

The FRAUD-Resistant Organization

Tools, Traits, and Techniques to Deter and Detect Financial Reporting Fraud

ANTI-FRAUD COLLABORATION
PROMOTING INTEGRITY IN FINANCIAL REPORTING

About This Report

This report focuses on financial reporting fraud at publicly traded companies of all sizes, and its recommendations are intended to be scalable to different situations. While the report addresses specific structures, such as an internal audit function or a formal fraud risk management program, it does not intend to suggest that "one size fits all." Optimal measures and approaches will vary, given different situations. It is important that each organization consider the concepts presented and tailor them to its particular characteristics. Furthermore, many of the points discussed here may be applicable to other types of organizations, such as privately owned companies, not-for-profit organizations, and governmental entities.

About the Anti-Fraud Collaboration

The Anti-Fraud Collaboration (Collaboration) was formed in October 2010 by the Center for Audit Quality (CAQ), Financial Executives International (FEI), The Institute of Internal Auditors (The IIA), and the National Association of Corporate Directors (NACD). The four organizations represent members of the financial reporting supply chain—external auditors (through CAQ), company financial management (through FEI), internal auditors (through The IIA), and audit committees (through NACD).

The goal of the Anti-Fraud Collaboration is to promote the deterrence and detection of financial reporting fraud through the development of thought leadership, awareness programs, educational opportunities, and other related resources specifically targeted to the unique roles and responsibilities of the primary participants in the financial reporting supply chain. The Collaboration defines financial reporting fraud in its most general sense, as a material misrepresentation in a financial statement resulting from an intentional failure to report financial information in accordance with generally accepted accounting principles.

The Collaboration's areas of focus include:

- Advancing the understanding of conditions that contribute to fraud
- Promoting additional efforts to increase skepticism
- Encouraging a long-term perspective so as to moderate the risk of focusing only on short-term results
- Exploring the role of information technology in facilitating the deterrence and detection of fraudulent financial reporting

CENTER FOR AUDIT QUALITY
Serving Investors, Public Company Auditors & the Markets
Affiliated with the American Institute of CPAs

fei financial executives international

The Institute of Internal Auditors

NACD NATIONAL ASSOCIATION OF CORPORATE DIRECTORS

ANTI-FRAUD COLLABORATION
PROMOTING INTEGRITY IN FINANCIAL REPORTING

On behalf of the Anti-Fraud Collaboration, we are pleased to present *The Fraud-Resistant Organization: Tools, Traits, and Techniques to Deter and Detect Financial Reporting Fraud*. In this report, when we discuss financial reporting fraud we are referring to a material misrepresentation in a financial statement resulting from an intentional failure to report financial information in accordance with generally accepted accounting principles.

Financial reporting fraud comes at a high cost. The *2014 Report to the Nations on Occupational Fraud and Abuse* by the Association of Certified Fraud Examiners (ACFE) found that while such reporting fraud made up just nine percent of the occupational fraud cases studied, it continues to be the most costly form of fraud, with a median loss of $1 million.

While we cannot predict who will commit fraud, and although it is challenging to detect fraud once perpetrated, research in recent years has yielded valuable information about the conditions that might make an organization more susceptible to fraud, as well as techniques and tools that support both deterrence and detection. This knowledge is of value to all participants in the financial reporting supply chain, including management, boards of directors, audit committees, and internal and external auditors.

This report incorporates research that is intended to serve as a resource for anyone involved in financial reporting.

With the increasingly global nature of our economy and markets, U.S.-based companies operating in international markets must contend with a number of additional challenges, including cultural and language differences, and disparate, sometimes conflicting regulatory requirements. This report, which builds on the Center for Audit Quality's (CAQ) 2010 report, *Deterring and Detecting Financial Reporting Fraud: A Platform for Action*, examines special challenges facing global companies, drawing on research and in-depth roundtable discussions. Throughout the report, look for global notes that highlight these considerations.

The CAQ is committed to enhancing investor confidence and public trust in the capital markets. In 2010, along with FEI, The IIA, and NACD, we launched the Anti-Fraud Collaboration to promote the deterrence and detection of financial reporting fraud through the development of thought leadership, awareness programs, educational opportunities, and other related resources for the members of each of our organizations. The energy and insights exchanged among the four groups, all of whom contributed much to this report, have been remarkable and productive. Additional resources can be found at the website, *www.AntiFraudCollaboration.org*.

We hope this report provides a helpful resource to all who have a stake in the deterrence and detection of financial reporting fraud.



Michele Hooper
Co-Chair, Anti-Fraud Collaboration
President and CEO, The Directors' Council



Cindy Fornelli
Co-Chair, Anti-Fraud Collaboration
Executive Director, Center for Audit Quality

TABLE OF CONTENTS

Executive Summary 5

Chapter 1: The Fraud-Susceptible Culture 9

Chapter 2: Keys to a Fraud-Resistant Organization 14

Chapter 3: Tone at the Top: Management and Fraud Deterrence 19

Chapter 4: Responsibilities of Other Participants in the Supply Chain 26

Chapter 5: Building a Global Fraud-Resistant Culture 39

Conclusion 44

Endnotes 45

Bibliography 48

EXECUTIVE SUMMARY

High-profile financial reporting fraud cases in the early years of this century caused a number of bankruptcies and significant turmoil in the U.S. capital markets. These events in turn triggered an examination into the governance failures at those companies. A number of new laws and regulations resulted, including the Sarbanes-Oxley Act of 2002 (SOX), which improved governance and helped deter and detect fraud.

Financial reporting fraud remains a concern today, however, and research continues to explore conditions that were present in organizations where frauds were uncovered. A consistent finding from research is that the risk of financial reporting fraud tends to increase when the individuals who comprise the organization's financial reporting supply chain—management, the board of directors, audit committee, and internal and external auditors—do not fully understand their responsibilities and/or do not execute them appropriately. In such organizations, one or more of the following situations often are found:

- Lack of a strong *"tone at the top"* and an ethical culture;
- Insufficient *skepticism* on the part of all participants in the financial reporting supply chain; and
- Insufficient *communication* among financial reporting supply chain participants.

Global organizations face an array of additional challenges such as cultural and language differences that can confound efforts to deter and detect financial reporting fraud.

Conversely, if all who have a role in the financial reporting supply chain understand their responsibilities, encourage a strong tone at the top and ethical culture through both word and deed, know how to exercise skepticism, and communicate consistently and effectively with all relevant parties across all geographic locations, an environment conducive to financial reporting fraud is less likely to occur.

Outlined below are the chief responsibilities of each of the participants in the financial reporting supply chain, and the requirements and best practices with respect to communications between and among them, followed by an overview of challenges and potential solutions for global organizations.

Management and Tone at the Top

Studies show that organizations that encourage ethical behavior are more resistant to misconduct

of all kinds, including financial reporting fraud. A strong ethical culture hedges against all three sides of the fraud triangle—pressure, opportunity, and rationalization. In an ethical culture, pressure to commit fraud is counteracted through sound risk management strategies and appropriate incentives. It will support well-designed controls that reduce opportunities for fraud and increase the likelihood of early detection. A culture of honesty limits an individual's ability to rationalize fraudulent actions.

The primary responsibility for an organization's culture falls to management. Corporate leadership, including senior executives and the board of directors, sets the *"tone at the top"* by communicating and visibly adhering to clear ethical principles and codes of conduct, and by providing necessary support and resources for robust fraud risk management programs and internal controls.

Another vital ingredient in an ethical culture is skepticism. Management should encourage employees to feel not only comfortable but also obliged to question and challenge the results for which they are responsible.

Boards of Directors and Audit Committees

With an essential role in strategy development, allocation of resources, risk oversight and the hiring, evaluation, and compensation of senior management, boards are uniquely positioned to assist in deterring and detecting financial reporting fraud. In addition, although management arguably has the most critical role in fraud deterrence and detection, most material financial reporting fraud cases involve senior management,[1] which makes it even more critical to have knowledgeable, engaged boards of directors overseeing them.

Board members need to have an informed approach to all matters that come before them. This means that they must know how to exercise skepticism in a constructive manner, being aware of their own possible biases in judgment. The board, collectively, must have a reasonably thorough knowledge of the company it serves, including an understanding of the key drivers of revenue and profitability. Like management, board members should be cognizant of the role that pressure, opportunity, and rationalization can play in financial reporting fraud. They also should be alert to signs of possible weaknesses in management's tone at the top.

The audit committee of the board oversees management's financial reporting process and internal controls, the internal audit function, and the external auditor. Skepticism is vital in all these aspects of the audit committee's role, including the selection of the external auditor and evaluation of auditor performance. Audit committee members should be familiar with risks that can increase the likelihood of fraud, and how to monitor the risk of management override of internal controls.

In public companies, the audit committee is responsible for establishing a confidential, anonymous reporting mechanism, which is required under the Sarbanes-Oxley Act, to manage complaints about an organization's accounting, internal controls, or auditing matters. This usually takes the form of a whistleblower or ethics helpline. This is a critical function, because tips from employees are the most common method for uncovering fraud.[2] Audit committee members should also be familiar with Public Company Accounting Oversight Board (PCAOB) auditing standards governing what the external auditor is required to communicate to the audit committee, particularly specific requirements related to fraud and illegal acts.

Internal Audit

The internal audit function acts as the eyes and ears of an organization with respect to risk management, control, and governance processes. Taking a risk-based approach, internal auditors evaluate the effectiveness of these processes on a continual basis. In addition, they may monitor and evaluate results of whistleblower programs and collaborate across departments to help ensure that

results are addressed and that applicable weaknesses in the governance, risk management, and internal control environment are remediated. In many cases, they also assess compliance with the code of ethics, conduct ethics surveys of employees, and analyze year-over-year changes in key metrics.

Internal audit should communicate, evaluate, and reinforce the ethical tone of an organization, as well as test compliance with anti-fraud programs and other controls. Skepticism must be employed in the examination of management's fraud risk assessment, review of evidence supporting management's assertions in the financial statements, and in the evaluation of controls intended to deter or detect fraud.

Internal audit must operate with organizational independence, which usually means direct functional reporting to the audit committee and unrestricted access to both the board and audit committee in the event concerns arise.

External Audit

The external auditor provides an opinion on a company's annual financial statements and, in many cases, an opinion on the effectiveness of the entity's internal control over financial reporting. External auditors are engaged by and report directly to the audit committee, but have regular contact with management across a company's operations. While not a component of a company's system of internal control over financial reporting, the accumulated general knowledge external auditors bring from working across multiple organizations can be a resource for boards, management, and audit committees.

Professional standards require the external auditor at a minimum to understand the company's system of internal control over financial reporting as part of its risk assessment process during the planning of a financial statement audit. This includes consideration of the company's tone at the top and corporate culture, and incentives or pressures that may drive an employee to commit financial reporting fraud. When developing the audit plan, the auditor should consider such factors as management's philosophy and operating style (including the integrity and ethical values practiced by management), the nature of the board and audit committee's oversight, and the company's human resource policies and practices, with a particular focus on its compensation arrangements.

Auditing standards require external auditors to exercise "professional skepticism," which means they need to be alert for information suggesting material misstatements of financial statements, and to be critical when evaluating audit evidence. Auditing standards define professional skepticism as "an attitude that includes a questioning mind and a critical assessment of audit evidence."[3] External auditors must apply professional skepticism when considering the risk that management may override internal controls, and take that risk into account when formulating judgments about the nature, timing, and extent of audit testing. External auditors should also be aware of judgment biases that can affect the exercise of an effective level of professional skepticism in the conduct of the audit.[4]

Communications

An environment of open and ongoing communication with a goal of sharing knowledge, insights, and concerns to enhance the collective efforts is also vital in a fraud-resistant organization.

Management should encourage communication between managers and employees at all levels and help ensure boards, audit committees, and internal and external auditors are well informed on a timely basis about the company's operations, strategies, and risks.

Communication is also a key element in identifying and assessing potential risks of financial reporting fraud, and in developing controls that help mitigate those risks. The updated 2013 internal control-integrated framework published by the Committee

of Sponsoring Organizations of the Treadway Commission (COSO) calls for management to conduct a fraud risk assessment and emphasizes that organizations need to include the appropriate levels of management as part of that assessment.

Boards and audit committees are integral to this process and should ask questions of management, internal auditors, and external auditors to elicit indications of potential concerns related to incentives or opportunities for financial reporting fraud. They should have executive sessions with their internal audit staff, as well as the external auditor, even in the absence of special concerns or significant issues. In addition, they should take advantage of opportunities to interact with managers, employees, vendors and customers to enhance knowledge of the company and possible risks of financial reporting fraud. Internal auditors should conduct regular meetings with senior management, the audit committee, and the external auditor to exchange insights and perspectives. Ongoing, open lines of communication between the organization's chief audit executive and both management and the audit committee are crucial.

External auditors should promote opportunities for robust conversations with the audit committee on relevant matters, including management's approach to developing significant accounting estimates and factors considered in the auditor's assessment of fraud risk. While executive sessions with the audit committee are not required under the auditing standards, they do provide a forum for candid discussion.

Global Considerations

Larger organizations, particularly those operating in more than one country, can face unique challenges in determining a consistent application of their anti-fraud principles and initiatives throughout all locations and within various cultures. Varying customs and languages can challenge the maintenance of a consistent level of ethical behavior in a global organization. Not only must organizations translate ethical principles, codes of conduct, and fraud training materials into different local languages, they also must understand the various cultures in which a company operates, and tailor policies to local customs and monitor controls and compliance across all locations.

The three sides of the fraud triangle—pressure, opportunity, and rationalization—can take on additional significance in global organizations. Employees might feel pressure to achieve aggressive targets. Distance from headquarters cannot only increase opportunity to commit fraud, but might also lead to diluted communications from headquarters about ethical standards, enabling rationalization. Risk management programs must be fully implemented in, and adapted to, all locations to reduce opportunity, especially in parts of the world where perpetrators of fraud may be less likely to fear, or even face, consequences.

Global organizations can mitigate the challenge of translating an ethical culture to overseas locations by having awareness of laws, customs, and unique risks in the various regions in which a company is operating, and by adapting policies, communications and training accordingly. Companies also should be aware of the consequences of failure to comply with laws such as the U.S. Foreign Corrupt Practices Act (FCPA) of 1977, the UK Bribery Act of 2010, and the Organisation for Economic Co-operation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which came into force in 1999.

1 THE FRAUD-SUSCEPTIBLE CULTURE

Oxalite Inc.: A Cautionary Tale*

The headlines stunned investors, regulators, and the business community. Over a period of five years, several members of the management team at Oxalite Incorporated had engaged in fraudulent financial reporting. The offenses discovered included revenue-timing schemes and the creation of fictitious revenue in both U.S. and Asian offices.

Prior to the discovery, a cursory look at Oxalite would have given little hint of vulnerabilities to financial reporting fraud. Its board of directors was populated with respected individuals. Oxalite had a written code of conduct. It had expanded at a healthy rate, even opening facilities in Asia. The company had experienced steady profits.

But a look behind the curtain revealed a culture that encouraged and enabled fraud. Promotions were based on loyalty rather than competence. "Fast" and "new" were the watchwords, trumping "deliberate" and "documented." Employees did not feel safe bringing bad news forward. Furthermore, skepticism was discouraged; questions frowned upon.

Executives shared the company code of conduct with investors, media, and others outside the company; however employees were simply provided with a weblink to the code upon hire and few had ever accessed or read it. A significant portion of executive compensation hinged on "making the numbers." The Asian offices came under particular pressure, as hopes for ever-higher earnings were pinned on rapid-growth markets. Executives struggled to hit targets but learned to manipulate the books to make it appear they had.

