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CROSSING THE ETHICAL BOUNDARY – INSIGHTS FROM A FRAUD INVESTIGATOR

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LEARNING OBJECTIVES

- // Discuss examples of CPAs & other individuals that have crossed ethical boundary
- // Explore ethical decision making & repercussions in these examples
- // Define ethics & other key related concepts
- // Describe a model for ethical decision making
- // Examine examples of evaluating & resolving ethical dilemmas

WEBSTER'S DEFINITION OF ETHICS

- // Discipline dealing with what is good & bad & with moral duty & obligation
- // Set of moral principles: theory or system of moral values
- // Principles of conduct governing individual or group
- // Guiding philosophy
- // Consciousness of moral importance

ETHICS





Department of Justice Press Release

For Immediate Release March 1, 2010 U.S. Department of Justice Office of Public Affairs (202) 514-2007/TDD (202) 514-1888

Two Former Executives of Medical Manager Found Guilty in Securities Fraud Scheme

Two former executives of Medical Manager Health Systems Inc., (Medical Manager), a subsidiary of WebMD Corporation from 2000 to 2005, were convicted today by a federal jury in Charleston, S.C., with participating in a conspiracy to fraudulently inflate the reported earnings of Medical Manager by more than \$16.8 million between 1997 and 2003, announced Assistant Attorney General Lanny A. Breuer of the Criminal Division; Kevin F. McDonald, Acting U.S. Attorney for the District of South Carolina; David A. Thomas, Special Agent in Charge of the FBI's Columbia Division; and Jeannine Hammett, Special Agent in Charge of the Charlotte, N.C., Field Office of the Internal Revenue Service (IRS) Criminal Investigation.

Former Medical Manager president John H. Kang, 46, of Trabuco Canyon, Calif., and former vice president and chief operating officer John P. Sessions, 67, of Myrtle Beach, S.C., were convicted of conspiracy to commit mail, wire and securities fraud. Kang and Sessions were charged in a second superseding indictment on Feb. 27, 2007, along with other executives of Medical Manager, for their roles in the fraudulent scheme.

"As the president and vice-president of their company, these defendants were supposed to lead their company with honor and integrity—instead, they orchestrated an elaborate accounting scheme meant to defraud investors about the financial success of their company," said Assistant Attorney General Lanny A. Breuer of the Criminal Division. "Corporate executives cannot decide to play by their own set of rules. The message is simple—obey the laws or face prosecution for your crimes."



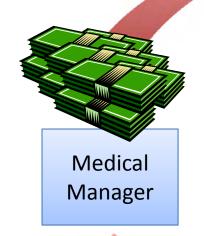


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SOME TRIAL EXHIBITS

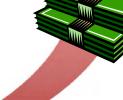
CIRCULAR REVENUE TRANSACTION

(ROUND TRIP)



