Far too many companies naively assume that encouraging an honest business environment is enough to counter fraud and corruption. It isn't. **Nigel Iyer** and **Martin Samociuk** explain how to stop the rot before it's too late.

Cut out a rotten core

It is still rare to find an organisation with a top down fraud and corruption preventive strategy that is part of its culture. This is often because certain executive directors believe that promoting an open, honest culture will ensure the likelihood of fraud and corruption remains low. However, even with the best culture, organisations have little or no control over an individual's personal circumstances, private life or motivation. In over 25 years of investigations, the one common factor we have observed is that discovery of a fraudster comes as a complete surprise.

Another reason for the lack of a holistic strategy is, ironically, the crippling effect of excessive regulation, legislation and bureaucracy. So much time and effort has gone into corporate responsibility and governance, internal controls and risk management strategies that very little time has been devoted to getting to grips with the way criminals think, the methods they use, how to detect attempts and how to prevent them from succeeding.

Many companies face a third challenge, as they may actually promote a culture in which some managers feel they are above the system because they are making a big profit. They start claiming excessive travel, entertaining and personal expenses through the company, favouring friends or family members, and creating hidden salary packages and options. This tends to promote a culture of dishonesty, as other employees notice it and follow suit.

A high price
Every incident of fraud or corruption reduces net income by an equivalent amount. If the profit margin is 10%, then recovering the lost income requires at least ten times that revenue to be generated.

In most cases, the hidden indirect costs, such as constraints on expansion and development, damage to reputation and employee morale, and the expense of an eventual investigation, greatly outweigh the direct costs.

Tracking fraud and corruption

How to subtract value	How to add value
Argue about definitions of fraud and corruption, wasting valuable time and fragmenting management focus.	Achieve maximum management focus by grouping fraud and corruption together and making your definitions as wide as possible.
Be lulled into a false sense of security by assuming that once policies are distributed they are automatically read.	Identify and work with the many allied departments to create mandates and implied mandates.
Be afraid to let employees tell you which methods of fraud would work best.	Foster a culture of openness when talking about fraud and corruption. Understand the methods and then apply the controls.
Get bogged down in checklists and satisfying regulations for the sake of it.	Identify people in the organisation who can become official or unofficial ambassadors against fraud and corruption.
Feel that you have to make a change alone, allowing others to comfortably sit on the fence.	Plan for the long term. Countering fraud and corruption works like a vaccination programme rather than a one-time cure: regular boosters are required.

Erosion of value: what should you be looking for?

Major examples of fraud and corruption include:

- misrepresentation by third parties and insiders with regard to a corporate merger, acquisition or divestment

- diversion of expenditure on either major capital expenditure projects or otherwise procurement operations

- deliberate overcharging by suppliers

- payments paid to agents, third parties and officials that would normally be called 'bribes'

- preferential treatment of customers in exchange for a kickback

- false accounting, including material and deliberate misstatement of financial information.

CIMA guidance on avoiding fraud and corruption

CIMA has published a guide to good practice in fraud and risk management that can help businesses effectively prevent, identify and respond to fraud. It adopts a broad definition of fraud, which includes, among other things, corruption, bribery and extortion. More recently, CIMA worked with the International Federation of Accountants (IFAC) Professional Accountants in Business (PAIB) Committee on International Good Practice Guidance on 'Defining and developing a code of conduct for organisations'. This document is designed to draw greater attention to the need for effective codes of conduct, provide guidance on the development of such codes and support sound corporate governance and ethical practices. It is also aimed at supporting professional accountants in business, encouraging an ethical culture in organisations.

There is a wealth of academic and empirical research that shows the annual cost to organisations of corporate fraud and corruption is around 1–5% of their turnover.

Investing in preventing fraud and corruption is far better than investigating and cleaning up after the event. It also leads to large increases in profit margins.

The first step is for executives to join forces against fraud and corruption and treat it as one problem. There is increasing convergence between the words 'fraud' and 'corruption'. The Association of Certified Fraud Examiners, for example, treats corruption as a subset of 'occupational fraud and abuse'[1]. Similarly, papers on corporate responsibility tend to use the words 'corruption' and 'bribery' repeatedly, and allude to corporate fraud without actually using the word.