The board of directors and audit committee met regularly but rarely availed themselves of the opportunity to engage internal or external auditors, or the company's ethics and compliance personnel. Board meetings discouraged two-way discussion, and the board frequently ran out of time before ethics and compliance issues could be discussed. The audit committee rarely met with executives or middle management, and when they did, failed to ask questions whose answers might have raised red flags. In short, the participants in the financial reporting supply chain were insufficiently inquisitive or skeptical. They assumed all was well. It was not.

*Oxalite Inc. is a fictional company created for illustrative purposes.

Each case of financial reporting fraud is its own drama, with a unique set and cast of characters and actions that unfold across different scenes. But if one watches enough of these dramas, themes emerge.

While Oxalite, Inc. is fictional, the vulnerabilities described are present in many cases of financial reporting fraud. While the company had a code of ethics, in reality, the practices followed by top management did not conform with the code. Financial reporting fraud does not require a perfect storm—an organization need not have multiple vulnerabilities to fall victim to financial reporting fraud. Any one of an array of deficiencies can increase an organization's susceptibility. However, the vigilance and engagement of all who have a role in preparing or reviewing an organization's financial statements can act as a protective mechanism, so frauds are more often deterred and more easily detected.

An examination of what causes one organization to be susceptible to fraud while another is resistant should begin with the character at center stage in every fraud drama: the fraudster.

The "Typical" Fraudster

Who perpetrates financial reporting fraud? A mastermind, a born fraudster with a clever, criminal mind who recruits others to his or her cause? Or is it an otherwise honest employee who, through circumstances, turns to fraud?

Research indicates it is more often the latter. According to data compiled by KPMG on investigations of 348 serious frauds in 69 countries, 60 percent of individuals who are found to have committed fraud had been with their companies for more than five years. Since the average fraud is discovered within three years, it is a logical conclusion that most fraudsters do not join an organization with the intent to defraud. Just as certain conditions can make an organization more susceptible to fraud, so too can conditions lead an otherwise honest employee to commit fraud.[5] In this study, serious frauds are those considered to be of material value, such as material misstatement of financial results, theft of cash or other assets, and abuse of expenses.

The COSO study, *Fraudulent Financial Reporting, 1998 – 2007: An Analysis of U.S. Public Companies. 2010,* examined Securities and Exchange Commission (SEC) Accounting and Auditing Enforcement Actions (AAERs). The analysis of 347 enforcement actions indicated that the CEO was named in 72 percent of the fraud cases, and the CFO was named in 65 percent. In 89 percent of the fraud cases, the SEC named the CEO and/or the CFO for some level of involvement.

The Fraud Triangle

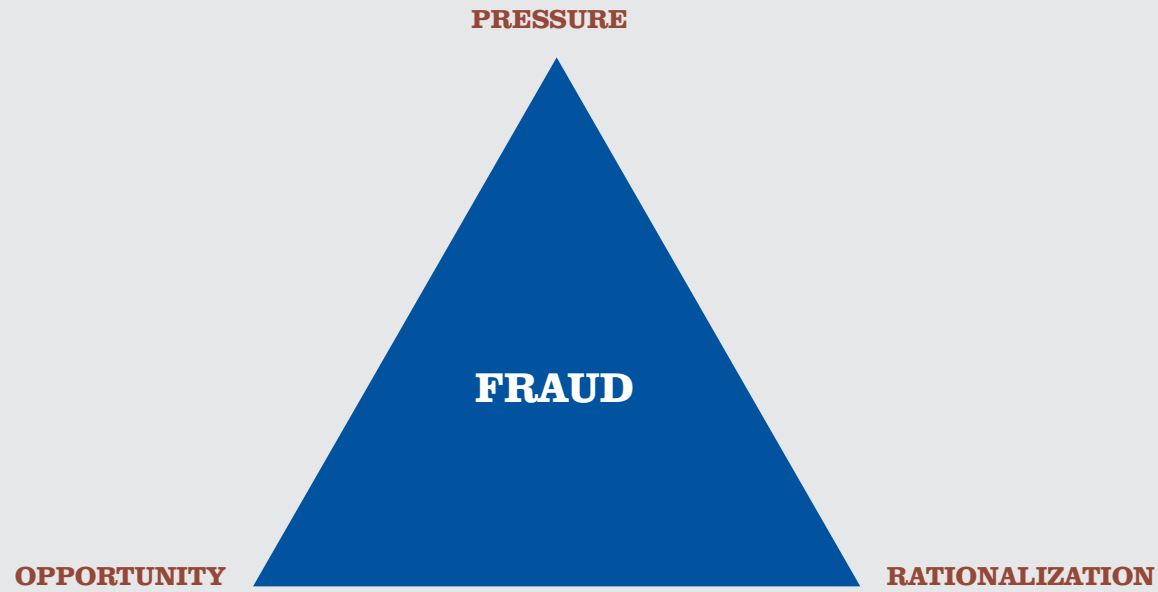
Noted 20th century criminologist Donald Cressey developed the "fraud triangle" to describe three conditions—pressure, opportunity, and rationalization—that can lead someone to commit fraud. He or she is tempted by pressures, enjoys opportunity through few or easy-to-overcome controls, and is encouraged by a corporate culture that enables rationalization of actions.

The three sides of the triangle merit further examination, as they play a role in almost every factor that causes an organization to be susceptible to fraud.

Pressure: Pressure can be a positive force. When goals are achievable, they inspire creativity, efficiency, and healthy competitiveness. But what if goals are unrealistic, seemingly unattainable by normal means? In those circumstances, pressure can inspire fear, particularly if failure to meet goals affects advancement, compensation, and possibly even continued employment.

Fear, greed (the desire for personal gain), or a combination can exacerbate pressure. In KPMG's *2013 Integrity Survey*, more than two-thirds of the

The Fraud Triangle



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

3,500 U.S. employees surveyed cited pressure to do "whatever it takes" to meet business goals as the prime driver of misconduct, more than any other cause cited. Similarly, the analysis of SEC enforcement reports published by COSO in 2010 found the most commonly cited motivations for financial reporting fraud were "the need to meet internal or external earnings expectations, an attempt to conceal the company's deteriorating financial condition, the need to increase the stock price, the need to bolster financial performance for pending equity or debt financing, or the desire to increase management compensation based on financial results."[6]

Opportunity: Even when pressure is extreme, financial reporting fraud cannot occur unless an opportunity is present. Opportunity arises most basically from the susceptibility of the company's accounting systems to manipulation due to inherent risks from management override or collusion, as well as risks due to poorly designed or implemented internal control structures.

Rationalization: Rationalization of fraud can be a byproduct of pressure—"If I hit my quarterly target, it will trigger bonuses for me and my team." An individual may intentionally make what they believe is a one-time reporting error and rationalize that it will be corrected in subsequent periods. Instead, the error gets compounded, making it more difficult for the individual to come forward and correct the mistake for fear of repercussions from supervisors, thus sending the employee down the "slippery slope." Sometimes the rationalization is altruism—the misreporting is intended to help the company through a difficult period. If an organization has no affirmative code of ethics, or if it exists but is not visibly promoted, or if the culture does not encourage the reporting of "bad news," then it will be even easier for employees to keep silent and rationalize their fraudulent behavior.

WHO COMMITS FRAUD?

The snapshots below are gleaned from 348 actual fraud investigations in 69 countries, representing a broad sample of frauds that include theft of cash and/or other assets, abuse of expenses, and a range of other fraudulent acts that are considered to be of material value, including material misstatement of financial results.

Age of fraudster:

- 36–45: 41%
- 46–55:..... 35%
- Other:..... 24%

Time at the organization:

- 3–5 years: 29%
- 6–10 years:..... 27%
- Over 10 years: 33%
- Other:..... 11%

Gender:

- Men: 87%
- Women:..... 13%

Fraud committed:

- In collusion with another party:.. 61%
- Acting alone: 39%

Rank within the organization:

- Senior management:..... 35%
- Management: 29%
- Other:..... 36%

Methods used to override controls:

- Weak internal controls exploited: 74%
- Reckless dishonesty, regardless of controls: 15%
- Collusion to circumvent good controls:..... 11%

Where the fraudster works:

- Finance: 32%
- CEO: 26%
- Operations/Sales: 25%
- Other:..... 17%

Discovery of fraud:

- Frauds discovered by chance: 13%
- Frauds preceded by a "red flag": ..56%
- Initial red flags acted on:.....6%
- Other:..... 25%

Employed by the organization that was defrauded:.....90%

Source: KPMG International. *Who is the Typical Fraudster?* 2011.

If an individual experiences the pressure, opportunity, or the ability to rationalize fraudulent behavior, his or her organization likely is susceptible to two flaws. The first is a potential absence of or weak skepticism. Key individuals or entities fail to ask probing questions, to critically assess evidence put before them, or are inattentive to inconsistencies. The second is the potential of one or more governance deficiencies. These can take any of a number of forms, alone or in combination, including a management team that fails to set an ethical tone; a disengaged board; management override of controls; collusive behavior that goes unnoticed; a lack of communication between the entities responsible for financial reporting; or a lack of sufficient knowledge on the part of those who have a role in financial reporting. To return to the dramatic analogy, these are the tragic flaws.

The Fraud-Resistant Organization

Having examined what makes an organization susceptible to fraud, what qualities does a fraud-resistant organization possess? What techniques or tools does it use?

While there is no way to guarantee an organization will not fall victim to fraud, research on the qualities of, and techniques employed by, fraud-resistant organizations yields three themes:

- A tone at the top that encourages an ethical culture
- The presence of skepticism
- The engagement of all participants in the financial reporting supply chain, with all relevant parties understanding and effectively performing their roles with respect to the company's financial reporting

2 KEYS TO A FRAUD-RESISTANT ORGANIZATION

The phrase "defense in depth," usually used in reference to the military and information technology, describes a complex and multilayered defense system to protect against threats. The term also aptly describes the deterrence and detection of financial reporting fraud, with the participants in the financial reporting supply chain representing the layers of defense in the respective roles that they play.

One of the most effective weapons that each supply chain member can wield is the appropriate exercise of skepticism.

The Engaged Supply Chain

The financial reporting supply chain consists of participants who have some responsibility for the company's delivery of high-quality financial statements. In addition to management, the supply chain consists of boards, audit committees, internal auditors, and external auditors. Each participant has a separate but interconnected role in deterring and detecting fraud, and success requires leveraging each party's complementary activities by sharing information and concerns and identifying gaps in the collective efforts to mitigate the risk of financial reporting fraud.

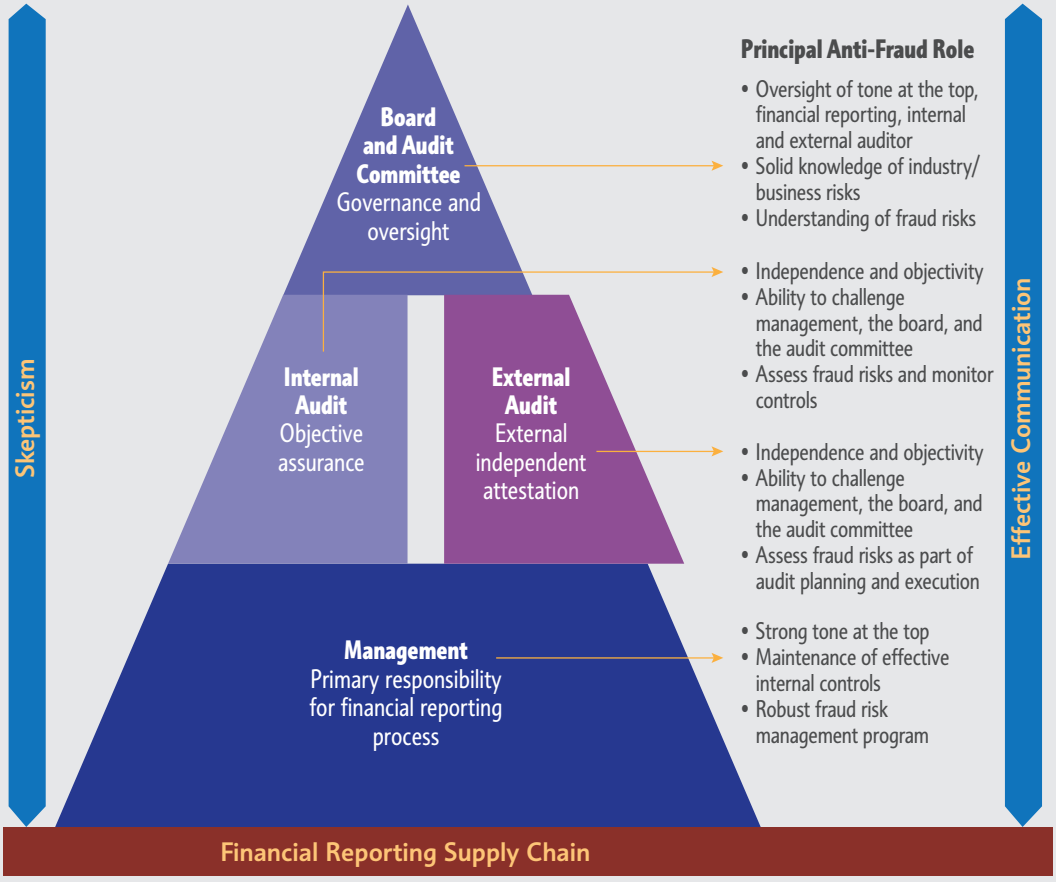
While management has primary responsibility for the financial reporting process and the implementation of controls to deter and detect financial reporting fraud, the other participants play vital roles too. Boards and audit committees have influence over the business and control environment. The audit committee oversees the financial reporting process, the internal audit function, and the company's external auditors.

Internal auditors can play a key role in assessing and providing assurance on an organization's internal control structure; they have a professional responsibility to evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.

External auditors, who must be independent of the company they audit, provide a public report and opinion on the annual financial statements and, in many cases, a report and opinion on the effectiveness of internal control over financial reporting.

Financial reporting supply chain participants can form a "defense in depth" that a fraudster will find difficult to vanquish. However, to do so requires being intentional and knowledgeable about their roles in deterring and detecting fraud. They must know how to employ skepticism, and engage in regular, open, and robust communications and collaboration with the other participants.

Responsibility for Mitigating the Risk of Financial Reporting Fraud



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

Financial Reporting Fraud: Relevant U.S. Federal Laws

The Securities and Exchange Act of 1934: "The 1934 Act" governs the secondary trading of securities in the United States. The Act established the SEC, which has primary responsibility for enforcement of U.S. federal securities laws.

The Foreign Corrupt Practices Act (FCPA): Signed into law in 1977, the FCPA, in addition to its anti-bribery provisions, contains "books and records" provisions that, among other things, require public companies to devise and maintain an adequate system of internal accounting controls.

The Sarbanes-Oxley Act of 2002: The Sarbanes-Oxley Act was passed in response to a number of accounting fraud incidents in the early 2000s. In an effort to bolster confidence in the U.S. capital markets, the law strengthened governance and independence standards for public companies, boards of directors, management, securities analysts, and accounting firms. The Sarbanes-Oxley Act created the Public Company Accounting Oversight Board (PCAOB), a "nonprofit corporation established by Congress to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports."

The Dodd-Frank Wall Street Reform and Consumer Protection Act: Dodd-Frank was signed into law in 2010. Among its many provisions, Dodd-Frank required the SEC to establish a new program that would provide an alternate path for whistleblowers in certain circumstances.

What is Skepticism?

