Building a Fraud-Resistant Organization

January 8, 2015

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Skill Specific

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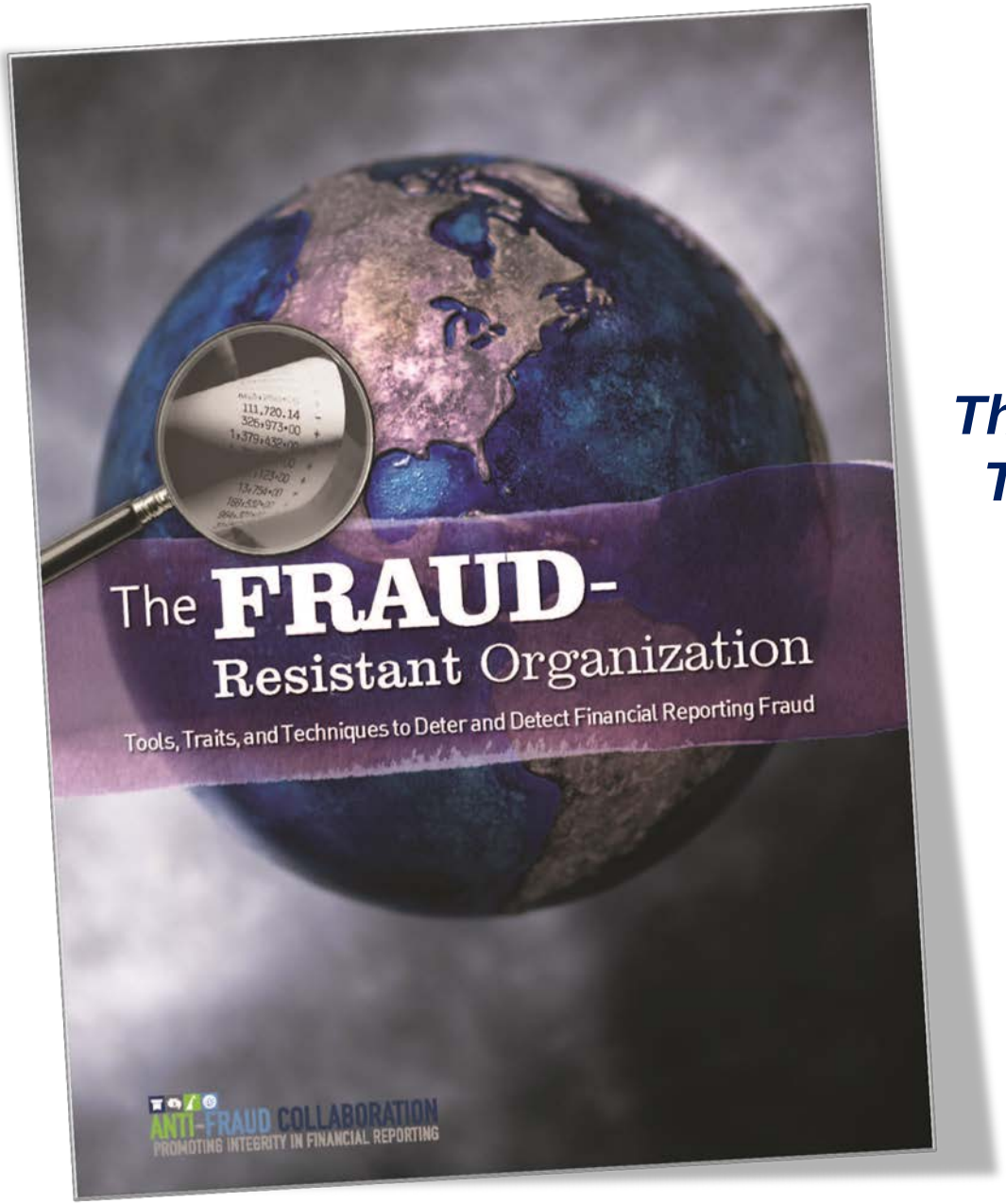
Today's Program

Goals of the Program

- Provide perspective on the three central themes of the Anti-Fraud Collaboration's recently published report, *The Fraud-Resistant Organization*
- Provide insights into how successful organizations establish and reinforce an ethical tone at the top, the exercise of skepticism, and robust communications in an effort to mitigate the risks of financial reporting fraud
- Address some of the challenges that multinational organizations face in executing effective fraud deterrence and detection programs



The Fraud-Resistant Organization: Tools, Traits, and Techniques to Deter and Detect Financial Reporting Fraud

Key Attributes of a Strong Ethical Culture

Top management sets the tone and establishes the values

- Establishes and communicates company values
- Creates an expectation that employees will do the right thing
- Builds an environment where employees feel comfortable bringing “bad news” forward
- When companies value ethical performance, misconduct is substantially lower

How Workers Judge Their Leaders

- Overall character as experienced through personal interaction
- How senior managers handle crises
- Policies and procedures adopted by senior leaders

Source: *ERC Research Report Ethical Leadership* (2014)

