

Driving ethical growth –
new markets, new challenges
11th Global Fraud Survey

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Foreword

Having managed through the financial crisis of the last two years, many companies are beginning to focus on growth. Achieving growth often means planning expansion into new international markets or looking again at potential acquisition targets. Both of these may mean doing business in new geographies, some of which may bring particular fraud, bribery and corruption risks. Establishing a robust compliance environment to mitigate these risks requires real investment – in leadership time, people, technology and training. Demonstrating that all of this effort is making a difference – that the firm itself is committed to ethical growth – is a critical business imperative.

Our experience with corporate clients, however, suggests that this is not a simple undertaking. Developing a code of conduct is one thing, but actually putting it into practice is a much more challenging exercise. Embedding a strong compliance mentality within the organization requires substantial training and investment, as well as sensitive handling of different cultural practices. Harder still, staff operating in local markets need to understand that their actions must comply with the standards set by remote, less culturally-sensitive regulators.

Responding to fraud or corruption allegations can create further difficulties. Companies need to react swiftly – often within 24 hours – to gauge the impact of the allegations, to establish an effective crisis management approach, and to identify and secure the relevant evidence. Careful consideration also needs to be given as to how to handle a whistle-blower and what immediate steps to take to substantiate the allegations.

Any subsequent investigation will likely introduce additional complications. For example, who should be involved – legal, human resources, finance, internal audit, security, the board? What is the division of responsibility between these functions? At what stage should regulators and auditors be informed? If the allegations relate to third parties, what further steps need to be taken?

As the new UK Bribery Act demonstrates, regulators are being given new tools to scrutinize companies and executives historically outside their jurisdiction and impose tougher sanctions where necessary. Companies therefore need to consider possible cross-border investigations and parallel proceedings when designing a response plan.

With these issues in mind, Ernst & Young undertook the 11th Global Fraud Survey. We sought out chief financial officers (CFOs) and heads of internal audit, legal and compliance to get their views on how companies are managing the risks associated with fraud, bribery and corruption. More than 1,400 interviews were conducted in 36 countries, and the results make for important reading.

Despite the significant time and money already spent by many companies, our respondents' confidence in the effectiveness and level of adherence to internal compliance programs varied widely, both by geography and role. None of the functions interviewed had full confidence in all aspects of their fraud and corruption risk management strategies, and most had more confidence in the other functions than they did in themselves.

However, those interviewed were more consistent when it came to concerns for the future. Many of these concerns relate to corruption and competition risks arising from the drive for growth. Due diligence is obviously key to managing the risks arising from acquisition. But both these risks and the confusion that seems to permeate so many compliance regimes can be mitigated by clear communication from the top.

A strong commitment to ethical growth will encourage employees to live the values of the company and will better position the company to deter fraudulent schemes taking hold when growth returns. It will also send a message to third parties, regulators and the public that the company takes its responsibilities seriously and is willing to take appropriate action to deal with aberrational behavior. We explore this and other issues in the report to follow.

The survey was conducted in 2009 and 2010 on behalf of Ernst & Young's Fraud Investigation & Dispute Services practice. We would like to acknowledge and thank all respondents for their time and insights.

Sincerely



David L. Stulb

Global Leader
Fraud Investigation & Dispute Services

Executive summary



The 11th Global Fraud Survey has challenged those responsible for leading the response to corporate fraud and corruption to look back over two of the most difficult years in the economic cycle in living memory. The feedback has been both candid and revealing in an area of business risk that is always more sensitive to economic decline. Once again, the global reach of this survey provides a unique insight into how different economic regions compare. Moreover, the decision to target CFOs and heads of legal, internal audit and compliance functions has provided fresh insight into the challenges faced by executives in these pivotal roles.

While these findings specifically relate to the private sector, our experience suggests that they are also relevant to the public sector and non-governmental organizations, both of which encounter many of the same fraud and corruption issues.

- ▶ **A substantial number of respondents reported suffering a significant fraud in the past two years.** As most forecasters anticipated, this confirms there has been a small but noticeable increase during the recent economic turmoil. Respondents in Western Europe note a striking rise – twice as many respondents as before suffered a significant fraud.
- ▶ **Despite the increased incidents of fraud, corporate entities' responses to fraud allegations appear to be ad hoc and inconsistent:**
 - ▶ While more than 60% of respondents in North America demonstrate what might be considered leading practice, having adopted well-defined reporting and investigatory policies, other parts of the world demonstrate a marked lag. Worryingly, 14% of those interviewed in Central and Eastern Europe admit to not being aware of any documented response plan.
 - ▶ More than half of all respondents outside of North America do not have a documented response plan involving parts of the business with investigative skills. It is our experience that this will seriously undermine the success of investigations into fraud and corruption.

- ▶ **Proactive measures to manage the risk of fraud were also not universally contemplated:**
 - ▶ One in seven of those interviewed have never conducted a formal fraud risk assessment.
 - ▶ Despite the massive organizational changes that tend to follow financial slowdowns, which often themselves create unique and unforeseen fraud risks, just over a quarter of respondents admitted to not having updated their fraud risk assessment in the past year.
- ▶ **Measures to mitigate corruption and bribery exposure are still not standard practice for companies, including those looking to drive growth through acquisitions:**
 - ▶ More than half of respondents will be looking for opportunities for growth in the next 12 months, particularly those in Latin America and the Far East, regions that are perceived to pose ethical challenges.
 - ▶ However, two in five of our respondents rarely perform fraud or corruption due diligence, despite the inherent risk that could lead to enforcement action and potential successor liability.

The experiences of the key stakeholders in the fight against corporate fraud raise a unique set of issues. The following important findings were provided by our respondents:

- ▶ **CFOs** report that board members are now concerned about their personal liability but that they are not sufficiently informed to manage their company's fraud and corruption risks:
 - ▶ More than three-quarters of CFOs interviewed report that their boards are concerned about personal liability.
 - ▶ Half of the CFOs interviewed think their boards need a better understanding of the business to effectively manage fraud and corruption risks.
 - ▶ Only 4 out of 10 of our CFOs have been asked by the board to perform a review of anti-fraud and corruption controls in the last 12 months.

