published by the IIA, December 2009

- **Pressure or incentive (motive)** represents a need that an individual attempts to satisfy by committing fraud. Often, pressure comes from a significant financial need or problem.
 - The need to keep one's job or earn a bonus.
 - The desire to maintain his or her position in the organization and to retain a certain standard of living to compete with perceived peers.
 - Saving a family member or loved one so he/she can pay for high medical bills.



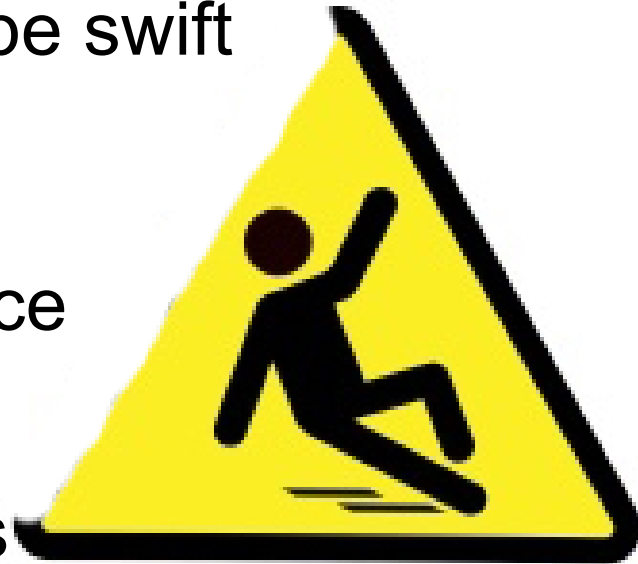
Internal Auditing and Fraud, IPPF Practice Guide published by the IIA, December 2009

- **Rationalization** is the ability for a person to justify a fraud:
 - The person simply labels the theft as “borrowing,” and intends to pay the stolen money back at a later time.
 - Rationalize their behavior as the rules don’t apply to them.
 - Everyone else is doing it so why not me.
- Polling question #3



Best Deterrence

- Take away the one side of the triangle you can best control:
 - Create within your organization the expectation that wrongdoers will be caught and that punishment will be swift
 - Training at all levels
 - Periodic fraud assurance activities
 - Strong internal controls



The typical organization loses 5% of its annual revenues to occupational fraud

Source: “*The 2014 Report to the Nations on Occupational Fraud and Abuse*” by The Association of Certified Fraud Examiners (ACFE)

- If applied to the 2013 estimated Gross World Product, this translates to a potential projected global fraud loss of nearly \$3.7 trillion.



Occupational Fraud is defined as: *The use of one's occupation for personal enrichment through the deliberate misuse of the employing organization's resources or assets.*

Source: "***The 2014 Report to the Nations on Occupational Fraud and Abuse***" by The Association of Certified Fraud Examiners (ACFE)

