Beane Associates News January 2007

A bi-monthly collection of news and advice for stakeholders of financially and operationally challenged businesses

Welcome...

I hope 2006 was a healthy and prosperous year for you, your organization and your family.

This month our focus is on occupational fraud, a sobering yet important topic. Occupational fraud can siphon resources from healthy businesses and can accelerate the fall of those in trouble. We'll provide tips on spotting potential problems, as will our special guest contributor, John Kelleghan, Special Agent In Charge of the Philadelphia office of U. S. Immigration and Customs Enforcement.

My thanks to everyone for your comments regarding our first newsletter – Avoiding Trouble Ahead. Copies are available at www.beaneassociates.com. Please feel free to forward our newsletters to others, and don't hesitate to suggest topics that interest you. Write to me at tjbeane@beaneassociates.com.

On behalf of everyone at Beane Associates, Inc., I want to express my sincere thanks for your continued support and confidence in us.

Sincerely,
Tom Beane, *President CMC CIRA*

Tip Sheet

Potential Warning Signs:

1 Poor Internal Controls: More than any other factor, poor internal controls (a lack of segregation of duties) contribute to an environment where fraud can occur undetected.

2 Management's Attitude and Actions: Be wary of managers who are not candid and responsive. There may be something they don't want you to know.

3 Quality of Financial Statements: Be wary of financial statements not received on time or that do not include a signed outside auditor's report.

4 Timeliness of Closings: Today there are companies that can close their books in one day. Late reporting may simply be the result of sloppy bookkeeping but a continued inability to provide accurate, timely reports is a major warning sign.

5 Software Conversions: Believe it or not, we have seen this used as an excuse in a number of instances as a cover for fraud. Simply put, software conversion times vary but typically a plan supported by management can be completed in a defined timeframe. A well-thought-out conversion will allow for legacy systems to run parallel with new systems — providing reliable and timely data until the new system is operational.

An Inside Look At Occupational Fraud By Tom Beane

Occupational Fraud : "The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets."

Occupational fraud is a widespread problem that affects virtually every organization, no matter what its industry, size or location. According to the Association of Certified Fraud Examiners (www.acfe.com), the typical U.S. organization loses 6 percent of its annual revenues to fraud. Based on the 2003 U.S. GDP, that adds up to about $660 billion in losses.

Insider fraud alone does not usually take a company down. However, our experience shows that as a company begins to experience significant difficulties, it becomes more likely that its management or employees may be tempted to act fraudulently to conceal problems in an attempt to save the company.

Those outside the day-to-day operations of a company may not be able to prevent fraud from occurring, but there are plenty of warning signs that may alert you to potential trouble. Heeding these suggestions may help you protect their interests and minimize losses

- Look for indicators of the company's business ethics. Check its Web site, its human resources manuals, its mission statement. Has the company taken a proactive approach to dealing with the possibility of fraud? Owners and management teams that use education, hotlines and surprise audits to increase the perception of detection are likely to experience fewer, and less costly, incidences of theft.
- Monitor the responsiveness of the company's management. Do they avoid or delay meetings with outside stakeholders? Do illnesses, vacations and schedule conflicts always seem to get in the way? Perhaps there's something they want to hide.
- Be wary of reporting red flags. A lack of timely financial information may be masking larger dangers.

Businesses can take significant steps to prevent fraud and, as with all cultural issues, it starts at the top. Top management must communicate to all managers that they are responsible for managing fraud risks within their areas of jurisdiction. Boards of directors and top management must establish processes for oversight of fraud risks.

Even with oversight in place, a report by the Association of Certified Fraud Examiners noted that three-quarters of the studied organizations victimized by fraud had external audit procedures at the time the fraud occurred, and more than half had internal audit procedures as well. Clearly, these procedures, while helpful, are not enough to prevent fraud. Interestingly, the Association did find that the tactic that had the greatest impact on minimizing losses was setting up anonymous fraud hotlines. Publicly owned companies subject to the Sarbanes-Oxley Act must have confidential reporting mechanisms in place; companies not subject to Sarbanes-Oxley would do well to set up such systems too. Finally, the Association found that confidential reporting procedures are even more effective when the reporting channel is open to customers, vendors and other third parties, in addition to employees.

The Best Defense

In our practice we have seen time and time again that companies that do not proactively approach fraud will experience significantly more instances of theft.

As logical as it seems that all companies should have strong ethics policies and procedures to minimize fraud, many do not. To prevent fraud, proactive owners and managers can increase detection through education, oversight, hotlines, surprise audits and overall ethical climates. For this reason, all stakeholders should assess the standards of the businesses with which they are involved and be alert to any changes in business practices.

For warning signs of fraud, see Tip Sheet.

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Q&A With John Kelleghan

John Kelleghan is the Special Agent in Charge of the Philadelphia Office of U.S. Immigration and Customs Enforcement (ICE), part of the Department of Homeland Security.