- ▶ **Legal departments** are under mounting budgetary pressure and are concerned about the level of regulatory scrutiny they face, especially given the increasingly international nature of the businesses they serve:
 - ▶ 38% of legal respondents said they are worried that their function is a target for regulators and law enforcement.
 - ▶ 48% of chief legal officers interviewed see competition law as a significant legal risk in mergers and acquisitions (M&A).
 - ▶ Less than a quarter believe they are very well-prepared for cross-border litigation, intellectual property theft and data privacy laws.
 - ▶ 21% of the chief legal officers interviewed report that their budgets fell last year, and a third state that they are looking to cut legal costs further.
- ▶ **Compliance** is a new function in many companies, and there seems to be a significant gap in the levels of adherence to internal compliance policies between the different regional units of international businesses:
 - ▶ 53% of compliance officers interviewed have been in a compliance role for fewer than five years.
 - ▶ Even in North America, which has a relatively mature compliance regime, 75% of our compliance respondents said they struggled to demonstrate the value their function brought to the wider organization.
 - ▶ The majority of European and American respondents are apparently very confident in the level of adherence to internal compliance policies, but this contrasted sharply with the opinions of respondents from the rest of the world, where the majority thought adherence varied widely by geography and business unit.
- ▶ **Internal auditors** are also under increasing budget pressure and have less confidence in their ability to counter fraud than the other functions interviewed:
 - ▶ Consistent with previous global fraud surveys, internal auditors are still seen as the first line of defense against fraud by 65% of our respondents.
 - ▶ Almost a third of respondents from other functions have confidence in internal audit's ability to identify fraud versus less than one in five of the internal auditors interviewed.
 - ▶ Internal audit has significantly reduced in-person visits to key markets, despite 80% of internal auditors telling us that these formed a very important part of the fraud risk management process.

Despite confidence that companies readied themselves against the threat of fraud during the benign economic years of the prior decade, several high-profile cases have exposed significant shortcomings. In addition, management is starting to realize that fraud is an ongoing issue and cannot be resolved by any “quick fixes.”

As the world comes to terms with the changes resulting from the past economic slowdown, our respondents have revealed that their employers are well aware of the threat of fraud and corruption but are still not managing the attendant risks effectively. More work needs to be done, and we hope the findings in this survey provide useful insights to those charged with taking up this challenge.

Our findings



I. Doing more with less

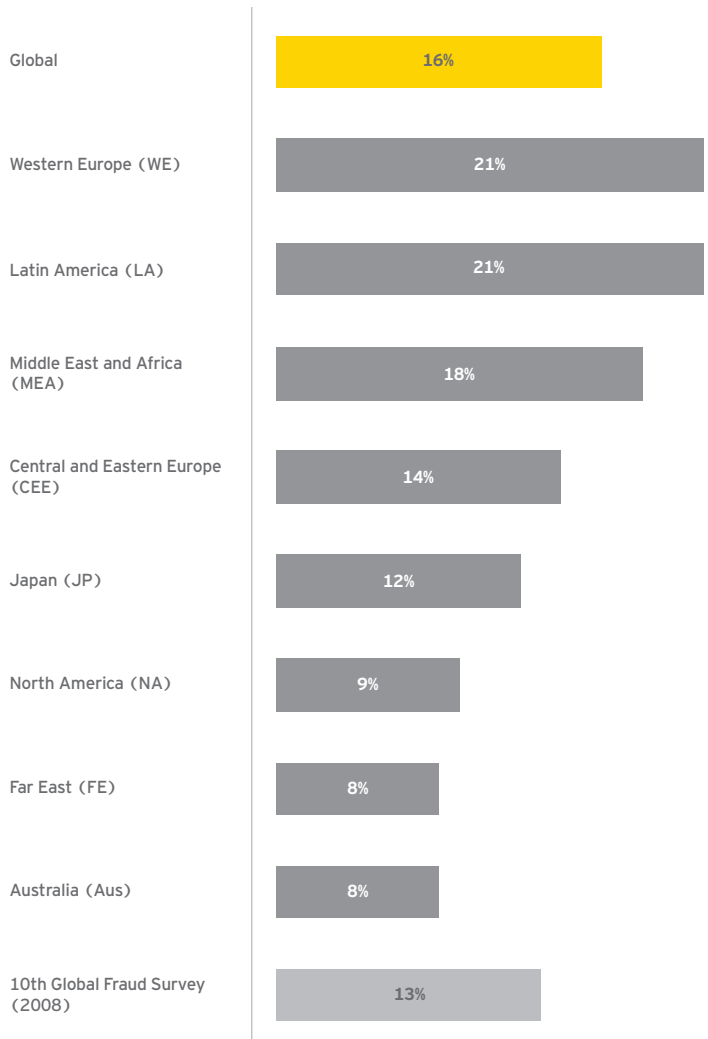
The novelty of fighting fraud and corruption may have worn off, and so too, perhaps, has the sense of urgency. Our 10th Global Fraud Survey indicated that the issue was already a high-profile item on corporate agendas, causing concern for middle managers and directors alike. Widespread awareness of the reputational, legal and commercial risks led many companies to put in place the basic elements needed to detect fraud and ensure compliance with anti-corruption statutes. But a robust, sustainable fraud and corruption risk management framework still eludes the majority of companies.

Many companies are still falling victim to fraud. 16% of respondents to the present survey reported that their company has experienced a significant instance of fraud in the past two years. In Western Europe, home to more than a quarter of our survey respondents, this number increased from 10% to 21% (Figure 1).

Given the credit crunch and the ensuing recession in most economies over the last two years, perhaps this is not surprising. The financial crisis has increased the pressure on those at the top of major companies to maintain corporate results in ever more difficult conditions. The financial crisis has also caused companies to look more closely at their costs and the quality of their earnings, which has led to more pre-existing fraud schemes being detected.

Yet just as anti-fraud and anti-corruption initiatives gained traction, the downturn eroded the resources needed to support them. More effort is now expected from in-house resources, particularly internal audit groups, just as many entities are forced to make cuts in personnel, site visits and other vital elements of an anti-fraud program. Personnel reductions are particularly significant, as many of those cut are middle managers or other functions that are core to an effective control environment. Without them, the separation of duties and other key internal control systems will suffer.

Figure 1
Recent experiences of fraud



Q: Has your organization experienced a significant fraud in the last two years?

Base: All respondents globally (1,409), in Central and Eastern Europe (353), Far East (150), Japan (50), Latin America (100), Middle East and Africa (152), North America (102), Oceania (52), Western Europe (450), 2008 survey (1,186)

Note: See survey approach for an explanation of the distribution of interviews by region.

“Strong regulation is essential to the fair, orderly and efficient operation of markets. A vigorous examination program can not only reduce the opportunities for wrongdoing and fraud, but also provide early warning about emerging trends and potential weaknesses in compliance programs.”

