

*2008 Pacific Emerging Issues Conference*  
“Charting the Course Through Financial Adversity”

*It's Almost Midnight,  
Do You Know Where  
Your Assets Are?*

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**DAVID L. COTTON, CPA, CFE, CGFM**  
**COTTON & COMPANY LLP CHAIRMAN**

Dave Cotton is chairman of Cotton & Company LLP, Certified Public Accountants. Cotton & Company is headquartered in Alexandria, Virginia. The firm has a practice concentration in assisting Federal and State agencies, inspectors general, and government grantees and contractors with a variety of government program-related assurance and advisory services. Cotton & Company has performed grant and contract, indirect cost rate, financial statement, financial related, and performance audits for more than two dozen Federal inspectors general as well as numerous other Federal and State agencies and programs.

Cotton & Company's Federal agency audit clients have included the U.S. Government Accountability Office, the U.S. House of Representatives, the U.S. Small Business Administration, the U.S. Bureau of Prisons, and the U.S. Marshals Service. Cotton & Company also assists numerous Federal agencies in preparing financial statements and improving financial management and accounting systems.

Mr. Cotton received his BS in mechanical engineering (1971) and an MBA in management science and labor relations (1972) from Lehigh University in Bethlehem, PA. He also pursued graduate studies in accounting and auditing at the University of Chicago, Graduate School of Business (1977 to 1978).

Mr. Cotton is presently serving on the Advisory Council on Government Auditing Standards. He is a member of the Advisory Council of the Academy for Government Accountability. He is also a member of the advisory board of the Institute for Truth in Accounting. He is serving on the Institute of Internal Auditors (IIA) Anti-Fraud Programs and Controls Task Force, and is a former member of the American Institute of CPAs (AICPA) "Group of 100." He served on the AICPA task force that wrote *Management Override: The Achilles Heel of Fraud Prevention*. He is the past-chairman of the AICPA Federal Accounting and Auditing Subcommittee and has served on the AICPA Governmental Accounting and Auditing Committee and the Government Technical Standards Subcommittee of the AICPA Professional Ethics Executive Committee.

Mr. Cotton served on the board of the Virginia Society of Certified Public Accountants (VSCPA), and on the VSCPA Litigation Services Committee, Professional Ethics Committee, Quality Review Committee, and Governmental Accounting and Auditing Committee. He is member of the Greater Washington Society of CPAs (GWSCPA) and is serving on the GWSCPA Professional Ethics Committee. He is a member of the Association of Government Accountants (AGA) and is past-advisory board chairman and past-president of the AGA Northern Virginia Chapter. He is also a member of the Institute of Internal Auditors and the Association of Certified Fraud Examiners.

Mr. Cotton has testified as an expert in governmental accounting and auditing issues and fraud issues before the United States Court of Federal Claims and other administrative and judicial bodies.

Mr. Cotton served as a technical reviewer for the 1999 through 2003 editions of the AICPA Audit and Accounting Guide *Audits of Federal Government Contractors*.

Mr. Cotton is the author of the AICPA continuing education courses *Fraud in Governmental and Not-for-Profit Audits—the Auditor's Responsibilities Under SAS 82* and *Joint and Indirect Cost Allocations: How to Prepare and Audit Them*. He has lectured frequently on auditors' fraud detection responsibilities under **SAS 99**, *Consideration of Fraud in a Financial Statement Audit*. He also has been an adjunct instructor at the Inspectors General Auditor Training Institute (*Auditing the Federal Contracting Process* and *Contract and Procurement Fraud*) and currently teaches at the George Mason University Small Business Development Center (*Fundamentals of Accounting for Government Contracts*).

