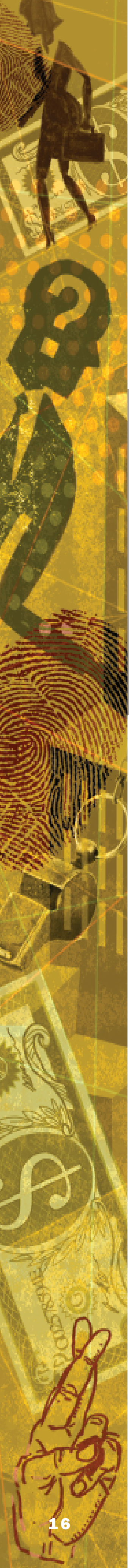

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Fraud Continues, but So Does Good Corporate Citizenship

Several new studies report on the state of fraud and fraud prevention within companies during the current difficult economic conditions. Both the Treasury Department and Kroll found that incidences of fraud are up, while a Boston College survey found that companies are still trying to continue practicing good corporate citizenship.

Conventional wisdom indicates that a recession results in more fraud being committed. In fact, the 2009-2010 edition of the *Kroll Global Fraud Report* found that companies lost an average of $8.8 million to fraud over the past three years, an increase of 7% over last year's average. Hardest hit were financial services firms—more than 90% reported being a victim of some kind of fraud. The findings result from a global survey of more than 700 senior executives in diverse industries performed by the Economist Intelligence Unit.

According to Kroll President Tim Whipple, "What goes up [in a recession] is the discovery of fraud, not always the same thing [as its commission]." He added, "Just like legitimate businesses, fraudsters are threatened by loss of income or the financial weakness of their businesses; Ponzi schemes are especially vulnerable. But other fraudulent areas—management conflict of interest, corruption, employee theft—also come to light when business conditions sour."

The Kroll report goes on to describe industry and regional trends and to explain details of its findings. While the recession has increased the motivation to commit fraud, at the same time, less business activity provides reduced opportunities for corrupt practices. Three factors that often increased vulnerability to fraud in the past are having less effect this year: high staff turnover, entries into new and unknown markets, and interfirm collaboration. In the down economy, these factors have mostly decreased in many companies. Lower profits do heighten other risks, however, such as reduction in staff devoted to internal controls in order to save money. One in six respondents to the survey saw this vulnerability increase from last year's results.

In industry terms, the Kroll report states that the financial services sector, with broad and deep exposure to many risks, saw its average fraud loss climb to $15.2 million, an 18% increase. The sector has the greatest opportunities for fraudulent behavior. Fraud risks include money laundering, financial mismanagement, regulatory and compliance shortfalls, internal financial fraud, and loss or theft of information. The handling of other people's money in so many circumstances requires healthy controls and other antifraud measures, including staff background checks and formal risk management systems run by high-level risk officers.

In comparison, the average fraud in the construction, engineering, and infrastructure industry dropped by more than half to $6.4 million. Its fraud issues are largely related to its risk profile, caused by the nature of its contracts and operations as well as its supply chain. In construction, as well as a number of other industries, the year also saw a marked increase in the levels of corruption and bribery, reflecting the greater importance of governmental contracting.

At the economy-wide level, the contrasting tendencies almost cancelled each other out. A cautionary message expressed by the Kroll report is that when the current economic situation turns more positive, the fraud risk kaleidoscope will take another turn, with different issues and exposures. Each industry needs to continually prioritize the threats it faces and then establish the measures it is ready to take to detect, prevent, or mitigate those threats.

The report notes that companies, especially those in financial services, would be well advised to adopt the following fraud risk mitigation strategies:

- Robust employee screening;
- Data security from both internal and external threats;
- Transaction monitoring for anomalies that may indicate money laundering, corruption, or other fraud;
- Facilities through which employees can report all suspicions of wrongdoing—anonymously, if required—and the capacity to investigate resulting information independently of the business areas involved;
- Appropriate due diligence on customers and suppliers;
- Staff training in all areas of fraud prevention, particularly for senior management who set the tone for the organization.

