

Preface

Welcome to the second edition of *Executive Roadmap to Fraud Prevention and Internal Control*. The first edition was very well-received with excellent feedback from readers, and for that we are most appreciative. Nothing pleases authors more than to know their writing labor is providing educational value. This book is being used as a textbook at colleges and universities. It has been translated into Chinese and used in compliance programs as a reference source. Yet time and fraud march on. There have been events and changes since the original publication that require updating this book. For this second edition, we have kept what is still timeless and relevant while adding new material.

We continue to see fraud and corporate misdeeds with the inevitable impact and enforcement response. Dozens of companies were caught up in the government probes of backdating of stock options. The United States Department of Justice and the Securities and Exchange Commission ramped up investigations of corruption and bribery, bringing more and more prosecutions for violations of the Foreign Corrupt Practices Act. A huge accounting fraud occurred at a once highly regarded technology powerhouse in India. We witnessed the worst financial crisis since the Great Depression and the collapse of once-venerable financial institutions. As a result, new laws were enacted, including the Fraud Enforcement and Recovery Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

In a perfect world, this book would not be needed. All corporate employees, from the Chief Executive Officer, the Chief Financial Officer, and the Board of Directors to the entry-level workers, would have the highest degrees of honesty and integrity. Fraud and abuse would be nonexistent. There would be no financial statement fraud, asset misappropriation, kickbacks, or bribery. Unfortunately, we live in an imperfect world in which noncompliance, misconduct, fraud, and

corruption exist. One only needs to read the daily papers or watch the evening news to learn of the latest corporate scandal, government investigation, or shareholder litigation. Once respected corporate titans continue to face the prospect of “perp walks” and prison because of financial impropriety.

Common sense tells us that a business executive or manager only needs to hear: “Never commit fraud of any kind.” However, fraud prevention always involves further measures: a zero tolerance of fraud in any shape or form, providing fraud awareness and prevention training for all employees, instituting strong internal controls, and limiting exposure to fraud through a robust fraud detection, investigation, and prevention program. Nevertheless, it is naïve to expect that these steps alone can stop all forms of fraud and abuse from occurring. It is a given that corporate crime will always be with us. What is really needed is an ongoing culture of compliance that takes years to build but only a moment to collapse. Corporate executives who are charged with protecting their companies from fraud need a guide to establish an effective program. The passage of the Sarbanes-Oxley Act of 2002, the Amendments to the Federal Sentencing Guidelines for Organizational Crime, the enactment of Dodd-Frank, and other related compliance enhancements have required CEOs, CFOs, and boards to understand the protections that need to be in place to prevent corporate fraud.

Fraud is nothing new. History has shown that fraud has long been a part of our society and will continue to be. As Judge Edwin R. Holmes said in the case of *Weiss v. United States* in 1941, “The law does not define fraud; it needs no definition; it is as old as falsehood and as versatile as human ingenuity.”¹ We continue to see corporate scandals and the strong enforcement response of the government. Gone are the days of a slap on the wrist to the wrongdoer and all is forgotten. Today, corporate fraud results in shareholder lawsuits, the implosion of companies, executive prison sentences, and an investor outcry for reform.

In addition, there is a greater focus than ever before on uncovering and preventing fraud as a result of the loss of billions of dollars in equity and greatly diminished investor confidence in the markets. Financial statement fraud and other internal fraud schemes provide considerable risk to a corporation. The enactment of enhanced reporting requirements and greater public scrutiny of companies have

contributed to this new age of enforcement. However, internal fraud is not the only risk that businesses face. External fraud schemes also attack companies and can do significant damage to both finances and reputations.

Although no one expects CEOs, CFOs, and other corporate executives and managers to be experts in fraud prevention, the current climate requires a thorough understanding of the principles of fraud examination and state-of-the-art compliance programs. This book is a roadmap to help executives understand fraud and reduce its impact. George Santayana once said that those who do not remember the past are condemned to repeat it. This book looks to the past to gain a better understanding of the nature of fraud and how to prevent it. It relates lessons that can be applied now and in the future to prevent fraud, and it also reviews theories and models that explain how and why fraud happens inside an organization. It then describes the current climate as well as the critical importance of fraud prevention and culminates by providing a roadmap to establishing a culture of compliance. Creating this culture is the only way businesses can position themselves to meet the new environment of tighter regulations, transparency, and accountability. It is a proactive method for actually preventing fraud. Simply reacting to fraud issues as they occur is no longer acceptable.

The authors bring a unique perspective to corporate fraud prevention. We are life-long practitioners in the field, with a combined 60-plus years of experience in both the public and private sectors detecting and investigating fraud and white-collar crime. Our careers parallel each other. As federal agents with the United States Postal Inspection Service and the Federal Bureau of Investigation, we investigated fraud and corruption, including corporate crime, investment fraud, kickback schemes, international fraud scams, insurance and healthcare fraud, organized crime, and violations of the Racketeering and Corrupt Organizations Act (RICO). We were involved in the prosecutions of hundreds of fraudsters.

We then went into the private sector to conduct investigations on behalf of corporate clients that were victims of fraud and other crimes. We worked cases all over the world for companies large and small, public and private, and we helped business executives understand the importance of fraud prevention. We were subsequently recruited by corporations and given the responsibility of creating and

managing worldwide fraud prevention and anti-corruption programs using our knowledge, skills, and experience. We are both Certified Fraud Examiners (CFEs) who are still doing this work today.

After spending our careers with victims and perpetrators, investigators and prosecutors, in courtrooms and boardrooms, we have great insight into all kinds of fraud and the reasons people commit them. We have many lessons to share as well as numerous case studies and experiences about how to detect, investigate, and prevent fraud. This book is intended to be a primer for corporate executives at both public and private companies who are expected to protect their organizations from fraud and inappropriate behavior. This book will provide special insights to executives at medium and smaller size companies who may falsely believe that they are not facing fraud issues or who may not fully understand the relationship between fraud prevention and good corporate compliance. In addition to senior executives, this book will be beneficial for middle and lower-level executives and managers to help them understand their roles in fraud prevention. It will also be of value to fraud investigators, prosecutors, academics, students, and anyone with an interest in the world of fraud. Each chapter starts with an Executive Summary detailing the key points and takeaways from each chapter. Executive Insights and exhibits are used in various chapters to emphasize important concepts and provide case studies. We have designed the book to be user friendly—the reader does not have to be a CFE to understand the concepts and procedures described. By setting out the generally accepted standards for fraud prevention along with new recommendations, this book helps executives establish a world-class fraud investigation and prevention program. A discussion of the enforcement landscape helps the reader understand the implications of fraud and the need for compliance at every turn.

In all the years we have been investigating fraud and corruption, we have yet to see a decrease in the problem. We probably never will. However, there have been changes in how fraud is addressed. Tougher laws against corporate wrongdoing have been enacted with greatly increased prison sentences for those convicted. It is not the best of times for fraudsters; it is definitely a good time for guardians and gatekeepers. There has never been a better time to be a fraud investigator. Any corporate executive, manager, or employee

contemplating a journey to the “dark side” should keep in mind that fraud and noncompliance will be met with the strong arm of the law.

This book will be your roadmap to an understanding of corporate fraud, the implementation of fraud prevention, and the creation of a culture of compliance. Lastly, it is our honor and privilege to be your guides on this journey.