Skepticism is integral to the conduct of external auditors. The PCAOB emphasizes, through its standards and oversight, professional skepticism as central to the external auditor's role and performance. But the exercise of skepticism should not be limited to external auditors. Even if not codified in law or regulation, deterrence and detection of financial reporting fraud requires all participants in the financial reporting supply chain to exercise skepticism. Skepticism is a questioning mindset, and it requires an understanding that even the best organizations can be susceptible to fraud. Management, audit committees, and internal auditors, at a minimum, should take a "trust but verify" approach with systems, methods, and communications rather than accept critical information at face value.

Skepticism is not an end in itself and is not meant to encourage a hostile atmosphere or micro-management. The word skepticism, in fact, comes from the Greek word skeptikos, which means "inquiring" or "reflective."

The exercise of skepticism requires balance. Should a participant in the financial reporting supply chain begin with an assumption of complete doubt, or complete trust? Most operate somewhere on a continuum between those poles.

Lower risk circumstances may not require the rigorous examination of supporting documentation as might be required when there are higher risk factors present. Those areas that are material or that are more susceptible to fraud should result in heightened skepticism.

Skepticism throughout the financial reporting supply chain increases not only the likelihood that fraud will be detected, but also the perception that fraud will be detected, which reduces the risk that fraud will be attempted.

Is skepticism a set of personality traits, or is it a learned skill? The short answer is both. Professor Kathy Hurtt of Baylor University saw skepticism as an individual characteristic, albeit with multiple dimensions, and examined research to develop a scale to measure skepticism. See the "Six Characteristics of Skepticism" below.

Six Characteristics of Skepticism

- **Questioning mind**—A disposition to inquiry, with some sense of doubt
- **Suspension of judgment**—Withholding judgment until appropriate evidence is obtained
- **Search for knowledge**—A desire to investigate beyond the obvious, with a desire to corroborate
- **Interpersonal understanding**—Recognition that people's motivations and perceptions can lead them to provide biased or misleading information
- **Autonomy**—The self-direction, moral independence, and conviction to decide for oneself, rather than accepting the claims of others
- **Self-esteem**—The self-confidence to resist persuasion and to challenge assumptions or conclusions

Summarized from R. Kathy Hurtt, "Development of a Scale to Measure Professional Skepticism," *Auditing: A Journal of Practice and Theory*, May 2010.

GLOBAL NOTE: Skepticism is discouraged in some cultures around the globe, particularly when it means challenging superiors within an organization. As discussed in Chapter 5, training and education can mitigate this reluctance.

But while some individuals are more naturally disposed toward skepticism, research shows that individuals can be trained to employ professional skepticism. Specific ways in which each member of the financial reporting supply chain should exercise skepticism are outlined throughout this report.

Subsequent chapters offer suggestions for the application of skepticism for management, boards, and audit committees as well as internal and external auditors.

Threats to Skepticism

There is research that identifies threats to professional skepticism and ways in which such threats can be mitigated. One threat is a lack of vigilance about possible sources of bias in judgment. While everyone uses shortcuts to facilitate forming judgments or making decisions, it is important to be aware of the potential for cognitive shortcuts that can lead to poor decisions. When an individual fails to notice financial reporting irregularities, it could be because he or she fell into one of the several common judgment traps. (See exhibit on page 18, "Common Judgment Tendencies and the Strategies to Avoid Them and Mitigate Bias.")

What to Do When a Fraud Is Suspected?

Part of a good line of defense against fraud entails having a good offensive plan. Organizations should be prepared to act quickly when a suspected fraud is brought to their attention. They should have an agreed upon set of protocols that address various scenarios. Below are some helpful suggestions that can guide an organization's response:

- Identify implicated parties
- Consider the quality of preliminary information
- Assess possible materiality of the allegation
- Be prepared to respond thoughtfully and consistently while recognizing that every matter is unique
- Consider the type and level of expertise necessary to investigate
- Consider logistics, such as timing and resources
- Consider the perspectives of others
- Investigate objectively
- Consider whether and when to engage the audit committee chair
- Report findings to appropriate stakeholders

Excerpted from Anti-Fraud Collaboration webcast, *How to Improve Your Whistleblower Program and Address Impediments to Reporting,* July 1, 2014.

Common Judgment Tendencies and the Strategies to Avoid Them and Mitigate Bias

Common Judgment Tendencies	Strategies to Avoid Judgment Tendencies and Mitigate Bias
Confirmation *The tendency to put more weight on information that is consistent with initial beliefs or preferences*	• Make the opposing case and consider alternative explanations • Consider potentially disconfirming or conflicting information
Overconfidence *The tendency to overestimate one's own ability to perform tasks or to make accurate assessments of risks or other judgments and decisions*	• Challenge opinions and experts • Challenge underlying assumptions
Anchoring *The tendency to make assessments by starting from an initial value and then adjusting insufficiently away from that initial value*	• Solicit input from others • Consider management bias, including the potential for fraud or material misstatements
Availability *The tendency to consider information that is easily retrievable or what's easily accessible as being more likely or more relevant*	• Consider why something comes to mind • Obtain and consider objective data • Consult with others and make the opposing case

Source: Center for Audit Quality, *Professional Judgment Resource*. 2014.

Cognitive biases have their place. Without them, decisions can fall victim to the inefficiency of "analysis paralysis." However, when not kept in check, judgment biases can lead to bad decisions and to overlooking possible indications of fraud. A delicate balance is required. The first step in striking that balance is awareness. Once decision-makers are aware of vulnerability to judgment biases, they can employ the following model for avoiding problematic bias in decision-making:[7]

1. Define the problem and identify fundamental objectives
2. Consider alternatives
3. Gather and evaluate information
4. Reach a conclusion
5. Articulate and document the rationale

Judgment biases are not the only threat to the exercise of skepticism. Threats exist at every level of the financial reporting supply chain. For example, the individual might face deadline pressure, pressure to please one's boss or client, or lack of experience in significant accounting estimates. These threats can be mitigated, but the first step is clear-eyed acknowledgment that the threats exist.

3 TONE AT THE TOP: MANAGEMENT AND FRAUD DETERRENCE

> *"Companies that play games with their accounting mirror this philosophy that nothing is more important than meeting and beating Wall Street's numbers, and that philosophy begins at the top."* [8]
>
> **Howard Schilit,** *Forensic Accountant*

While one might define the term "corporate culture" in many ways, the following data demonstrate consensus on one point—an ethical culture is vital to an organization in resisting financial reporting fraud.

- Companies with weak ethical cultures experience 10 times more misconduct than companies with strong ethical cultures.[9]
- When companies value ethical performance and build strong cultures, misconduct is substantially lower. In 2013, 20 percent of workers reported seeing misconduct in companies where cultures are "strong," compared to 88 percent who witnessed wrongdoing in companies with the weakest cultures.[10]
- By every measure, strong ethics programs and strong ethics cultures produce substantially better outcomes—less pressure, less misconduct, higher reporting, and less retaliation—than in weaker ethical environments.[11]

Culture begins with the tone at the top, with an organization's most senior leaders, and cascades through the entire organization to create the "mood in the middle" and a "buzz at the bottom," reflecting and reinforcing the tone at the top. Boards and audit committees have influence on corporate culture through their oversight roles.

Corporate culture affects all three sides of the fraud triangle. A strong ethical culture creates an expectation to do the right thing and counteracts pressure and incentive to commit fraud. Such a culture supports well-designed, effective controls that diminish opportunities for fraud and increases the likelihood of early detection. And a culture of honesty and integrity severely limits an individual's ability to rationalize fraudulent actions.

A fundamental ingredient to an ethical culture is healthy skepticism. Management must establish an expectation that all employees will question and challenge all results for which they are responsible, with the specific intent of confirming that corporate standards of accuracy, excellence, and ethics are met. Effective managers rely on skepticism in all their activities—strategy, risk assessment, goal setting, progress reviews, and evaluation of results. The law encourages skepticism: finance officers have a legal obligation under the Sarbanes-Oxley Act to vouch for internal controls and financial statements. And under the Dodd-Frank Act executives can face clawbacks of bonuses awarded under financial statements later restated.

A dual approach is required for management to build an ethical culture. First, managers must "talk the talk," by clearly stating ethical standards, and second, they must "walk the talk," visibly living by those standards every day and reinforcing them throughout an organization. The processes and criteria by which management makes decisions are crucial as they signal to the organization what is truly valued.

In publicly traded companies, the ethical principles espoused (the talk) and the activities and tactics that are put in place to prevent fraud (the walk) are part of an organization's ethics and compliance program. The *2013 Integrity Survey* conducted by KPMG highlighted the importance of such programs. It found that among companies with a comprehensive ethics and compliance program, 82 percent of respondents described the environment as one where people feel motivated and empowered to do the right thing. In companies without a comprehensive ethics and compliance program, only 39 percent gave that response.[10]

"The Talk"

Studies show that when employees understand expectations, believe misconduct will not be tolerated, and observe management strictly adhering to standards, they are less likely to commit fraud and more likely to report it. In other words, if employees are familiar with their organization's code of conduct, and clear about its ethical standards, fraud is less likely to take root or flourish.

Terms in the vernacular of corporate ethics can be used differently or interchangeably from one organization to the next, but for the purposes of this report, ethical principles are defined as an organization's core values, its "right and wrong." An organization's statement of ethical principles communicates values. "We put our clients' interest first… We behave with honor and integrity in all our dealings… We treat employees with dignity," are all examples of ethical principles.

All employees should be familiar with their organization's ethical principles. But the principles are distinct from rules that make up a code of conduct or compliance instructions. If an employee suspects a coworker of engaging in behavior that is not in keeping with the organization's ethical principles, what should he or she do? A code of conduct should provide such guidance, telling employees how to comply both with the ethical principles of the firm, as well as with relevant rules, regulations, and laws. With respect to financial reporting, a code of conduct might dictate that employees "record transactions in the appropriate accounting period," or instruct employees not to "delay or accelerate revenue recording."

Ethical principles, in other words, are the why, while the code of conduct is the how.

It is senior leadership's responsibility to communicate both the company's ethical principles and code of conduct throughout all levels of an organization and in all geographic locations—and continually reinforce them so they permeate through their entire organization.

Employees should hear the same messages not only from top leaders, but also from direct supervisors, who have the most powerful and direct influence



GLOBAL NOTE: Ethical principles and codes of conduct must be translated into all languages spoken at an organization, and multinational corporations should have policies to facilitate communication of these principles with the same consistency and frequency in all locations. However, as discussed in Chapter 5, instilling a consistent standard of ethical behavior is more complex than just translating materials—it also requires capturing nuances of meaning and tailoring policies to local customs and cultures.

on the ethical judgments of employees. The "mood in the middle" among supervisors should echo the company's talk on ethical values, so values become part of the daily conversation and the "buzz at the bottom."

The following are qualities of strong ethics and fraud deterrence communications:

- Ongoing—not just a "one and done"
- Consistent
- Rolled out across multiple forms of media
- Clear about specific objectives
- Appealing to an employee's emotions
- Customized to different employee groups, geographies, and cultures
- Regularly assessed and updated

Management should seek feedback and recommendations from employees and other financial reporting supply chain participants, particularly internal audit, to assess whether tone at the top and ethical messages have permeated throughout the organization's culture.

"The Walk"

Is a written statement of ethical principles or a code of ethics sufficient to deter financial reporting fraud? Enron provides a cautionary tale, as their 65-page code of ethics extolled the company's commitment to honesty and integrity, an irony which once made old copies of the code a brisk seller on eBay.

In their *2013 Integrity Survey*, KPMG found that more than half of the 3,500 employees of U.S. companies that were surveyed had observed misconduct in their organizations in the previous year, and 60 percent of those cited the belief that the company's code of conduct was not taken seriously as a major driver of misconduct. More than three-quarters of respondents (78 percent) indicated that they would report misconduct to a supervisor.

As with "talking the talk," while other participants in the financial reporting supply chain play vital roles, management has primary responsibility for ethics and compliance activities so that the organization "walks the talk" to create an ethical culture that will deter fraud and misconduct of all kinds, including financial reporting fraud.

Management is responsible for the financial reporting process. They have responsibility for the creation and maintenance of accurate books and records, as well as the design and implementation of an effective system of internal control over financial reporting, and thus for the deterrence and detection of financial reporting fraud.

Management can also demonstrate commitment to an ethical tone at the top in staffing decisions. In some larger organizations management may elect to hire a dedicated compliance officer. And in companies of all sizes, management can set the tone by ensuring that ethical performance is considered in performance evaluations and promotions.

Elements of a Fraud Risk Management Program

- Roles and responsibilities
- Commitment
- Fraud awareness
- Affirmation process
- Conflict disclosure
- Fraud risk assessment
- Reporting procedures and whistleblower protection
- Investigation process
- Corrective action
- Quality assurance
- Continuous monitoring

Summarized from *Managing the Business Risk of Fraud: A Practical Guide,* by the American Institute of CPAs, Association of Certified Fraud Examiners and The Institute of Internal Auditors, 2008.

Fraud Risk Management

"Fraud risk management" is defined somewhat differently from one organization to the next, but it is commonly used to describe the aggregate of activities, policies, and documents geared toward mitigating the risk of fraud, including the risk of financial reporting fraud. While fraud risk management teams consist of employees across multiple disciplines, strong commitment and oversight from the top is essential. Visible dedication to fraud risk management sets an ethical tone, and a well-planned and executed fraud risk management program will significantly increase an organization's resistance to financial reporting fraud.

The fraud risk assessment begins with risk identification, analysis of the likelihood and potential significance of various risks, and the organization's planned response.

Another key element is a system for continuous evaluation of the fraud risk management program. The 2014 ACFE *Report to the Nations on Occupational Fraud and Abuse* found that, on average, financial reporting frauds continued for two years from the point they began to the point they were detected. Continuous improvements in fraud risk management will not only help deter fraud, but will help in detecting fraud on a timely basis.

For more details about the components of such programs, see the box "Elements of a Fraud Risk Management Program" above.

Internal Controls

Organizations use a wide variety of internal control processes and activities to mitigate errors and financial reporting fraud risk. The *Three Lines of Defense in Effective Risk Management Control*, a position paper published by The IIA in 2013, outlines a model that companies can follow:[12]

- The first line of defense is comprised of operational managers that own and manage risks.
- The second line of defense is comprised of functions that oversee risks, such as management or compliance functions.
- The third line of defense is an internal audit function that provides independent assurance on the effectiveness of governance, risk management, and controls.

One important principle of internal control is the segregation of duties, so that no one person controls an entire process. This is important because collusion between two individuals is less likely than misconduct by one. In broad terms, internal controls are either "preventive" or "detective," meaning they are designed to either deter or detect errors, including fraud.

According to the 2014 ACFE *Report to the Nations on Occupational Fraud and Abuse*, frauds perpetrated in organizations with any of 18 common controls were detected sooner. Those organizations also had significantly lower losses than organizations that lacked those controls. The table "Impact of Controls on Fraud Losses, Duration" (see below) lists individual controls present in the organizations included in the study and the percentage of reduction in losses from, and duration of, frauds that occurred.

Impact of Various Controls on Fraud Losses, Duration

The Association of Certified Fraud Examiners' analysis of frauds included in their 2014 study, *Report to the Nations on Occupational Fraud and Abuse*, looked at the impact of the presence of common controls on the median losses suffered by organizations for all types of frauds, not just financial reporting frauds, as well as the impact of those controls on the duration of the fraud scheme before it was detected. Each control is associated with a reduction both in median dollar losses and in the median duration of the fraud.

