

# What CEOs Need to Know About Corruption Prevention & Detection – The Eternal War

**“How to Limit Opportunities for Internal and External Malfeasance”**

Center *for*  
Strategic  
Business  
Integrity

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# Agenda

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- Preface – Why Listen to Me
- Stakes of the Game
- Challenge of the Game
- Practical Game Solutions – The Forever War



# Nancy's Challenge to Me – Why We Are Here

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“What CEOs (from the CEO/Owners perspective) need to know about Corruption Prevention & Detection”

Or in other words:

“How to limit opportunities for Internal and External Malfeasance”



# The Forever War – The Goal

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Protect  
The Company  
&  
The CEO/Owners  
From  
Corruption



# Preface - Why Listen to Me?

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- Not an Academic sitting in the Ivory Tower.
- I have sat where you are sitting.
- It is all about Your Future and the Future of Your Business!



# Stakes of the Game – Corruption's Many Flavors

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- Taking What Does not Belong to You & Hiding That Taking
  - Fraud
  - Theft
  - Pay-for-Play
  - False Statements for Benefit(s)
  - Many Others





# Stakes of the Game - Corruption Involves Everybody

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- Private Businesses
- Public Businesses
- Governments
- Non-Profits
- Individuals
- Organized Criminal Groups



# Stakes of the Game - The Real Problem – Why Care????

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# Corruption

# Destroys





# Stakes of the Game - Hidden Cost of Corruption

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- The 1% to 5% **Myth**
- Clearly More than 1%
- But Nobody Will Ever Know

# Stakes of the Game – The Real Costs - Probably Trillions

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- *Enron*
- *Tyco*
- *Merrill Lynch*
- *Lehman Brothers*
- *Bear Sterns*
- *Countrywide*
- *AIG*
- *WorldCom*
- *RJR Nabisco*
- *Kodak*
- *General Motors*
- *Chrysler*
- *Penn Central*
- *Volkswagen*

*and on and on through time.*

# Challenge of the Game - Objective

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Preventing or  
Recognizing  
Corruption before it's  
*too* late.



# Challenge of the Game - Key Driving Force of Corruption is Human Nature

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Greed

&

Fear



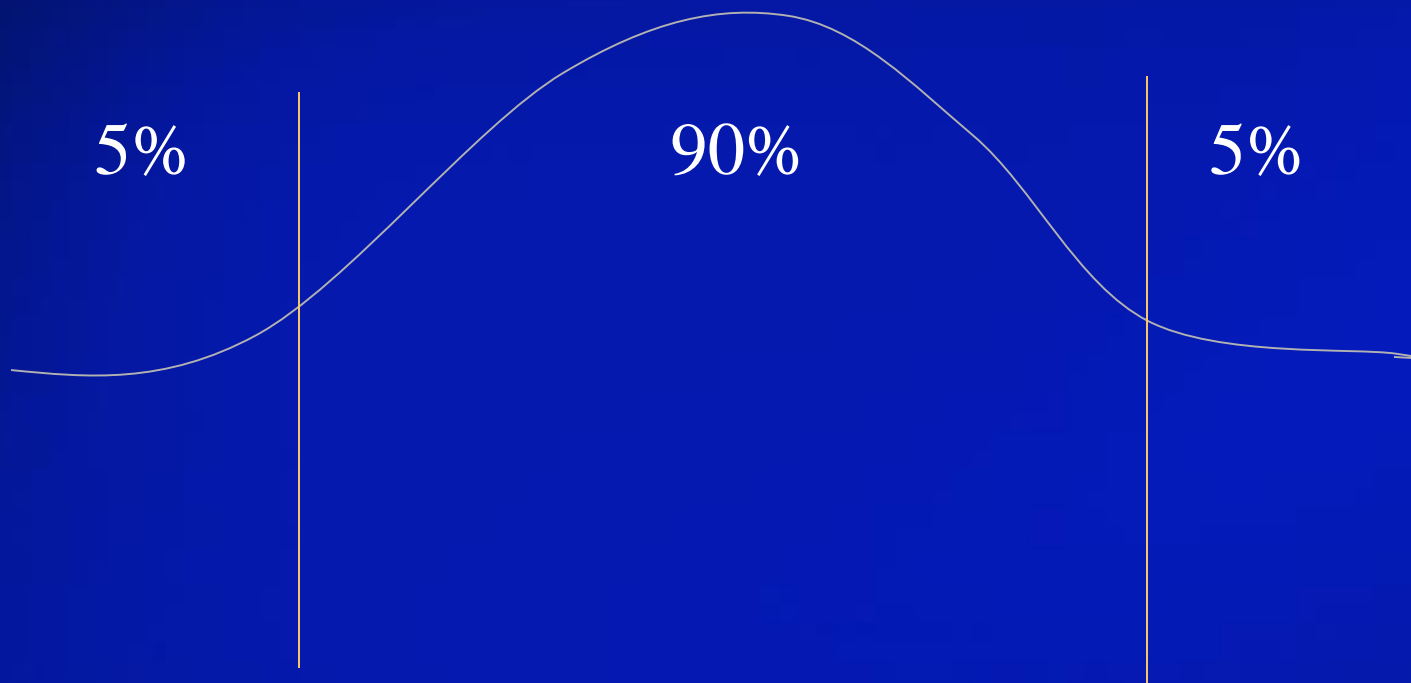
# Challenge of the Game – Human Nature – The Eternal War