The continued presence of fraudulently suspicious activities in financial institutions is mirrored in the latest report of the Treasury Department's Financial Crimes Enforcement Network. This agency periodically reports a number of characteristics of the many Suspicious Activity Report (SAR) forms that are filed with it by various segments of the financial services industry. The agency's latest report shows that, in spite of a 27% decrease in filings by money service businesses (perhaps due to a reduction in sending funds to a foreign location), SARs for nondepository institutions as a whole were down only slightly. Further, SAR filings by depository institutions were up by 13%, largely because of increases in mortgage loan fraud. Some of the suspicious activities noted include transactions being conducted in bursts of activity within a short period of time, especially in previously dormant accounts, and unusual mixed deposits of money orders, third-party checks, payroll checks, etc., into a business account.

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On a more positive note, the Boston College Center for Corporate Citizenship research study, *2009 State of Corporate Citizenship in the United States*, reports that commitments to corporate citizenship continued despite the recession. Subtitled *Weathering the Storm*, the findings of the study are based on 756 responses from senior executives in a nationally representative sample of small, medium, and large U.S. companies. Previous studies were conducted in 2003, 2005, and 2007. The earlier studies showed that company executives viewed good corporate citizenship as a fundamental part of doing business, but they often allowed aspirations to outpace actions.

For guidance in applying the *IMA Statement of Ethical Professional Practice* to your ethical dilemma, contact the IMA Ethics Helpline at (800) 245-1383 in the U.S. or Canada. In other countries, dial the AT&T USADirect Access Number from www.usa.att.com/traveler/index.jsp, then the above number.

Key issues explored by the survey include:

- What changes in corporate citizenship practices are businesses making during these turbulent times?
- What do they see as the best ways to solve the current economic crisis and create a more stable American economy?
- What do businesses see as the most important areas of corporate citizenship in these organizations?
- What motivates companies to be better "corporate citizens," and has this changed since the 2007 survey?
- How well are they incorporating corporate citizenship in their products and services?
- Has their support for the communities in which they operate changed?
- Have they continued to support lower-income or economically distressed communities?
- With whom are they partnering to solve social and environmental problems, and why?

The findings in the 2009 study reveal that companies generally continued their commitment to corporate citizenship despite the recession. Approximately 54% of

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respondents believe corporate citizenship is even more important in a recession. The top-three areas of good citizenship continue to be: operating with ethical business practices (91% implementing), treating employees well (81%), and managing and reporting company finances accurately (76%). Only 38% of responding companies reduced their philanthropy and giving, and 83% of large companies supported their employees' volunteer efforts in the community. Employment practices encouraging a balance of work and life were backed by 60% compared to 46% in 2007.

Other findings from the *State of Corporate Citizenship* report were that a citizenship gap appeared between the practices of large and small companies. Large companies more or less kept on track with most corporate citizenship efforts during these difficult times, though many did lay off employees. On the other hand, small firms stayed committed to their priority of treating employees well by avoiding layoffs, but they significantly decreased emphasis on other aspects of good citizenship.

The importance of the business value of corporate citizenship was emphasized by the fact that 70% of responding executives (82% from large firms) identified reputation as the number one driver of the strategy. The CEO leads the corporate citizenship agenda in three out of four companies. The breadth of the citizenship commitment is exemplified by the reported finding that environmental sustainability is seen as a major business driver. Sustainable products and services are offered by 52% of all companies and 65% of large companies. In 45% of companies, employees were compensated for ideas that benefited both the bottom line and the environment or community. This compares to 37% in 2007.

Since all of the good citizenship activities contained in the survey are self-reported by senior executives, we have to contemplate whether they do in fact fairly represent the human resource and other policies actually being practiced in the respondents' companies. While it appears that responsibility and sustainability reporting is increasingly viewed as necessary by U.S. companies, the total lack of any independent verification or assurance in such reports is remarkable. Although sustainability reporting standards do exist, there's wide variation in how they're applied. Both accountants and auditors still have a lot of work to do to be sure that all stakeholders receive accurate, complete, and unbiased nonfinancial and financial information. **SF**

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