Control	Percent reduction in median loss from fraud	Percent reduction in median duration of fraud
Anti-fraud policy	35.5%	50.0%
Code of conduct	50.0%	33.3%
Dedicated fraud department, function or team	39.0%	50.0%
Employee support programs	55.0%	22.2%
External audit of financial statements	32.8%	25.0%
External audit of internal control over financial reporting	42.8%	37.5%
Formal fraud risk assessments	44.0%	47.9%
Fraud training for employees	39.0%	50.0%
Fraud training for managers/executives	40.5%	38.1%
Hotline	40.5%	50.0%
Independent audit committee	20.0%	41.7%
Internal audit department	44.4%	41.7%
Job rotation/mandatory vacation	33.3%	40.0%
Management review	51.9%	45.8%
Management certification of financial statements	34.8%	37.5%
Proactive data monitoring/analysis	59.7%	50.0%
Rewards for whistleblowers	25.9%	33.3%
Surprise audits	43.3%	50.0%

Management sets the tone for a strong ethical culture by providing support and resources for internal controls, and determining they remain a priority in both good and bad economic times. When results are strong and markets are up, companies can tend toward complacency, with diminished focus on internal controls and reduced scrutiny of results. In tough economic times, companies trying to do more with less may cut budgets in areas that compromise the effectiveness of internal controls.

COSO's 17 Principles of Internal Control

In an update to its Internal Control-Integrated Framework published in May 2013, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) included 17 principles which are required to be present and functioning—along with a requirement that the five core components from COSO's original (1992) internal control framework are present, functioning, and operate together—for internal control to be deemed "effective." The five core components of internal control are control environment, risk assessment, control activities, information and communication, and monitoring activities.

The 17 principles of internal control are further explained by more detailed "points of focus" in COSO's updated framework.

Principle Number 8 calls for management to conduct a fraud risk assessment. Many companies have been conducting a fraud risk assessment voluntarily for years as a best practice. Companies will need to document that their practices conform to the 2013 COSO framework, particularly if making any external attestations that reference the framework.

Summary of Updates

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.

Whistleblower Reporting Mechanism

Confidential tip mechanisms work. The 2010 *IIA Knowledge Alert on Emerging Trends in Fraud Risks* found that tools for confidential reporting were key components of fraud management programs. In most organizations, as directed by the Sarbanes-Oxley Act, the audit committee is responsible for establishing and overseeing the whistleblower helpline or other similar complaint mechanism. However, management can set the tone by ensuring that reported matters are investigated promptly, that those who report misconduct are not retaliated against, and that meaningful penalties are imposed on confirmed violations.

The sweeping reforms enacted in the Dodd-Frank Act expanded on the provisions in the Sarbanes-Oxley Act, adding an alternative path for whistleblowers to report violations of securities laws to the SEC. In some circumstances, those who voluntarily provide the SEC with original information about violations that lead to successful enforcement action resulting in penalties in excess of $1,000,000 are eligible for bounties from 10 percent to 30 percent of monies collected in that action or in a related action. While the rule requires direct reporting to the SEC, it provides incentives to whistleblowers who first report violations internally. The Dodd-Frank Act also extended anti-retaliation protection to SEC whistleblowers, and prohibited whistleblowers from being impeded or discouraged from reporting violations through such measures as confidentiality agreements.

Additional details about whistleblower helplines can be found in the discussion of audit committee responsibilities in Chapter 4.

Sensitivity to Pressures

Management should consider the impact of compensation plans and performance expectations for employees, particularly in high-pressure situations. To avoid creating unintended pressure to falsify results, managers should be mindful of the stresses that their employees may feel in trying to "make the numbers," and endeavor to set realistic and achievable goals. In the event of changes, either in the economic environment or other assumptions that underpinned original goals, managers should consider modifying such goals accordingly.

Annual Surveys

Annual employee surveys are excellent tools to obtain feedback on employees' understanding and perspective on ethics and compliance programs and may serve as an early warning signal. According to the consulting organization LRN, an effective employee survey includes questions that probe working conditions and overall job satisfaction, which often have significant ethical implications.[13] For example, a survey might ask whether employees feel management follows through on commitments and promises, whether the organization is one in which they are proud to be associated, and might also query the level of personal commitment the employee feels toward the organization.

Training

According to research by ACFE, duration of and losses from all types of frauds are lower in organizations with anti-fraud training programs.[14] Programs should educate employees on the characteristics of fraud and the behaviors and other red flags that may suggest fraudulent conduct, and should be tailored to the levels and needs of different employee groups. Training can reinforce the company's code of conduct and encourage those who observe misconduct to report it.

4 RESPONSIBILITIES OF OTHER PARTICIPANTS IN THE SUPPLY CHAIN

The primary responsibility for setting the tone at the top and implementing fraud risk management programs falls to management. The other participants in the financial reporting supply chain—boards, audit committees, and internal and external audit—also have critical roles. Not only do these other participants have unique capabilities and perspectives, but they also provide important checks and balances, which are vital given that management is more often involved when material financial reporting fraud does occur. Dollar losses from fraudulent activity with management involvement tend to be much higher. All participants in the financial reporting supply chain must clearly understand their responsibilities with respect to fraud deterrence and detection.

Boards of Directors and Audit Committees

Given their strategic role in resource allocation, oversight of the management team and of risk, boards and audit committees are uniquely positioned to assist in deterring and detecting financial reporting fraud. To do so effectively, board members should have a thorough understanding of the industry and the company's place in the competitive environment, how the company makes money, and what drives revenue and profitability. They should also understand their role in setting an ethical tone at the top, how to employ skepticism, and how to communicate and interact with employees and other participants in the financial reporting supply chain to deter and detect fraud.

> *"Dedicated and observable fraud risk oversight activities by the board not only set the stage for an internal anti-fraud culture, but also serve to increase confidence among various stakeholders and to enhance the ethical reputation of the organization."*
>
> **The Conference Board,** *Role of the Board in Fraud Risk Management,* 2011

The audit committee is a vital link in the financial reporting supply chain. Oversight of management's financial reporting process and internal controls, the internal audit function, and the company's external auditors endows the audit committee with critical powers in the deterrence and detection of financial reporting fraud. Under the Sarbanes-Oxley Act, audit committee members of U.S. listed companies must be independent of management, and the committee must have a designated "audit committee financial expert" or explain why it does not. Furthermore, under New York Stock Exchange (NYSE) rules adopted following SOX, each audit committee must have a charter describing its duties. (See box on page 27 for NYSE rules for audit committee charters.)

Ethical Tone

A board that visibly promotes the highest ethical standards will help foster a fraud-resistant culture. Each board should exhibit ethical principles consistent with the corporate code: its members should be visible in the organization as proponents of ethical standards, and reinforce standards in all their duties.

While the ethical tone of a company is set by the CEO, the board should take decisive action against any member of senior management who does not adhere to the company's ethical standards and code of conduct. The board must also understand the role pressure plays in fraud, and the effect incentive structures can have on an ethical environment. This knowledge should be used in setting ambitious, yet realistic goals.

New York Stock Exchange Listing Guidelines: Audit Committee Charter

The audit committee must have a written charter that addresses:

- the committee's purpose—which, at minimum, must be to assist board oversight of the integrity of the listed company's financial statements, the listed company's compliance with legal and regulatory requirements, the independent auditor's qualifications and independence, and the performance of the listed company's internal audit function and independent auditors; and prepare an audit committee report as required by the SEC to be included in the listed company's annual proxy statement;
- an annual performance evaluation of the audit committee; and
- the duties and responsibilities of the audit committee [required by law] as well as to:
  - at least annually, obtain and review a report by the independent auditor describing: the firm's internal quality-control procedures; any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor's independence) all relationships between the independent auditor and the listed company;
  - meet to review and discuss the listed company's annual audited financial statements and quarterly financial statements with management and the independent auditor, including reviewing the company's specific disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations;"
  - discuss the listed company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies;
  - discuss policies with respect to risk assessment and risk management;
  - meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function) and with independent auditors;
  - review with the independent auditor any audit problems or difficulties and management's response;
  - set clear hiring policies for employees or former employees of the independent auditors; and
  - report regularly to the board of directors.

Excerpted and adapted from the *New York Stock Exchange Company Manual*.[15]

The audit committee contributes to the ethical tone and culture of an organization in its oversight of management's efforts to design and implement internal controls and other policies to mitigate financial reporting fraud, and is in a position to help ensure management communicates intolerance for misstating financial information.

Skepticism

A skeptical audit committee asks vigorous and probing questions of management and auditors, both to test the integrity of management and to communicate a clear expectation of ethical behavior. They also will be able to spot judgment bias that can color decisions, not only by management, but by the board itself and other financial reporting supply chain participants. The audit committee will be best positioned to craft questions if it has an understanding of how bias can lead to misstatements, and potentially to fraud. See "Common Judgment Tendencies and the Strategies to Avoid Them and Mitigate Bias" included in Chapter 2 for an examination of the common biases that can cause board members to overlook potential financial fraud.

While the audit committee may trust management, they also have a responsibility to verify what they are being told. An effective audit committee will know when to drill down with follow-up questions, be familiar with red flags, and understand how to identify and assess possible nonverbal cues. The audit committee should review reports and statistics from the whistleblower program, and know the protocols for investigating allegations of fraud that stem from the whistleblower program or other reporting sources.

An effective audit committee employs skepticism in overseeing the financial reporting process, including selecting the external auditor and evaluating auditor performance. The audit committee should ask tough questions, and use its many lines of communication so that it receives all news, good and bad. Audit committee members need not be auditors, but their education should include an understanding of risks that may increase the likelihood of financial reporting fraud, and how to monitor the risk of management override of internal controls.

A compelling reason for audit committees to exercise skepticism comes from the SEC's willingness to pursue cases against boards deemed reckless in oversight of management. In 2011, for example, the SEC filed a complaint in federal court against three former directors of DHB Industries, Inc., all of whom had served on DHB's audit committee. The suit alleged the former board members had "turned a blind eye to numerous, significant, and compounding red flags." The settlement imposed monetary sanctions of over $1.6 million, as well as permanent officer-and-director bans on the three defendants.

> *"Deviance from revenue recognition policy is frequently the most common example of financial statement fraud in a company. An audit committee can start by looking at a policy, then move to what adjustments have been suggested by the external auditor, then move to items like the number and size of credits issued and the trends in bad debt reserves and revenue reserves. If you connect the dots from all of these independent data points, this may point very early to...a potential problem."*
>
> **Martin M. Coyne II,** lead director and audit committee member at Akamai Technologies, *Directorship,* "Honing Skepticism," 2013

Risk Management

The board's role in risk oversight is even more important in an age of increasing globalization, more complex transactions, cyber speed of communications and transactions, and constant change. While the audit committee may have particular responsibility for the oversight of fraud

Ten Principles for Effective Board Oversight of Risk

The Report of the NACD *Blue Ribbon Commission on Risk Governance* (2009) identifies 10 principles for effective board oversight of an organization's risk management system. These principles can serve as a foundation for a comprehensive risk management system tailored to the specific characteristics and needs of each individual company.

1. Understand the company's key drivers of success
2. Assess the risk in the company's strategy
3. Define the role of the full board and its standing committees with regard to risk oversight
4. Consider whether the company's risk management system is appropriate and has sufficient resources
5. Work with management to understand and agree on the types of risk information the board requires
6. Encourage a dynamic and constructive dialogue about risk between management and the board, including a willingness to challenge assumptions
7. Closely monitor the potential risks in the company's culture and its incentive structure
8. Monitor critical alignments of strategy, risks, controls, compliance, incentives, and people
9. Consider emerging and interrelated risks to help prepare for what's around the corner
10. Periodically assess the board's risk oversight processes

risk management, all risks that an organization faces are interconnected, so fraud risk must be considered in the context of overall risk exposures, strategy, and tolerance.

Boards must be familiar with their organization's fraud risk management plan, including the fraud risk assessment used to design the plan, as well as division of responsibilities. See "Ten Principles for Effective Board Oversight of Risk" in the box above for a summary of NACD guidance on the subject.

The Whistleblower Helpline

The audit committee is responsible for a confidential, anonymous, reporting mechanism, required under the Sarbanes-Oxley Act, for managing complaints about the company's accounting, internal accounting controls, or audit matters. This mechanism usually takes the form of a whistleblower helpline.

Whistleblower helplines are extremely effective. According to the ACFE, tips are by far the most common method for uncovering fraud in the workplace. The majority of those tips come from employees of the organization in which the fraud has taken place, and if a helpline mechanism is available, half of the tips will come through it. This can be seen as an indication that employees perceive that management will take seriously reports that come through the helpline and thus are willing to utilize it. Also of note, frauds uncovered in organizations that have whistleblower helplines in place tend to be lower in dollar amounts than in those that do not have such a mechanism.[16]

Numerous surveys reveal that many employees fail to report fraud or other misconduct out of fear of retaliation, or the belief that management will not take action in the event of unethical behavior. In order for the program to be effective, there must be a clear record of non-retaliation, and the audit committee should determine that all reported matters are investigated promptly, that allegations are investigated by qualified individuals who are sufficiently objective, and that meaningful penalties are imposed for violations. In some cases, such as those allegations involving senior management, the audit committee or other governance body should be involved.



GLOBAL NOTE: Not only must companies customize whistleblower programs to comply with laws of foreign jurisdictions, they must also take cultural differences into consideration. Additional training may be required for employees, foreign agents, and vendors in those jurisdictions.

Features of a Well-Designed Whistleblower Helpline

- Option for anonymity
- Organization-wide (global) and available 24/7, ideally by telephone, with professionally-trained interviewers in all local languages
- Single helpline for all ethics-related issues
- Dual dissemination of the information received so that no single person controls the information, with criteria for immediate escalation where warranted, and for notification of the audit committee when financial irregularities or senior management are involved
- Case management protocols, including processes for the timely investigation of helpline reports and documentation of the results
- Management analysis of trends and comparison to norms
- Data security and retention policies and procedures
- Customization to comply with the laws of foreign jurisdictions and to address cultural differences
- Ongoing messaging to motivate everyone in the organization, as well as vendors, to use the helpline

Summarized from *Best Practices in Ethics Helplines,* T. Malone and R. Childs, The Network, 2009.

Communications

Board meetings should make time for open discussion between and among board members and management. The audit committee is a hub for coordinating many financial reporting communications, with primary reporting lines from management, the internal auditor, and the external auditor. In addition, it is increasingly common for the audit committee to have a link with the compensation committee through overlapping members, joint meetings, or attendance of the audit committee chair at certain compensation committee meetings. The objective of this process is to satisfy both committees that the executive compensation structure provides sound incentives for achieving corporate strategies without unintentionally providing motivations for fraud or other unethical behavior.

Communication between the audit committee and the external auditor are of particular importance. Audit committees find significant benefit from the wisdom external auditors bring from working across multiple companies. KPMG's surveys of audit committees have shown a heavy reliance on external auditors for a range of information, such as insight into ethical culture and tone at the top, understanding highly technical accounting matters affecting an organization's financial statements, and suggestions to improve audit committee organization and activities.[17]

Discussions between external auditors and audit committees can also extend beyond the review of financial statements, to a frank dialogue on "'soft' topics such as corporate values, management style, and the potential for financial reporting fraud."[18]

In meeting with all parties, both in formal and in individual private sessions, the audit committee must ensure there is adequate time on the agenda, and use that time for productive inquiry. For example, when discussing the financial statements with management or the external auditor, or results of internal audit engagements with the Chief Audit Executive, the audit committee should inquire about controls over financial reporting, including controls over management override. The audit committee should take advantage of sessions with the Chief Financial Officer and operating personnel and financial management below top level. "Were you pressured to do anything?" "What are you uncomfortable with?" are examples of questions that can elicit helpful insights. If time at scheduled meetings is not adequate, inquiries can also be made on an ad hoc basis.

