

THE NEW APPROACH

Protection Against Fraud and Embezzlement

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Overview

The purpose of this document is primarily to get your attention about how vulnerable your business or local government is to fraud and embezzlement. Given your attention, we can show you how **The New Approach can help protect you against fraud and embezzlement using simple, understandable, and economical accounting procedures.**

Fraud and Embezzlement – What are we talking about?

Fraud and embezzlement encompass many BAD deeds, and you have few and minimal protections against them. Among the bad deeds are 1) **intentional mis-statements** on the balance sheet, such as overstated assets or understated liabilities, and 2) **employee theft** of assets, such as cash or inventory convertible to cash.

Fraud and Embezzlement – How serious is the problem?

Fraud and embezzlement have been around forever. And It appears to be getting worse. You only have to search the internet for “theft of cash,” “fraud,” “embezzlement,” “detection,” “audit,” etc. You will learn very quickly there is a serious problem out there. Consider the following generalizations:

- 1) Fraud and embezzlement affect accounting entities of all types and all sizes. Small businesses and local governments are particularly vulnerable.
 - 2) There are different types of fraud and embezzlement but the most common is employee theft of cash.
 - 3) A single case of fraud or embezzlement can continue unabated longer than you realize, particularly if you, a business owner or local government, are not “paying attention.”
 - 4) Losses can be staggering.
- **Cash Embezzlements.** Following are two cases that illustrate cash embezzlement characteristics that are much more common than you might think.
 - 1) **Case 1 – Small City.** The finance director embezzled nearly \$54 million over a period of more than 20 years. The embezzlement was uncovered by accident. An independent financial statement audit of the city was conducted for all those years.
 - 2) **Case 2 – Small Business.** Within a year of being hired, the chief financial officer began embezzling over a two-year period \$4 million, most of which allegedly was gambled away. The embezzlement was uncovered by accident.

Take-Away No. 1 – Length of Embezzlement Period. An embezzlement period exceeding two decades sounds like a long time, UNTIL you realize there very likely are embezzlements that are never detected.

Take-Away No. 2 – Embezzler Has Access to Accounting Records. Most cash embezzlements are accompanied with fraudulent record keeping to hide the theft. In the above cases the embezzler had high level access to the accounting system.

Take-Away No. 3 – Embezzlement Detection by Accident. A surprising number of embezzlements are uncovered by coincidence, by accident, and by anonymous tip. Some studies show that this type of detection rate is higher than by the typical financial statement audit.

Take-Away No. 4 – Embezzlement “Non-Detection” By Audit. It is widely believed that a financial statement audit is money well spent if, for no other reason than to look for possible fraud and embezzlement. There are problems with this thinking:

- 1) Audits are expensive.
- 2) Audits are not an effective tool to prevent, or detect the existence of, fraudulent reporting and embezzlements. This is evident in the above case and well documented in many studies.
- 3) Even if an audit does not detect fraud or embezzlement, the auditor will not tell you it does not exist because the auditor does not know.
- 4) Study after study shows that theft of cash is easily the most common type of employee fraud. This is where the attention should be. This is NOT where the attention IS.

Suggestions. Small business and local governments are both very vulnerable to cash embezzlements. There are a lot of suggestions out there, the most common being a financial statement audit. Such audits, however, are not very effective partly because they are not designed for detecting fraud.

More Suggestions. Other common suggestions include a fraud audit and fraud insurance. These suggestions are not very popular simply because of the cost.

Yet More Suggestions. Another common suggestion is to hire additional employees for the purpose of segregating certain accounting-related functions for better internal control. This also is not very popular because of the cost.

Over-the-Top Suggestion. A member of an oversight body was quoted as saying their auditor suggested the entity maintain two sets of books – one by the “regular” accountant and one by the designated “treasurer.” The reason for the suggestion – the auditor had no other ideas how to deal with fraud and embezzlement. IF this is indeed true, it represents a new level of desperation.

Internal Control Suggestions. Everybody suggests establishing a strong internal control environment. Many, perhaps most, of the underlying suggestions to strengthen the internal control “environment” have been around forever, and have the appearance of mere window dressing. Consider these examples – 1) strong messages from top management, 2) clear

written policies, including consequences, for not adhering to established procedures, and 3) hire employees with high integrity. These ideas are okay, but it gets a little tiresome for a business owner or local government to constantly be told that they need segregation of duties when they have an accounting department of one.

- **Where are we at?** With regard to the prevention and detection of fraud and embezzlement, the conventional wisdom is that foolproof fraud prevention is next to impossible, or at the very least, cost prohibitive. Therefore, any fraud prevention program, by default, is only capable of providing a business owner or local government with **reasonable assurance** that a fraud does not take place.