Set a good example
Research has shown that few organisations treat operational risks, such as prevention of fraud and corruption, on a strategic level as part of good management practice.

What might surprise some executives is that honest employees want and support honest behaviour in their managers and colleagues. Traditional economics assumes that behaviour is motivated by self-interest, implying that ethics and self-interest are in conflict. However, this has been shown by recent studies to be untrue, as people gain satisfaction from complying with and enforcing ethical standards. Honest employees will go out of their way to ensure that people they see as fraudulent or corrupt get their just desserts[2].

So the tone at the top only works when it is credible. Senior managers must commit to and communicate their ethical position. They should first apply the standards to their own behaviour and do as they would have others do.

Criminal minded
Rather than using checklists, which are often associated with compliance-based approaches, managers and employees should engage in an open discussion as to which job functions have the highest potential for fraud and corruption, including top management, and then which method would work best against their company. This can be

Delivering results: TNT roots out fraud and corruption

The security function of TNT, a leading global express and mail business, conducts professional investigations into suspected fraud and corruption and has embedded procedures for dealing with whistleblowers.

It has also taken the lead in developing proactive measures against fraud and corruption as a way of improving integrity for all stakeholders. TNT carries out security financial reviews (its name for health checks) of its business units aimed at identifying, analysing and dealing with the red flags of fraud and corruption.

Parallel with the security financial review, employees are trained through the TNT integrity programme, which was developed by a newly created group integrity department in conjunction with other key departments, including security and corporate audit.

Simon Scales, TNT's Deputy Global Security and Compliance Director, says: 'Prevention is better than cure. It's about doing the right things as well as doing things right.'

'Nearly all the behavioural, transactional and systematic indicators of fraud and corruption are hidden in the money flows.'

Ringing success: Nokia's anti-fraud and corruption strategy

Mobile telephone giant Nokia has launched a successful appropriate business behaviour programme called the Code of Conduct. By December 2006, more than 81% of its employees had completed the e-learning course. The campaign was awarded first prize in the Federation of European Business Communicators Association's Grand Prix 2006 in the category of Business Strategy Communications.

Credible and realistic situations were used and the training recognised and dealt with global cultural differences. Instead of frightening audiences they were motivated and encouraged to make the code of conduct work in their professional and personal lives

The overall message was: 'we take our responsibilities seriously, and we support each other in achieving our ethical goals through our Code of Conduct.' The Code of Conduct is something that all employees and partners of Nokia, in the widest sense, should focus on.

The window of opportunity presented by Nokia's involvement in the UN Global Compact was used to spearhead efforts against potential fraud and corruption. As a result, the programme was led by the corporate responsibility function.

Several other functions, such as the CFO's office, corporate risk management and corporate security, were deeply involved in the development of the programme, ensuring that all aspects of fraud corruption and other inappropriate business behaviour were addressed. This avoided the danger of each department giving partial messages that could easily be perceived as inconsistent with each other.

Nokia paid attention to cultural issues with Code of Conduct training delivered in over 30 languages.

done in workshops, training sessions and interactive multimedia training.

The secret is to allow employees and management to think like potential criminals in a controlled environment, which is far better at exposing and uncovering hidden loopholes. There have been cases where ongoing frauds were identified as a result of workshops.

Once the real methods of fraud and corruption have been identified, they can be evaluated and ranked according to their likelihood and impact, and recorded in a 'fraud and corruption profile', unique to each organisation. Specific controls to mitigate the high-risk methods can then be implemented.

Empower employees

A growing number of organisations are now empowering their employees to prevent fraud and corruption. Firstly, they ensure that employees have read and understood relevant policies, such as the Code of Conduct and Fraud and Corruption. Then they train them to recognise the red flags indicating potential problems and how to report concerns. These can include changes in a person's behaviour, discrepancies or anomalies in the process or transactions, and alarms from systems monitoring.

It is common to find that very few employees have previously received any form of practical instructions. The really effective programmes are those that:

- use realistic and engaging examples where feedback from the participants is an integral part of the programme
- are mandatory for all employees and management
- are well coordinated and planned to avoid confusion and duplication of effort.

The best way to uncover fraud and corruption is to actually look for the red flags, something that is still under-resourced in many organisations. Nearly all the behavioural, transactional and systematic indicators of fraud and corruption are hidden in the money flows, both in and out of the company. The key elements of the process (which we refer to as a health check) is knowing what to look for and testing for these indicators.