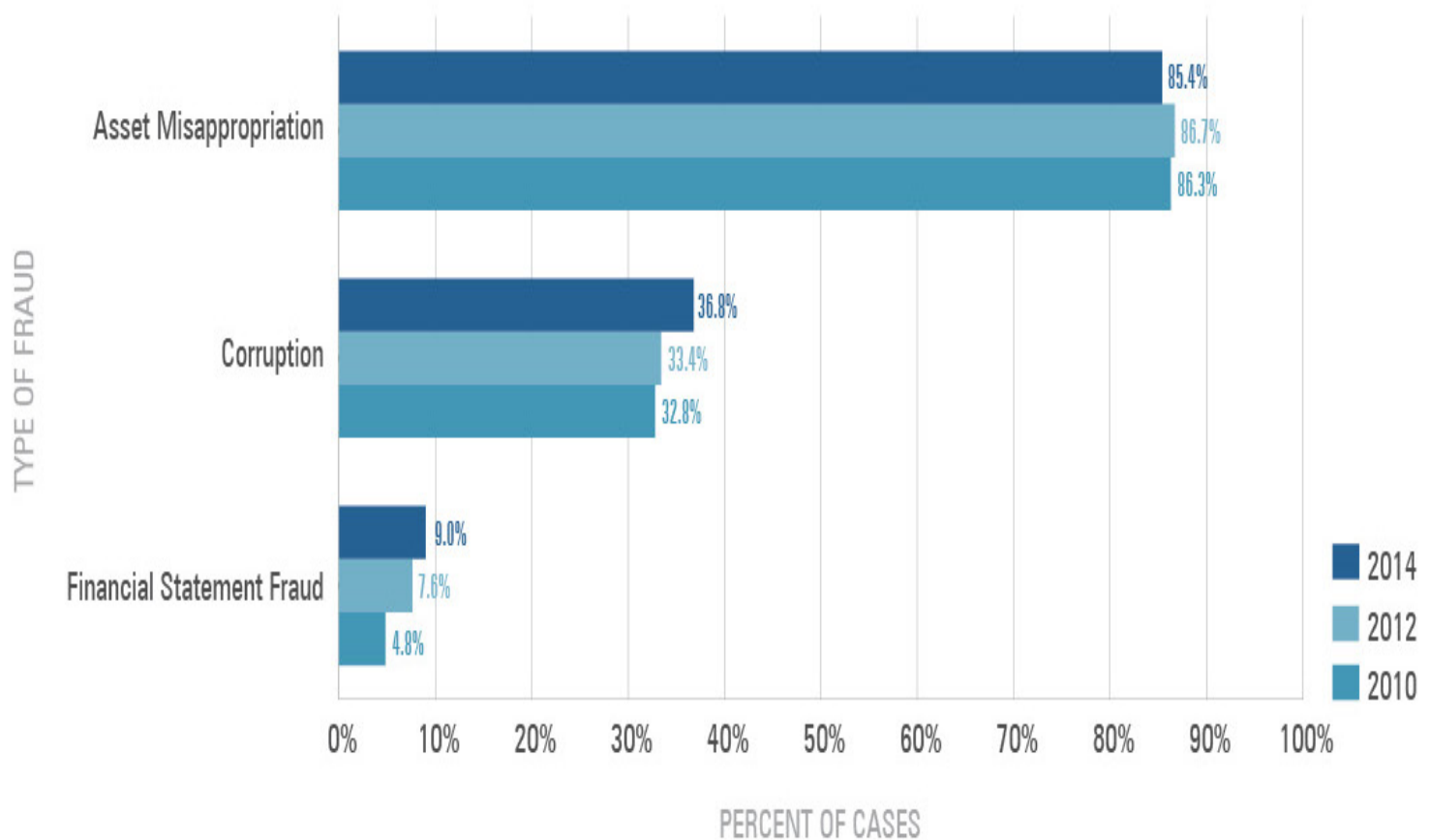
1. **Asset misappropriation** schemes are frauds in which the perpetrator steals or misuses an organization's resources
2. **Corruption** is when fraudsters use their influence in business transactions in a way that violates their duty to their employers in order to obtain a benefit for themselves or someone else
3. **Financial statement fraud** involves the intentional misstatement or omission of material information from the organization's financial reports



How Occupational Fraud is Committed

Source: “*The 2014 Report to the Nations on Occupational Fraud and Abuse*” by The Association of Certified Fraud Examiners (ACFE)