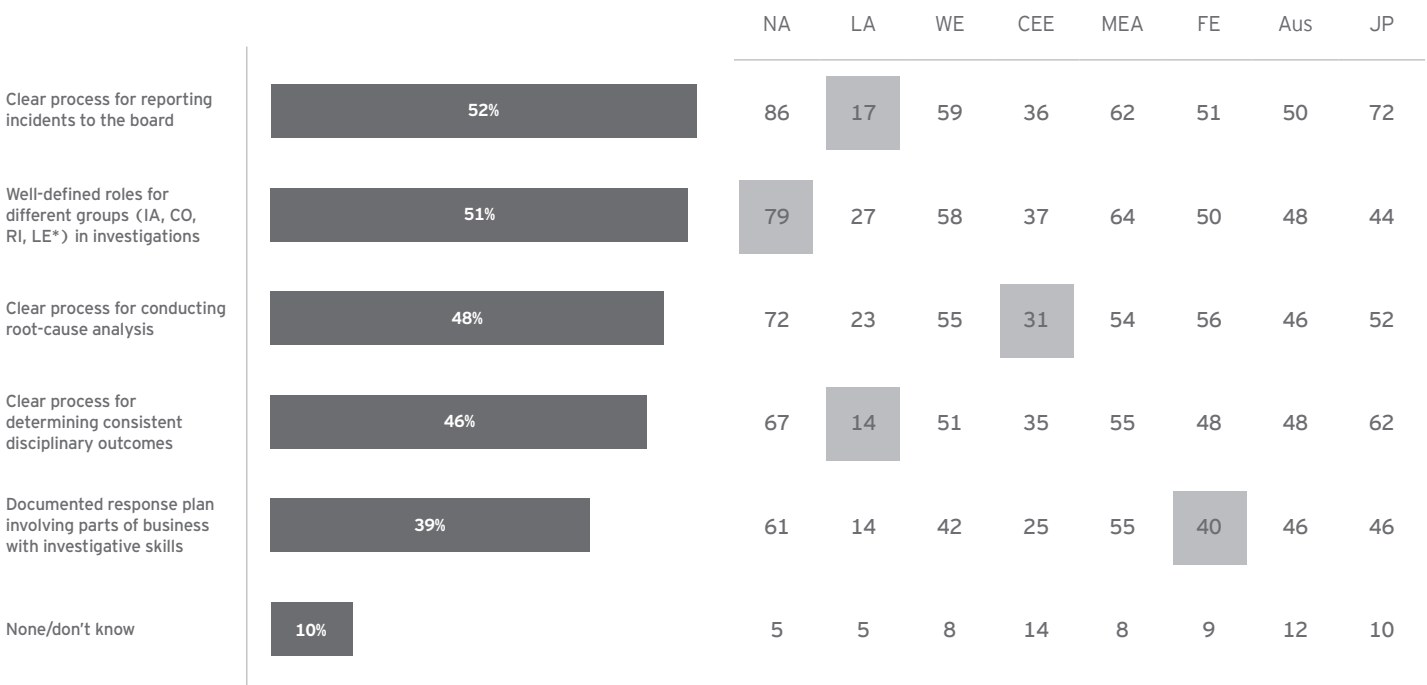
Mary L. Schapiro, Chairman of the US Securities and Exchange Commission

The greater effort now expected from the remaining resources has complicated the move from awareness to action that is fundamental to managing fraud and other enterprise risks. Many corporates are realizing that putting an optimal compliance program in place may take more than a single budget cycle.

The response by companies to the heightened risk of fraud appears generally patchy and disjointed (Figure 2). This can partly be explained by the impact of budgetary constraints on the appetite for taking appropriate procedures to mitigate fraud risk. In many cases it reflects initial support for initiatives that is not backed up by sustainable top-level commitment to complete the task and create a lasting program.

This may be less a matter of money than structure and discipline. When we asked how companies typically respond to an initial report of fraud, around half picked four of the five options offered. But all five are part of a robust response – a clear reporting structure, well-defined roles for the different investigative functions involved, clear disciplinary procedures, processes for analyzing the root causes of the incident, and a documented response plan. Our North American respondents come closest to appreciating this, but Western Europe, where instances of fraud have doubled over the last two years, still has some way to go toward deploying all of the components of a robust response program.

Figure 2
Types of response to the first report of fraud and bribery



* IA – internal audit, CO – compliance, RI – risk, LE – legal.

Q: Which, if any, of the following apply to your organization's response to the first reporting of a possible case of fraud, bribery or corrupt practice?

Base: All respondents (1,409)

Percentage of all respondents are split by region. Regional percentages significantly different from global results are highlighted.



Another aspect of failing to implement a robust anti-fraud program might be called a tick-box mentality. Here, the elements are put in place but not properly embedded within the overall culture of the organization. One example is the whistle-blower hotline. More than half of the companies with a whistle-blower hotline in place told us they have seen usage rise over the last two years, yet it is not always clear who has responsibility for evaluating and responding to these reports.

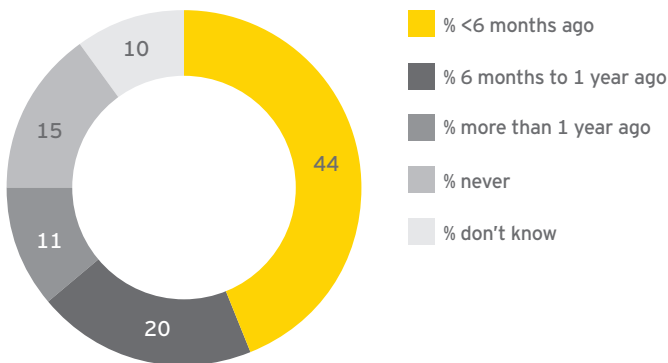
Even the obvious elements of a strong anti-fraud program are often missing. A database of fraud incidents and investigations can be crucial for detecting shortcomings in current policies and procedures. Yet only 52% of our respondents from internal audit and compliance said their company maintained such a database. Failing to take the time to draw lessons from previous incidents to strengthen current policies and monitoring approaches, results in a missed opportunity to maximize available resources in a time of constraint.

Fraud risk assessments – still optional for some?

While two-thirds of companies have carried out a fraud risk assessment in the last year, there remains a core group of companies that have never formally assessed fraud risk (Figure 3). Performing such an assessment will help to prioritize actions to deal with the most significant fraud risks and is therefore fundamental when budgets and resources are scarce.

Other proactive measures should be designed to engage everyone in the organization. Introducing a formal code of ethics and organizing regular compliance training for all staff will help drive key messages. The training can be tailored by grade or role but should be designed to ensure that all employees are familiar with the issues and are aware of their responsibilities both to act appropriately and report any fraud or corruption suspicions. As many national anti-corruption statutes also cover third parties' and agents' activities, companies should consider reviewing these

Figure 3
Frequency of fraud risk assessments



Q: When did your organization last carry out a fraud risk assessment?
Base: All respondents (1,409)

	% never
Total	15
North America	7
Latin America	6
Western Europe	10
Central and Eastern Europe	20
Middle East and Africa	15
Far East	25
Australia	6
Japan	30

“I want to see an anti-corruption culture that is based on genuinely held values and not simply compliance with the strict letter of the law.”