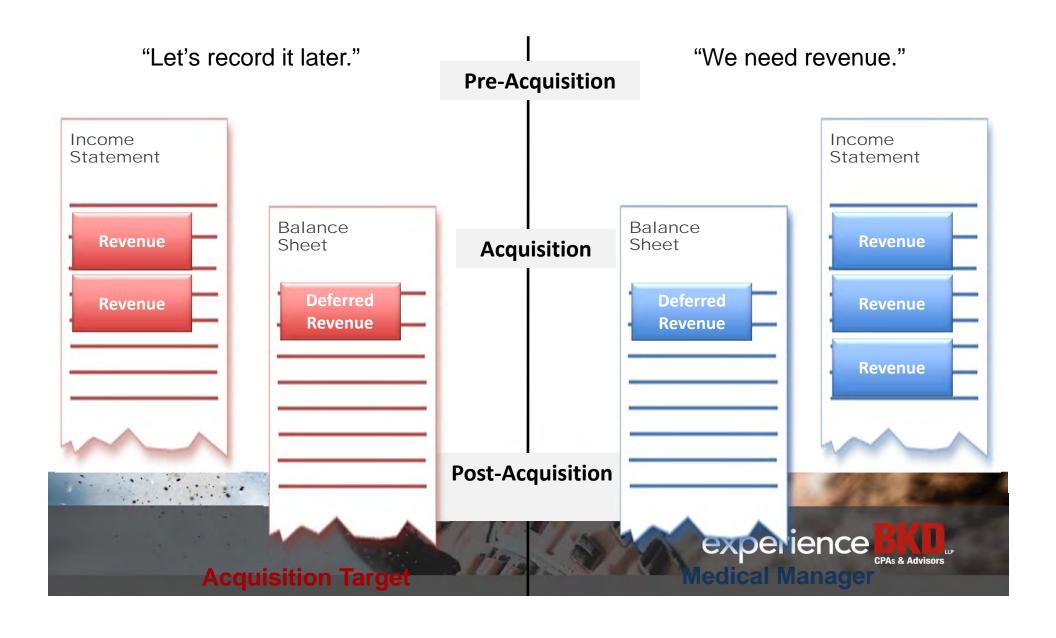
Acquisition Proceeds \$5 million



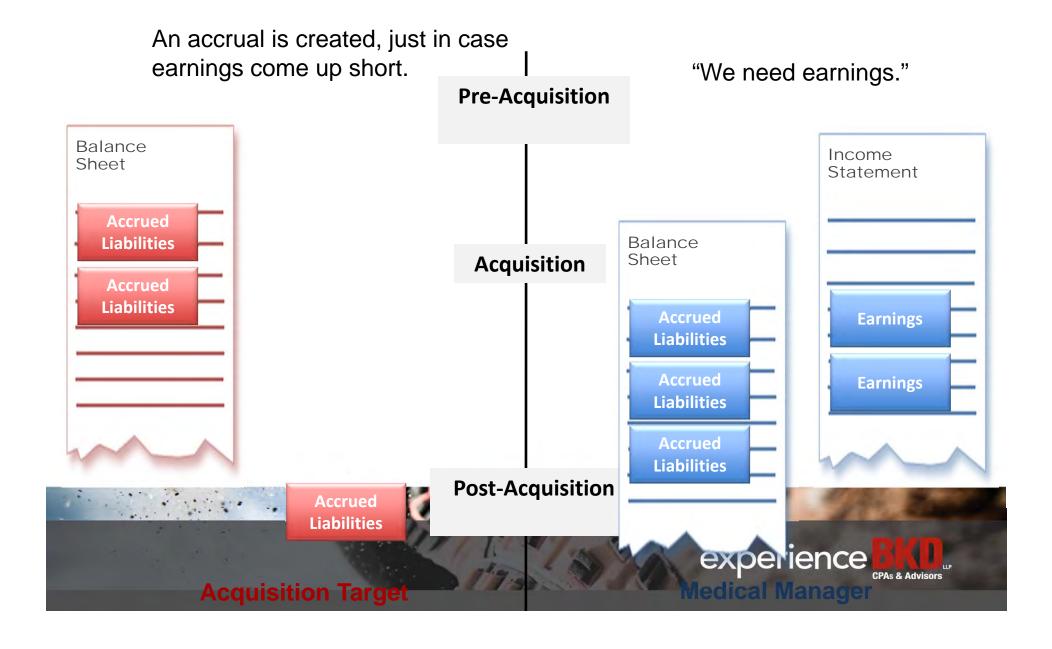


Return of part of Proceeds and Recorded as revenue \$1.5 million

MANIPULATION OF PRE-ACQUISITION DEFERRAL OF REVENUES



MANIPULATION OF PRE-ACQUISITION ACCRUED LIABILITIES



MEET CAROLINE BEMBRY

- // Medical Manager Corporation Assistant Corporate Controller
- // Participated in a financial statement fraud two years into her career
- // Key witness at trial



EXCERPTS FROM BEMBRY TESTIMONY

- Q. Okay. Now, what type of understanding did you and the people who we just identified have on using improper accounting to inflate those earnings?
- A. It was an understanding of this is what we need to make the numbers, to make it happen. It was "a wink and a nod" type of agreement. So it was just, "This is what we need. Go make it happen, whatever it takes."
 - Q. And what did you understand that to mean?
 - A. Cook the books when you need to to make the numbers.



EXCERPTS FROM BEMBRY TESTIMONY

- Q. Why did you participate in this?
- A. Um, you know when I started, I -- it was really kind of small at the beginning. It -- they weren't large transactions at first. Everything was kind of small, and you kind of started to believe the excuses that you make up, um, and you "drink the Kool-Aid" is what I say. You know, you start telling yourself the lies so much that you start to believe it, and eventually it gets out of hand.