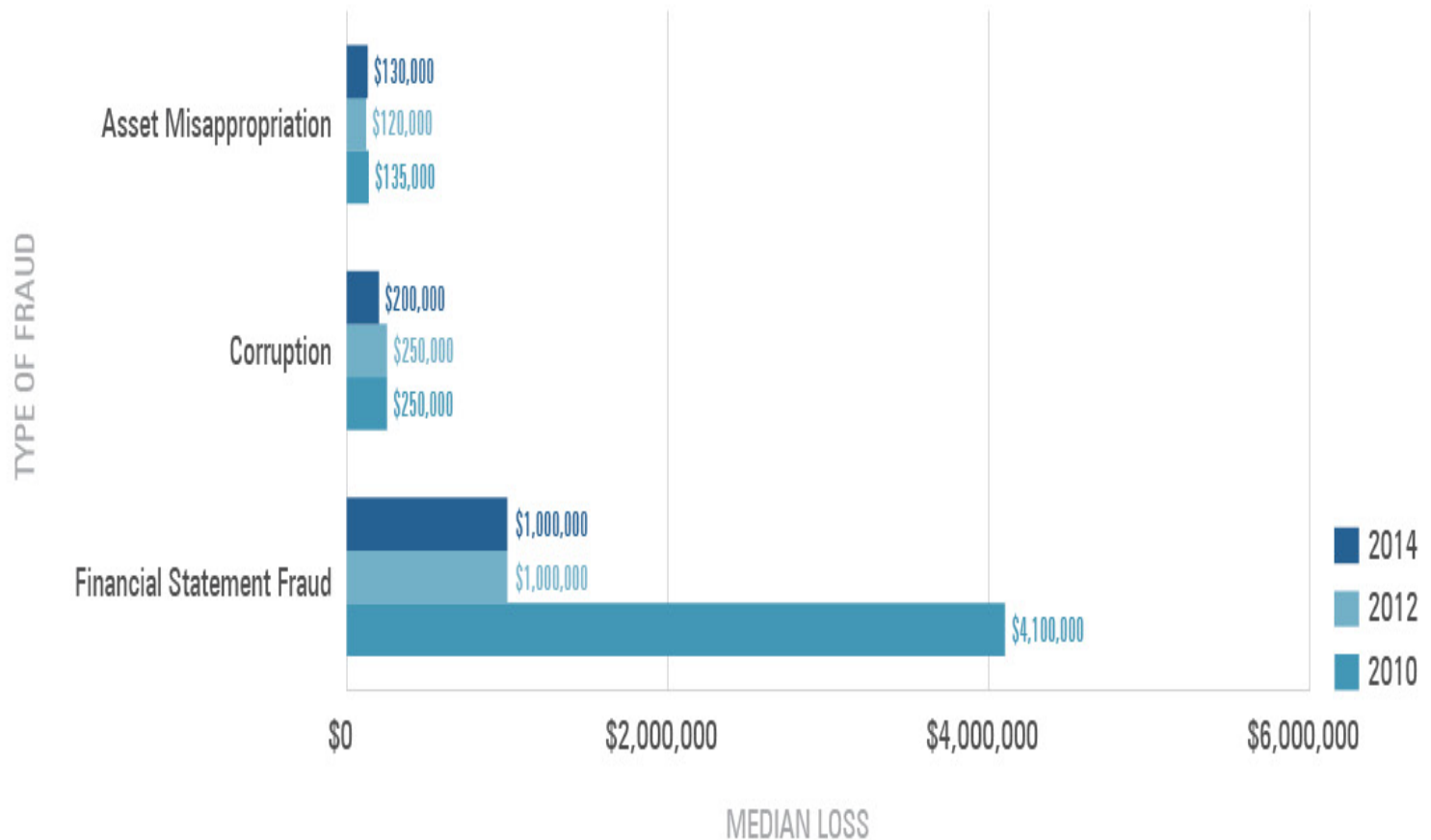
Figure 4: Occupational Frauds by Category — Frequency



How Occupational Fraud is Committed

Source: “*The 2014 Report to the Nations on Occupational Fraud and Abuse*” by The Association of Certified Fraud Examiners (ACFE)

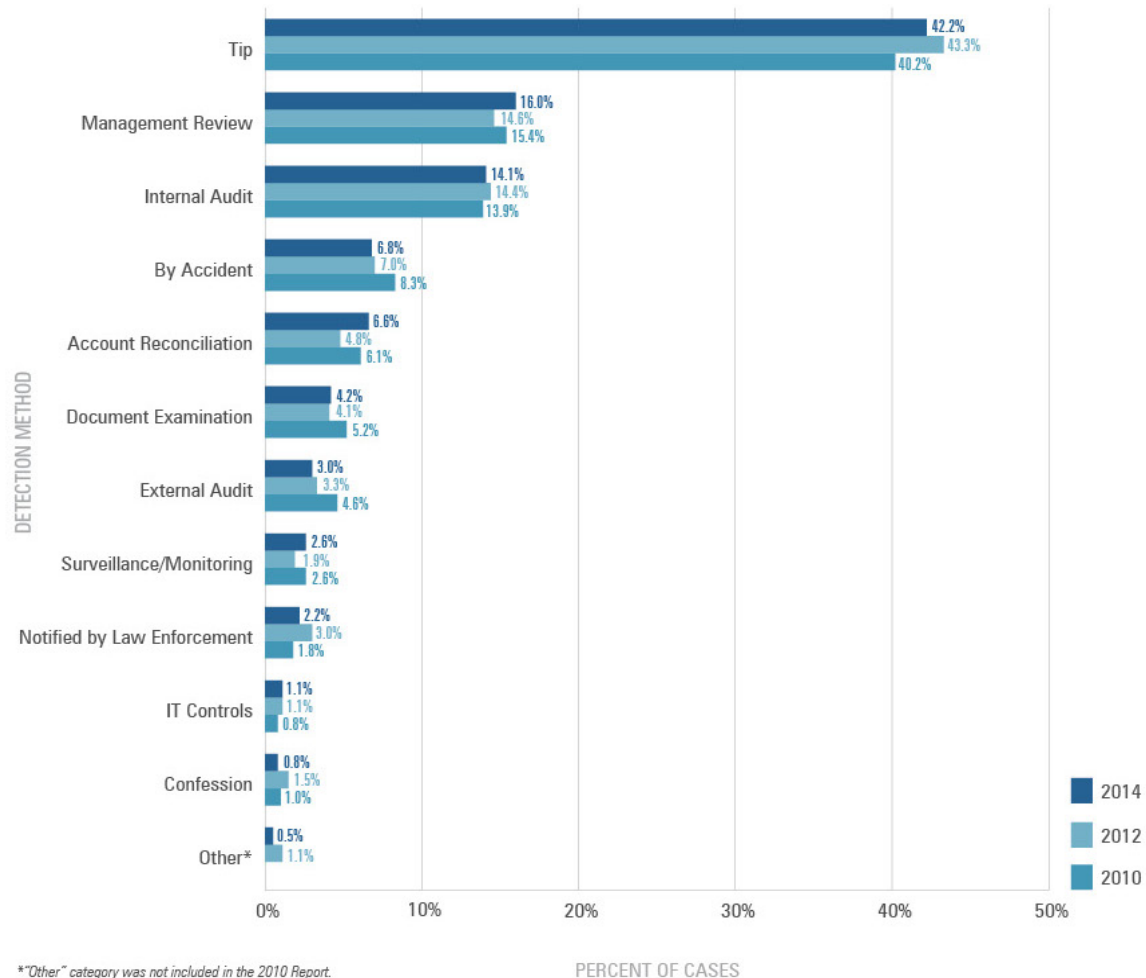
Figure 5: Occupational Frauds by Category — Median Loss