Richard Alderman, Head of the UK Serious Fraud Office

entities’ code of ethics and training programs, too. In high-risk industries or geographies, we also encourage management to contemplate performing due diligence and/or mandating rights to audit compliance before entering into any additional third-party relationships. Continuing to assess their compliance on an ongoing basis is also important.

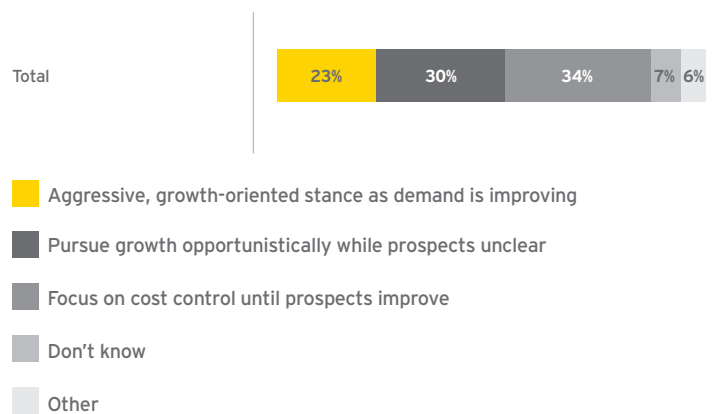
To reinforce this message of shared responsibility, employees and related parties could be required to sign off annually that they are aware of their responsibilities and have complied with the relevant internal policies. Similarly, statements from the board that inappropriate activity will not be tolerated will help to instill a collective culture of fraud and corruption risk management.

II. Moving out of recession and into growth

Having coped with the downturn thus far, many companies are beginning to look for new growth opportunities. With the mature markets of Western Europe and North America recovering slowly, corporations are increasingly looking farther afield for growth. However, such ventures into unfamiliar markets bring with them both potential risks and rewards. Companies need to consider the drawbacks carefully when proceeding and ensure that fraud and corruption risks are appropriately managed.

More than half of the companies interviewed will be looking for opportunities for growth in the next 12 months, particularly those based in Latin America, Japan and the Far East. The US and Europe, by contrast, remain cautious (Figure 4).

Figure 4
Substantial proportion of management targeting aggressive growth



Region	% targeting aggressive growth
North America	13
Latin America	33
Western Europe	19
Central and Eastern Europe	15
Middle East and Africa	28
Far East	36
Australia	29
Japan	42

Q: Which of the following best characterizes your company's strategy over the next year?

Base: All respondents (1,409)

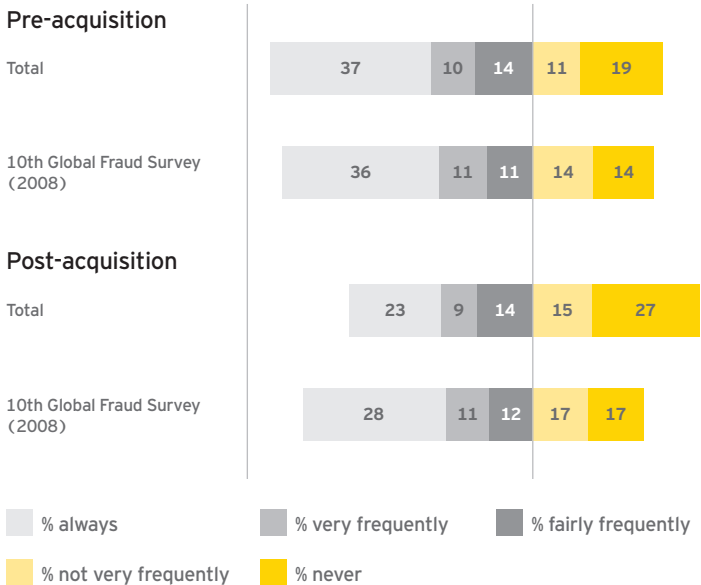


In many cases, growth will come through acquisitions. This should trigger a range of concerns for our respondents as they can expose organizations to a multitude of risks, potentially including corruption or competition issues. To date, a significant proportion of US Securities and Exchange Commission (SEC) enforcement actions relating to the Foreign Corrupt Practices Act (FCPA) has resulted from acquisitions where companies have assumed legacy corruption issues. The issue of acquisition risk is likely to get even more important as other regulators seek to expand their reach and emulate the US approach. The greater powers granted to the UK authorities by the recent Bribery Act is a case in point.

Do your homework

One way to reduce the risk of successor liability and subsequent regulatory enforcement actions is to conduct thorough pre-acquisition due diligence specifically related to fraud and corruption. This is particularly pertinent where the target company is operating in a high-risk or highly regulated market or industry. It should also be followed by a similarly focused post-acquisition review. Yet this approach does not seem to be standard practice in our respondents' organizations. Almost half of the companies that completed acquisitions within the last two years said they only conducted pre-acquisition due diligence fairly frequently, not frequently or, in the case of almost one in five, never. The figures for post-acquisition due diligence are even more worrying, with 42% rarely or never undertaking such procedures (Figure 5).

Figure 5
Frequency of conducting due diligence into fraud risks



	% not very frequently/never	
	Pre-acquisition	Post-acquisition
North America	18	41
Latin America	16	27
Western Europe	33	43
Central and Eastern Europe	38	43
Middle East and Africa	29	42
Far East	30	41
Australia	25	54
Japan	40	53
CFO	38	47
Compliance	24	36
Internal Audit	31	41
Legal	24	41

Q: How frequently has your company conducted due diligence into fraud and/or corruption-related risks before acquiring a new business in the last two years?

Q: How frequently has your company conducted fraud and/or corruption-related post-acquisition due diligence in the last two years?

Base: All making acquisitions (888)
The "Don't know" percentages have been omitted in order to allow better comparison between the responses given.

“Although many companies have made significant inroads in their compliance efforts, there is more work to be done.”