MEET A HOSPITAL CFO - MR. P

- // Fired for smoothing earnings using contractual account as cookie jar
- // Product of his environment
- // Believed this was proper
- // Failed to recognize ethical dilemma



MANIPULATION OF NON-PROFIT HOSPITAL FINANCIALS

- // Subsidiary hospital of large non-profit system
- // CFO thought revenue seemed low
- // One quarter booked approx. \$5 mil revenue to make same as last year
- // Another quarter, earnings were great
 - // Booked a \$1 million liability against contractuals
 - // Created a reserve for smoothing earnings

DEPOSITION EXCERPT

- Q. My question is really simple, Mr. Do you recall telling the panel, the three executives of Health, that smoothing is a generally accepted accounting principle?
- A. I recall -- I know I'm -- I recall saying yes in my definition of smoothing.
- Q. And do you recall telling the panel further that you could look up smoothing in generally accepted accounting principles and that they could find that principle in GAAP?

MR. Form and foundation.

THE WITNESS: I believe I said that.



SMOOTHING EARNINGS

SEC on Smoothing



IS IT OK TO BE OVER ACCRUED?

IS IT BETTER TO BE OVER ACCRUED THAN UNDER ACCRUED?



WHAT BASIS EXISTS FOR CONSERVATISM?

Is conservatism:

- // An accounting principle?
- // GAAP?
- // Encouraged by any accounting standard or guidance?

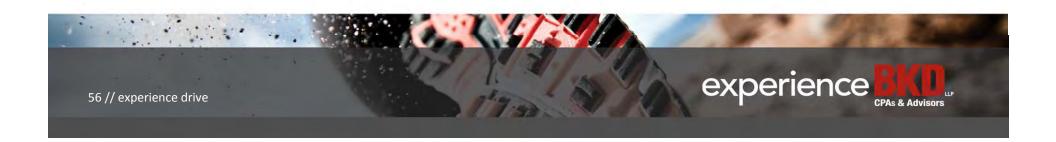


FINANCIAL ACCOUNTING STANDARDS BOARD

FASB CONCEPTS STATEMENT NO. 2 (AS AMENDED) QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION ISSUED: MAY 1980

...conservatism tends to conflict with significant qualitative characteristics, such as representational faithfulness, neutrality, and comparability (including consistency)... (para. 92)

...if two amounts are not equally likely, conservatism does not necessarily dictate using the more pessimistic amount rather than the more likely one... (para. 95)





|Code|of | Ethics

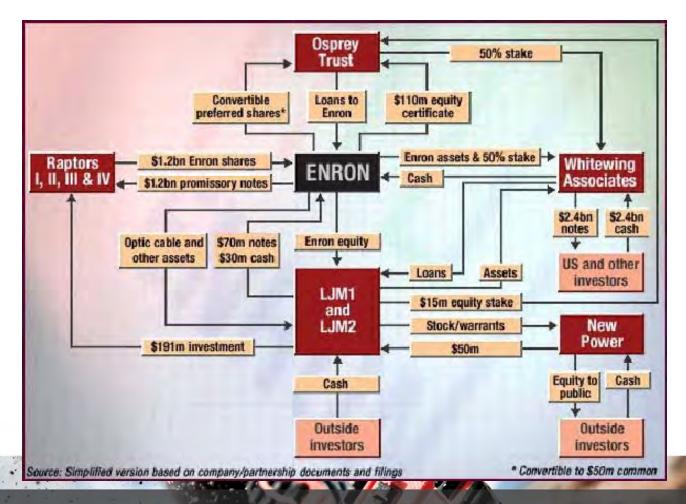
July, 2000



ETHICAL CULTURE

- // Excerpt from Enron's Business Ethics Policy
 - "Employees of Enron Corp., its subsidiaries, and its affiliated companies (collectively the "Company") are charged with conducting their business affairs in accordance with the highest ethical standards. An employee shall not conduct himself or herself in a manner which directly or indirectly would be detrimental to the best interest of the Company or in a manner which would bring to the employee financial gain separately derived as direct consequence of his or her employment with the Company..."
- // It's been reported underlying culture was one that encouraged you "make the numbers" at all costs & don't get caught
- // Employees were taking greater risk to "make those numbers"