Key Attributes of a Strong Ethical Culture

Reinforce the importance of ethical behavior

- Lead by example
- Include reminders in messaging throughout the year
- Reward ethical behavior by calling out employees who “do the right thing”
- Internal audit activities should include measurements of compliance with code of conduct
- Implement a zero-tolerance rule

Key Attributes of a Strong Ethical Culture (cont'd)

Problems identified, investigated, and resolved

- Violations reported without fear of retaliation
- Clear escalation protocols
- Helpline/hotline program
- Misconduct dealt with promptly
- Appropriate remedial action taken
- Appropriate communications to employees about program operations and outcomes

Codification of 17 principles embedded in the original Framework

Control Environment	1. Demonstrates commitment to integrity and ethical values 2. Exercises oversight responsibility 3. Establishes structure, authority, and responsibility 4. Demonstrates commitment to competence 5. Enforces accountability
Risk Assessment	6. Specifies relevant objectives 7. Identifies and analyzes risk 8. Assesses fraud risk 9. Identifies and analyzes significant change
Control Activities	10. Selects and develops control activities 11. Selects and develops general controls over technology 12. Deploys through policies and procedures
Information & Communication	13. Uses relevant information 14. Communicates internally 15. Communicates externally
Monitoring Activities	16. Conducts ongoing and/or separate evaluations 17. Evaluates and communicates deficiencies

Source: COSO. *17 Principles of Internal Control*, www.coso.org.

Effective Board Oversight of Risk

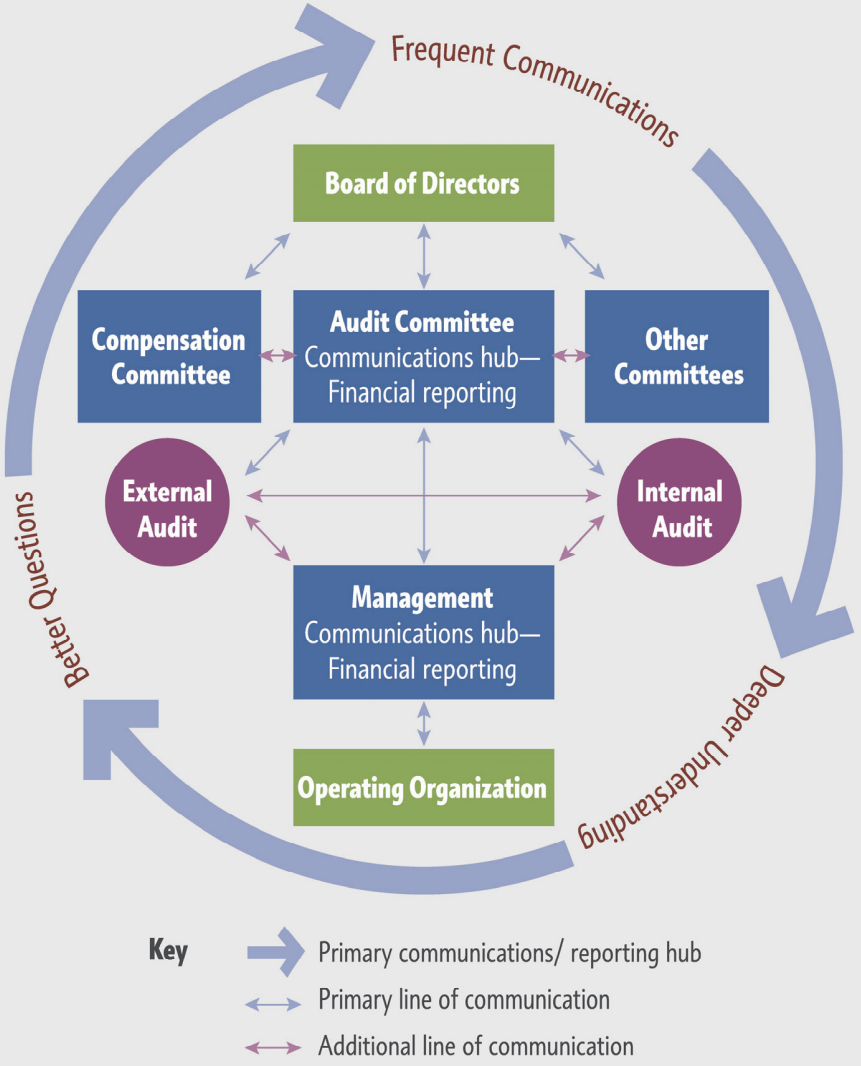
- Assess the risk in the company's strategy
- Determine if the risk management system is appropriate and has sufficient resources
- Work with management to understand and agree on the types of risk information the board requires
- Monitor critical alignments of strategy, risks, controls, compliance, incentives, and people

Source: *NACD Blue Ribbon Commission on Risk Governance* (2009)

Key Features of a Well-Designed Whistleblower Helpline

- Option for anonymity
- Compliant with regional and national laws
- Processes for timely investigation of helpline reports and documentation of results
- Management analysis of trends and comparison to norms
- Available to company–wide constituencies: employees, vendors, other third-parties

Financial Reporting — Lines of Communication



Source: Center for Audit Quality, *Deterring and Detecting Financial Reporting Fraud: A Platform for Action;* October 2010.