Cheryl J. Scarboro, Chief of the Foreign Corrupt Practices Act Unit, US Securities and Exchange Commission

Post-acquisition anti-corruption due diligence

Sometimes exhaustive pre-acquisition due diligence is not possible. In such cases, post-acquisition anti-corruption due diligence ought to be considered. Among the areas that management should contemplate are:

- ▶ Reviewing existing code of conduct and other relevant policies and procedures for completeness and to ensure that these are effectively integrated between the parent and acquisition
- ▶ Understanding policies and procedures surrounding cash disbursements and facilitation payments, gifts and hospitality, sponsorships, and any differences from corporate policy
- ▶ Assessing the ability of systems to report or monitor expenditures in these high-risk areas
- ▶ Performing interviews with key personnel regarding, among other things:
 - ▶ Corporate culture and attitude toward ethics and compliance
 - ▶ Vetting procedures for and use of third parties and agents
 - ▶ Interactions with government officials and departments
- ▶ Testing internal controls already in place to mitigate fraud, bribery and corruption risks
- ▶ Reviewing fraud and corruption incident logs along with the nature of the responses and ultimate outcomes
- ▶ Identifying third-party agents involved in obtaining key assets, operating licenses or sales contracts and understanding their role
- ▶ Checking whether audit rights relating to suppliers, agents and other third parties have ever been exercised with regard to bribery and corruption controls
- ▶ Assessing to whom compliance training is offered and how often, as well as checking compliance training attendance records

Acquirors may be able to insulate themselves from inherent bribery and corruption risks by early communication with regulators. For example, the US Department of Justice's 2008 Halliburton opinion release recognized that there may be legitimate legal limitations on the extent of pre-closing due diligence that could be performed. However, the opinion created an expectation that in such circumstances “significant, focused, risk-based efforts to identify corruption issues”¹ should be conducted post-acquisition. There appears to be a gap, therefore, between the expectations of regulators and the reality of how companies are conducting due diligence. In any event, conducting no pre-acquisition due diligence would certainly place a company in a weak position when dealing with regulators should issues arise post-acquisition.

¹ Source: US Department of Justice Opinion Procedure Release 08-02. <http://www.justice.gov/criminal/fraud/fcpa/opinion/2008/0802.pdf>



Who, what, where, when

A push for growth could mean entering new markets for some, executing acquisitions for others. These efforts will bring new risks. Clearly delineated roles for internal audit, legal, compliance and finance, therefore, are increasingly important. For example, who assesses a tip from a whistle-blower hotline and decides on what action? Who should investigate? Who should impose disciplinary procedures? Who informs the board (and when)? Who should maintain a record of proceedings?

There is a clear disparity between CFOs and other governance stakeholders regarding the level of certainty for how fraud is responded to within their organizations. Only 43% of CFOs claim that well-defined roles for different groups in investigations exist, compared with an average of more than half of the other functions surveyed (Figure 6). The input from the CFOs suggests an awareness that their companies do not respond as consistently as assumed. This is an indication that internal audit, compliance and legal may be operating in silos, and do not necessarily respond seamlessly to instances of fraud.

There will never be an easy time to sort out these responsibilities and procedures. But using the time between the downturn and the next round of acquisitions to align the anti-fraud and anti-corruption policies and create a sustainable compliance program will send a clear message to staff, third parties and regulators. These efforts will contribute to future ethical growth.

Figure 6
Well-defined investigative roles are lacking



Q: Does your organization have well-defined roles for different groups (internal audit, compliance, risk and legal) in response to the first reporting of a possible case of fraud, bribery or corrupt practice?

Base: Percentage of respondents (1,409) agreeing

“The biggest fear is of humiliation and loss of reputation. As countries are more actively prosecuting corporate fraud, CFOs and their superiors are afraid of personal liability by being implicated in illegal activity and facing jail time.”

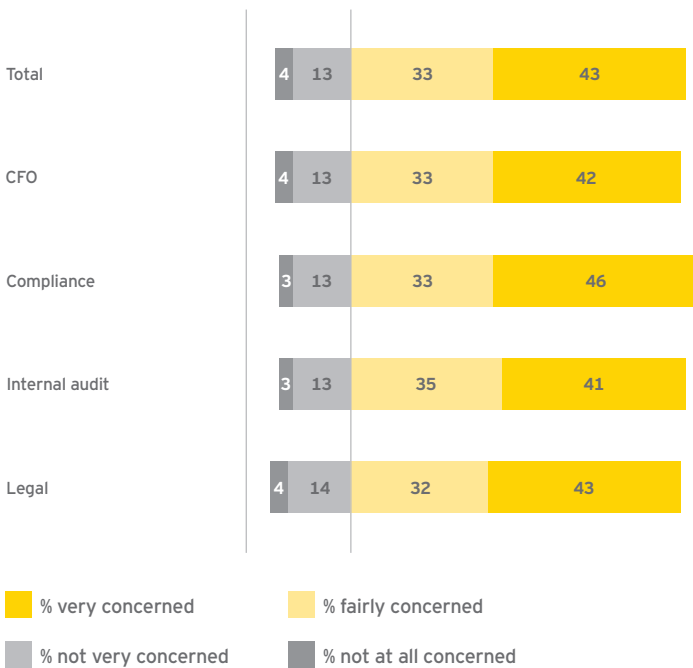
CFO, Singapore

III. CFO and board

More than any of our other respondents, CFOs have delegated the day-to-day work of fraud detection and compliance assessments to less senior staff. Yet they carry the responsibility for reporting to the board and building on the work done in this area by external advisors. At a time of constraint, they are also involved in setting the budgets for internal audit, compliance and legal, giving them an ability to influence the corporate resources devoted to anti-fraud and anti-corruption efforts.

One sign that boards are aware of fraud and corruption issues is the concern that directors now have about their own personal liability. It is not surprising that our survey indicates that the level of concern has risen with the overall rise in fraud and corruption risks in the difficult economic climate. All the respondents to our survey are aware that board members are taking their own personal exposure seriously (Figure 7).

Figure 7
Directors concerned about potential liability



	% very concerned and fairly concerned
Total	76
North America	76
Latin America	95
Western Europe	62
Central and Eastern Europe	84
Middle East and Africa	87
Far East	77
Australia	81
Japan	66

Q: How concerned, if at all, would you say your board of directors is about their personal liability for the actions carried out by the company?