At any time, day or night, 365 days a year, year after year, somebody is up to no good!



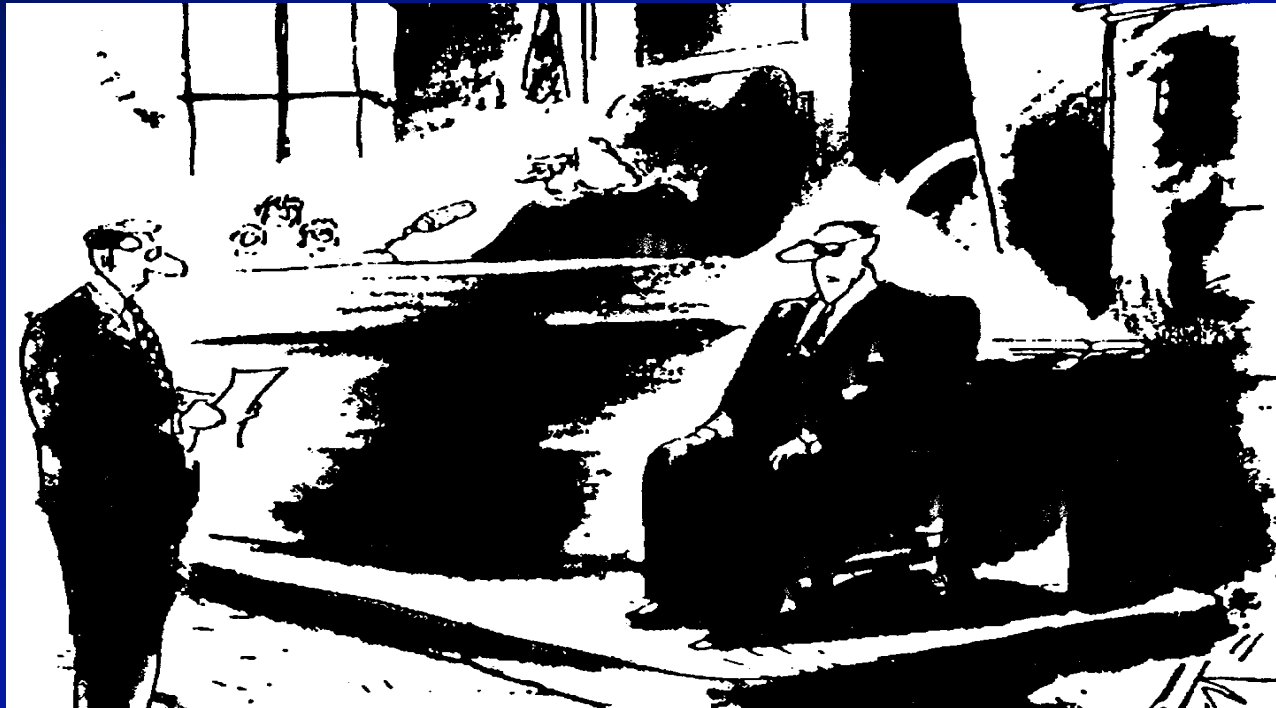
# Challenge of the Game - The Bell Curve & Human Nature\*