Audit regulators have focused on the communications between the external auditor and the audit committee. The PCAOB's original standards for communications between these two parties were enhanced in 2012. The box on page 32 highlights aspects of the new auditing standard on communications with audit committees, which emphasizes open, transparent, two-way communication, and requires external auditors to report periodically to the audit committee on a variety of matters. Effective communications between the external auditor and the audit committee may go beyond the minimum required under the standard.



GLOBAL NOTE: One of the objectives of the International Forum of Independent Audit Regulators (IFIAR), an organization comprised of independent audit regulators from 50 jurisdictions, is to provide a platform for dialogue with public and private international organizations that have an interest in audit quality. At the 2014 IFIAR Plenary Meeting, a session focused on how audit committees and auditors can best meet the needs of investors. IFIAR intends to continue its outreach to audit committees to further explore how audit regulators can assist audit committees in performing their jobs.

Highlights of PCAOB Auditing Standard 16 (AS 16)
Communications with Audit Committees

AS 16 requires communication about audit planning:

- An overview of the overall audit strategy, including the timing of the audit, and the significant risks the auditor identified during risk assessment procedures
- Considerations regarding the participation of others in the audit
- Significant changes to the planned audit strategy or significant risks initially identified, including the reasons for such change

AS 16 incorporates communication requirements around the results of the audit, including:

- Significant accounting policies and practices
- Critical accounting policies and practices, critical accounting estimates, and significant unusual transactions
- The auditor's evaluation of the quality of the company's financial reporting

AS 16 also requires the communication of information related to:

- Going concern
- Uncorrected and corrected misstatements
- Other information in documents containing audited financial statements
- Difficult or contentious matters for which the auditor consulted
- Management consultation with other accountants
- Material written communications
- Departure from the auditor's standard report, disagreements with management, and difficulties encountered performing the audit

Note: *AU Section 316, Consideration of Fraud in a Financial Statement Audit, deals specifically with the auditor's responsibilities with respect to fraud. The PCAOB's risk assessment standards (AS 8 – AS 15) incorporate many of the AU 316 provisions.*

GLOBAL NOTE: In rapid growth markets, overwhelming percentages of executives say their "board needs a more detailed understanding of the business in order to be an effective safeguard against fraud, bribery and corrupt practices," including 73 percent of respondents in Mexico, 83 percent in Nigeria, 93 percent in China, and 100 percent in Indonesia.[19]

Internal Audit

Internal auditors are in many respects the "eyes and ears" of an organization, responsible for evaluating the effectiveness of, and providing assurance on, the company's governance, risk management and internal control processes.

According to the *International Standards for the Professional Practice of Internal Auditing*,[20] as promulgated globally by The IIA, as it relates to fraud internal auditors must:

- Have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud. (Standard 1210.A2)
- Exercise due professional care by considering the probability of significant errors, fraud, or noncompliance. (Standard 1220.A1)
- (In its reporting), include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board. (Standard 2060)
- Evaluate the potential for the occurrence of fraud and how the organization manages fraud risk. (Standard 2120.A2)
- Consider the probability of significant errors, fraud, noncompliance, and other exposures when developing the engagement objectives. (Standard 2210.A2)

Accordingly, among other aspects as it relates to the risk of fraudulent financial reporting, internal audit's range of activities may include:

- Monitoring and evaluating results of whistleblower programs and collaborating with other departments to address results and remediate applicable findings
- Assessing compliance with the entity's code of ethics
- Conducting ethics surveys of employees
- Analyzing year-over-year changes in key metrics[21]

Ethical Tone

Internal audit can significantly enhance an organization's ethical tone by communicating, reinforcing, and evaluating the ethical culture of an organization, as well as testing compliance with anti-fraud programs and other controls. The requirement that internal audit be independent from "the activities they audit and from interference in the conduct of their activities" communicates to employees the presence of unbiased experts.[22] The more visible and substantive the internal audit's efforts to support ethical standards and assess fraud risk, and the more the board and senior management explicitly support those efforts, the greater their impact.

Skepticism

Appropriate skepticism is critical to the internal auditor, as he or she reviews audit evidence, verifies management's assertions, and examines management's fraud risk assessment. Skepticism is also important in those organizations where internal auditors are involved in evaluating the design and operating effectiveness of internal controls intended to detect or deter fraud.

Skepticism reinforces alertness to information or conditions indicating that a material financial misstatement, intentional or otherwise, could occur or may have occurred. Because of their constant presence in the company and their intimate knowledge of the company's culture, personnel, and operations, internal auditors are well situated to identify early indicators of potential fraud, including indicators that the external auditor normally might not be in a position to identify.

Specific factors that internal auditors should consider in the conduct of their work include:

- The risk that senior management may override internal controls
- Known external and internal matters affecting the entity that may create incentives to commit fraud or enable rationalizations for committing fraud
- The need for persuasive evidence that thoroughly probes into complex issues
- An understanding of judgment biases and other threats to skepticism, outlined in Chapter 2.

The phrase "can't see the forest for the trees" should never apply to an internal auditor. In fact, the internal auditor must see both the forest and the trees, particularly when it comes to risk. In order to develop an effective audit plan, internal auditors must be able to evaluate not only the risk of fraud and the manner in which it is managed by the organization, but also the organization's overall risk strategy.

As The IIA President and CEO Richard Chambers said, "Skepticism can have a much broader definition for internal auditors because our mission includes addressing a broad variety of risks—not just financial risks, but also operational risks, compliance risks, and business and strategic risks that organizations deal with every day."[23]

Communications

According to The IIA, internal audit should operate with organizational independence, which commonly includes direct reporting to the audit committee and unrestricted access to the board and audit committee should matters of concern arise. Internal audit should also communicate with the audit committee regarding fraud risks and deterrence and detection programs, as well as any incidents of actual fraud. Internal auditors should implement a formal process to educate the board and audit committee on the risks and red flags of financial reporting fraud, with a particular focus on the risks of management override of controls.

Internal auditors frequently work with external audit, sharing evaluation of management's fraud risk assessment and results of testing of internal controls. Familiarity with the external audit's findings will inform the ongoing internal audit plan.

External Audit

The primary responsibility of the independent external auditor is to provide an opinion on an organization's annual financial statements. The opinion is intended to provide reasonable assurance that the financial statements are presented fairly in all material respects. Most large companies (i.e., those with over $75 million in public float), are also required to have their external auditor report on the effectiveness of the company's internal control over financial reporting.

External auditors are engaged by, and report directly to, the audit committee, but they

often have contact across many parts of an organization's operations, and can garner valuable insights not only about controls, but also about an organization's culture. In addition, their work across multiple companies endows external auditors with useful perspectives.

Ethical Tone

Professional standards require the external auditor in a financial statement audit to understand the company's system of internal control as part of the audit planning process. This understanding includes consideration of the tone at the top and overall corporate culture, and incentives or pressures that may impel fraudulent financial reporting. The auditor considers factors such as management's philosophy and operating style (including the integrity and ethical values practiced by management), the company's commitment to competence, the effectiveness of the board and audit committee's oversight, and the company's human resource policies and practices (including compensation arrangements). All of these factors contribute to the auditor's risk assessment of the company.

In addition, the knowledge external auditors bring from working across multiple organizations can make them an excellent resource in their independent role for boards, management, and audit committees with respect to the leading practices they may have observed related to ethics communications, helplines, and programs to mitigate the risk of financial reporting fraud.

Skepticism

Throughout the audit process, auditing standards call for external auditors to exercise professional skepticism, defined by the auditing standards as "an attitude that includes a questioning mind and a critical assessment of audit evidence."[24]

External auditors are required by professional standards to be alert for information that suggests material errors in the financial misstatements, and must exercise skepticism when considering the possibility that there may be a material misstatement of the financials due to fraud.[25] External auditors must also apply professional skepticism when they consider the risk that management may override internal controls, and take that risk into account when formulating judgments about the nature and extent of audit testing.

> *"As they exercise professional judgment—from defining the right problem to documenting their findings—external auditors approach their task with skepticism..."*
>
> ***Directorship***, "Honing Skepticism," 2013

PCAOB's Practice Alert No. 10 *Maintaining and Applying Professional Skepticism in Audits,* reminds auditors of their obligation to exercise professional skepticism throughout the audit, and suggests skepticism is "particularly important" in the following circumstances:

- Significant management judgments
- Transactions outside the normal course of business, such as nonrecurring reserves, financing transactions, and related-party transactions that might be motivated solely, or in large measure, by an expected or desired accounting outcome
- The auditor's consideration of fraud

To properly exercise skepticism, in addition to diligently pursuing sufficient appropriate audit evidence, an external auditor can employ effective interview and inquiry techniques, including how to evaluate nonverbal communications. External auditors also should be familiar with judgment biases and other threats to skepticism, which were reviewed in Chapter 2.

To effectively conduct an audit of an organization's financial statements, an external auditor should have a thorough understanding of an organization

Indicators of Possible Illegal Acts

Auditors should be familiar with conditions that may warn of illegal acts. The following list contains information an auditor might encounter that could indicate possible fraud or other illegal activity:

- Unauthorized transactions, improperly recorded transactions, or transactions not recorded in a complete or timely manner in order to maintain accountability for assets
- Investigation by a governmental agency, an enforcement proceeding, or payment of unusual fines or penalties
- Violations of laws or regulations cited in reports of examinations by regulatory agencies that have been made available to the auditor
- Large payments for unspecified services to consultants, affiliates, or employees
- Sales commissions or agents' fees that are excessive in relation to those normally paid by the client or to the services actually received
- Unusually large payments in cash, purchases of bank cashiers' checks in large amounts payable to bearer, transfers to numbered bank accounts, or similar transactions
- Unexplained payments made to government officials or employees
- Failure to file tax returns or pay government duties or similar fees that are common to the entity's industry or the nature of its business

Source: PCAOB. AU Section 317.09: *Specific Information Concerning Possible Illegal Acts.*

and its industry to evaluate whether the results suggest that a fraud risk exists. The external auditor should know how to assess fraud risk, including the risk of management override of controls, and how to respond to identified risks. In accounts or assertions with lower risk of material misstatement, less evidence and documentation may be required, while accounts or assertions where higher risk factors are present demand more rigorous examination of evidence.

The box "Indicators of Possible Illegal Acts" (see above) contains information an external auditor might encounter that could signal the need for the auditor to respond as directed in the auditing standards. An illegal act may not necessarily indicate that a fraud has been committed.

Communications

The more an external auditor engages, and engages effectively, with various members of management throughout an organization, the better the audit design and results. In obtaining information, face-to-face meetings encourage open discussion and the opportunity to assess nonverbal communications.

Early in the engagement, auditing standards require the external auditor to brainstorm about possible fraud risks. Topics for brainstorming include:

- How and where the engagement team believes a company's financial statements could be susceptible to material misstatement due to fraud

- How management could perpetrate and conceal fraudulent financial reporting
- How assets of the company could be misappropriated
- The importance of maintaining the proper state of mind throughout the audit regarding the potential for material misstatement due to fraud

As noted in the section above on Ethical Tone, the external auditor is required to understand the company's system of internal control. These same considerations (management philosophy and operating style, competency, effectiveness of board oversight, and human resource policies), are key to the external auditor's assessment of the risks of material misstatement of the financial statements due to error or fraud in a company. Other factors that the external auditor may consider as part of its risk assessment include the following:

- Communications and training programs, including the tools that help each level of management reinforce the desired messages with its direct reports
- Incentives or pressures that may exist for management to engage in fraudulent financial reporting
- Management's fraud risk assessment and results of testing of internal controls

The board and audit committee can leverage the external auditor's fraud risk assessment to ask questions of management.

Transparent, open, two-way communications between the external auditor and the audit committee are so vital that the PCAOB enacted standards to reflect them, and enhanced those standards in 2012. See "Highlights of PCAOB Auditing Standard 16 (AS 16) *Communications with Audit Committee*" on page 32 for a summary of the new standard.

Knowledge Sharing to Deter and Detect Fraud

While it is important for financial reporting supply chain participants to know their roles in reinforcing an ethical tone and employing skepticism, for this knowledge to be put to use, all participants must help establish and maintain an environment of open and ongoing communication with a goal of sharing knowledge, insights, and concerns to enhance the collective efforts.

Effective communications are a self-reinforcing cycle. Frequent, high-quality communications enhance the knowledge and understanding of all parties, resulting in better questions and a constantly improving communications process. Communications are vital for identifying any gaps in the collective efforts to mitigate the risk of financial reporting fraud. Communication and collaboration also stimulate continuous improvement in efforts to deter and detect financial reporting fraud.

Good communications improve ethical tone and are essential to the exercise of healthy skepticism, fostering a culture of inquiry and openness so that board and audit committee members, and even company staff, are not intimidated or discouraged from asking challenging questions.

The graphic "Financial Reporting: Lines of Communication" on page 38 depicts the lines of communications between supply chain participants. To summarize:

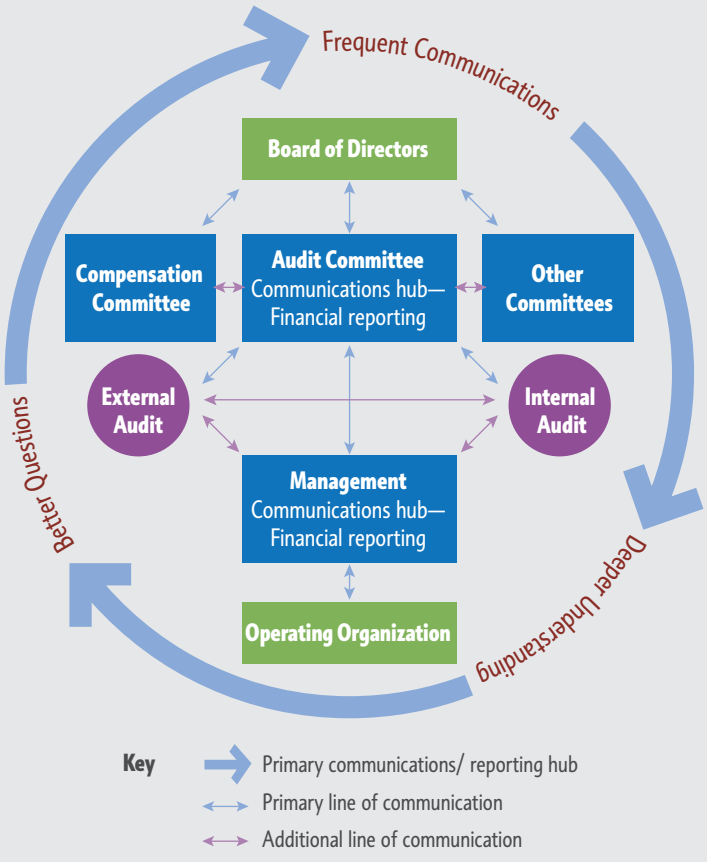
- Management should encourage open, two-way communication between managers and employees at all levels in the organization. Management should also ensure that boards of directors, audit committees, and internal and external auditors are well informed on a timely basis about the company's operations, strategies and risks.
- Boards and audit committees should routinely ask questions of management, internal auditors, and external auditors to

elicit indications of potential concerns related to incentives or opportunities for financial reporting fraud. They should connect with the organization outside the boardroom, seeking opportunities to interact with managers, employees, vendors and customers to enhance knowledge of the company and possible risks of financial reporting fraud.

- The internal auditor should establish a regular schedule of face-to-face meetings with senior management, the audit committee, and the external auditor to exchange insights and perspectives, and explore opportunities for the external auditor to leverage their work. Ongoing, open lines of communication between the organization's chief audit executive and both management and the audit committee are crucial.