Base: All respondents (1,409)

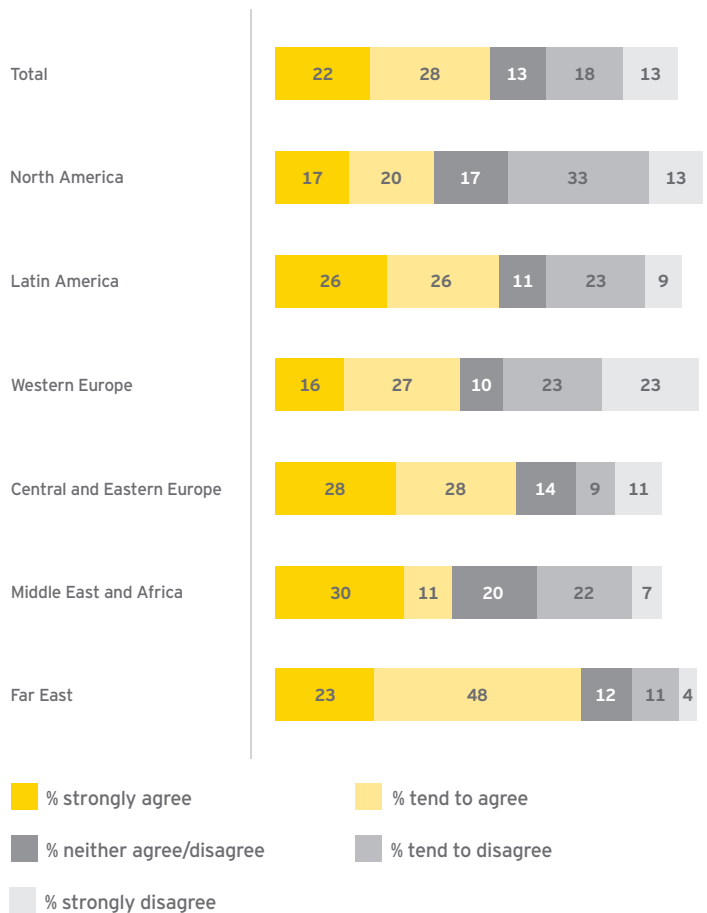
The “Don’t know” percentages have been omitted in order to allow better comparison between the responses given.



Surprisingly, boards do not seem to be behaving in a way that would increase their own protection. Half of the CFOs we talked to agreed that directors need a more detailed understanding of the company's exposure if their board is to be an effective safeguard against fraud and corrupt practices. The proportion is lower in North America and higher in the Far East, but the sense that boards need to know more was widely shared (Figure 8).

As recent high-profile cases have demonstrated, fraud arising from the management override of controls is particularly devastating. It is therefore imperative that the board understands how the company truly operates and is sufficiently skeptical to get behind the numbers presented to them.

Figure 8
Companies can do more to educate directors



Q: To what extent do you agree or disagree with the statement: "Our board needs a more detailed understanding of the business if it is to be an effective safeguard against fraud, bribery and corrupt practices"?

Base: All CFO respondents (492)

The "Don't know" percentages have been omitted in order to allow better comparison between the responses given.

“Strong corporate management and an ethical corporate culture will help prevent fraud and corruption from occurring.”

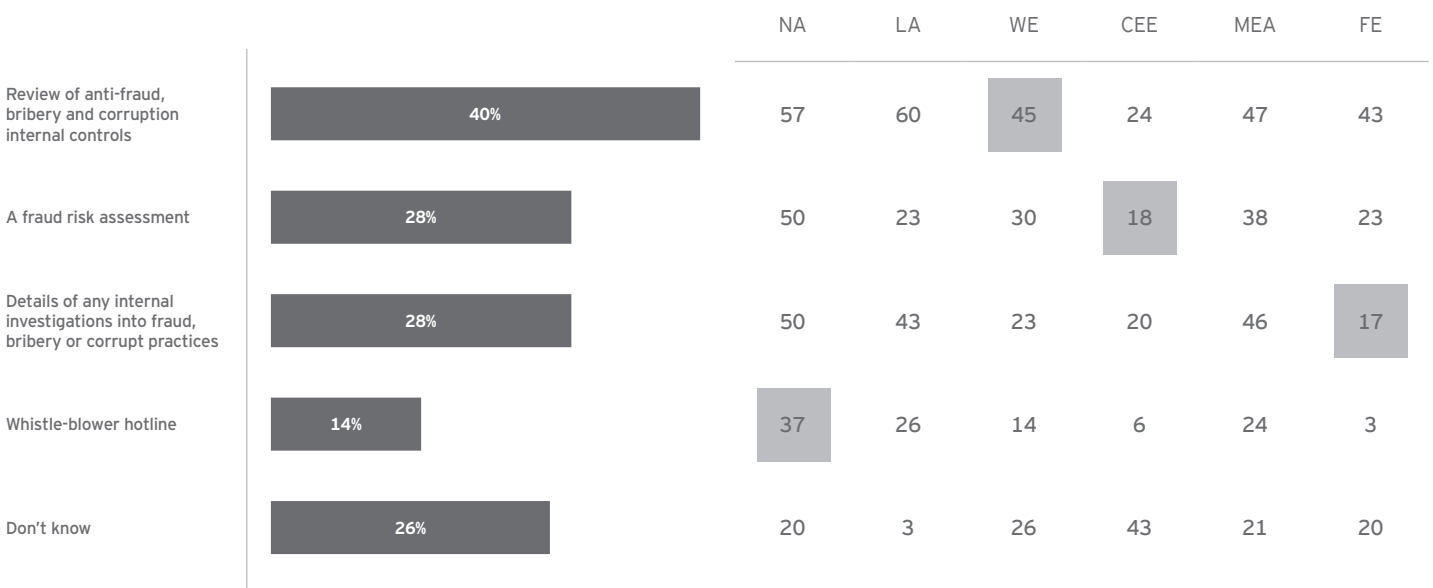
CFO, Canada

Won't ask, won't know

Are boards doing less than they might to educate themselves? Only 4 in 10 of our CFOs had been asked for a review of anti-fraud and corruption controls in the previous 12 months, and only 28% had been asked to produce a fraud risk assessment. Results of board information requests regarding fraud and bribery issues were generally better in North America than elsewhere, but results from Western Europe were, again, disappointing (Figure 9).

Part of the responsibility for these oversights must rest with the board. The board must instigate an organization's commitment to ethical growth; it will then become the responsibility of the business as a whole. Employees throughout the company – not just those with explicit compliance responsibilities – need to understand that identifying fraud and corruption risks, and escalating them as necessary, is a job for everyone.

Figure 9
Board requests for fraud information could be more focused



Q: Which, if any, of the following has the board asked you for in the last 12 months?

Base: All CFO respondents (492)

Percentage of all respondents are split by region. Regional percentages significantly different from global results are highlighted.