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# Challenge of the Game - My Friend: Jeff Skilling CEO of Enron & Chief Sorcerer



*“I know the difference between right and wrong, but so far I’ve never had reason to act on that information.”*  
NYT

## Challenge of the Game - Jeff Skilling CEO – Believer in the Old Pirate's Philosophy

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- Laws, Regulations & Business Policies are more like guidelines than rules.  
LOL
- Beware of the Slippery Deck- FIG Factor.

***Fear, Incompetence & Greed***

*will always find a way to ruin your day!*



# Challenge of the Game – Jeff's Force of Personality

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- Charming
- Brilliant
- Skilled
- Trusted
- Charismatic
- Powerful
- Respected
- Feared
- Authoritative
- Dominating
- Dangerous
- Ruthless
- **Narcissistic**

# Challenge of the Game - The Sorcerer Apprentices – The Enron Mafia

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- Chief Financial Officer
- Chief Accounting Officer
- Chief Trading Officer
- Vice-Chairman - Trading
- Arthur Andersen - External CPAs
- Arthur Andersen – Internal Auditors
- Regulators
- McKinsey????
- Law Firms????
- Many Others – Big & Small



# Challenge of the Game - The Enron Mafia - A Warning from the Real World

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## God's Book Of Internal Controls

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**In case of Collusion!**



# Challenge of the Game – The Sorcerer – Perfectly Positioned

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“The  
Indispensable  
Subordinate”