Manage and learn from incidents

While it is difficult to prevent all incidents of fraud and corruption, it is possible to reduce their impact by having a fraud response plan. If the organisation does not have an in-house investigation capability, a trusted external provider should be retained to professionally manage investigations and conduct interviews.

It is essential to learn from past incidents rather than focusing on a witch hunt to find scapegoats. Information outlining why things went wrong and what improvements are being made should be communicated across the organisation.

Developing resistance to fraud and corruption should significantly improve profits as well as protecting reputation and culture. There are 12 key factors in developing resistance, all of which can be quantitatively measured (see figure below).

The key to fraud and corruption prevention is to get key people from diverse disciplines to sit down together to implement a top down strategy, understand their risks and spread the message to all employees that prevention is part of the culture. When top management can demonstrate that the organisation has a high resistance to fraud and corruption, stakeholders should be able to see that significant value has been added to the business. ■

References

1 *Report to the Nation on Occupational Fraud and Abuse*. Association of Certified Fraud Examiners; 2004, 2006.

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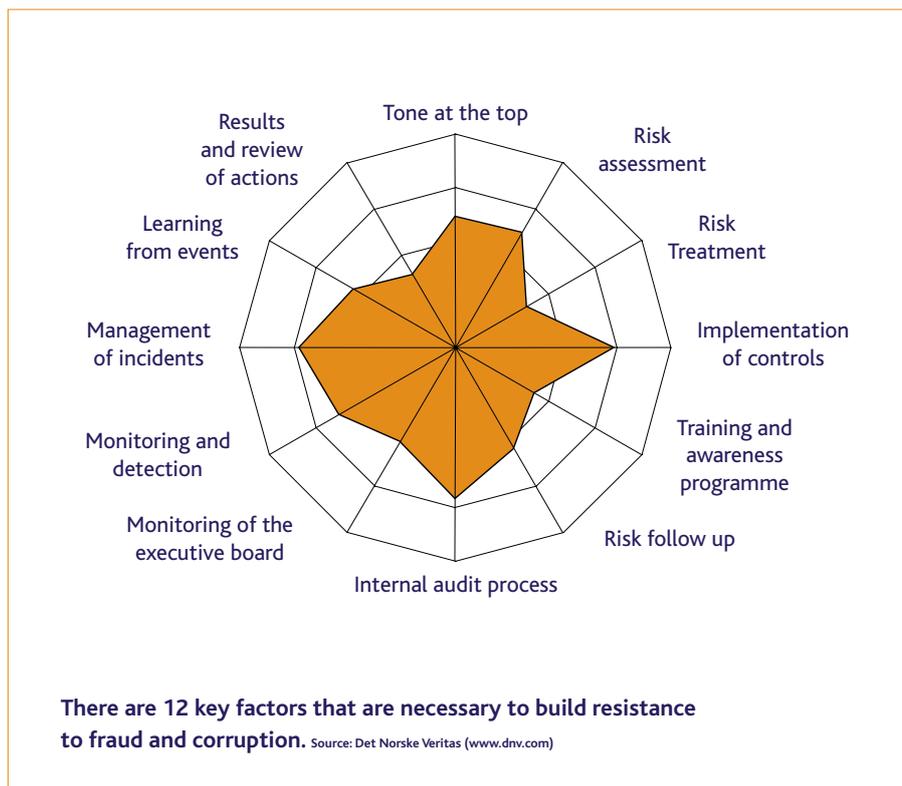
Nigel Iyer

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Martin Samociuk

Martin Samociuk joined London-based Network Security Management in 1981 and became Managing Director and then Executive Chairman as the company grew to become one of Europe's leading fraud investigation companies, prior to its sale to Control Risks Group in 1999. He moved to Australia in 2000 to found Hibis Consulting.

Iyer and Samociuk's book, *Fraud and Corruption – Prevention and Detection*, which includes the management novel, *The Tightrope – A story of fraud and corruption…*, was published by Gower (www.gowerpub.com) in January 2007.

There are 12 key factors that are necessary to build resistance to fraud and corruption. Source: Det Norske Veritas (www.dnv.com)