ENRON'S SPECIAL PURPOSE ENTITIES



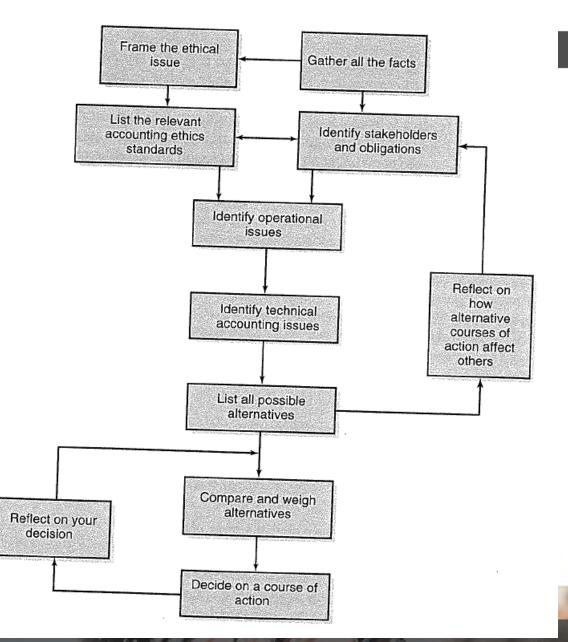
ETHICAL DECISION-MAKING PROCESS

- // Often we do not have all facts & must probe to uncover "right" or best way to respond to our dilemma
- // Ethical issues often times involve competing values
- // Sometimes, there may be more than one "right" answer. As a professional, you cannot shy away from these gray areas but instead must learn to actively work through them
- // Ethical decision-making model, which is a series of evaluation questions to help you analyze & determine best possible solution to an ethical dilemma

ETHICAL DECISION-MAKING PROCESS

- // To address ethical matters & make good judgments, you must first be able to recognize issues when they arise
- // This means being familiar with profession's body of rules & regulations from AICPA & your local state boards
- // You also don't need to do this analysis alone or make this decision by yourself (See Risk, Seek Help) – there is lots of help available
- // AICPA Ethics Hotline 1.888.777.7077

FIGURE 2.2 An Ethical Decision-Making Model



STEPS IN ETHICAL DECISION-MAKING MODEL

- 1. Frame ethical issue
- 2. Gather all facts
- 3. List relevant accounting & ethics standards
- 4. Identify stakeholders & obligations
- 5. Identify operational issues & technical accounting issues
- 6. List your possible alternatives
- 7. Consider effects on stakeholders
- 8. Compare & weigh alternatives
- 9. Decide on a course of action
- 10. Reflect on your decision
- 11. HBC addition: document your efforts

PREAMBLE TO AICPA CODE OF PROFESSIONAL CONDUCT

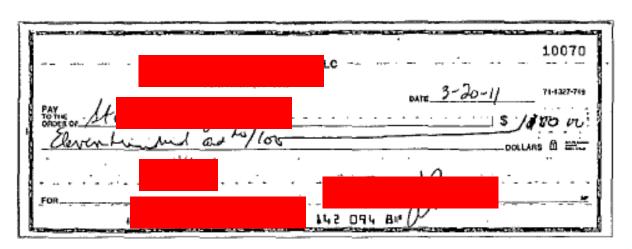
- // "Membership in the AICPA is voluntary. By accepting membership, CPA assumes an obligation of self-discipline above and beyond the requirements of laws and regulations."
- // Ethics can be defined as
 - // Rules & standards governing conduct of members of a profession
 - // Study of general nature of morals & of specific moral choices
 - // In accordance with accepted principles that govern conduct of a group, especially a profession

MEET THE SURGERY CENTER

- // Director of Surgery Center
- // Collusion with Manager
- // \$500K taken over 3 year period
- // 5 methods:
 - // Personal Use of Credits Cards
 - // AP Checks
 - // ACH Payments
 - // Cash Withdrawals
 - // Payroll
- // Lessons Learned and Ethical Implications