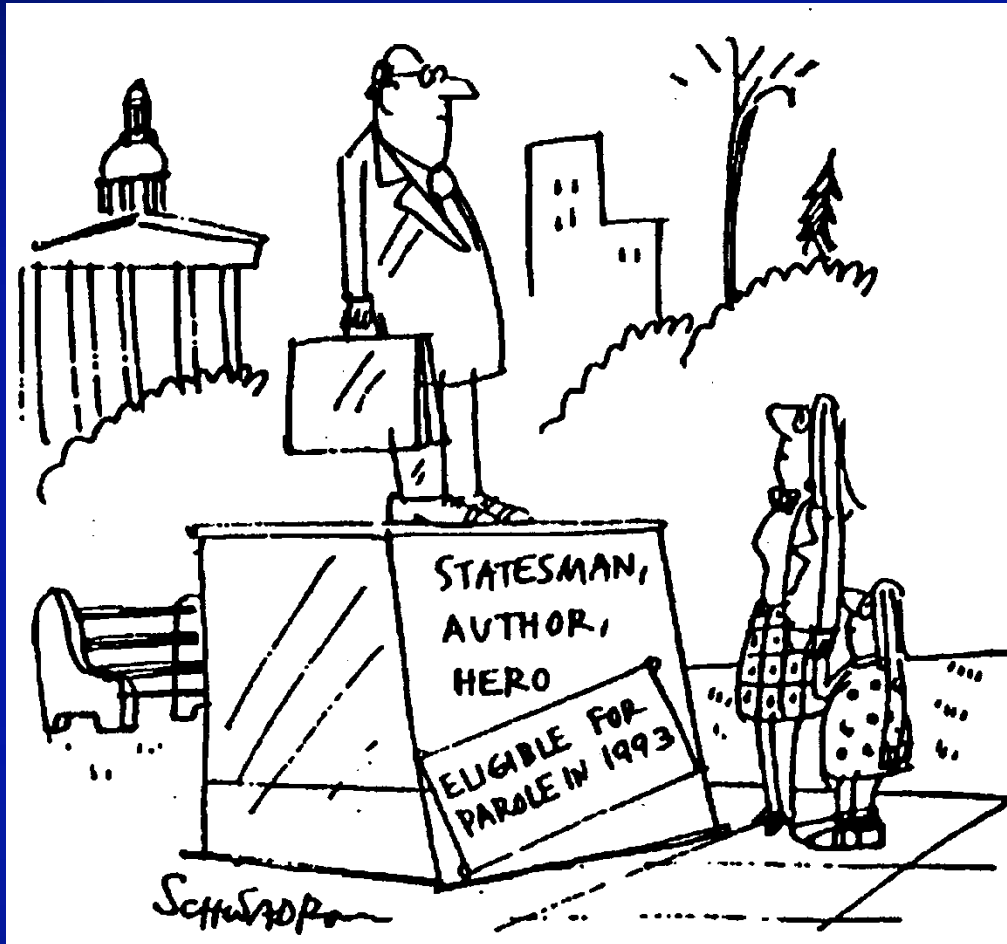




# Challenge of the Game - Ken Lay

## Chairman Enron – Missing-in-Action

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# **Challenge of the Game - Collusion & Conspiracy**

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**“One thing that most people agree on is that white-collar crime finds its biggest accomplices at the top of the company—either through collusion or a lack of oversight.”**

**— *Journal of Business Strategy***



# Challenge of the Game - Collusion & Conspiracy – The Threats You Face

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- Manipulation.
- Subversion.
- Distraction.
- Replacement – “I’ve Got This”.
- Oversight Functions that Do not Work – The Auditors.



# Challenge of the Game – Who's Doing It? - Profile of the Enemy

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- Middle to Senior Manager.
- Well Respected—Knowledge and Abilities.
- Often Highly Trusted.
- High probability of addiction.
- Lifestyle.
- Control Freak—Runs a Tight Ship.
- Emperor Complex—Forceful and Authoritative.
- Mr. Sensitivity or “The Nice Guy”.



# Challenge of the Game – Profiles In Evil – The Marquet Report – 2013 (con't)

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- 71% committed by employees who held finance/bookkeeping & accounting position.
- Average scheme lasted 4.6 years.
- Nearly 7% had a prior criminal/fraud history.
- Average stole more than \$19,000 per month.
- 81% involved **individual perpetrators**.
- 57% of the incidents involved females.
- Male perpetrators embezzled about two-and-a-half times as much as females.

# Challenge of the Game – Profiles In Evil - The Marquet Report - 2013

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- The average age at the commencement of their embezzlement was just over 43 years.
- 40 – 49 year old's most frequent culprits.
- Most appear to have been motivated by a desire to live a relatively more lavish lifestyle, rather than driven by financial woes.
- Nearly 24 percent in which a motivating factor was known involve gambling & addiction issues.
- The average prison sentence was 44 months.





# Challenge of the Game – Profiles In Evil – What Is This Telling Us

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- Almost Nothing Useful.
- General Lesson - Access, Authority & Motivation.

The Real Key to Identifying

Who is Doing It

## Profile versus Behavior



# Challenge of the Game – Smoke Signals – Behavior Issues\*

- Making things appear more complicated than they are the “Black Box”.
- Incredible performance: “We’re just smarter than everybody else”.
- Lack of information: “Don’t ask, you’re not smart enough to understand”.
- Lifestyle & Addiction.
- Odd occurrences and even odder explanations.
- Wives & Girlfriends – Husbands & Boyfriends.
- **The rumor mill.**



# Practical Game Solutions – The Forever War\*

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- 1) Recognize that you're in a game with serious consequences to failure.
- 2) Nurture situational awareness.
- 3) Act.

“Only the Paranoid Survive.”

Andy Grove - CEO Intel

“Trust but Verify.”

Ronald Reagan



# Practical Game Solutions – The CEO’s Game – The Three Strategic Keys\*

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1) Visible Leadership

2) Organizational Design for  
“Checks & Balances”.

3) The Right Staff, Tools & Tactics.