What kind of fraud cases does your office handle? We look at fraud under the guise of traditional customs fraud, such as undervaluation or misclassifying of goods that are imported to avoid paying higher duties. We also investigate violations of intellectual property rights to include copyright and trademark infringements. These can impact public safety such as counterfeit pharmaceuticals or electronic components that do not meet or qualify for the Underwriters Laboratories seal. And, of course, there's financial fraud — money laundering — people/businesses who utilize financial institutions and other methods to launder their ill-gotten gains.

Who are typically the victims of the fraud that ICE investigates? It depends on the actual fraud. It could be anybody. It could be legitimate businesses that follow the laws and regulations; it could be consumers, as they are most affected because they're the ones who are paying the higher dollar for the product because of the fraud. Technically, we're all victims.

What are the key differences between the types of fraud you look at as an ICE official, and the types that go on in businesses in the United States? The most important distinction is that ICE investigates fraud involving things that are imported into or exported from the United States. If it crosses the border, going in or out of the country, it's within our jurisdiction.

As for what we see, a fraud is a fraud. The criminal elements are in the business to make money, then to hide it from authorities. The types of fraud you see on the local level — street fraud schemes — you also see on the international level. Money laundering is a big part of our investigative priorities; every crime we investigate has a financial component. That's what criminals are in business for.

How can you help businesses in a proactive way? Immigration and Customs Enforcement (ICE) has a program called Cornerstone, a comprehensive initiative that focuses on financial and trade fraud investigations. Cornerstone seeks to identify and eliminate vulnerabilities within the U.S. financial, trade and transportation sectors that terrorists and other criminal organizations might be tempted to exploit. We'd be happy to schedule a presentation on Cornerstone for your business or organization.

How does cooperation with businesses and banks pay off for ICE? Here's one example. We had a case a while ago where an individual had $10 in his bank account, and all of a sudden there were a few wire transfers that hit the account for something like $3 million. The bank teller got suspicious,

and notified the bank manager, who called the Secret Service, who called us, and it led to an international money laundering case. Some folks had stolen some money from a corporation in South America and through some contacts they proceeded to clean out the corporation's accounts and send the money into the United States. Through the cooperation of the bank, we were able to seize the money, and will eventually return it to the victim. Based on the financial institution's cooperation, we are now working a criminal investigation against several individuals who attempted to exploit the financial institution for personal gain.

For more from John Kelleghan, visit www.beaneassociates.com

Red Flag Indicators

Some financial transactions are "red flag" indicators demanding further scrutiny because they suggest criminal activity. They include:

- Frequent deposits of money orders, cashier's checks or other monetary instruments inconsistent with the customer's business type.
- Suspicious wire transfers to, from or through countries of concern or to companies located in countries known to be bank or tax havens.
- Issuing checks, money orders or other financial instruments, often numbered sequentially, to the same person or business, or to a person or business whose name is spelled similarly.
- Frequent transfer of funds between business and personal accounts.
- Transactions inconsistent with usual and customary business or personal practices.

For more information, visit www.ice.gov/cornerstone

In The News

Directors Earn Certification

Three Directors at Beane Associates, Inc. have recently earned accreditation as a Certified Management Consultant (CMC) from the Institute of Management Consultants USA. Receiving accreditation were Millard D. Brown II, Noel M. Parsons and James E. Pater.

Five associates, including Thomas J. Beane, President, and Christopher J. Beane, Director, have now earned the CMC designation. This accreditation has been awarded to about 1,000 consultants, less than 1 percent of all active professional management consultants in the United States.

"The criteria for achieving CMC designation are rigorous, but we insist that all of our directors work to achieve this accreditation," Tom Beane says. "It gives our clients additional evidence of our skills and high ethical standards."

Brown, a former manager for General Electric Co. and Hercules Inc., is Managing Director of the Beane Associates office in Atlanta, Ga. Parsons, an expert in business development and sales management, is Managing Director of the Beane Associates office in Charlotte, N.C. Pater, formerly a corporate lending and special assets officer for PNC Bank, is Managing Director responsible for the refinancing practice area of the firm, serving clients throughout the U.S.

Staying Ahead Of The Curve

At companies where scandal is in the mix, turnarounds are especially difficult. Here's how to handle these cases:

- **Clean House —** Every tainted executive and board member must go.
- **Set The Ethics Bar High —** Publish clear rules. Set up an anonymous e-mail and telephone system for reporting wrongdoing.
- **Find The Bottom —** Conduct a forensic accounting investigation to find out the true state of the business.
- **Preach Patience —** Set expectations with investors, customers and employees, so you can pursue a long-term strategy.
- **Communicate —** Constantly update all stakeholders. The message: Total transparency.

Adapted from BusinessWeek, Nov. 21, 2005

About Beane Associates, Inc.

Beane Associates, Inc.

Founded in 1984, Beane Associates, Inc. continues to build an impressive track record in helping private and publicly owned companies improve operational effectiveness and profitability during a time of financial challenge. The company has offices in Wilmington, DE, Charlotte, NC, and Atlanta, GA.

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