BDO September Blog Post: *"Strengthening Corporate Governance: Dispelling Fraud Myths"*

There are numerous resources available that guide those charged with governance toward building programs to include anti-fraud controls and cultivation of anti-fraud environments. When put into place and followed, these programs go a long way in the prevention and deterrence of fraud. However, even when the strongest fraud prevention programs are in place and operating as designed, fraud may still occur. Let's first dispel some common misconceptions:

**Myth:** Handling alleged instances of fraud committed within an organization is solely the responsibility of company management and internal audit.

**Truth:** Establishing effective mechanisms for the reporting, investigating and remediating of fraud is a shared responsibility with the company's audit committee:

> Section 301 of the Sarbanes-Oxley Act specifically requires the audit committee "*to establish procedures for the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters."*
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> The SEC's interpretative guidance for management with respect to internal controls[1] does not specifically address the role of the audit committee, however, it does note: *"We [SEC] would ordinarily expect a board of directors or audit committee, as part of its oversight responsibilities for the company's financial reporting, to be reasonably knowledgeable and informed about the evaluation process and management's assessment as necessary in the circumstances."*
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> Additional guidance may be found in auditing literature including PCAOB Auditing Standards (AU 316) that state: "*…it is management's responsibility to design and implement programs and controls to prevent, deter and detect fraud… Management, along with those charged with governance, should set the proper tone, create and maintain a culture of honesty and high ethical standards… When management and those charged with governance fulfill those responsibilities, the opportunities to commit fraud can be reduced significantly.*[2]

**Myth:** Fraud is primarily found in large, multi-national organizations.

**Truth:** Fraud is not limited to companies of a certain size and composition. A finding of the 2010 study released by COSO, "*Fraudulent Financial Reporting: 1998-2007 – An Analysis of*

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1 Refer to SEC interpretative release *Commission Guidance Regarding Management's Reporting on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934* available at: **http://www.sec.gov/rules/interp/2007/33-8810.pdf**

2 Refer to paragraphs .01-.12 of the AICPA's Statement on Auditing Standards No. 99, "*Consideration of Fraud in a Financial Statement Audit*," which is included in the PCAOB's interim standards (AU 316) available at: **http://pcaobus.org/Standards/Auditing/Pages/AU316.aspx**

*U.S. Public Companies*,"[3] indicates that the companies charged with fraudulent reporting by the SEC, as represented within the study over a ten-year period, included startups with no assets or revenues as well as much larger companies.

**Myth:** It is not possible to predict potential fraud before it happens, so creating a plan in advance to deal with suspected fraud would be a waste of time and resources.

**Truth:** While not every instance of fraud may be predictable, companies and their audit committees are best served by gaining an understanding of fraud risk factors and establishing a plan in advance to deal with suspected fraud expeditiously if and when it arises rather than scrambling to identify and pull together adequate resources in the midst of a crisis.

To find out more about creating an anti-fraud environment and building effective mechanisms for reporting, investigating and remediating fraud, refer to BDO's Practice Aid detailing the key elements of an anti-fraud environment and responsibilities with emphasis on the structure, policies and procedures that audit committees need to ensure are in place *before* fraud occurs and the specific action steps to take *if and when* alleged fraud is suspected.

Facing allegations of fraud within an organization can be a frustrating and challenging time for those charged with governance. Cultivating an ethical culture and having established policies/procedures and identified resources in advance of fraud allegations will allow those with oversight responsibility the wherewithal to react quickly and effectively to combat fraud and minimize the damage to the organization.

[3] Refer to the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) 2010 study "*Fraudulent Financial Reporting: 1998-2007 – An Analysis of U.S. Public Companies*" available at: **http://www.coso.org/documents/COSOFRAUDSTUDY2010.pdf**