FORENSIC ACCOUNTING

Book Review

The Handbook of Fraud Deterrence

By Harry Cendrowski, James P. Martin, and Louis W. Petro
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Hardcover, 430 pages, $90

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A considerable body of professional standards, laws, regulations, and penalties has grown around fraud deterrence over the past several years. In order to satisfy the objectives of these various standards, responsible managers must understand the motivations, incentives, and opportunities for fraud; know how to design and implement fraud deterrence tools, techniques, procedures, and controls; and instill a corporate culture in which all employees take fraud deterrence seriously and follow the established procedures conscientiously.

The Handbook of Fraud Deterrence does an excellent job of detailing professional standards, the laws regarding corporate fraud, various statutes and regulations from a number of federal agencies, the COSO Integrated Framework, the Bankruptcy Code, and of course the Sarbanes-Oxley Act. It thoroughly discusses Mazlow's Hierarchy of Needs and the Fraud Triangle—the motivations, incentives, opportunities, and other elements that give rise to the commission of fraud.

The section on "Tools of Fraud Deterrence" occupies almost 145 pages. I found the sections on process and information validation, data analysis and monitoring, and bankruptcy fraud to be the most interesting and practical parts of the book, because they include useful examples and are written with implementation in mind. The authors provide a comprehensive survey of these topics with information that I could use immediately.

The final chapters of the book include timely sections on special situations such as business formation and dissolution, identity theft and privacy protection, intellectual property, and fraud issues related to private equity finance.

Culture

In the post-Enron era of burgeoning standards, laws, and penalties, it is easy to get fixated on compliance issues and neglect fostering the type of corporate culture that really deters fraud. Corporate culture is one area that the authors do not address in sufficient depth.

Rules and standards don't prevent fraud—good management, the right culture, and well designed controls that employees will implement and follow are what minimize losses. A few simple examples will demonstrate the importance of corporate culture in fraud deterrence.

A very common situation that I

see in my clients is that a management person, often the controller or accounting manager, keeps custody of the signature plate used for signing checks. This custodial person is usually so overworked, harried, and stressed out that, day after day, he or she will routinely hand the signature plate over to whatever clerk the accounts payable manager sends to get it, without even looking up to see who they are handing it to. Sometimes those two people will pass in the hallway and the custodial person will tell the clerk that the signature plate is in his or her top desk drawer, "just go get it." On paper, or when the auditors inquire, there is an effective control over the company's signature plate (and hence cash disbursements), but employees who are not conscientious can render good controls virtually useless.

A client I am currently working with has controls that have been in place for so long that few employees remember or understand their purpose anymore. So yes, there are always three people in the room when cash is being counted, but the pair who aren't counting have been given so much additional work to do that they don't remember that the reason they are in the room is to watch the person doing the counting. They spend their entire time in the room looking at their computer screens and would not notice if the cash counter slid envelopes into the folds of her sweater. In this case, management's push for greater productivity has rendered their deterrence tool useless.

In companies with "broken" cultures, it seems that the more dysfunctional the organization is, the more they try to compensate for their cultural problems with controls and procedures. When managers don't have the gumption or authority to manage conflicts between departments or divisions, they write procedures and controls instead of managing people. Once you have too many controls, you may as well not have any, because even well-intentioned people can't possibly remember and comply with all of them.

I consulted on an internal control project for a Fortune 500 company whose accounting-related controls filled four 2-inch binders. When departments don't get along with each other, they write procedures to try to control each other. This company seemed to have a procedural war between departments and divisions, with everyone blaming the other for problems, and "solving" them by adding more pages to their control binders. We broke through a lot of their problems just by getting them to realize that they can (and need to) talk to each other. We also were able to eliminate 80 percent of the "controls" with no loss of asset integrity, because the remaining 20 percent were left in a much stronger and enforceable position.

In fact, almost every corporate fraud I've seen occurred in an environment of abundant internal controls that were set in a culturally flawed situation.

The authors of *The Handbook of Fraud Deterrence* mention the cultural element of fraud deterrence superficially throughout the book. They write, for example, that "when management is able to recognize the needs of employees, top-down initiatives are regarded with greater respect" (page 8); and "management must consistently reinforce, through words and actions, that a properly functioning internal control structure is an imperative of all employees and business processes" (page 122). But they generally assume that managers are adept at establishing and maintaining the proper control environment, and simply need to be reminded to do it. That is often not the case.

A few "war stories" here and there, illustrating how to apply the principles and techniques that they discuss in a real-life setting, demonstrating what can go wrong in a control environment, or how to reconcile company policy and procedure to what employees are actually doing, would have gone a long way toward helping the reader implement the wealth of valuable information presented in this book.

So, who should be read this book? CFOs and auditors will find it to be a valuable compilation of information that they need to be aware of and should definitely have in their libraries. Company directors are putting themselves at great risk if they are not intimately familiar with the material presented here. Fraud investigators will find it to be a useful survey of the environment they are operating in, although the main focus of the book is not on investigation or detection. Business managers or consultants who are actually charged with deterring fraud may be disappointed—this book will tell them what they need to do, but doesn't provide enough guidance or examples on how to actually do it. They may need to supplement this handbook with additional examples and guidance on the design and implementation of internal controls, assessment of the control environment, training and managing employees to reduce fraud, and basic business process improvement. VE

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