"How do you define honesty?" asks Steve Clark, J.D., CFE, an ACFE faculty member and visiting professor of law at St. Thomas University School of Law in Miami, Florida. Formerly the attorney general of Arkansas, Clark has decades of experience as a fraud investigator and prosecutor.

Over the years, he's posed the question to many students and colleagues. Most, he reports, base their definition on some absolute concept. But Clark says our beliefs are not always clear cut and consistent, especially when we face new or ambiguous circumstances.

"We derive our sense of honesty from each other," he said. "So guess what happens in the workplace when management doesn't clearly define, prohibit and follow through on dishonest business practices? Not surprisingly, an untrained, uninformed employee in an ethical dilemma will look to the person across the aisle or in the next office and ask what to do. When a colleague offers bad advice, people often take it. That's a problem when any employee does so. But if management breaks the rules, the consequences can be catastrophic."

FALSE TONE AT THE TOP

Clark cites a current corporate fraud scandal in his home state of Arkansas, involving Affiliated Foods Southwest, Inc. (AFS), a privately held wholesale grocery distributor that declared bankruptcy in 2009.

In 2010, John Mills, AFS's former president, CEO and board chairman, pleaded guilty to a bank fraud in which he and the company's CFO, Alexander Martinez, used nearly $475 million in worthless checks to bolster AFS's shrinking cash flow. More than 500 AFS employees lost their jobs when the once strong food cooperative, which had offered bulk purchasing power to hundreds of independent grocers in six states, closed its doors. Mills was sentenced to a three-year prison term and ordered to pay more than $3 million in restitution. Some — including laid-off AFS staff — think he got off easy.

Martinez is now on trial. Unlike Mills, whose guilty plea sped his sentencing, Martinez claims he is innocent.

In early 2009, the U.S. Attorney for the Eastern District of Arkansas, acting on findings from an audit of AFS by its creditor, U.S. Bank, filed an information against Mills and Martinez. It charged them with devising an elaborate check-kiting scheme involving two AFS subsidiaries.

Prosecutors said the fraud violated Title 18, United States Code, Section 1344, Bank Fraud, and Section 2, Principals, which provides that anyone committing an offense against the U.S. is punishable as a principal, rather than as an accomplice. Section 2 applies because U.S. Bank is nationally chartered.

"The tragic, but valuable lesson of this case is that these two executives instructed staff accountants to
perform fraudulent transactions that facilitated and concealed the scheme,” Clark said. “Mills and Martinez provided the worst example possible for those looking to them for ethical leadership.”

At his plea hearing, Mills explained how the check-kiting scheme worked. Each business day, an AFS accountant would calculate the company’s cash-flow shortfall by subtracting the company’s anticipated clearing items from its expected deposit items. AFS’s accountant then would “order” from two AFS subsidiaries checks drawn on their virtually empty accounts and payable to AFS, which then deposited the checks. After they cleared, AFS paid down its tab at U.S. Bank, and used its refreshed credit to supply the subsidiaries with funds to cover the checks they had provided to AFS.

“The AFS board was asleep at the wheel,” Clark said. “They didn’t notice that the positive cash flow was phony, and no one who might have known felt empowered to tell them. If the tone at the top had been different, there would have been effective ethics policies, procedures and a reporting mechanism. Someone might have spoken up. But ethics and due diligence weren’t priorities for AFS, and the fraudsters took advantage.”

THE RIGHT WAY TO DO IT

Living only 20 miles south of Walmart headquarters in Bentonville, Ark., Clark is well-versed in the retail giant’s business culture.

“Purchasers for Walmart are like investigative journalists,” he said. “They won’t let you give them anything, not even a cup of coffee. So, when a vendor says, ‘Hey, I’ve done $3 million worth of business with you. Here’s an opportunity that could give us a little something on the side,’ they throw him out. Why is that outcome so certain? Because Walmart leadership has communicated it, reiterated it and enforced it. There’s no doubt in employees’ minds about what’s wrong, what the penalties are and whether management will back them up if they report a breach. It’s the right way — the smart way — to run a business.”

In addition to recommending that CFEs compare their employer’s and clients’ codes of ethics with Walmart’s, Clark cites three best practices of companies that know how to make ethical profits and fend off fraudsters:

1. Design and enforce a comprehensive fraud prevention policy and code of ethics. Ensure that every employee attends refresher training annually to stay abreast of new risks in a constantly changing business environment. Establish and publicize confidential reporting mechanisms.
2. Obtain unequivocal, ongoing C-suite and middle management support for the anti-fraud regime and ethics program.
3. When abuse or neglect is certain, fully enforce the ethics code and anti-fraud policies and procedures, regardless of the offender’s rank. Likewise, investigate allegations promptly and thoroughly, following up with enforcement when suspicions prove true. Bear in mind that the significance of minor offenses may be more symbolic than substantive. In such cases, when termination is inappropriate, alternatives such as temporary demotion or closer supervision can demonstrate management’s commitment to enforcement without depriving the organization of an otherwise valuable employee.

LEGAL AVENUES

Clark said state or federal prosecutors primarily want to know whether you can document any loss your client or employer alleges. Time- and resource-strapped state prosecutors will not be interested unless damages have reached at least six figures, and many U.S. attorneys do not have enough time to work on cases involving less than $1 million in damages, he said.

Also, prosecutors infrequently try fraud cases, Clark said. “So you, the CFE, have to explain your investigative strategy and demonstrate its thoroughness,” he said. “I therefore strongly recommend that you develop a relationship with a CPA or auditor to deal with financial issues. And have a lawyer you can call in when necessary.”

Clark said working with a lawyer will protect communications with your client under the confidentiality of the attorney-client privilege. An attorney also will ensure you don’t violate a suspect’s legal rights, obtain inadmissible evidence or violate the provisions of any contract between your client and an employee you’re investigating, he said.

Establish a relationship with your employer or client’s human resources department, he adds, so you’ll have access to employee records, which can be invaluable in an investigation.

Finally, Clark recommended presenting evidence to prosecutors concisely.

“Keep it simple,” he said. “A picture is worth a thousand words, but a thousand pictures are worth nothing.”

Robert Tie is a New York business writer.

The Association of Certified Fraud Examiners assumes sole copyright of any article published on www.fraud-magazine.com or www.ACFE.com. ACFE follows a policy of exclusive publication. Permission of the publisher is required before an article can be copied or reproduced. Requests for reprinting an article in any form must be emailed to: FraudMagazine@ACFE.com.
Tone will always be at the top. It is unfortunate that developing countries are still far behind of appreciating the significance of ethics on fraud and corruption. Catastrophically, public sector worldwide did not invest properly and sufficiently in this regard. The ethics issue is complex. Yet, one cannot ignore its importance any where in the world. I do think that we need more research to be done to fight fraud globally.