- Communication between the auditor and the audit committee can focus on relevant matters, including the factors considered in the auditor's assessment of fraud risk and the company's approach to developing significant accounting estimates. A leading practice is to have the audit committee invite the auditor to executive sessions to encourage candid conversation, even when there are no special concerns or significant issues to discuss. External auditors could suggest areas that the audit committee may want to raise with management, internal auditors, and other key employees, particularly with respect to how they are addressing the potential risks of financial reporting fraud.

Financial Reporting — Lines of Communication



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

5 BUILDING A GLOBAL FRAUD-RESISTANT CULTURE

> *"Translation is not a matter of words only. It is a matter of making intelligible a whole culture."*
>
> **Anthony Burgess,** English writer and composer

As Mr. Burgess suggests in the quotation above, leaders of multinational organizations who wish to foster a consistent ethical culture from one part of the world to another must do more than simply translate statements of ethical principles, codes of conduct, or even fraud training materials into different local languages. Organizations must also consider the individual cultures in which they operate and tailor policies to local customs, laws, and regulations, as well as monitor controls and compliance in all locations. As the snapshots below demonstrate, the task is of increasing concern as organizations seek opportunities abroad, particularly in rapid-growth markets, some with underdeveloped financial reporting systems:

- Global organizations are seeing spikes in internal financial fraud. In one survey of senior executives worldwide, such cases rose from 12 to 16 percent in just one year. Some countries saw particularly dramatic increases, such as Mexico, where the percentage of respondents reporting their company being affected by internal financial fraud rose from 7 percent to 25 percent.[26]
- In Europe, the Middle East, Africa, and India, nearly 25 percent of employees said they had seen financial manipulation in their companies in the previous year. More than 40 percent of board directors and managers reported awareness of "some type of irregular financial reporting."[27]
- Fifty-nine percent of employees in 25 European countries said they expect management to cut corners in order to achieve targets, and 25 percent did not trust their management to behave ethically.[28]
- Knowledge of anti-bribery and corruption laws is very low in some countries. For example, in a 2011 survey conducted in Singapore, 78 percent of respondents were not very familiar with relevant U.S. FCPA provisions, 85 percent were not very familiar with the UK Bribery Act of 2010, which was due to go into effect in July of 2011, and 57 percent were not familiar with their own country's legislation regarding bribery and corruption.[29]

And, as is the case with financial reporting fraud in the United States, the cost to global corporations can be very high. While not the most reported occupational fraud or abuse, financial statement frauds cause the greatest median loss to an organization.[30]

The Fraud Triangle Works Globally

The three sides of the fraud triangle can present greater threats to multinational corporations. Companies often pin expectations for growth on overseas expansion, creating pressure to achieve aggressive targets, particularly in rapid-growth markets. This might explain the 15 percent of employees in a survey in Far East Asia who said misstating an organization's financial performance "can be justified if they help a business survive an economic downturn."[31] Pressure leads to rationalization, a problem compounded in locations far from headquarters, which are often underexposed to messages from headquarters about ethical standards and codes of conduct.

If fraud risk management programs are not fully implemented in and adapted to all locations, employees might also perceive greater opportunity to commit fraud, a sense heightened in parts of the world where perpetrators of fraud frequently do not face consequences. Participants in roundtable discussions conducted by the CAQ in Latin America, for example, suggested that while some Latin American countries such as Chile and Peru have toughened criminal sanctions, there is a widespread perception that white collar crimes go largely unpunished. Participants also noted that the perception of opportunity might also increase in the face of leaner budgets that lead to reduced investment in deterrence and detection.[32]

Legal Exposure

Global companies also face legal exposure from foreign locations and subsidiaries. While many associate the FCPA with its anti-bribery provisions, most of the government's FCPA proceedings are brought under its "books and records" provisions. The provisions require companies to maintain accurate books and records (with no regard for materiality) and proper internal controls around all transactions. Violations carry civil and criminal penalties, and sanctions can be severe. Compliance in jurisdictions outside the United States, where bookkeeping and accounting practices can vary widely, is a substantial challenge.

Lost in Translation

Corporate leaders from the United States must be careful not to project American attitudes and norms onto other cultures. Whistleblower helplines, which are underutilized in some parts of the world, illustrate the challenge. While whistleblowers in the United States are often celebrated by Hollywood and held up as heroes, the attitude is quite different in some other cultures:

- In some Latin American countries, large companies have historically been owned and run by families with strong patriarchal figures. Employees accustomed to this environment might be hesitant to speak out when they witness wrongdoing.[33]

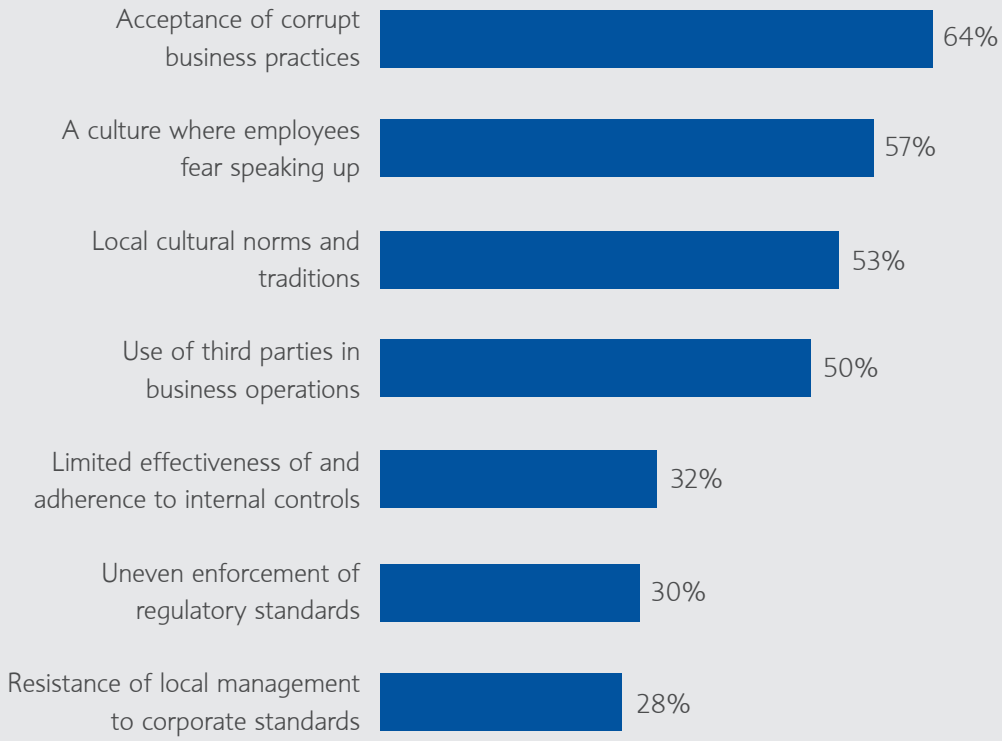
- Participants in a CAQ panel discussion in Japan said that country's ingrained culture of loyalty to management contributes to underutilization of helplines. In Japan, whistleblower helplines are used mainly for complaints, rather than reports of wrongdoing.[34]

- In South Korea, corporate whistleblowing can be seen as a betrayal.[35]

Underutilization might also be explained by a sense of futility. If employees believe crimes will not be punished, what is the point of reporting them? This hesitation is compounded in cultures skeptical about promises of anonymity, and where there is fear that helpline use will lead to retaliation. Some regions have little trust in local authorities and regulatory bodies, leading some managers to allow criminal perpetrators to resign rather than face prosecution.[36]

For all these reasons, global operations can be a source of uneasiness to corporate ethics and compliance leaders. As the chart "Ethics and Compliance Risk Factors of Most Concern in Emerging Markets" below illustrates, their top concern is corrupt business practices, followed closely by cultures in which employees fear speaking up.

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.

The Olympus Affair

In 2011, Olympus became the poster child for corporate governance problems in Japan. Soon after taking over the helm as CEO, British businessman Michael Woodford began asking questions about suspicious accounting—and was promptly fired by the board. Twelve members of the Olympus board were company executives, and one of three outsiders failed to pass a test of independence by a proxy firm.

In *Exposure: Inside the Olympus Scandal: How I Went from CEO to Whistleblower,* Woodford's book about the affair, he said, "*There is a desperate need for the country to ensure that all listed companies have a minimum number of external (non-executive) directors, but Japan's powerful business lobby asserts tremendous influence on limiting any such reforms.*"[37]

The Financial Reporting Supply Chain Abroad

Participants in the financial reporting supply chain often operate differently in other cultures. Japan, for example, is known for having different governance standards than the United States. Boards in Japan tend to be populated by insiders, an issue thrust into the public eye when the board of camera and equipment manufacturer Olympus fired its CEO after he uncovered an accounting scandal.

The challenge of insufficiently knowledgeable boards seems to be more pronounced in rapid-growth markets. This points to a need for boards to become more informed, and for those who are responsible for sharing knowledge with them to make sure they do so efficiently, supplying them not just with greater quantities of information, but rather better quality.[38]

Think Globally, Act Locally

> *"Employees in organizations with strong, values-based cultures are significantly more comfortable reporting misconduct."*
>
> **LRN Corporation,**
> *The HOW Report,* 2012

Global companies can mitigate the challenges of translating an ethical culture to overseas locations. The first step is to learn the laws, customs, and unique risks presented by various locations in which an organization is doing business, and to use that knowledge wisely.

For example, it may be necessary to explain how the organization's policies are more restrictive than the law or common practice in a particular country. Certain expectations for behavior, such as a prohibition on "facilitation payments," may be more restrictive in the United States than what is normally acceptable in another jurisdiction.

In Japan, for example, professional skepticism may run counter to the prevailing culture, but external auditors and others can learn much from experts about how to phrase questions to encourage the right dialogue.[39]

Management can exercise skepticism in making decisions about staffing overseas locations. A KPMG study attributes Central and Eastern Europe's lower rates of frauds in the finance function to a tactic used by many companies. Trusted expatriates from the parent company fill key financial functions in subsidiary locations in the region, monitoring and policing the location from within, and setting the example for how management expects the subsidiary to operate.[40]

Training and Local Partnerships

In order to translate the tone at the top set at corporate headquarters, ethics and compliance training and other communications should be tailored to local customs, while still retaining original principles. Employees must also be trained in any relevant local, national, and international laws and regulations. Regional teams can provide feedback on making codes of ethical behavior and conduct comprehensible and relevant to international audiences. The compliance firm LRN urges companies to have local ethics professionals who are known and credible in their region deliver ethics and compliance training.[41]

Not only will better education increase awareness, it will also provide employees with the professional self-confidence they need to act ethically. Education is a key to encouraging skepticism in cultures where it may come less naturally.[42]

CONCLUSION

Each case of financial reporting fraud may be its own drama, but there is, unfortunately, no deus ex machina, no one device that will miraculously solve the problem or offer perfect protection. In an age of complex accounting and in an increasingly global economy, the entire financial reporting supply chain needs to execute on their respective roles in deterring and detecting financial reporting fraud.

The effort begins with a tone at the top that promotes an ethical culture, a tone set by the CEO and management, reinforced by boards, audit committees, and internal auditors, and enhanced with the knowledge and presence of external auditors. The effort requires the exercise of healthy skepticism up and down the financial reporting supply chain.

Ultimately, it is the responsibility of all the players in an organization to know their roles in delivering high-quality financial reporting, to be part of the financial reporting supply chain's "deep defense" in deterring and detecting financial reporting fraud, and to perform those roles to the best of their abilities.

ENDNOTES

1 Committee of Sponsoring Organizations of the Treadway Commission. *Fraudulent Financial Reporting, 1998 – 2007: An Analysis of U.S. Public Companies.* 2010. http://www.coso.org/documents/COSOFRAUDSTUDY2010_001.pdf

2 Association of Certified Fraud Examiners. *Report to the Nations on Occupational Fraud and Abuse.* 2014. http://www.acfe.com/rttn/docs/2014-report-to-nations.pdf

3 Public Company Accounting Oversight Board. *AU Section 230.07, Due Professional Care in the Performance of Work. PCAOB Interim Auditing Standard.* http://pcaobus.org/Standards/Auditing/Pages/AU230.aspx

4 See "Common Judgment Tendencies and the Strategies to Avoid Them and Mitigate Bias," Center for Audit Quality, *Professional Judgment Resource* 2014. http://www.thecaq.org/reports-and-publications/professional-judgment-resource/professional-judgment-resource. See also Robert A. G. Monks and Alexandra R. Lajoux. "Antivaluation! Human Valuation and Investment Foibles." Corporate Valuation for Portfolio Investment: Analyzing Assets, Earnings, Cash Flow, Stock Price, Governance, and Special Situations. New York: Wiley, 2012. http://onlinelibrary.wiley.com/doi/10.1002/9781118531860.app11/summary

5 KPMG International. *Who is the Typical Fraudster?* 2011. http://www.kpmg.com/us/en/issuesandinsights/articlespublications/pages/typical-fraudster.aspx

6 Committee of Sponsoring Organizations of the Treadway Commission. *Fraudulent Financial Reporting, 1998 – 2007: An Analysis of U.S. Public Companies.* 2010. http://www.coso.org/documents/COSOFRAUDSTUDY2010_001.pdf

7 Committee of Sponsoring Organizations of the Treadway Commission. *Enhancing Board Oversight, Avoiding Judgment Traps and Biases.* 2012. http://www.coso.org/documents/COSO-EnhancingBoardOversight_r8_Web-ready%20(2).pdf

8 Schilit, Howard M. *Financial Shenanigans: Detecting Accounting Gimmicks that Destroy Investments.* CFA Institute. 2010. http://www.cfainstitute.org/learning/products/publications/cp/Pages/cp.v27.n4.1.aspx

9 Corporate Executive Board. Survey of 500,000 employees in 85 countries. September, 2010. http://news.executiveboard.com/index.php?s=23330&item=50990

10 Ethics Resource Center. *National Business Ethics Survey.* 2013. http://www.ethics.org/nbes/

11 Ibid.

12 The Institute of Internal Auditors. *The Three Lines of Defense in Effective Risk Management Control.* 2013. https://na.theiia.org/standards-guidance/Public%20Documents/PP%20The%20Three%20Lines%20of%20Defense%20in%20Effective%20Risk%20Management%20and%20Control.pdf

13 LRN. *The Impact of Codes of Conduct on Corporate Culture: Measuring the Immeasurable.* 2006. http://www.ethics.org/files/u5/LRNImpactofCodesofConduct.pdf

14 Association of Certified Fraud Examiners. *Report to the Nations on Occupational Fraud and Abuse.* 2014. http://www.acfe.com/rttn/docs/2014-report-to-nations.pdf

[15] New York Stock Exchange. *New York Stock Exchange Company Manual,* 303A.07 as amended (omitting commentary and exceptions): November 25, 2009 (NYSE-2009-89); August 22, 2013 (NYSE-2013) at http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp_1_4_3&manual=%2Flcm%2Fsections%2Flcm-sections%2F

[16] Association of Certified Fraud Examiners. *Report to the Nations on Occupational Fraud and Abuse.* 2014. http://www.acfe.com/rttn/docs/2014-report-to-nations.pdf

[17] KPMG. *Audit Committee Surveys.* 2006 – 2010. http://www.auditcommitteeinstitute.ie/publications-international.htm

[18] Center for Audit Quality. *Deterring and Detecting Financial Reporting Fraud: A Platform for Action.* 2010. http://www.thecaq.org/docs/reports-and-publications/deterring-and-detecting-financial-reporting-fraud-a-platform-for-action.pdf?sfvrsn=0

[19] *EY. Growing Beyond: 12th Global Fraud Survey.* 2013. http://www.ey.com/Publication/vwLUAssets/Global-Fraud-Survey-a-place-for-integrity-12th-Global-Fraud-Survey/$FILE/EY-12th-GLOBAL-FRAUD-SURVEY.pdf

[20] The Institute of Internal Auditors. *International Standards for the Professional Practice of Internal Auditing.* https://na.theiia.org/standards-guidance/Public%20Documents/IPPF%202013%20English.pdf

[21] The Institute of Internal Auditors. *International Professional Practices Framework Practice Guide, Definition of Internal Auditing.* 2013. https://na.theiia.org/standards-guidance/Pages/Standards-and-Guidance-IPPF.aspx

[22] Ibid.