Initial Detection of Occupational Frauds

Source: “*The 2014 Report to the Nations on Occupational Fraud and Abuse*” by The Association of Certified Fraud Examiners (ACFE)

Figure 11: Initial Detection of Occupational Frauds



*"Other" category was not included in the 2010 Report.

Detection of Fraud Schemes

Source: “*The 2014 Report to the Nations on Occupational Fraud and Abuse*” by *The Association of Certified Fraud Examiners (ACFE)*

Source of Tips

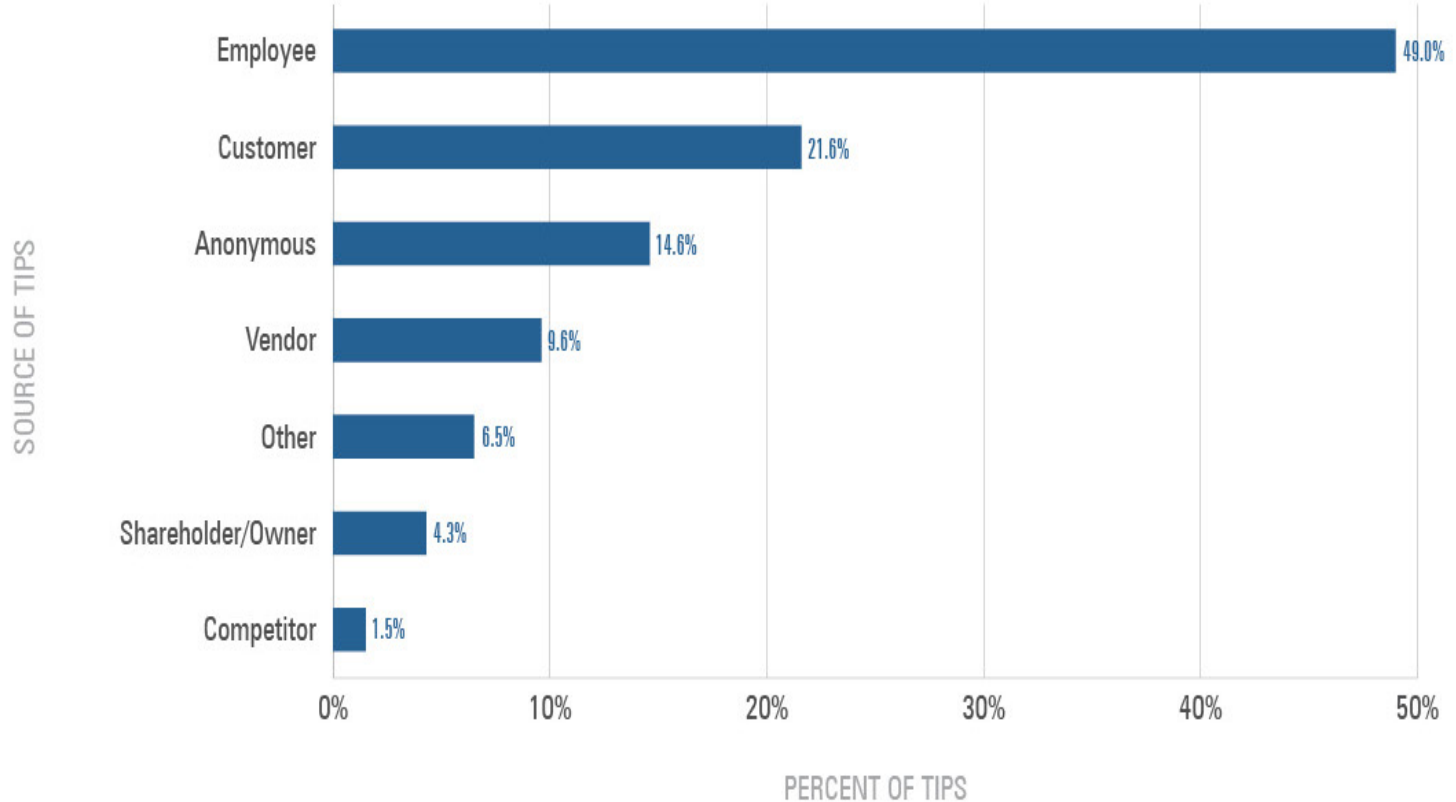
- Not surprisingly, employees were the most common source of fraud tips.
- However, customers, vendors, competitors and acquaintances (i.e., non-company sources) provided at least 39% of fraud tips, which suggests that fraud reporting policies and programs should be publicized not only to employees, but also to customers, vendors and other external stakeholders.