# Practical Game Solutions –The Three Strategic Keys – #1 Leadership Element\*

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## The Tone at the Top

*But What Does It Mean?*

“I will not lie, cheat or steal  
and **most importantly tolerate**  
**these behaviors in others.**”



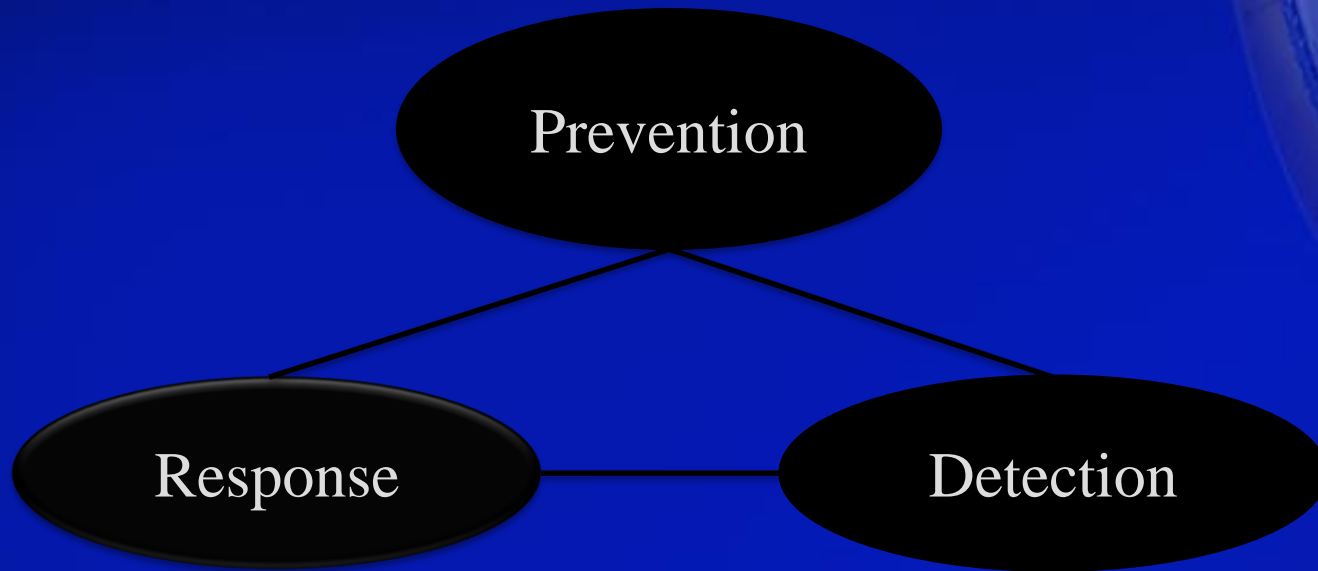
# Practical Game Solutions - The Three Strategic Keys – #2 “Checks & Balances” – The Strategic Framework

- Threat Deterrence Strategy
- Prevention - Blocks & Barriers
- Detection & Response





# Practical Game Solutions - The Three Strategic Keys – #2 “Checks & Balances” – The Strategic Framework\*



Business Controls Structure

A Prevention Strategy That Works

# Practical Game Solutions – #2 “Checks & Balances” - A Broad Strategic Framework

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## Business Controls

## Versus

## Financial Internal Controls

# Practical Game Solutions – #2 “Checks & Balances” - A Broad Strategic Framework

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- Executive Level Strategic Controls
- Financial & Operational Controls
- Management & Financial Information Systems Controls
- Corporate, Physical & Personnel Security
- Crisis Management & Response



# **Practical Game Solutions – #2 “Checks & Balances” – Management Controls - A Broad Strategic Framework**

- Business **strategy**, core skill & competitive position.
- **Organizational style, structure & culture.**
- **Business processes:** policies, procedures & systems.
- Staffing skills.
- The roles of inside & outside auditors, corporate security, corporate counsel & other oversights functions.
- Audit Committee & Corporate Governance.
- Internal audit & security.



# Practical Game Solutions – #2 “Checks & Balances” – Management Controls – Segregation & Coordination

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- Accounting versus Finance
  - *Controller versus CFO*
- Accounting versus Operations
  - *Strategic Business Unit & Financial Accounting*
- Internal Auditors & Security
- Corporate Counsel
- Board of Directors



# Practical Game Solutions – #2 “Checks & Balances” – Management Controls – Coordination - A Warning

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Beware of the Silos

&

Things That Fall Between the  
Cracks





# Practical Game Solutions – #2 “Checks & Balances” – The Oversight Elements

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- Internal & External auditors.
- Corporate Security
- Corporate & Outside Counsel.
- The Consultants
- The Board
- Oversight Analytics