[23] National Association of Corporate Directors. *Directorship.*"Honing Skepticism." 2013. http://www.nacdonline.org/Resources/Article.cfm?ItemNumber=6329. See also the *Anti-Fraud Collaboration's Skepticism Series to Combat Fraud* http://www.nacdonline.org/Education/skepticismwebinars.cfm?navItemNumber=3717

[24] Public Company Accounting Oversight Board. *AU Section 230.07, Due Professional Care in the Performance of Work. PCAOB Interim Auditing Standard.* http://pcaobus.org/Standards/Auditing/Pages/AU230.aspx

[25] Public Company Accounting Oversight Board. AU Section 316, *Consideration of Fraud in a Financial Statement Audit. PCAOB Interim Auditing Standard.* http://pcaobus.org/Standards/Auditing/Pages/AU316.aspx

[26] Kroll. *Global Fraud Report.* 2013-2014. http://fraud.kroll.com/?utm_campaign=global-fraud-report&utm_source=Kroll&utm_medium=Web

[27] EY. Europe, Middle East, India and Africa Fraud Survey. 2013. http://www.ey.com/Publication/vwLUAssets/Navigating_todays_complex_business_risks/$FILE/Navigating_todays_complex_business_risks.pdf

[28] EY. European Fraud Survey. 2011. http://www.ey.com/GL/en/Services/Assurance/Fraud-Investigation---Dispute-Services/European-fraud-survey-2011--recovery--regulation-and-integrity

[29] KPMG. *Singapore Fraud Survey Report.* 2011. http://www.kpmg.com/sg/en/issuesandinsights/articlespublications/pages/fraud-kpmgsgfraudsurveyreport2011.aspx

[30] Association of Certified Fraud Examiners. *Report to the Nations on Occupational Fraud and Abuse.* 2014. http://www.acfe.com/rttn/docs/2014-report-to-nations.pdf. 2014.

[31] EY. *Growing Beyond: 12th Global Fraud Survey.* 2013. http://www.ey.com/Publication/vwLUAssets/Global-Fraud-Survey-a-place-for-integrity-12th-Global-Fraud-Survey/$FILE/EY-12th-GLOBAL-FRAUD-SURVEY.pdf

[32] Observation drawn from CAQ roundtable discussion in Cartagena, Colombia, July 2013.

[33] Observation drawn from CAQ roundtable discussion in Managua, Nicaragua, October 2012.

[34] Observation drawn from CAQ panel discussion held in Tokyo, Japan, October 2012.

[35] Choe Sang-Hun. "Help Wanted: Korean Busybodies with Cameras," *The New York Times,* September 28, 2011, A-6.

[36] KPMG. *Who is the Typical Fraudster?* 2011.
http://www.kpmg.com/us/en/issuesandinsights/articlespublications/pages/typical-fraudster.aspx

[37] Woodford, Michael. *Exposure: Inside the Olympus Scandal: How I Went from CEO to Whistleblower, Portfolio,* 2012.

[38] *EY. Growing Beyond: 12th Global Fraud Survey.* 2013.
http://www.ey.com/Publication/vwLUAssets/Global-Fraud-Survey-a-place-for-integrity-12th-Global-Fraud-Survey/$FILE/EY-12th-GLOBAL-FRAUD-SURVEY.pdf

[39] Observation drawn from CAQ panel discussion held in Tokyo, Japan, October 2012.

[40] KPMG. *Who is the Typical Fraudster?* 2011.
http://www.kpmg.com/us/en/issuesandinsights/articlespublications/pages/typical-fraudster.aspx

[41] LRN. *2011-2012 Ethics and Compliance Leadership Report.*
http://www.ethics.org/files/u5/LRNImpactofCodesofConduct.pdf

[42] Observation drawn from CAQ roundtable discussion held in Cartagena, Colombia, October 2013.

BIBLIOGRAPHY

ACFE. *Report to the Nations on Occupational Fraud and Abuse 2012 Global Fraud Study.* Association of Certified Fraud Examiners, Inc., 2012. http://www.acfe.com/uploadedFiles/ACFE_Website/Content/rttn/2012-report-to-nations.pdf

ACFE. *Report to the Nations on Occupational Fraud and Abuse 2014 Global Fraud Study.* Association of Certified Fraud Examiners, Inc., 2014. http://www.acfe.com/rttn/docs/2014-report-to-nations.pdf

ACFE, AIPCA, and The IIA. *Managing the Business Risk of Fraud: A Practical Guide.* 2011. http://www.aicpa.org/interestareas/forensicandvaluation/resources/practaidsguidance/downloadabledocuments/managing_business_risk_fraud.pdf

Ahmed, Mohammed and Donna Epps. *Fraud, Bribery and Corruption: Protecting Reputation and Value.* Deloitte Development LLC, 2011.

Askelson, Ken, et. al. *Global Technology Audit Guide 13: Fraud Prevention and Detection in an Automated World.* The Institute of Internal Auditors, 2009. http://www.theiia.org/bookstore/product/global-technology-audit-guide-gtag-13-fraud-prevention-and-detection-in-an-automated-world-download-pdf-1464.cfm

Anti-Fraud Collaboration. *Closing the Expectation Gap in Deterring and Detecting Financial Statement Fraud: A Roundtable Summary.* 2013. https://na.theiia.org/standards-guidance/Public%20Documents/Anti-Fraud%20Collaboration%20Report.pdf

Anti-Fraud Collaboration. *How to Improve Your Whistleblower Program and Address Impediments to Reporting.* Webcast originally aired July 1, 2014. http://antifraudcollaboration.org/

Anti-Fraud Collaboration website: www.AntiFraudCollaboration.org

Audit Committee Institute. *2010 International Audit Committee Member Survey.* KPMG International, 2010. http://www.kpmg.com/FR/fr/IssuesAndInsights/ArticlesPublications/Documents/2010-ACI-Etude-internationale.pdf

Ballou, Brian, Dan L. Heitger and Dale Stoel. "How Boards of Directors Perceive Risk Management Information." *Management Accounting Quarterly* 12, no. 4 (2011): 14 – 22. http://www.imanet.org/PDFs/Public/MAQ/2011_q3/MAQ_summer_2011_ballou.pdf

Bart, David P. and Scott Peltz. "The Threat Within: Employee Fraud Detection and Prevention." McGladrey.com. http://mcgladrey.com/content/dam/mcgladrey/pdf/threat_within_employeefraud_detection_prevention.pdf

Basilico, Elisabetta and Hugh Grove. "Major Financial Reporting Frauds of the 21st Century: Corporate Governance and Risk Lessons Learned." *Journal of Forensic & Investigative Accounting* 3, no. 2 (2011): 191 -226. http://www.bus.lsu.edu/accounting/faculty/lcrumbley/jfia/Articles/FullText/2011_v3n2a7.pdf

BDO Consulting. *Doing Business Abroad: Spotlight on UK Bribery Act.* BDO, 2011.

BDO Seidman, LLP. *The BDO Consulting Critical Anti-Fraud Program Creating; A Genuine Anti-Fraud Environment.* BDO, 2008. http://www.bdoconsulting.com/resources/brochures/BC-CAPbrochure5-08.pdf

BDO Seidman. "Effective Audit Committees in the Ever Changing Marketplace." *Aćsense*, 2010. http://www.bdo.com/acsense/documents/EffectiveAC-2010-FINAL.pdf

Beasley, Mark S., et al. *Fraudulent Financial Reporting, 1998 – 2007: An Analysis of U.S. Public Companies.* Committee of Sponsoring Organizations of the Treadway Commission, 2010. http://www.coso.org/documents/COSOFRAUDSTUDY2010_001.pdf

Brazel, Joseph, Keith Jones, and Mark Zimbelman. *Using Nonfinancial Measures to Assess Fraud Risk.* The IIA, 2008. http://www.theiia.org/bookstore/product/using-nonfinancial-measures-to-assess-fraud-risk-1374.cfm

Carpenter, Tina and Jane L. Reimers. "Professional Skepticism: The Effects of a Partner's Influence and the Presence of Fraud on Auditors' Fraud Judgments and Actions." *SSRN*, September 1, 2009. http://ssrn.com/abstract=1068942

Center for Audit Quality. *Deterring and Detecting Financial Reporting Fraud: A Platform for Action.* 2010. http://www.thecaq.org/docs/reports-and-publications/deterring-and-detecting-financial-reporting-fraud-a-platform-for-action.pdf?sfvrsn=0

Choe Sang-Hun. "Help Wanted: Korean Busybodies with Cameras," *The New York Times,* September 28, 2011, A-6.

CIMA. *Fraud Risk Management a Guide to Good Practice.* London: CIMA, 2009. http://www.cimaglobal.com/documents/importeddocuments/cid_techguide_fraud_risk_management_feb09.pdf.pdf

Committee of Sponsoring Organizations of the Treadway Commission. Internal Control – Integrated Framework. 2013. www.coso.org/IC.htm

Corporate Executive Board. "Research Reveals That Integrity Drives Corporate Performance: Companies With Weak Ethical Cultures Experience 10x More Misconduct Than Those With Strong Ones." *Press Release,* September, 2010. http://news.executiveboard.com/index.php?s=23330&item=50990

Counterparty Risk Management Policy Group. *Containing Systemic Risk: The Road to Reform the Report of the CRMPG III.* Counterparty Risk Management Policy Group, 2008. http://www.crmpolicygroup.org/docs/CRMPG-III.pdf.

Deloitte & Touche. *Audit Committee Resource Guide.* Deloitte Development LLC, 2011. http://www.iasplus.com/de/binary/usa/1004auditcommitteeguide.pdf

Deloitte Forensic Center. *Anti-Corruption Practices Survey 2011: Cloudy With a Chance of Prosecution?* Deloitte Development LLC, 2011. http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan047888.pdf

Deloitte Forensic Center. *Ten Things About Bankruptcy and Fraud a Review of Bankruptcy Filing.* Deloitte Development LLC, 2008. http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/us_dfc_tenthingsaboutbankruptcy_24112008.pdf

Dienhart, John, et al. "Enterprise Risk Management: Why the Ethics and Compliance Function Adds Value." The ERC Fellow Research Series, 2010. http://www.ethics.org/files/u5/ERM.pdf

Domzalsk, Patricia T. "Cooking the Fraud Triangle: A Recipe for Disaster." Financialexecutives.org. http://www.financialexecutives.org/eweb/upload/chapter/Philadelphia/Cooking%20the%20Fraud%20Triangle%20-%20A%20Recipe%20for%20Disaster.pdf

ERC. *2011 National Business Ethics Survey.* Ethics Resource Center, 2012. http://www.ethics.org/files/u5/FinalNBES-web.pdf

ERC. *2013 National Business Ethics Survey.* Ethics Resource Center, 2014.
http://www.ethics.org/nbes/download-reports/

Ethics Fellows Program. *Too Big To Regulate? Preventing Misconduct in the Private Sector.* The Ethics Resource Center, 2010.
http://www.ethics.org/files/u5/enforcementWP.pdf

EY. "Global Bribery and Corruption Fraud Risks." 5: *Insights for Executives to Cover,* 2011.

EY. *European Fraud Survey 2011.* EYGM Limited, 2011.

EY. *Growing Beyond: A Place for Integrity 12th Global Fraud Survey.* EYGM Limited, 2013.
http://www.ey.com/Publication/vwLUAssets/Global-Fraud-Survey-a-place-for-integrity-12th-Global-Fraud-Survey/$FILE/EY-12th-GLOBAL-FRAUD-SURVEY.pdf

EY. *Overcoming Compliance Fatigue Reinforcing the Commitment to Ethical Growth 13th Global Fraud Survey.* EYGM Limited, 2014. http://www.ey.com/Publication/vwLUAssets/Overcoming_compliance_fatigue/$FILE/13th%20GLOBAL%20FRAUD%20SURVEY%20FINAL%20low%20res.pdf

EY. *Navigating Today's Complex Business Risks, Europe, Middle East, India and Africa Fraud Survey 2013.* EYGM Limited, 2013.
http://www.ey.com/Publication/vwLUAssets/Navigating_todays_complex_business_risks/$FILE/Navigating_todays_complex_business_risks.pdf

Flood, Brian. "Addressing the Risks of Fraud and Misconduct." (Presentation at the Internal Auditor's Association Conference, Austin, TX, December 1, 2010.)

Gazzaway, Trent, et al. "Guidance on Monitoring Internal Control Systems." *Internal Control — Integrated Framework,* 1-4. The Committee of Sponsoring Organizations of the Treadway Commission, 2009.
http://www.coso.org/documents/COSO_Guidance_On_Monitoring_Intro_online1.pdf

Girgenti, Richard and Timothy Hedley. *Managing the Risk of Fraud and Misconduct; Meeting the Challenges of a Global, Regulated, and Digital Environment.* New York: McGraw Hill, 2011.

Glover, Steven M., KPMG LLP and Douglas F. Prawitt. *Enhancing Board Oversight Avoiding Judgment Traps and Biases.* The Committee of Sponsoring Organizations of the Treadway Commission, 2009
http://www.coso.org/documents/COSO-EnhancingBoardOversight_r8_Web-ready%20(2).pdf

Glover, Steven M. and Douglas F. Prawitt. *Enhancing Auditor Professional Skepticism.* Global Public Policy Committee. 2013.
http://www.thecaq.org/docs/research/skepticismreport.pdf

Grant Thornton. "Enterprise Risk Management: Creating Value in a Volatile Economy." *CorporateGovernor,* Summer, 2009.
http://www.grantthornton.com/staticfiles/GTCom/Advisory/CorporateGovernor/CGwhitepaper_ERM_FINAL.pdf

Grant Thornton. "Managing Fraud Risk: The Audit Committee Perspective." *The Audit Committee Guide Serie+E44s.* https://www.grantthornton.com/~/media/content-page-files/audit/pdfs/ACH-guides/ACH_Guides_Managing_Fraud_Risk_.ashx

Grant Thornton. "Monitoring the System of Internal Control." *The Audit Committee Guide Series.*
http://www.boardoptions.com/monitoringinternalcontrol.pdf

Grant Thornton. "Overseeing the Internal Audit." *The Audit Committee Guide Series.*
http://www.grantthornton.com/staticfiles/GTCom/Audit/Assurancepublications/Audit%20committee%20guides/ACH_Guides_Overseeing_Internal_Audit_WEB.pdf

Hendrickson, Justin. "Whose Job is it? Deciphering Roles and Responsibilities in Enterprise Risk Management." *Corporate Governor,* Winter, 2011. http://internalaudits.duke.edu/documents/articles_archive/CorporateGovernor7_25_11.pdf

Hundt, Reed, et. al. *Toward a Single Global Digital Economy: The First Report of The Aspen Institute Idea Project.* The Aspen Institute, 2012. http://www.aspeninstitute.org/sites/default/files/content/upload/IDEA_Project_Toward_a_Single_Global_Digital_Economy.pdf

Jordan, Bailey and Warren Stippich. "Is ERM Right For Your Organization?" *CorporateGovernor,* Winter, 2010. http://insights.grantthornton.ca/i/103856/2

Kaden, Kevin J. "Cross-Border Due Diligence: Addressing Local Complications?" *ViewPoints,* no. 1 (2011): 6. http://www.bdoconsulting.com/resources/publications/BDOC-Viewpoints-2011-Issue%201%20Newsletter.pdf

