Curtis C. Verschoor, CMA, Editor

Integrity Still Lacking in U.S. Business

The layoffs and budget cutbacks common to an economic downturn can lead to less-effective internal controls and create even greater opportunities for desperate individuals to commit fraud. As the incidence of occupational fraud continues to grow in the U.S., companies need to focus more efforts on instilling a solid ethical culture.

The "experts" providing their opinions on what caused the credit crisis and how to prevent a future recurrence are matched—in reliability and quantity—only by the number of weather forecasters who fail to accurately predict the weather each day. Since trust in capital markets is a key to economic stability and growth, companies, regulators, and investors are still searching for a better understanding of the factors that may have contributed to the challenges being faced in the current economy.

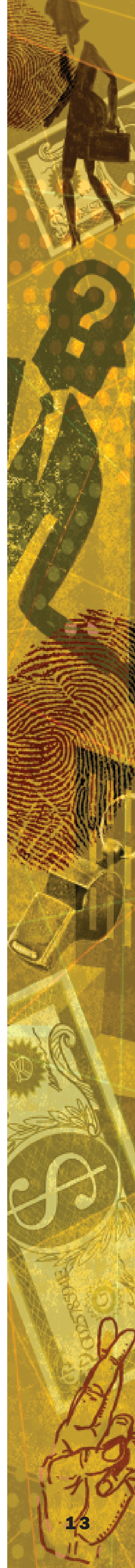
What seems evident in this time of economic uncertainty is the increasing incidence of occupational fraud. In a survey conducted by the Association of Certified Fraud Examiners (ACFE) titled *Occupational Fraud: A Study of the Impact of Economic Recession*, half the Certified Fraud Examiner (CFE) respondents indicated that the number of frauds they observed, as well as the dollar amounts lost to fraud, had increased during the past year. The change in dollar amount was described as "significant" by more than 20% of the respondents. Importantly, 88% of the respondents believed their organizations would experience an even higher level of fraud in the next 12 months. The type of fraud most expected to increase is embezzlement.

The major cause of the increase in observed fraud was reported to be the intense financial pressure so many individuals are facing. But also important is the greater potential opportunity for fraud to take place as a result of layoffs and reduced employer funding for antifraud activities, which may lead to less-effective internal controls. Nearly 60% of the responding CFEs working inside an organization reported layoffs at their companies. Almost 35% of those said some controls were eliminated, while 44% indicated the layoffs had no effect. As an additional causative factor, the length and depth of the current downturn may lead to feelings of pessimism and helplessness, which, in turn, can lead to employees considering engaging in unethical and illegal acts they previously saw as unthinkable.

According to James Ratley, president of the ACFE, "Desperate people do desperate things. Loyal employees have bills to pay and families to feed. Especially now, organizations must be vigilant during these turbulent times by ensuring proper fraud prevention procedures are in place."

The newest relevant observations of the overall state of ethical culture in U.S. organizations are provided by the *KPMG Integrity Survey 2008-2009* study of corporate misconduct. The research is based on the experiences and perceptions of more than 5,000 employees at all levels in U.S. organizations having at least 200 employees. Half the respondents were from organizations with more than 5,000 employees. The latest study updates the findings of similar KPMG research in 2000 and 2005.

Not surprisingly, prevalence of fraud and misconduct remains at a high level. Nearly three-quarters of employees report they have either seen personally or have first-hand knowledge of wrongdoing in their organization within the past 12 months. The amount



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of observed and reported misconduct remains relatively unchanged from previous studies and is prevalent across all 13 industries included in the study. Employees working in the government/public and automotive sectors report slightly higher rates.

The nature of observed misconduct continues to be serious. Nearly half the survey respondents—comprising roughly two-thirds of those reporting wrongdoing—say that what they observed could cause "a significant loss of public trust if discovered." This frequency is marginally lower than in previous years. It peaks at 60% of the total—or 80% of those reporting misconduct—in the government/public, healthcare, and banking/finance industries. The types of reported misconduct vary widely in different industries and occupational categories. They include categories that compromised customer or marketplace trust, shareholder or organizational trust, employee trust, supplier trust, and public or community trust.

