Belief $\rightarrow$ Action $\rightarrow$ Results
A Passion for Internal Auditing
MacKay Explored
Human Nature

- Tulipomania
- South Sea Bubble
- The Mississippi Scheme
John Kenneth Galbraith in *A Short History of Financial Euphoria* tells us that there has long been speculative euphoria.

It is:

- Predictable
- Recognizable
- Avoidable.
“It’s quite amazing… It’s like having a near-death car experience, and you get back in the car and you drive just as wildly as before.”

John Reed, former CO-CEO of Citigroup

Quoted in Fortune Magazine, October 2010, describing behavior of bankers…
What’s Going On?
Increasing complexity because of:

1. Technology
2. Global sources & markets
3. Increased visibility around the world
4. Environmental concerns
5. Leaders commitment to personal wealth & power
6. Erosion of character
7. Increased reliance on 3rd parties
Increasing scandals:

1970’s
1980’s
1990’s
2000’s
2010’s?

We seem unable or unwilling to address causes.
1999 Repeal of Glass-Steagall Act
Despite all these efforts we continue to have scandals...

Why?
There has been a failure of

COMPETENCE
INTEGRITY
COURAGE
<table>
<thead>
<tr>
<th>Failure of</th>
<th>Competence</th>
<th>Integrity</th>
<th>Courage</th>
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<tbody>
<tr>
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<tr>
<td>CFO</td>
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<tr>
<td>CPAs</td>
<td>✗</td>
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FFR - What’s Going On?

Solutions have:

1. Seemed to provide the illusion of addressing FFR
2. Provided regulation
3. Created revenue for consultants
4. Done little to reduce risk of FFR
Effective Executives have always understood their risks!
NEW YORK TIMES BESTSELLER

THE BLACK SWAN

The Impact of the Highly Improbable

“The most prophetic voice of all.” —GQ

Nassim Nicholas Taleb
“During my eighty-seven years I have witnessed a whole succession of technological revolutions. But none of them has done away with the need for character in the individual or the ability to think.”

Bernard Baruch
Technology can lull management into believing all is well when it is not.
Is there fraud that is facilitated by technology?

Without computers…

Could we have had derivatives?
Could we have program trading?
“Some contracts are just too complicated and complex to be understood or audited.”

A quote from an audit manager.
Overcharges for Air Travel

Class action lawsuits
Settled by 3 firms for over $100 million
The Federal Government's settlement was even more...

The most bothersome aspect...
Some seem unable to tell right from wrong.
Marin County Allegations

1. Overstated capabilities & experience
2. Billed for work not done
3. Billed for substandard work
4. Corrupted an approver
   • To approve deficient work
   • To approve more contracts
5. Tried to silence dissent

From Federal Complaint
A PC vendor worked on the computer network, traveling from branch to branch. The contract allowed billing for travel time and mileage. He made circle trips.

*What do you think he billed for?*

The local branch manager approved the invoice.

*What do you think he thought he was approving?*

Accounts payable paid the approved invoices.

*What do you think they believed the approvals meant?*
Let’s look at the math...

“Our goal is 15% net income growth annually...”
In 1759 a cabinet maker built a beautiful secretary (desk) for which he was paid the equivalent of $300. In 1999 the piece sold at auction for $7,500,000!

As happy as the owners were, would they have been better off getting 5% on their $300 investment all those years?
Growth of $300 compounded for 240 years…

<table>
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<tr>
<td>3%</td>
<td>$361,456</td>
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<tr>
<td>4%</td>
<td>$3,673,861</td>
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<tr>
<td>5%</td>
<td>$36,521,872</td>
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<td>$355,245,772</td>
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<tr>
<td>15%</td>
<td>$110,816,119,854,613,000</td>
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Are 15% growth goals realistic for sizeable organizations?

How long before a company is bigger than the entire economy?
Man is most credulous when happy.

from an early editor of The Economist
We are most happy when people tell us what we want to hear!

We may be so happy we will ignore all evidence that there might be problems!
Success encourages blindness!
Unrealistic expectations have a role!

- Expectations about growth
- Faster is better…
- We can do more with less without sacrificing anything.
- *We will work harder and smarter.*
- Smart and well-educated people will make good decisions.
- Underestimating the time required to *think things through*.
- *People will act as if they are valued, no matter what!*
The Human Element

- Willful blindness – *a factor in all major cases!*
- Carelessness – *these are just technical matters!*
- Making decisions for the wrong reasons
- Decisions are contaminated
- Emotions and ego play an exaggerated role
- Poor problem solving or decision making methods
“Business decisions, as many of our colleagues and your own experience can attest, are frequently based on hope or fear, what others seem to be doing, what senior leaders have done and believe has worked in the past, and their dearly held ideologies – in short, on lots of things other than facts.”

Hard Facts, Dangerous Half-Truths & Total Nonsense
by Jeffrey Pfeffer and Robert I. Sutton
Suggestions for Auditors in 2012

- Commit to KYY.
- Understand and influence executive attitudes about problem identification and response.
- Be sure that management understands the importance of knowing their risks.
- Commit to learning WGO in detail.
- Commit to understanding risks and exposures related to third party relationships.
- Commit to exploring new and evolving risks, particularly in technology.
- Audit where the action is!
Courtenay M. Thompson Jr.

Provides practical experience based training to auditors managers, and investigators. Currently offering the following open enrollment courses:

Fraud Detection & Investigation for Internal Auditors
Construction Fraud: Detection, Prevention & Response
Effective Auditing of Construction Activity
In conjunction with Construction Audit & Cost Control Institute

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