

# THE FRAUD CLINIC

By Tim J. Leech, CA, MBA

## Surviving the Diagnosis Phase

IN last month's column, I recounted the story of a young internal auditor who learned about the perils and pitfalls of succeeding at fraud detection. This month's column will discuss some of the techniques that internal auditors can use to increase their chances of surviving the "diagnosis phase."

Here are two potentially fatal sample situations:

### Situation 1

An audit has identified strong evidence that the vice-president of marketing has set up an incentive system in the form of all-expense paid trips to Las Vegas for customers who buy large volumes of the company's products.

Prior to this, sales revenues had been steadily declining. This VP was hired within the past year by the president with strict instructions to "turn things around" within a time deadline. The president has made it clear that he is not interested in knowing details as long as the desired results are achieved. The trips are being charged to the expense accounts of sales personnel as "Entertainment."

The vice-president refers quite openly to the program as a "customer bonding" strategy and has told you that it is common in the industry. A fraud detection course you attended leads you to believe that the practice is an infraction of the criminal code. Your department reports directly to the president. Your external auditor has never, to your knowledge, examined charges made to this expense category, presumably on the grounds that they are immaterial.

### Situation 2

You have just completed a statutory compliance audit. This is the first time your department has attempted to specifically examine statutory

compliance control systems. The audit has produced evidence that would seem to indicate that the company is currently in violation of some sections of provincial pension legislation, pollution laws and safety codes.

Discussions with the CFO and CEO have resulted in the involvement of your in-house lawyer. She has suggested that the findings, if they are correct, could be very damaging to both the company and to the senior officers and should be shredded or

turned over to her department to establish legal privilege.

The CFO and CEO have indicated to you that they

intend to address your findings at an early stage and have left no doubt that they intend you to shred your documentation. They have also made it clear that the findings are too "sensitive" to report to the audit committee and may reflect adversely on their management of the company. They have promised you that, if the issues are not addressed by next year, they will personally report the situation to the audit committee.

### What should you do?

Although the two cases cited appear to be quite different, the basic issue is the same: a problem of fairly serious proportions exists and the person you report to would prefer that the findings not be reported to the audit committee or to any other party.

As a professional, you know that you are supposed to do the "right" thing regardless of the consequences to you personally. But what is the "right" thing? What will happen to you if you don't choose the "right" course of action?

What is the position of The Institute of Internal Auditors on dealing with situations such as the two described, and what can it do, if anything, to back you up in your actions? If the "right" course of action leaves you without a job, what legal rights do you have? Where can you obtain professional

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advice and assistance about such situations? The Institute of Internal Auditors? Your professional accounting body? Somewhere else? And does your professional accounting body have prescribed rules that you need to be aware of? After all these considerations, if you decide to shred the documents and try to forget about your findings, will you ever be able to feel like a professional again?

Unfortunately, there is no simple answer to the dilemmas raised. Even though you will take steps to clarify your professional responsibilities, you will still be left with some very difficult decisions. I believe three options exist.

1. Look for a new job and quietly resign. This is likely the most common route taken by those with a conscience who are concerned about their careers and financial security and don't want to rock the boat. Beware that this route may not be without legal consequences to those who choose it.
2. Seek outside professional legal advice and carefully follow the advice provided. The advice may include engaging an outside forensic accounting specialist, keeping an off-site file of the issues and a diary of the efforts made by you to convince the senior officers to rectify the problems, playing hardball in obtaining a generous severance or promotion, providing advice on how best to frame your points to the president and/or the board, and other strategies.

This route provides a certain amount of risk transfer and certainly will allow you better insight into the perils and pitfalls of your various options. Your budget may allow you to engage outside specialists on relevant issues. Ideally, your department's charter provides a mechanism to resolve this type of situation.

3. Report the situation to the audit committee and hope that the president will respect you for doing the "right" thing. A former international

chairman of the board of the Institute of Internal Auditors, when questioned by a U.S. congressional committee on the issue of independence and whistleblowing safeguards, indicated that, at his age of 64, he felt he could be quite independent in difficult situations. He pointed out, however, that it might be very difficult for an internal auditor who is 35, with a young family and a promising professional career, to do the "right" thing in every situation.

When available, I prescribe the second option. I believe that it allows auditors to maintain their pride while still recognizing the realities of life. The third option can be described as the kamikaze approach and I recommend it for those who wish to die fighting for their cause. It is important to note that the first option is becoming increasingly less attractive as investigators are learning to focus on finding out who was aware of infractions, and what they did about them.

Another approach is to take advantage of this newsletter's confidential Advisory Hotline. Even if there isn't an easy answer, an independent viewpoint may offer unique options that you hadn't considered.

Good luck to those of you who have had the misfortune of encountering situations such as the two which I have described. One way or another, you will have to survive the diagnosis phase, while maintaining your professional stature and conscience.

*At the time this article was written in 1990 Tim Leech was Managing Director of NCM Control & Security Services Limited, the Canadian subsidiary of an international consulting firm based in London, England. Tim Leech is now Principal Consultant and Chief Methodology Officer at Paisley Consulting, a world leader in business accountability software solutions. He can be reached by phone at 905 823 5518 or by email at [tim.leech@paisleyconsulting.com](mailto:tim.leech@paisleyconsulting.com)*