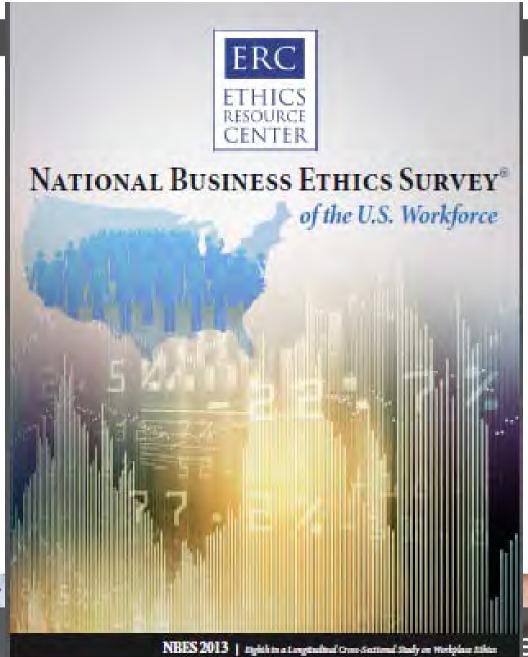
THE SURGERY CENTER

Account ID	▼ Account Description ▼	Date	▼ Reference	▼ Jrnl ▼	Trans Descriptic 🔻	Debit A ▼	Credit A ▼	Balan 🔻
6521-415	Supplies-Anesth-Non Chargeable	3/1/11			Beginning Balance			1,991.30
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10070 \$1,100.00 03/23/2011

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"Let the minutes show that Fenwick brought up the subject of corporate ethics."

experience

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THE SURVEY

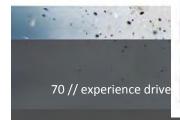
// Published every 2 years, ERC's National Business Ethics Survey® (NBES) nationally recognized barometer of workplace ethics.



MOST FREQUENTLY OBSERVED TYPES OF MISCONDUCT

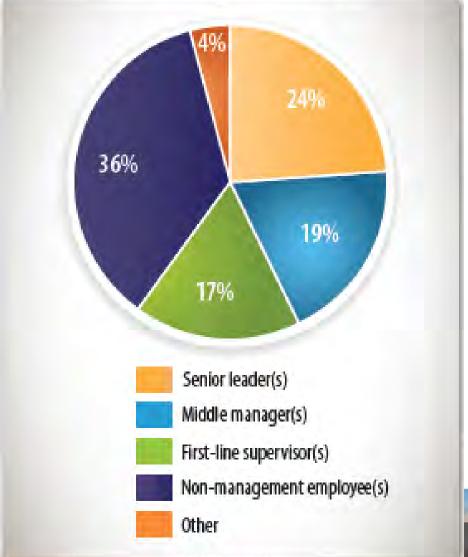
OBSERVED MISCONDUCT

	2011	2013
OVERALL	45%	41%
Abusive behavior or behavior that creates a hostile work environment	21%	18%
Lying to employees	20%	17%
A conflict of interest – that is, behavior that places an employee's interests over the company's interests	15%	12%
Violating company policies related to Internet use	16%	12%
Discriminating against employees	15%	12%
Violations of health or safety regulations	13%	10%
Lying to customers, vendors, or the public	12%	1096
Retaliation against someone who has reported misconduct		10%
Falsifying time reports or hours worked	12%	10%
Stealing or theft	12%	9%
Violating employee wage, overtime, or benefit rules	12%	9%
Delivery of substandard goods or services	10%	9%
Abusing substances, such as drugs or alcohol, at work	11%	9%
Breaching employee privacy	11%	8%
Improper hiring practices	10%	7%
Sexual harassment	11%	7%
Breaching customer or consumer privacy	7%	5%