# Practical Game Solutions – #3 The Right Staff with the Right Stuff – People\*

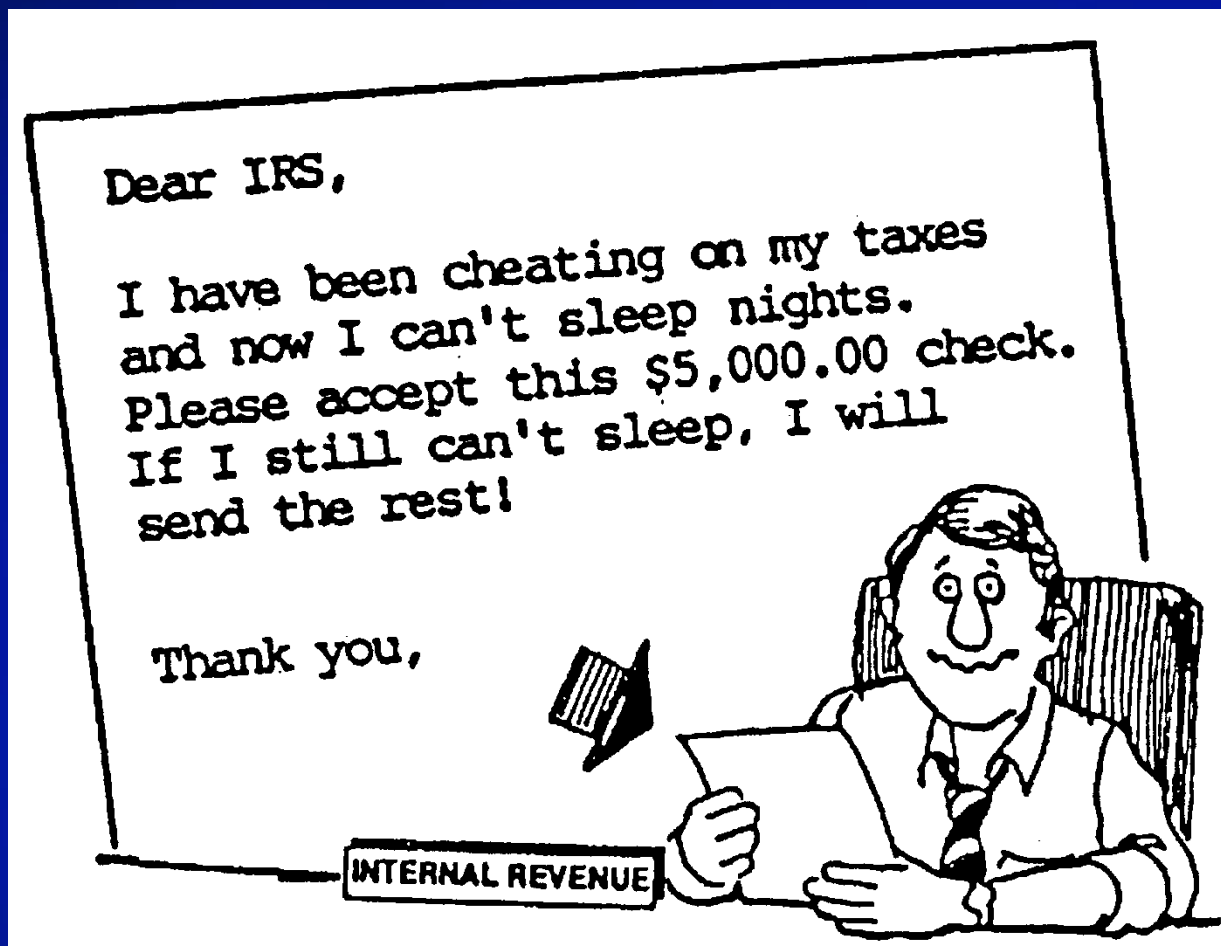
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## People