Katz, Jeffrey M. "Post-Acquisition Dispute Arbitration: Key Factors To Consider." *ViewPoints,* no. 1 (2011): 7-9. http://www.bdoconsulting.com/resources/publications/BDOC-Viewpoints-2011-Issue%201%20Newsletter.pdf

KPMG. *The Audit Committee Journey Charting Gains, Gaps, and Oversight Priorities.* KPMG International, 2008. http://www.auditcommitteeinstitute.ie/documents/InternationalSurvey_Aug08.pdf

KPMG. *The Audit Committee Journey Evolving Priorities, Practices, and Perspectives—A Global View.* KPMG International, 2007. http://www.auditcommitteeinstitute.ie/documents/InternationalSurvey_July07.pdf

KPMG. *Fraud and Misconduct Survey 2010.* KPMG LLP, 2010. http://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/Fraud-Survey/Documents/Fraud-and-Misconduct-Survey-2010.pdf

KPMG. *Highlights from the 7th Annual Audit Committee Issues Conference.* KPMG LLP, 2011. https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/audit-committe-issues-conference-highlights-2011.pdf

KPMG. *Integrity Survey.* KPMG LLP, 2013. http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Documents/Integrity-Survey-2013-O-201307.pdf

KPMG. *Is Governance Keeping Pace?* KPMG LLP, 2012. http://www.kpmg.com/BM/en/IssuesAndInsights/ArticlesPublications/Documents/Advisory/IsGovernancekeepingpace.pdf

KPMG. *KPMG Singapore Fraud Survey Report 2011.* KPMG Services Pte. Ltd., 201 http://www.kpmg.com/SG/en/IssuesAndInsights/ArticlesPublications/Documents/kpmgSgFraudSurveyReport2011.pdf

KPMG. *Survey on Bribery and Corruption Impact on Economy and Business Environment.* KPMG, 2011. http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/bribery-corruption.pdf

KPMG. *Who is The Typical Fraudster.* KPMG LLP, 2011. http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/who-is-the-typical-fraudster.pdf

KPMG and NACD. *The Audit Committee Journey Adapting to Uncertainty, Focusing on Transparency.* KPMG LLP, 2010. http://www.auditcommitteeinstitute.ie/documents/aci-nacd-survey-2010.pdf

KPMG and NACD. *The Audit Committee Journey — Recalibrating for the "New Normal".* KPMG LLP, 2009. http://www.auditcommitteeinstitute.ie/documents/2009_ACI_NACD_AC_Member_Survey.pdf

KPMG and NACD. *2011 Public Company Audit Committee Member Survey – Highlights.* KPMG, 2011. https://www.kpmg.com/FR/fr/IssuesAndInsights/ArticlesPublications/Documents/Public-Company-Audit-Committee-Member-Survey-Highlights-2011.pdf

Kroll, et. al. *2013/2014 Global Fraud Report.* New York: Kroll, 2013. http://fraud.kroll.com/wp-content/uploads/2013/10/GlobalFraudReport_2013-14_WEB.pdf

Lackstrom, Carl. *Preparing for Fraud: Performing Fraud Response Planning.* RSM McGladrey Inc., November, 2006.

LRN Corporation. "Executive Summary." *Ethics & Compliance Alliance Risk Forecast Report 2012.* LRN Corporation, 2012. http://lon.lrn.com/operational-guidance-whitepapers/lrn-2012-ethics-compliance-alliance-eca-risk-forecast-report-execut

LRN Corporation. *Ethics & Compliance Alliance Risk Forecast Report 2013.* http://pages.lrn.com/risk-forecast-report-2013

LRN Corporation. *The Impact of Codes of Conduct on Corporate Culture: Measuring the Immeasurable.* LRN Corporation, 2006. http://www.ethics.org/files/u5/LRNImpactofCodesofConduct.pdf

LRN Corporation. The HOW Report: *New Metrics for a New Reality.* 2012. http://pages.lrn.com/how-report

LRN Corporation. *2011–2012 Ethics & Compliance Leadership Survey Report.* 2012. http://lon.lrn.com/sites/default/files/L1008_E&C_v05.pdf

Maclay, Andrew, Glenn Pomerantz and Martina Rozumberkova. "Will Your Anti-Corruption Program Pass the Test?" *ViewPoints,* no. 1 (2011): 4-5. http://www.bdoconsulting.com/resources/publications/BDOC-Viewpoints-2011-Issue%201%20Newsletter.pdf

Marais, Petrus and Naomi Smit. *Africa Fraud Barometer 2011 – Is Fraud in Africa on the Decrease?* KPMG International, 2012. http://www.kpmg.com/africa/en/issuesandinsights/articles-publications/press-releases/pages/africa-fraud-barometer.aspx

McGladrey. *Audit Committee Guide for Financial Institutions.* McGladrey LLP, 2013. http://mcgladrey.com/content/dam/mcgladrey/pdf/audit_committee_guide_financial_institutions.pdf

McGladrey and The IIA. *Global Corruption Law Compliance Report – Insights from the Middle Market.* McGladrey LLP, 2013. http://mcgladrey.com/content/mcgladrey/en_US/what-we-do/services/financial-advisory/forensic-accounting-and-fraud-investigations/global-corruption-law-compliance-report-insights-from-the-middle-market.html

McNeal, Andi. "The Role of the Board in Fraud Risk Management." *The Conference Board Inc.,* January, 2011. doi: DN-V3N21-11. http://www.conference-board.org/retrievefile.cfm?filename=TCB-DN-V3N21-111.pdf&type=subsite

NACD. *Honing Skepticism.* National Association of Corporate Directors, 2013. http://www.nacdonline.org/files/NACD%20Directorship%20article%20-%20Honing%20Skepticism.pdf

NACD. *Report of the NACD Blue Ribbon Commission on Director Professionalism.* District of Columbia.: National Association of Corporate Directors, 2011 edition. http://www.nacdonline.org/Store/ProductDetail.cfm?ItemNumber=3721

NACD. *Report of the NACD Blue Ribbon Commission on the Effective Lead Director.* National Association of Corporate Directors, 2011. http://www.nacdonline.org/Store/ProductDetail.cfm?ItemNumber=3934

NACD. *Report of the NACD Blue Ribbon Commission on Risk Governance.* National Association of Corporate Directors, 2009. http://www.nacdonline.org/Store/ProductDetail.cfm?ItemNumber=675

NACD and the Anti-Fraud Collaboration. *Skepticism Series to Combat Fraud.* October 1, 2012, and continuing. http://www.nacdonline.org/Education/skepticismwebinars.cfm?navItemNumber=3717

Office of the Chief Accountant of the SEC. *Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 for Issuers with Public Float Between $75 and $250 Million.* SEC, April 2011. http://www.sec.gov/news/studies/2011/404bfloat-study.pdf

Oversight Systems. "The 2007 Oversight Systems Report on Corporate Fraud." Ethicsworld.org. Inc. http://www.ethicsworld.org/ethicsandemployees/PDF%20links/Oversight_2007_Fraud_Survey.pdf

Pergola, Carl W. "An Integrated Approach To Anti-Corruption." *Law 360.* http://www.law360.com/articles/269387/an-integrated-approach-to-anti-corruption

Pergola, Carl W. "Letter from the Executive Director." *ViewPoints,* no. 1 (2011): 1. http://www.bdoconsulting.com/resources/publications/BDOC-Viewpoints-2011-Issue%201%20Newsletter.pdf

Pergola, Carl W. "Simplicity in the Face of Complexity: An Integrated Approach to Anti-Corruption Initiatives." *ViewPoints,* no. 1 (2011): 2-3. http://www.bdoconsulting.com/resources/publications/BDOC-Viewpoints-2011-Issue%201%20Newsletter.pdf

Pomerantz, Glenn M., Brian J. Mich and Martina Rozumberkova. "Doing Business in Russia: Navigating the Challenges of Corruption." *Financier Worldwide Limited,* February 2012. http://www.bdoconsulting.com/documents/Feb_2012_POMERANTZ_MICH_ROZUMBERKOVA_Financier_Worldwide_Doing_Business_in_Russia.pdf

Protiviti. *2010 Sarbanes-Oxley Compliance Survey Where U.S.-Listed Companies Stand: Reviewing Cost, Time, Effort and Processes.* Protiviti, 2010. http://www.protiviti.com/en-US/Documents/Surveys/2010-SOX-Compliance-Survey-Protiviti.pdf

Protiviti. *2011 Sarbanes-Oxley Compliance Survey Where U.S.-Listed Companies Stand: Reviewing Cost, Time, Effort and Processes.* Protiviti, 2011. http://www.protiviti.com/en-US/Documents/Surveys/2011-SOX-Compliance-Survey-Protiviti.pdf

Protiviti. *2012 Sarbanes-Oxley Compliance Survey Where U.S.-Listed Companies Stand: Reviewing Cost, Time, Effort and Processes.* Protiviti, 2012. http://www.protiviti.com/en-US/Documents/Surveys/2012-SOX-Compliance-Survey-Protiviti.pdf

Public Company Accounting Oversight Board. "Consideration of Fraud in a Financial Statement Audit." *SAS No. 1, Section 316* (2002). http://pcaobus.org/standards/auditing/pages/au316.aspx

Public Company Accounting Oversight Board. "Due Professional Care in the Performance of Work." *SAS No. 1, Section 230* (2002). http://pcaobus.org/Standards/Auditing/Pages/AU230.aspx#ps-pcaob_1c410f9b-5033-4f18-b865-af1307863bee

PwC. "Executive Summary." In *Audit Committee Effectiveness: What Works Best, 4th Edition.* The IIA Research Foundation, 2001. http://www.theiia.org/bookstore/product/audit-committee-effectiveness-what-works-best-4th-edition-1569.cfm#sthash.3nmX2fK2.dpuf

PwC. *Confronting Corruption: The Business Case for an Effective Anti-Corruption Program.* PricewaterhouseCoopers LLP, 2008. http://www.pwc.com/en_TH/th/publications/assets/confronting_corruption_printers.pdf

PwC. *Cybercrime: Protecting Against the Growing Threat.* PricewaterhouseCoopers LLP, 2011. http://www.pwc.com.br/pt/publicacoes/assets/pesquisa-crimes-digitais-11-ingles.pdf

PwC. *Fighting Economic Crime in the Financial Services Sector.* PricewaterhouseCoopers LLP, 2011. http://www.pwc.com/en_GX/gx/economic-crime-survey/pdf/fighting-economic-crime-in-the-financial-services-sector.pdf

PwC. *The Global Economic Crime Survey Cybercrime in the Spotlight.* November, 2011.
http://www.pwc.com/us/en/forensic-services/publications/assets/global-economic-crime-survey-us-supplement.pdf

Rollins, John. *Addressing Financial Fraud in the Private Equity Industry.* McGladrey LLP, 2014.
http://mcgladrey.com/content/dam/mcgladrey/pdf_download/wp_fas_addressing_financial_fraud.pdf

Schwartz, Ron. *Procurement Fraud Investigative Techniques to Help Mitigate Risk.* Deloitte Development LLC, 2010.

Schilit, Howard M. "Financial Shenanigans: Detecting Accounting Gimmicks that Destroy Investments." *CFA Institute Conference Proceedings Quarterly* 27. no. 4 (2010): 67-74.
http://www.cfainstitute.org/learning/products/publications/cp/Pages/cp.v27.n4.1.aspx

Stippich, Warren. "Conflict-of-Interest Internal Audit." CorporateGovernor, Winter, 2010.
http://insights.grantthornton.ca/i/103856/3

Stippich, Warren and Mark Sullivan. "Fraud in the Economic Recovery." *CorporateGovernor,* Spring, 2010.
http://www.grantthornton.com/staticfiles/GTCom/Advisory/Advisory%20publications/Corporate%20governance/CGwhitepaper.pdf

The Conference Board of Canada. "Enterprise Risk Management 2011: Taking ERM to the Next Level." (Paper presented at the meeting for The Conference Board of Canada ,Toronto, Canada, and December 5-6, 2011).
http://www.conferenceboard.ca/Libraries/CONF_PDFS_PUBLIC/11-0181.sflb

The IIA. "Al Hands on Deck: Partnering to Fight Fraud." *Tone at the Top,* no. 65 (2013).
https://na.theiia.org/periodicals/Public%20Documents/TaT_December_2013.pdf

The IIA. *International Professional Practices Framework (IPPF).* The IIA Research Foundation, 2013.
http://www.theiia.org/bookstore/product/international-professional-practice-framework-2011-1533.cfm

The IIA. "Practice Advisory 1210.A2-2: Auditor's Responsibilities Relating to Fraud Investigation, Reporting, Resolution, and Communication." NJ IIA, last modified April 27, 2006.
http://www.njiia.org/training_items/Practice_Advisory_1210[1].A2-2_Rev_4_27_2006.pdf

The IIA. *International Standards for the Professional Practice of Internal Auditing (Standards).* The Institute of Internal Auditors, 2012.
https://na.theiia.org/standards-guidance/Public%20Documents/IPPF%202013%20English.pdf

The IIA. *The Three Lines of Defense in Effective Risk Management Control.* The Institute of Internal Auditors, 2013.
https://na.theiia.org/standards-guidance/Public%20Documents/PP%20The%20Three%20Lines%20of%20Defense%20in%20Effective%20Risk%20Management%20and%20Control.pdf

The IIA. "Practice Advisory 1210. A2-1: Auditor's Responsibilities Risk to Fraud Risk Assessment, Prevention, and Detection." Njiia.org.
http://www.njiia.org/training_items/Practice_Advisory_1210[1].A2-1_rev_4_27_2006.pdf

Williams, Eric J. *The Impact of Globalization on Internal Auditors: The Evolution of Internal Auditing.* IIA, 2002.
https://na.theiia.org/about-us/Public%20Documents/Sawyer_Award_2002.pdf

World Compliance. *Fraud Prevention.* World Compliance.
http://www.worldcompliance.com/Libraries/WhitePapers/Fraud_Prevention.sflb.ashx

Woodford, Michael. *Exposure: Inside the Olympus Scandal: How I Went from CEO to Whistleblower*



The Center for Audit Quality (CAQ) is an autonomous, nonpartisan public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPA. For more information, visit *www.thecaq.org*.



Financial Executives International (FEI) is the leading advocate for the views of corporate financial management. Its more than 10,000 members hold policy-making positions as chief financial officers, treasurers and controllers at companies from every major industry. FEI enhances member professional development through peer networking, career management services, conferences, research and publications. Members participate in the activities of 74 chapters in the U.S. and a chapter in Japan. FEI is headquartered in Morristown, NJ, with a Government Affairs office in Washington, D.C. For more information, visit *www.financialexecutives.org*.



The Institute of Internal Auditors (The IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 180,000 members from 190 countries. The association's global headquarters are in Altamonte Springs, Fla. For more information, visit *www.theiia.org*.



The National Association of Corporate Directors (NACD) is the recognized authority focused on advancing exemplary board leadership and establishing leading boardroom practices. Informed by more than 35 years of experience, NACD delivers insights and resources that more than 14,000 corporate director members rely upon to make sound strategic decisions and confidently confront complex business challenges. NACD provides world-class director education programs, national peer exchange forums, and proprietary research to promote director professionalism, ultimately enhancing the economic sustainability of the enterprise and bolstering stakeholder confidence. Fostering collaboration among directors, investors, and governance stakeholders, NACD is shaping the future of board leadership. For more information, visit *www.nacdonline.org*.



ANTI-FRAUD COLLABORATION

PROMOTING INTEGRITY IN FINANCIAL REPORTING

www.antifraudcollaboration.org