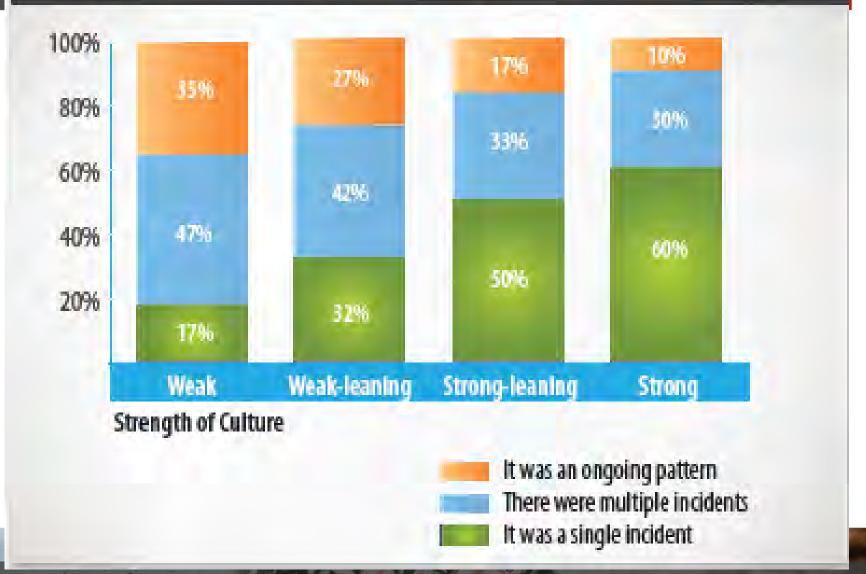


Most Misconduct Committed by Managers

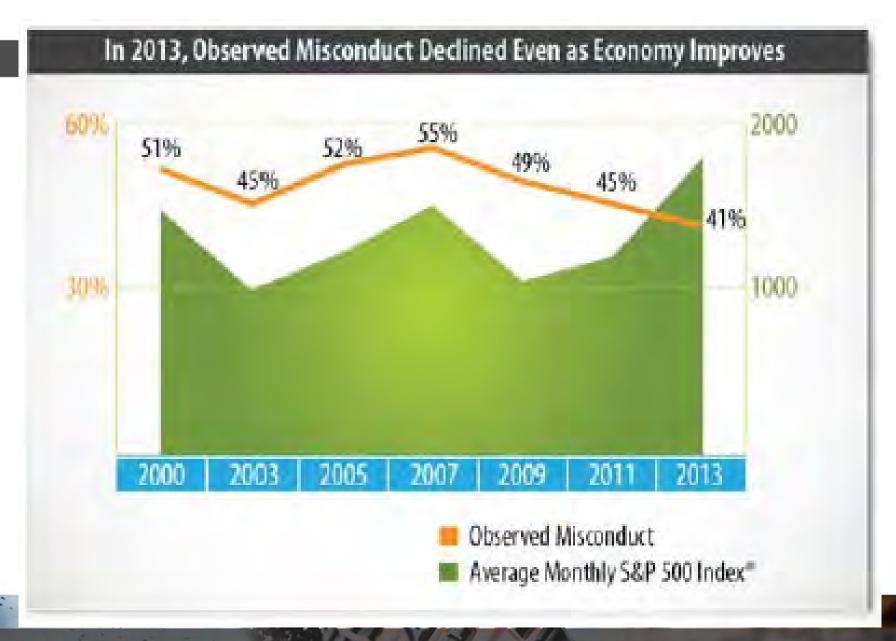




Ongoing Misconduct Far More Likely in Weaker Ethics Cultures









THE NUMBERS

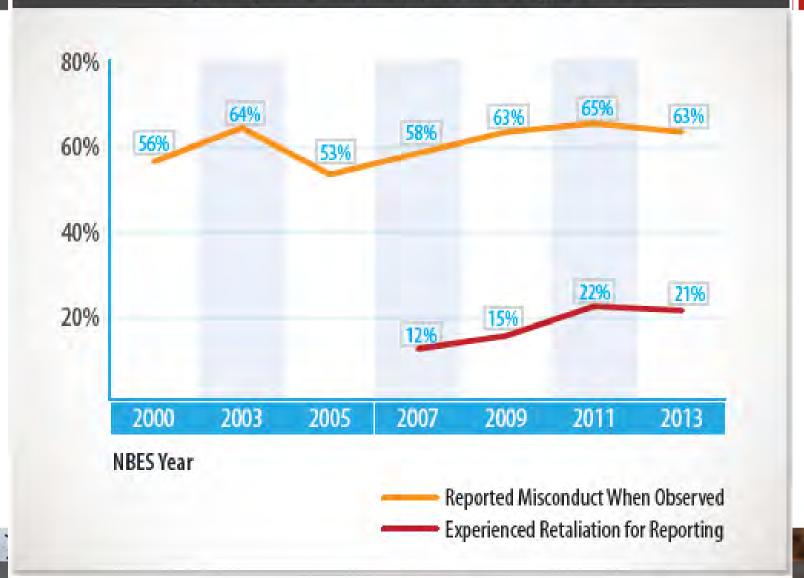




Growth of Ethics & Compliance Initiatives Over Time



Reporting & Retaliation Rates Remain High in 2013



THANK YOU

FOR MORE INFORMATION // For a complete list of our offices and subsidiaries, visit **bkd.com** or contact:

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