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## The Plan for Today

- ✓ Fraud discussions (brainstorming)
- ✓ Let’s play “Protect Those Assets”

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1

## Fraud Brainstorming

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### Discussions Among Engagement Personnel

- ✓ During audit planning
- ✓ Interactive exchange of ideas ... *brainstorming*
- ✓ Insights of more experienced team members
- ✓ How and where the financial statements might be susceptible to fraud within the framework
  - ✓ Motive
  - ✓ Opportunity
  - ✓ Rationalization
- ✓ Emphasize importance of proper state of mind (professional skepticism) during the audit
- ✓ Include the risk of management override of controls
- ✓ Thoroughly probe the issues
- ✓ Consider audit responses to fraud susceptibility

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### Discussions Among Engagement Personnel

- ✓ Summarize known fraud risks and control strengths and weaknesses
- ✓ Brainstorm ways that fraud might be committed by someone within the entity (by management or employees) or on the entity (by an outsider)
- ✓ Evaluate fraud schemes deemed viable or possible
- ✓ React by modifying planned audit tests to ascertain if fraud is occurring

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4

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## Discussions Among Engagement Personnel

- ✓ Summarize known fraud risks and control strengths and weaknesses
- ✓ **Brainstorm** ways that fraud might be committed by someone within the entity (by management or employees) or on the entity (by an outsider)
- ✓ **Evaluate** fraud schemes deemed viable or possible
- ✓ **React** by modifying planned audit tests to ascertain if fraud is occurring

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5

## *The purpose of brainstorming ...*

*...is to get as many ideas as possible from a group of people in the shortest possible time. Quantity and not quality is the order of the day. It does not matter if the ideas are thought to be unworkable, or crazy, or outlandish by anybody within the group. Sometimes these ideas are the very ones that are adapted into other forms that solve the problem adequately.*

*--<http://www.mindbloom.net/brain.html>*

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6

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## *The rules for effective brainstorming ...*

- 1. There should be no criticism of any idea from any member of the group*
- 2. There should be no evaluation of the ideas generated*
- 3. The more ideas generated, the better*
- 4. Combination or modification of the ideas generated is encouraged*

*--<http://www.mindbloom.net/brain.html>*

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7

## **Discussions Among Engagement Personnel**

- ✓ Sample Workpapers: See Attachment 1
- ✓ Email me ([dcotton@cottoncpa.com](mailto:dcotton@cottoncpa.com)) if you want the Word file .....

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Let's play  
“Protect Those Assets”

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What are assets???

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10

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## Let’s Play “Protect Those Assets”

- ✓ Divide into teams of 5 to 10 players
- ✓ Select a scribe
- ✓ Teams on the debit side of the room will be the defenders
- ✓ Teams on the credit side of the room will be the attackers
- ✓ Teams may pick their assets, or I will assign the assets to be protected and defended

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## Let’s Play “Protect Those Assets”

- ✓ **Defenders:** you have 15 minutes to design and define as many control procedures as you deem cost-effective and necessary to protect your assigned assets
- ✓ Record your controls

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12

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## Let’s Play “Protect Those Assets”

- ✓ *Attackers*: you have 15 minutes to devise fraud schemes designed to obtain (or damage) some or all of the assets you are assigned to attack
- ✓ Record your fraud schemes

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13

## *The purpose of brainstorming ...*

*...is to get as many ideas as possible from a group of people in the shortest possible time. Quantity and not quality is the order of the day. It does not matter if the ideas are thought to be unworkable, or crazy, or outlandish by anybody within the group. Sometimes these ideas are the very ones that are adapted into other forms that solve the problem adequately.*

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14

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## *Rules of Engagement*

- ✓ The defender team will read the group their list of controls*
- ✓ The attacker team will then read its list of fraud schemes*
- ✓ Our panel of judges will decide who wins each encounter*

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16

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**Consider this ...**

- ✓ Designing and maintaining internal controls to protect assets is ...*boring*
- ✓ Fraud perpetrators usually are more creative than asset protectors
- ✓ Maybe a better approach to protecting assets is to:
  - ✓ Try thinking like the perps
  - ✓ Devise ways to steal assets—use brainstorming
  - ✓ Once you’ve identified the schemes, THEN design controls that would prevent or detect those schemes

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17

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18