Beane Associates News May 2008

A bimonthly collection of news and advice for stakeholders of financially and operationally challenged businesses

Welcome...

One of our most-read newsletters in the past year took a look at Occupational Fraud and how it directly impacts the bottom line of otherwise healthy companies. In light of the current market, this month Chris Todd takes a look at how in troubling times, employees — even those high up in the management chain — may be even more inclined to engage in bad behavior. In my opinion, now is as good a time as any to review, or implement, processes and procedures and take a proactive approach to fraud prevention.

I get plenty of feedback from our readers and one of the most common requests is that we provide more "tombstones" outlining the types of assignments we have been working recently. We have included a few creditor advisory assignment summaries this month and will make them a regular feature going forward. Thanks to all who called or emailed me with suggestions.

As always, please feel free to contact me at any time.
For additional information on us, visit
www.beaneassociates.com

Sincerely,
Tom Beane, *President CMC CIRA*

Tip Sheet

Six steps for reducing exposure to internal fraud:

1. Establish strong internal controls.
2. Establish—and live by—a strong ethics policy.
3. Set up an anonymous tip line.
4. The company owner should always receive statements directly from the bank and review them carefully for any signs of suspicious or unauthorized activity.
5. Have a certified public accountant perform an annual audit and review internal controls.
5. Hire a certified fraud examiner to perform a fraud-prevention checkup.

For more information, visit the Association of Certified Fraud Examiners' Web site, www.acfe.com

Vigilance, Proactive Steps Essential to Controlling Fraud By Christopher H. Todd

When the economy heads south, the fraudsters start working overtime. There's never a legitimate reason to steal from your employer, but when times get tough, more employees rationalize "good reasons" to engage in some bad behavior.

The Association of Certified Fraud Examiners estimates that 5 percent of all business revenue — about $652 billion — is lost to fraud each year. The median loss is $159,000, but one-fourth of the cases result in losses of at least $1 million.

In good times and bad, experience shows that a company's higher-ups, the CEOs and the CFOs, are more likely than rank-and-file workers to be on the take.

A recent study by KPMG Forensics of 360 fraud cases it investigated in Europe, the Middle East and Africa found that nearly two-thirds of the perpetrators are in senior management. (Although the study did not include U.S. cases, it's reasonable to expect similar percentages here.)

Several factors account for this pattern. First of all, top executives have the status and knowledge to work their way around the company's financial controls. On a personal level, they may well get caught up in their own lavish lifestyle and lust for even more. Or, if things aren't going well for the company, they may resort to adjusting financial statements in order to conceal losses that could be attributed to poor decisions they've made.

In assessing internal theft, the biggest difference between what's taken by top-ranking fraudsters and those farther down the organization chart is the number of zeros at the end of the amount that's unaccounted for.

In the fraud examinations I've conducted, I've often found that personal financial crises have transformed employees with good records into thieves. It might be a gambling problem, a missed mortgage payment, or, more common these days, high medical bills after a family member suffers a serious illness or injury.

Many times the internal thief is one who feels his company owes him something —perhaps he's upset because he didn't get an anticipated raise or promotion. Perpetrators typically start small and escalate their misdeeds for as long as it seems no one is on to their schemes. Sometimes it doesn't end until the employee just stops coming in to work.

In fact, that KPMG study found that more than half the fraudsters conducted more than 20 frauds, and two-thirds of them escaped detection for one to five years.

Sometimes the fraud affects not only the employer but also its customers. In one recent case, a vice president for operations at a major bank took nearly $3 million from her employer and some 30 customers by stealing customer identity information, creating phony lines of credit and moving the money into her own accounts. The scam went on for four years before it was discovered.

In that case, the banker received an eight-year prison term, was ordered to repay her employer as well as pay more than $1 million in back taxes to the IRS.

Interestingly, however, many incidents of internal fraud never result in criminal charges against the perpetrator, and never come to the public's attention. That's because companies often decline to prosecute. They'd rather resolve the matter on their own, if possible, by recovering what they can and then dismissing the employee. The reason: if word gets out, the company suffers its own embarrassment for having a thief on its payroll. After all, the objective of any business is to make money, and publicizing its internal failings is not going to be part of its strategic plan.

The best way for businesses to prevent or control internal fraud is to take a proactive approach, creating an environment in which fraud is less likely to occur and establishing procedures that facilitate reporting suspected wrongdoing. Here are my key suggestions:

Establish strong internal controls. Emphasize separation of duties and internal controls. Cross-train a number of workers in handling finances, and never have the same person write the checks, make the deposits and reconcile the bank account.

Send a message from management. Establish a clear policy that sets high ethical standards — and make sure that top managers live that example.

Set up an anonymous tip line. Fraud hot lines are the most frequent sources of information that identifies fraudsters. A number of companies operate these lines as an independent third-party service.

To read more, go to:
http://www.beaneassociates.com/newsletters.asp

Beane Associates News

May 2008

Here are some examples of recent Beane Associates engagements on behalf of financially and operationally challenged businesses

Flooring Importer

Situation: A $20 million wood flooring importer implemented an aggressive expansion plan to cover 80 percent of the United States through added distribution points and carrying large amounts of inventory. This proved disastrous as the overall U.S. homebuilding market continued to decline. In conjunction with their secured lender, the owners decided to wind down company operations.

Result: The secured lender retained Beane Associates to assist management with the wind-down. By remaining on site, coordinating the auction, challenging management to act quickly, reviewing potential sales and maintaining focus on collection efforts, all assets were successfully liquidated within 90 days.

Auto Dealership

Situation: An auto dealership with multiple locations and sales in excess of $20 million had been out of trust twice in an 8-month time period. Beane Associates was hired to trace the out-of-trust funds and remain on site to determine if fraud was committed, while tracking all incoming funds until the dealer fulfilled his commitments to the lender.

Result: On-site monitoring allowed for the secured lender to receive ongoing up-to-date knowledge of vehicle sales, refinancing efforts and, most importantly, how the dealer was handling cash inflows and outflows. The presence of Beane Associates facilitated the successful completion of refinancing, allowing the secured creditor to recover all of the funds advanced to the dealer, plus fees.

Gas Stations

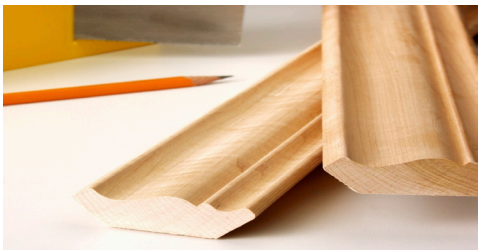
Situation: The owner of a group of gas stations had failed to notify his secured lender of past and impending sales of some of his stations. The lender retained Beane Associates to visit locations and inquire about the disposition of assets.

Result: Upon meeting with the owner, we were able to determine additional information about the sale of assets. Our research proved invaluable to the secured lender, allowing for a quick resolution and appropriate legal action.

Lumber and Millwork

Situation: A $40 million lumber and millwork company faced an uncertain future due to the U.S. housing crisis. Its secured lender had lost confidence in the company's management team, their projections and the stability of their collateral.

Result: The secured lender retained Beane Associates to perform a detailed business overview, including a review of management, projections and collateral. Following our recommendations, the secured lender was able to adjust rates, require monthly cash-flow projections, direct the company to seek refinancing and enter into a forebearance arrangement with confidence.



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.

Baynard Building, Suite 207, 3411 Silverside Road, Wilmington, DE 19810-4808 Phone: 302.479.5438 Fax: 302.479.5434 www.beaneassociates.com