Integrity Survey 2008-2009 outlines the major root causes of employee misconduct:

- Pressure to do "whatever it takes" to meet targets.
- Belief that rewards flow from results, not the means used to achieve them.
- Lack of familiarity with standards applicable to the job.
- Belief that the code of conduct isn't taken seriously.
- Lack resources to accomplish tasks without cutting corners.
- Fear of losing their job if targets aren't met.
- Policies and procedures believed to be easy to bypass or override.
- Desire to bend the rules for personal gain.

These causes have remained relatively constant over time, with two exceptions. Substantially fewer respondents believe the code of conduct isn't taken seriously or that they lack resources to accomplish tasks without cutting corners.

The importance of the ethical culture in the organization was reinforced in the report's discussion of how employees react when confronted with a violation of the standard of conduct. More than 80% of respondents indicated that they would notify their immediate supervisor or another manager. Half would try to resolve the matter on their own, and somewhat fewer (44%) would call the ethics/compliance help/hotline. The propensity to report misconduct generally has increased over the years, especially the use of a help/hotline.

The survey noted that outcomes of a decision to report misconduct is often linked to how the organization will respond. In response to the question, "What would happen if you reported wrongdoing to management?" roughly one-third of respondents suggested they wouldn't be confident that appropriate action would be taken or that their reports would be kept confidential. About half also indicated they weren't confident they would be protected from retaliation or that discipline would be administered evenly and consistently. More than half doubted they would be satisfied with the outcome. But despite these obstacles, almost 90% of employees felt they would be "doing the right thing" by coming forward with a report of misconduct. These results have held roughly steady over time.

While the "tone at the top" is universally recognized as a keystone component of an effective ethics and compliance program and related organizational culture, the study drilled more deeply into the tone at the local level. Nearly two-thirds of respondents agreed that their senior leaders adequately served as role models and set the right tone, but roughly half indicated they were unsure that top management was really familiar with actual practices further down in the organization. In view of the negative perceptions mentioned earlier, it was somewhat surprising that 70% of employees believed their CEOs would respond appropriately to ethical matters brought to their attention.

Over time, this research found that the existence of formal ethics and compliance programs had increased, largely since the enactment of the Sarbanes-Oxley Act of 2002. The results of the study show that the presence of comprehensive ethics and compliance programs has a favorable impact on the prevalence of misconduct in organizations. Further, these programs are linked to lower incidences of the factors that give rise to wrongdoing as well as to greater employee willingness to report misconduct.

As a final motivation for assuring that an organization does have an ethical culture as prescribed by the U.S. Federal Sentencing Guidelines is the August 2008 Department of Justice revision of guidelines prosecutors should use in determining whether to charge an organization with a crime or only its employees and agents. These factors include:

- Is the compliance program merely a "paper program?"
- Is management enforcing the program or covertly encouraging or pressuring employees to engage in misconduct to achieve business objectives?
- Is there sufficient staff to audit and evaluate the results of the program's efforts?
- Are employees informed and convinced of the organization's commitment to the program?

Without question, an ethical culture maintained by an effective ethics and compliance program is a best business practice and the cornerstone of a sound fraud risk management strategy. **SF**

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award winners, Student Case Competition winners, Lybrand Award winners, winners of the annual Chapter Competition, and other award winners. They are truly the backbone of our fine and growing global community.

Although it may seem a long way off, we're already planning IMA's 91st Annual Conference & Exposition in Baltimore next June (June 5-9, 2010). I hope you will join me and your fellow IMA members in celebrating all that IMA and this profession have to offer. Mark your calendars for another action-packed educational and community-building event! Check out the website (www.imaconference.org). The call for sessions is already open!

Jeff Thomson
IMA President and CEO