IV. Legal

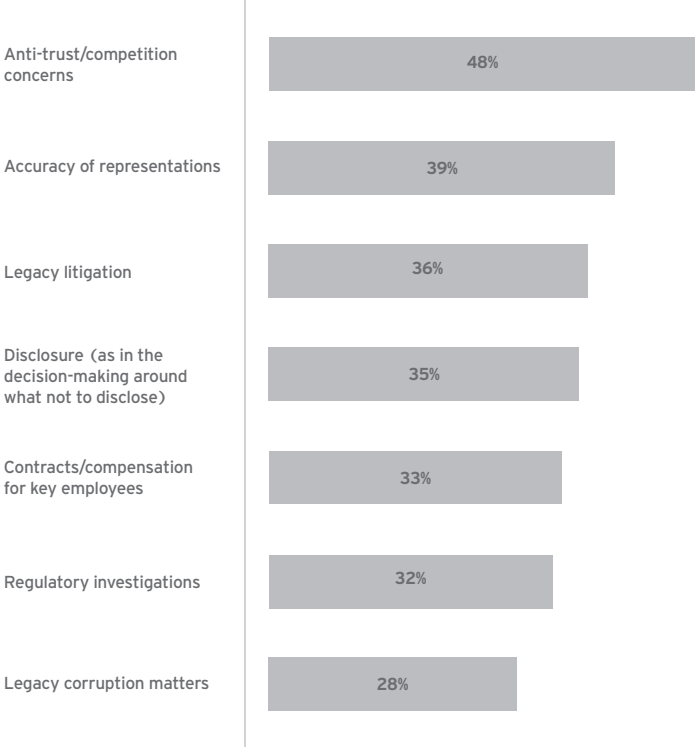
Legal departments have not been immune from the stresses created by the downturn. For example, 21% of legal respondents saw their budgets cut last year, despite an increasing involvement in disputes and investigations. This pressure will only grow as M&A activity picks up. In addition to this strain, there is a commonly held concern among our respondents that the activities of the in-house counsel are increasingly the focus of regulators.

Chief legal officers are often seen as a gate-keeper by regulators, and, as a consequence, their decisions come under significant scrutiny. Indeed, more than a third of the chief legal officers interviewed are worried about being the target of regulators. This anxiety is particularly strongly felt in the Far East, the Middle East and Africa where around 70% of our respondents highlighted this issue. Only in Europe is the level of concern relatively low.

In-house counsel have a good reason to be worried about their readiness to respond to any inquiry. Only 28% feel that their organization is very well-prepared to undertake a major fraud or bribery investigation. Less than a quarter feel confident of their ability to handle significant cross-border litigation, intellectual property theft or variations in data privacy law.

A number of these challenges arise in the context of M&A activity. With respect to legal risks related to M&A, competition concerns top the list, but a quarter of our legal respondents also worry about legacy corruption issues (Figure 10).

Figure 10
Competition law tops mergers and acquisitions risk



Q: Thinking about mergers and acquisitions, which two or three of the following are the most significant legal risks associated with them?
Base: All Legal respondents (307)

“It’s important that we hold individuals responsible. If not we would not have the deterrent effect we seek.”

Mark Mendelsohn, during his tenure as Deputy Chief, Fraud Section, US Department of Justice

Is that email suitable for public consumption?

One concern relates to the extensive review of electronically stored information required to deliver effective legal advice. A third of our respondents already regard email reviews as expensive even when it is undertaken by an in-house IT team. Half of the respondents reported that the significance of emails to investigations has increased in the last two years, but 35% say that they are planning to cut back spending on email reviews (Figure 11). Given that the need to conduct email reviews may not be elective, it would appear that our respondents intend to focus on efficiency savings when performing such exercises.

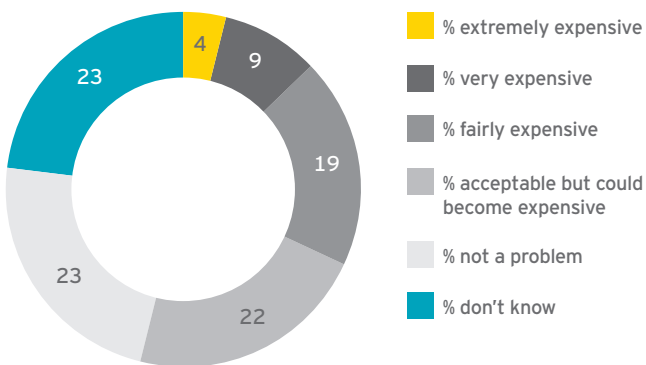
eDisclosure review techniques

New techniques are now available to assist investigators in identifying who communicated with whom about what during crucial time periods. Such techniques could be used, for example, to quickly establish communication patterns to help identify those who may be involved in financial statement manipulation or other illicit activities. These review techniques include:

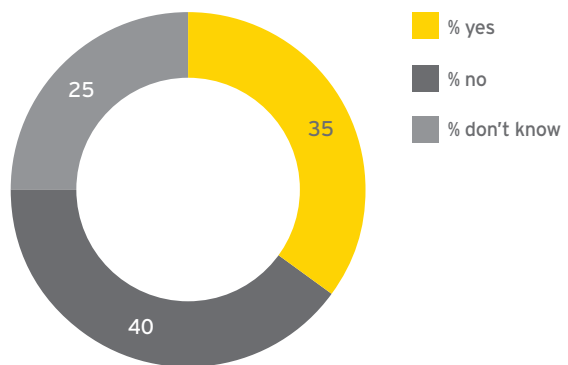
- ▶ Sentiment analysis
- ▶ Concept-based searching
- ▶ Social networking analysis
- ▶ Iterative, self-correcting search tools that learn from expert reviewer input
- ▶ Data visualization techniques to identify key concepts, volumes of data and time periods
- ▶ Automated quality assurance reviews by comparing discrepancies in the responsiveness designations of documents tagged for further review

Figure 11
Many legal respondents concerned by expense of email review

Cost of email reviews



Plans to reduce costs



	% extremely/very expensive	% yes
North America	48	61
Latin America	5	16
Western Europe	12	37
Central and Eastern Europe	7	32
Middle East and Africa	8	36
Far East	8	39

Q: Which of the following best describes your view on the costs of conducting such email reviews?
Base: All legal respondents (307)

Q: Do you have records management solutions or plans designed to reduce the cost of future email reviews?
Base: All legal respondents (307)



The need to manage the cost of these reviews is felt particularly acutely in North America, where the perceived high cost is probably linked to US regulators driving a linear approach to email reviews.

There is no guarantee that simply using an in-house e-discovery team will deliver a better value-for-money result. Only 52% of our respondents stated that they were either fairly or very satisfied with the performance of their in-house team. This low level of satisfaction is potentially indicative of our experience that in-house IT functions whose core responsibilities do not include day-to-day involvement in legal matters. They can occasionally miss some of the issues and concerns that need to be taken into account when conducting a large e-discovery exercise. It is easy to make a small error in the initial stages of processing, such as privacy or chain of custody issues, which can quickly lead to much larger problems. Similarly, key documents may be missed if the review team does not have dedicated subject-matter resources.

