

Mitigating Fraud Risks in a Down Economy

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History repeats itself, you have heard it many times. Data from the National White Collar Crime Center's June 2008 White Collar Crime Statistics Report shows that two years after each of the recessions in 1990 and 2000, white collar fraud arrests had increased 53 percent and 26 percent, respectively. Will history repeat itself? That is yet to be determined, but if the past is any indication, companies should perhaps consider assessing if they are exposed to additional risk.

Slowdown in the economy can make it more difficult for management to achieve planned results. It can also put more employees under personal financial pressure. Both may increase the likelihood of individuals resorting to fraud to achieve corporate objectives or to meet personal needs. If appropriate controls are not in place, increased financial pressure and tighter economic conditions may lead to an increase in entity-wide risks including the risk of fraud. However, there are many steps that organizations can consider taking to help mitigate fraud risk, including re-emphasizing tone at the top, re-assessing existing anti-fraud programs, and developing or improving a fraud response management plan.

Re-emphasizing Tone at the Top

What is "tone at the top?" Tone at the top is the ethical atmosphere created by an organization's senior management. The theory is that employees' behavior tends to reflect the ethical standards set by leadership. Management should re-emphasize a culture of honesty and integrity, and set an appropriate tone for the entity's attitude towards fraud and fraud prevention. In-house counsel can assist human resources to shape the message to employees, through policy and action, regarding consequences for violations of the code of conduct/ethics.

Re-assessing Anti-fraud Programs

Anti-fraud programs are the responsibility of management and encompass a wide range of activities and policies. Elements of an effective anti-fraud program include:

- Performing fraud risk assessments
- Creating a control environment that promotes ethical behavior
- Designing and implementing anti-fraud control activities throughout the organization
- Sharing information with employees and communicating the organization's philosophy and policies about fraud
- Monitoring the quality and effectiveness of antifraud programs and controls over time

Leading practices call for periodic assessment of an organization's anti-fraud programs. Now may be a good time for companies to perform an assessment in light of the potential heightened risk of fraud that may be experienced in a downturn.

Updating Fraud Risk Assessments

As many organizations respond to the changes in the economy by reorganizing or redirecting how they operate or by entering new markets overseas looking for growth opportunities, the need to update the fraud risk assessment process should be considered. Reorganization/downsizing and globalization may bring new fraud risks to an organization, and it is important to consider and identify what those new risks may be, the significance and likelihood of those risks and the countermeasures and action plans to respond to the risks identified.

Reorganization/Downsizing – Reorganization or downsizing can result in increased workload for the remaining employees, which may lower employee morale and potentially create a motivation for employees to look for opportunities (i.e., circumvent internal controls) to perpetrate fraud. Organizations can update their fraud risk assessments to consider the potential impact to existing internal control structures and identify where potential gaps in controls and additional fraud risks may arise; particularly where segregations of duties may be impaired due to the elimination of jobs.

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Globalization – On December 2, 2008, the SEC Office of Compliance Inspections and Examinations issued an open letter to CEOs of SEC-Registered Firms of the “critical role” compliance programs play in complying with securities laws. The letter states, “While many firms are considering reductions and cost-cutting measures, we remind you of your firm’s legal obligation to maintain an adequate compliance program reasonably designed to achieve compliance with the law.”

The letter further states, “Firms must be vigilant and proactive in preventing, detecting and correcting problems that could occur.” This is of particular importance for multinational organizations and compliance with the US Foreign Corrupt Practices Act of 1977 (FCPA). It is widely recognized that enforcement of the FCPA has increased dramatically in recent years, resulting in many high profile high dollar sanctions. As organizations expand globally, they may encounter risks such as bribery and corruption to quality frauds that can endanger customers for which they may not be adequately prepared. The process of updating the fraud risk assessment provides an opportunity to identify and develop a plan to address some of the inherent risks associated with doing business globally.

Assessing Whistleblower Hotline Effectiveness

The Association of Certified Fraud Examiners’ (ACFE) *2008 Report to the Nation on Occupational Fraud & Abuse* reports that approximately one half of fraud tips come from an anonymous reporting/whistleblower hotline making it one of the most effective fraud detection tools. To measure the effectiveness of an organization’s reporting hotline, an organization can look outside and compare its hotline activity with that of similar organizations. Are other organizations seeing the same rate of reports? On average, what percent of employees are reporting through the hotline within an industrial sector? Benchmarking can provide an organization with the metrics it needs to assess whistleblower hotline effectiveness as compared to activity within the industry. This knowledge can help drive the need for change within a hotline.

Developing a Fraud Response Management Plan

What is fraud response management? Fraud response management encompasses many of the processes through which an organization receives, triages, investigates, and reports on allegations of fraud and misconduct. Recent professional guidance, “Managing the Business Risk of Fraud: A Practical Guide” issued by the Institute of Internal Auditors (IIA), the American Institute of Certified Public Accountants (AICPA), and the ACFE recommends that organizations develop a fraud response management plan. According to the guidance, components of an effective fraud response management plan may include:

- Benchmarking whistleblower hotline activity to assess effectiveness (as previously discussed)
- Establishing investigative protocols to include interviewing, evidence collection, computer forensic examinations, and analysis
- Identifying fraud investigation resources, especially global response teams, in advance of a crisis
- Utilizing a case management system to effectively track and log the resolution of fraud allegations
- Implementing processes and control improvements enterprise-wide to gain efficiencies and prevent recurrences

Bottom-line: having an effective fraud risk management plan can help reduce exposure and facilitate responsiveness to potential fraud.

Next Steps

The economic downturn can present many challenges to organizations, including the potential for increased risk of fraud. The impact of fraud on an organization can go beyond financial damage to potentially having a negative impact on an organization’s reputation, employee morale, and investor confidence. Organizations can take additional precautions to address the potential of fraud by considering additional risk factors that may be presented by the economic downturn, re-assessing anti-fraud programs, and developing or improving a fraud response management plan.

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