- *Executive Level People*
- *Employees*
- *Vendors*
- *Partners*
- *Customers*



## Practical Game Solutions – #3 The Right Staff with the Right Stuff – Beware of this Guy



# Practical Game Solutions – A Road Map to Resource Allocation - Detection

ACFE - REPORT TO THE NATIONS 2018 GLOBAL STUDY ON OCCUPATIONAL FRAUD AND ABUSE

<u>Detection Source</u>	<u>% of Detected Incidents</u>
➤ Tip	➤ 40%
➤ Internal audit	➤ 15%
➤ Management review	➤ 13%
➤ By accident	➤ 7%
➤ Other	➤ 6%
➤ Account reconciliation	➤ 5%
➤ Document examination	➤ 4%
➤ External audit	➤ 4%
➤ Surveillance/monitoring	➤ 3%
➤ Notified by law enforcement	➤ 2%
➤ IT controls	➤ 1%
➤ Confession	➤ 1%

# Jeff Skilling – Released Early 2019

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*“I have a brief statement, a clarification  
and two denials.”*

# Practical Game Solutions – Road Map to Prevention – Final Thoughts (con't)

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- The CEO must be the chief **advocate** for anti-corruption.
- It is the CEO's primary job to direct company's executives and **drive oversight** of their activities.
- An independent and highly skilled audit committee is essential to maintain a robust system of "Checks & Balances" over all operations.
- To be truly effective, a system of "Checks & Balances" must be **independent** of those it is charged with watching.
- The CEO can use the company's oversight functions to maintain a "Checks & Balances" system, there is no substitute for personal, **direct involvement**.
- The CEO must be willing to **direct inquiries** into allegations of misconduct.





# Practical Game Solutions – Road Map to Prevention – Final Thoughts

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- **Whistleblowers** - One of the most effective compliance tools available to the CEO is the day-to-day vigilance of the company's employees, vendors, partners and customers. All must be protected from retribution to avoid any possibility of corrupting the process.
- A **zero-based budgeting** process — requiring that the individual elements of the company's budget be built from the bottom up, reviewed in detail, and justified — would have facilitated the identification of unusual spending in numerous corporate and operating units. This provides an in-depth view of spending as opposed to basing the current year's spending, in aggregate, on last year's spending, where irregularities may be buried and overlooked.
- Background checks must include review of potential ***conflicts of interest***.
- **Analytics.**

# What CEOs Need to Know About Corruption Prevention & Detection – The Eternal War

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Feedback

Ideas

Comments

[JohnLVerna@AOL.com](mailto:JohnLVerna@AOL.com)



# Thank You

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Center for Strategic Business Integrity

John L. Verna

*Executive Director*



**WWW.CenterSBI.Com**

# About the Center for Strategic Business Integrity

([www.CenterSBI.com](http://www.CenterSBI.com))



At CSBI, our core mission is to professionalize the boardroom by *improving and certifying the strategic decision-making, oversight and crisis management capabilities of Directors and their key Advisors.*

In keeping with this goal, all our training programs strive to equip Directors and their Trusted Advisors with ideas, strategies, tactics and tools to drive success. In short, *we train Directors to direct* — not to be merely corporate governance technicians.

“The State of America’s Corporate Boards” has been part of our *Board Leadership & Governance Course Series.* These courses, along with our series on *Strategic Decision Making* and *Integrity & Crisis Response,* are designed to provide a practical framework for dealing with critical Board issues.

# About the Presenter

## – John L. Verna CBA, CPA, CFE, CICA

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- John L. Verna is founder and Executive Director of the Center for Strategic Business Integrity, an organization dedicated to improving Directorship through certification, training and advocacy for competent corporate decision making and effective oversight skills.
- John is a highly experienced business executive with over 35 years of strategic development, crisis management, investigations, integrity monitoring and corporate governance experience.
- John has been a member of the board of directors of several privately-held companies and has advised the boards of many Fortune 1000 and privately-held companies.
- John has worked to resolve a number of organizational crises including the Bankruptcy of Orange County California, Enron , the Federal Monitorship of the Los Angeles Police Department , the Monitorship of Purdue Pharma's highly controversial narcotic OxyContin in conjunction with Giuliani Partners as well as many others.
- John holds an MBA in Strategic Business Development from Cornell University and a BSc with Honors in Management from Rider University.