Source of Tips

Source: “*The 2014 Report to the Nations on Occupational Fraud and Abuse*” by The Association of Certified Fraud Examiners (ACFE)

Figure 13: Source of Tips



Detection of Fraud Schemes

Impact of Anonymous Reporting Mechanisms (Hotlines)

- Such systems enable employees to anonymously report fraud or misconduct by phone or through a web-based portal, since employees often fear making reports due to the threat of retaliation from superiors or negative reactions from their peers
- However, challenges exist:
 - “Gripe-lines”
 - Follow-up investigations
 - Resources



Survey Conclusions

Source: “*The 2014 Report to the Nations on Occupational Fraud and Abuse*”
by The Association of Certified Fraud Examiners (ACFE)

- Occupational fraud is a universal problem around the globe.
- Proactive detection measures (hotlines, management review procedures, internal audits and employee monitoring mechanisms) are more effective.
- External audits are implemented by a large number of organizations, but they are among the least effective controls in combating occupational fraud. Such audits were the primary detection method in just 3% of the fraud cases reported
- The presence of anti-fraud controls is associated with reduced fraud losses and shorter fraud duration.



Leading Practices

- Communicate a concise and easy to read compliance and ethics program
- Build a culture of “perception-of-detection”
- Education for all so everyone (including key stakeholders) is on alert to report suspected fraud
- Make brainstorming of risks a routine practice



Finance & Audit Board Governance

- Continual improvement through education & training should always be an objective.
 - Compliance and ethics programs
 - Occupational fraud red flags and common schemes
 - Decision rights, information flows & communications
 - Enterprise risk management and the board's role
 - Maximizing value from the external auditor

- Questions?



Speaker Bio

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Ron is the Managing Partner of [Candela Solutions LLC](#), a public accounting firm with a national focus on governance, controls, and internal auditing. He has been an external auditor responsible for signing audit opinions and a divisional financial executive for a multi-billion dollar NYSE firm. Currently he is an author, educator, advisor and internal auditor for boards of directors and management teams.

Prior to forming Candela Solutions, he was a Principal Consultant with PricewaterhouseCoopers, leading performance auditing, internal controls and governance projects. Ron began his public accounting and consulting career with a California CPA firm as a Financial and Compliance Auditor, where he worked extensively with Big-4 firms.

Ron is a nationally recognized speaker on governance, business ethics, internal controls, and SEC regulations. Ron is a co-author of [The Board of Directors and Audit Committee Guide to Fiduciary Responsibilities](#). Ron believes that all business activities should be focused on creating and preserving shareholder value.

Ron is a member of the AICPA, FEI, IIA and IMA. He holds an MBA from Arizona State University and a BBA from the University of Wisconsin.



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