Reasonable Assurance – What does it mean? The question is rhetorical. Reasonable assurance can have different meanings for different purposes. For example:

- 1) Generic Meaning of Reasonable Assurance – Being in accordance with reason or sound thinking; being within the bounds of common sense; fair.
- 2) Business Meaning of Reasonable Assurance – Acknowledgement that it is not possible to assert absolutely and certainly that an event will (or will not) occur.
- 3) Legal Meaning of Reasonable Assurance – A standard for what is fair and appropriate under usual and ordinary circumstances.
- 4) Financial Statement Audit Meaning of Reasonable Assurance – The level of confidence that the financial statements are not materially misstated that an auditor, exercising professional skill and care, is expected to attain from an audit.

The take-away here is NOT the meaning of Reasonable Assurance! The take-away is – given that 1) fraud and embezzlement cannot be prevented or detected with certainty, 2) fraud and embezzlement are a huge problem for businesses and local governments, and 3) fraud and embezzlement does not appear to be going away anytime soon, what is being done to give some relief to those who need it, such as business owners and taxpayers?

- **What is being done?** To be blunt, experts will charge you big money to perform a financial audit of some type, to provide **reasonable assurance** of some type. Certainly, to some degree, the auditor is not being held accountable. Why? Reasonable assurance provides relief, to some degree, from the legal standard of accountability. History tells us this very fact when we see “clean” auditors’ reports followed by corporate collapses.

This does not look good for the auditing community. This does not look fair to a business owner or local government. BUT in my humble opinion, the biggest share of the blame for all of this lies in the financial accounting community!

Prevention and Detection – Where are the New Ideas and New Concepts?

Given the serious nature of fraud and embezzlement in general, and cash embezzlements specifically, where is the NEW guidance to deal with this problem, NEW ideas, NEW concepts. What has the financial accounting community done? How about the financial auditing community, or the financial reporting community, or academia?

It's fair to say the problem has NOT been seriously addressed, not to mention effectively addressed, in the past century, and maybe getting worse. It is costing small businesses and local governments big money, which should make it a huge priority. Yet, the problem persists.

There are experts across the nation who, in concert, are telling you how to do your financial accounting, how to do your financial auditing, how to do your financial reporting. These same experts are NOT telling you how to deal with financial fraud and embezzlement. Are they void of any new ideas or new concepts?

I am one of those experts. But unlike ALL of the others, whether individually or in groups, I have developed a simple, understandable, and economical solution to effectively fighting fraud and embezzlement. **The solution is: The New Approach to Financial Accounting, Auditing, and Reporting.**

Important. Please recognize that The New Approach not only addresses fraud and embezzlement, but also provides virtually all accounting entities the following: 1) a simple and understandable new concept in financial accounting, 2) a sophisticated system of electronic internal controls not possible in any other accounting system, and 3) a simple and understandable procedure to create financial statements of any kind including GAAP accrual basis financial statements, tax accrual basis financial statements, cash basis financial statements, tax cash basis financial statements, and commitment basis financial statements.

More to the point, The New Approach makes it possible for the business owner or local government to conduct, or have conducted by an independent third party, an analysis deliberately designed to prevent and detect fraud. This is what we refer to as a "Risk Analysis" and is fully documented on our website. The Risk Analysis is recommended monthly, but can be conducted on any type of regular or irregular schedule. The best news is that the Risk Analysis is informative and extremely affordable! Unfortunately, the Risk Analysis is only possible using The New Approach as a result of its unique approach to financial accounting.

Fraud and Embezzlement – What is the root cause of the problem?

We at The New Approach have quietly been conducting some of the most significant research in financial accounting, reporting, and auditing that the world has ever seen. We have solved problems related to financial accounting complexity. We have solved problems related to cost. We have solved problems related to financial statement reporting limitations. We have solved problems related to data integrity. We have solved problems related to the accuracy and reliability of financial statements and reports. We have even raised the level of manageable auditability to an unimaginable level.

The results of our work are not only incredible, but indisputable. Our testing has clearly demonstrated that our technology is not only unequivocally superior to current practice, but convincingly makes current practice obsolete, or it will in due time.

Virtually ALL of the present-day problems attributed to financial accounting, financial auditing, and financial reporting can be traced directly to double entry accounting. Put another way, The New Approach has indisputably exposed the huge deficiencies attendant with double entry accounting systems. Our new technology is both far reaching and wide ranging by virtually any measure: 1) Applicability, 2) Reporting Capability, 3) Feature Rich, 4) Understandability, 5) Simplicity, 6) Accuracy, 7) Auditability, 8) Efficiency, and 9) Effectiveness. **Can you see why we named our new technology THE NEW APPROACH?**

Are You Serious About Fraud?

Probably half of the people reading this have experienced fraud with their business or local government. Experience tells me the other half are not suspecting anything. It is the latter half that I am trying to persuade.

I would encourage you to read more about our work. The website contains several other detailed documents designed to show how we can help you, or your clients.