Curtis C. Verschoor, CMA, Editor

Surveys Show Ethics Problems Persist

Two organizations have completed their separate biannual analyses of the ethics environment in business and the fraudulent outcomes of unethical environments. The results they report are sobering.

The first organization, Walker Information, specializes in loyalty management and conducts periodic national studies of employee loyalty and ethics in the workplace. The second organization, the Association of Certified Fraud Examiners (ACFE), is an organization of 37,000 members with demonstrated knowledge in four areas: fraudulent financial transactions, fraud investigation, legal elements of fraud, and criminology and ethics.

The *Walker Loyalty Report* offers a view of the commitment and loyalty of workers and related behaviors. It also provides information about employee perceptions of company ethics and the ethical conduct of senior leaders. The survey is based on data collected from approximately 2,500 employees in business, not-for-profit, and governmental organizations having at least 50 employees.

The *Walker Report* notes that the percentage of employees committed to and having long-term loyalty to employers continues to improve. The latest study reports that 34% of workers are truly loyal, up from 30% two years ago and from 24% over the last six years. There's still a huge 60% of the workforce that falls into two groups—they are either high risk with plans to leave their employer within two years, or they feel trapped and believe they have no option except to stay. Thus, there is considerable room for improvement for employers to address workplace factors that drive loyalty, such as providing ample training and development opportunities and exhibiting a strong focus on employees. Just 41% of respondents said their organization treats employees as its most valuable asset.

According to Walker, the top five factors that affect employee loyalty based on experience in the workplace are: (1) care and concern for employees, (2) fairness at work, (3) day-to-day satisfaction, (4) feelings of accomplishment, and (5) compensation and benefits.

The top five attitude-based factors that drive employee loyalty are: (1) focus on employees, (2) opportunities to develop skills and advance, (3) job quality, (4) brand, and (5) reputation.

Walker shows that loyalty affects behavior. Only 35% of trapped or high-risk employees recommend their organization as a good place to work, compared to 95% of the truly loyal group. Of the truly loyal employees, 95% said they go above and beyond the call of duty, compared to only 62% of the high-risk and trapped employees.

As to ethics in the workplace, Walker reports that 64% of employees responded positively about the ethics climate in their organization, but only 58% thought their senior leaders were ethical. One-quarter of the respondents had knowledge of or suspected an ethics violation within the past two years. Of those, only 54% reported it, which, while low, is an improvement of 14 percentage points in two years. The most common reasons cited for not reporting wrongdoing were (1) fear of retaliation, (2) did not think the organization would respond, and (3) no anonymous/confidential way to report the behavior. These reasons underscore the importance of effective implementation of the Sarbanes-Oxley requirements for whistleblower protection.

Perhaps the most telling, yet understandable, finding of the Walker survey is that employees with the lowest level of tenure at their organization have the least loyalty to it. This confirms the considerable cost of high turnover. It simply takes time to totally assimilate a person into the structure and cultural environment of an organization so that they become truly loyal and most productive.

The biannual 2006 ACFE *Report to the Nation on Occupational Fraud and Abuse* had very similar findings to those reported in 2004. Occupational fraud and abuse continue to impose enormous costs on organizations of all sizes. The 1,134 cases reported caused a median loss of $159,000. If projected to the total U.S. Gross Domestic Product, this would amount to $652 billion. In 42% of the reported cases, the victim organization made no recovery; in another 23% of cases, the recovery was less than one-fourth of the loss. The total occupational fraud loss estimate for 2004 was $660 billion.

Occupational fraud is defined by the ACFE as: "The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets." It involves four elements:

- Is clandestine,
- Violates the perpetrator's fiduciary duties to the victim organization,
- Is committed for the purpose of direct or indirect financial benefit to the perpetrator, and
- Costs the employing organization assets, revenue, or reserves.

According to the ACFE, less than 8% of the perpetrators had convictions prior to committing their frauds. But this doesn't lead to a conclusion that background checks of new employees aren't valuable antifraud tools. Rather, it suggests that other measures such as antifraud/ethics training, surprise audits, and anonymous reporting mechanisms are more important in detecting fraud.

In fact, the detection of occupational fraud is most likely to occur through confidential help or hotlines and other reporting mechanisms, particularly in cases involving losses of $1 million or more. Of these large-size frauds in the study, 44% were detected by tips. This is more than twice the rate of detection by internal audits and three times the rate of detection by external audits.

In terms of fraud prevention, the ACFE analysis tested for five antifraud measures:

1. Did the victim organization have a fraud hotline or anonymous reporting mechanism?
2. Did the victim provide fraud awareness or ethics training for employees and managers?
3. Did the victim have an internal audit or fraud examination department?
4. Did the victim perform surprise audits on a regular basis?
5. Was the victim audited by external auditors?

Results of this analysis show that less than half of the entities utilized fraud or ethics training or a fraud hotline.

In terms of the size of losses, the ACFE found that the median fraud losses in organizations with confidential reporting mechanisms in place was only half that of entities where such opportunities weren't present. Similarly, reduced losses occurred in organizations where internal auditors regularly performed surprise audits. Where management conducted antifraud/ethics training for employees and managers, the median loss was also only half that of where there wasn't training.

Most of the occupational fraud schemes in the ACFE study involved either the accounting department or upper management. As might be expected, the size of the loss caused by occupational fraud is strongly related to position of the perpetrator. The median loss of frauds committed by owners or executives was $1 million, more than five times the median loss causes by managers. High-ranking executives and business owners are more likely to have the opportunity to circumvent internal controls, if any exist, or decline to insist on having effective controls in the first place.

The ACFE found that the length of service of perpetrators was understandably linked to their organizational level and was positively correlated to the size of the median fraud loss. Employees who had been with the victim for more than 10 years caused median losses of $263,000, 71% more than the overall median loss. Employees with long service will generally engender increasing trust from their employers. They will also become more familiar with control systems and how to work around them without getting caught.

An organization's size was also a factor. The median loss reported for small organizations, defined as those with fewer than 100 employees, was $190,000, 23% more than the median

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loss for all entities. Small organizations are less likely to have anonymous reporting mechanisms, internal audit activities, or fraud training.

Unanswered in the ACFE analysis is the impact of some of the ethics factors affecting loyalty that were studied in the Walker survey. It would be interesting to see the results of matching the organizations in both studies to ascertain whether organizations with a strong ethical culture had fewer or smaller losses from occupational fraud. It is the opinion of this editor that this is very likely to be the case. ■

Curtis C. Verschoor is the Ledger & Quill Research Professor, School of Accountancy and MIS, DePaul University, Chicago, and Research Scholar in the Center for Business Ethics at Bentley College, Waltham, Mass. You can reach him at cverscho@depaul.edu.