# What CEOs Need to Know About Corruption Prevention & Detection – The Eternal War

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## Supplements





# Practical Game Solutions – #2 “Checks & Balances” – Financial & Operational Process Controls

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## *Financial & Operational Process Controls*

- Revenue & sales processes.
- Manufacturing or service processes.
- Warehousing/logistic/inventory.
- Purchasing, including supplier & subcontractor selection & controls.
- Personnel and payroll processes.
- Treasury, financial accounting & reporting systems.



# Practical Game Solutions – #2 “Checks & Balances” – Red Flags – The Seven Shenanigans

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1. Recording revenue too soon
2. Recording bogus revenue
3. Boosting income with one-time gains
4. Shifting current expenses to a later period
5. Failing to record or disclose all liabilities
6. Shifting current income to a later period
7. Shifting future expenses into the current period



# Practical Game Solutions – #2 “Checks & Balances” – Information & Intellectual Property Controls & Security Review

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## *Information & Intellectual Property Controls & Security Review*

- Management & financial information systems.
- Internet systems.
- Operational & communication systems integrity.
- Intellectual property & trade secret controls.
- Counter-intelligence program design.



# Practical Game Solutions – #2 “Checks & Balances” – Corporate, Physical & Personnel Security Design

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## *Corporate, Physical & Personnel Security Design*

- Strategies & policies.
- Facilities design & access.
- Loss prevention tactics
- Executive & staff protection
- Workplace safety & protection
- Counter-terrorism strategies.
- Cyber security.



# Practical Game Solutions – #2 “Checks & Balances” – Crisis Management Planning & Response Design

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## *Crisis Management Planning & Response Design*

- Response to irregular business activity, natural disasters, terrorism & other corporate crises.
- Communications protocols & notification systems.
- Intelligence & reporting systems.
- Response strategies & team structures.
- Roles of management, key outsiders, ect.
- Crisis simulations.





# **Practical Game Solutions – The Road Map to Prevention – The Key Elements of Business Controls**

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## *Evaluation Techniques*

- Evaluate organization's existing business controls environment
- Walk-throughs of operations, including interviews with management and operations personnel, review of documentation and penetration exercises.
- Review of prior incidents and identification of future threats to organization.
- Design control strategies, tactics and tools necessary to deter and/or detect business irregularities and threats.





# Challenge of the Game – Danger Can Come from Many Directions

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## Functions

- Sales
- Purchasing
- Accounting
- Personnel/Payroll
- Finance
- Risk Mgt/Insurance
- Operations
- Maintenance
- Construction
- Deal Making

## Levels

- General Mgt
- Line Mgt
- Support Mgt
- Staff

➤ People with  
Control &  
Access

# Practical Game Solutions – The Three Strategic Keys – #1 Leadership Element

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## *In Other Words:*

- Tone
- Executive Decision Making Ability
- Oversight Skills – “Checks & Balances”
- *Courage*





# The Seven Shenanigans

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1. Recording revenue too soon
2. Recording bogus revenue
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# Practical Game Solutions – Road Map to Prevention – Last Thoughts

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## Industrial – Governmental/Judicial Complex

- 1) You can't fight corruption alone.
- 2) As Individual Industrial Leaders
- 3) As a Group of Leaders



# Stakes of the Game - The Real Costs - Probably Trillions

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- *Enron, Tyco, Chesapeake Energy, Merrill Lynch, Lehman Brothers, Fannie Mae, Bear Sterns, Countrywide, AIG, Washington Mutual, Adelfphia, WorldCom, Global Crossings, RJR Nabisco, Kmart, Kodak, General Motors, Chrysler, Orange County California, the S&L Crisis, Penn Central, Integra, Volkswagen and on and on through time.*





# What Happened— The Human Dimension

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- Middle to Senior manager
- Well respected for both knowledge and abilities
- Often highly trusted
- Lifestyle
- Control freak, runs a tight ship
- Emperor complex, forceful and authoritative
- Mr. Sensitivity —> The Nice Guy
- High probability of addiction



# Challenge of the Game – Smoke Signals – Behavior Issues

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- Recent changes in subjects' behavior.
- Recent changes in subjects' lifestyle.
- Creating appearance of the technical black box
- Odd occurrences and even odder explanations
- The Rumor Mill