Common Judgment Tendencies

Confirmation bias

- *More weight given to information consistent with initial beliefs*

Overconfidence

- *Overestimate one's ability to make accurate assessments/ judgments/decisions*

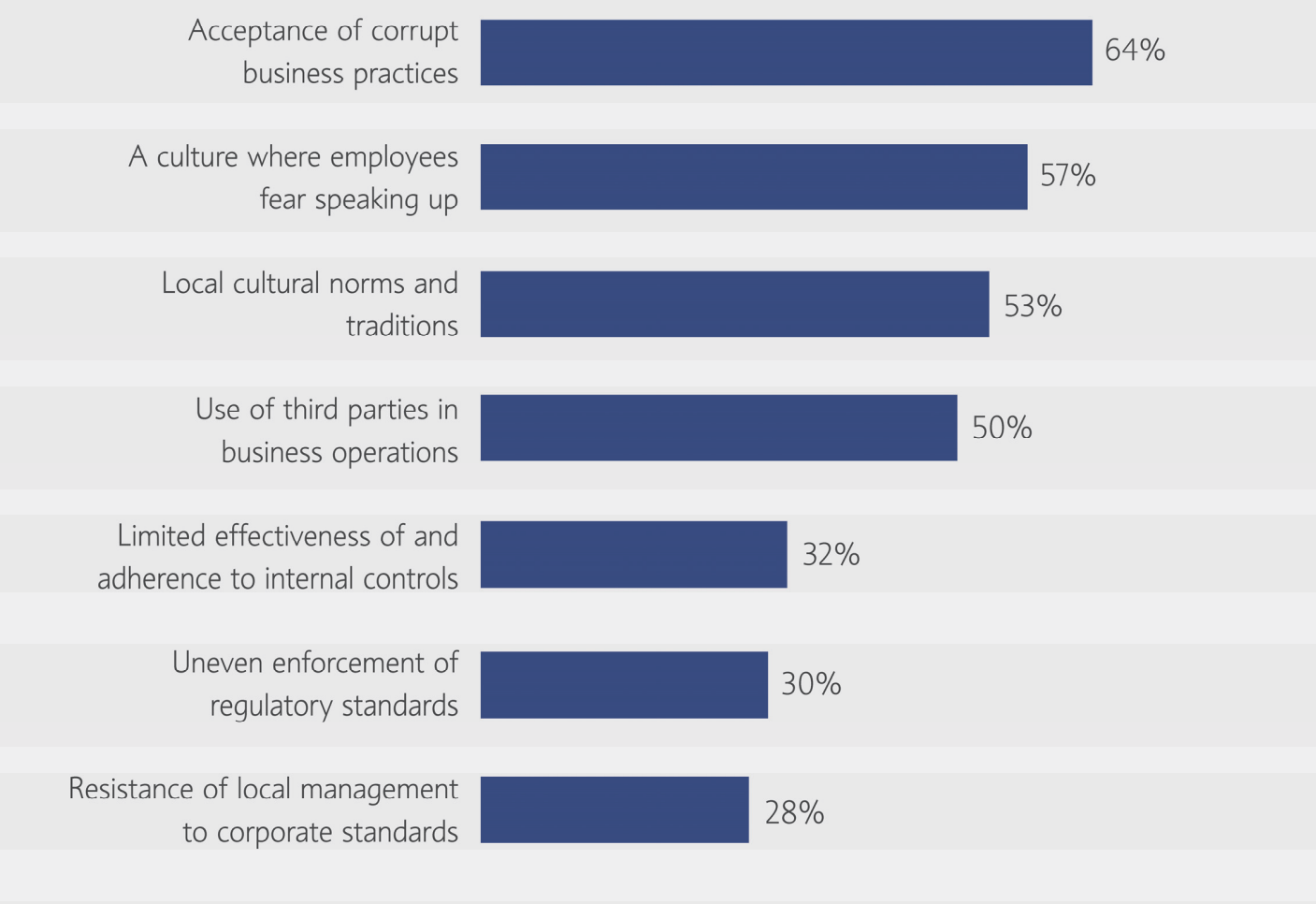
Anchoring

- *Start from an initial value and adjust insufficiently away from that value*

Availability

- *Information that is easily retrievable is considered to be more relevant*

Ethics and Compliance Risk Factors of Most Concern in Emerging Markets (e.g., Brazil, China, India, Russia)



Source: LRN Corporation, *Ethics & Compliance Leadership Survey Report*, 2011-2012.

How to Build a Global Fraud-Resistant Culture

- Think globally, act locally
- Tailor the ethics and compliance training to local customs
- Explain why company code of conduct may be more stringent than local practices
- Fill key financial and operational positions with trusted expatriates

Key Takeaways

- Fraud risk and anti-fraud efforts need more prominent placement on meeting agendas
- Make board reports more action oriented
- Open communication matters
- Management needs to be proactive

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