“Grease payments” undermining business ethics?

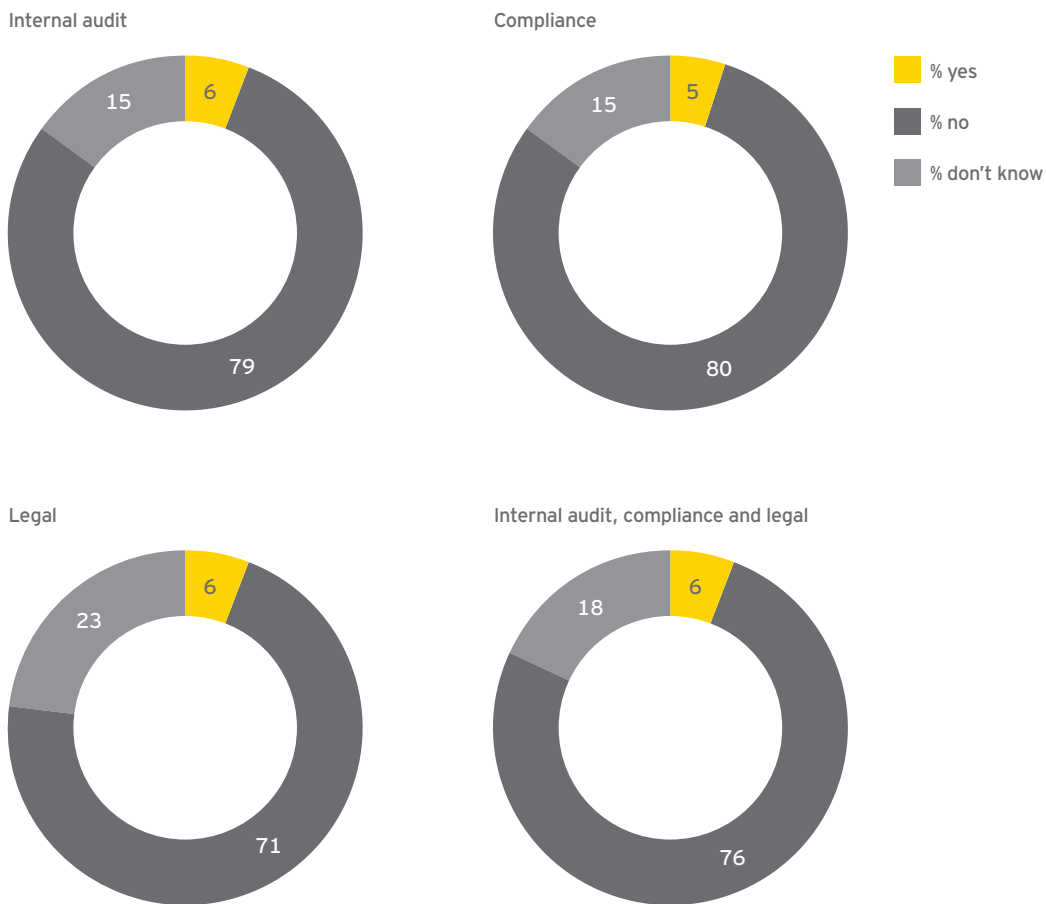
A poorly conceived growth strategy can bring additional difficulties. Where companies have plans for growth through international expansion, it is vital that those responsible for conducting financial and legal due diligence consider fraud and corruption risks. They should understand how both the target company and the acquiring company win their work, and the companies' positions on facilitation payments in theory and in practice. Despite recommendations by the Organisation for Economic Co-operation and Development (OECD) that member countries encourage companies to prohibit or discourage the use of small facilitation payments, such payments are frequently expected in emerging markets, and their legality varies between countries.

It was worrying, therefore, to note that lawyers, who could be expected to be most aware of their company's position on facilitation payments, were actually the least certain. Almost a quarter of the lawyers in our survey are unable to give a definitive answer either way (Figure 12).

“The most important lesson I’ve learned from past investigations is the need for proper records processing to enable swift collection, preservation and searching of emails and other data.”

Chief Legal Officer, Austria

Figure 12
Legal respondents least certain of internal policy regarding facilitation payments



Q: Does your organization allow facilitation payments?

Base: Internal audit (331) / Compliance (279) / Legal (307) / Internal audit + compliance + legal (917)

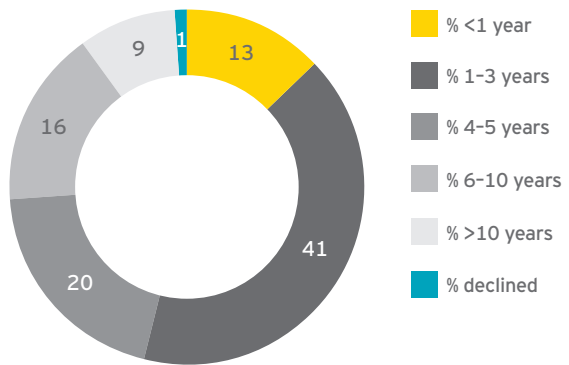


V. Compliance officers

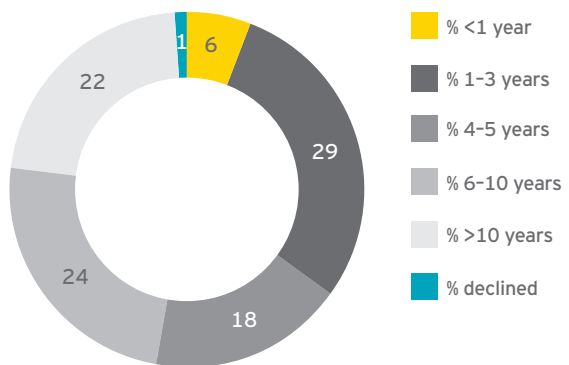
Compared to the other functions interviewed in our survey compliance is still a developing area outside of more regulated industries such as the life sciences and financial sectors. This is demonstrated by the fact that more than half of the senior compliance executives interviewed have been in a compliance role for fewer than five years (Figure 13). In many cases, compliance was added to an existing portfolio of responsibilities for senior executives.

Figure 13
Many compliance professionals new to their role

How long have you been in your current role?



How long have you been in a compliance role?



Q: How long have you been in your current role?

Q: How long have you been in a compliance role (so including your current role and any previous compliance roles)?

Base: All compliance respondents (279)

“Management need to be educated about the value compliance can bring to the rest of the business. This will help drive this message through the rest of the company.”

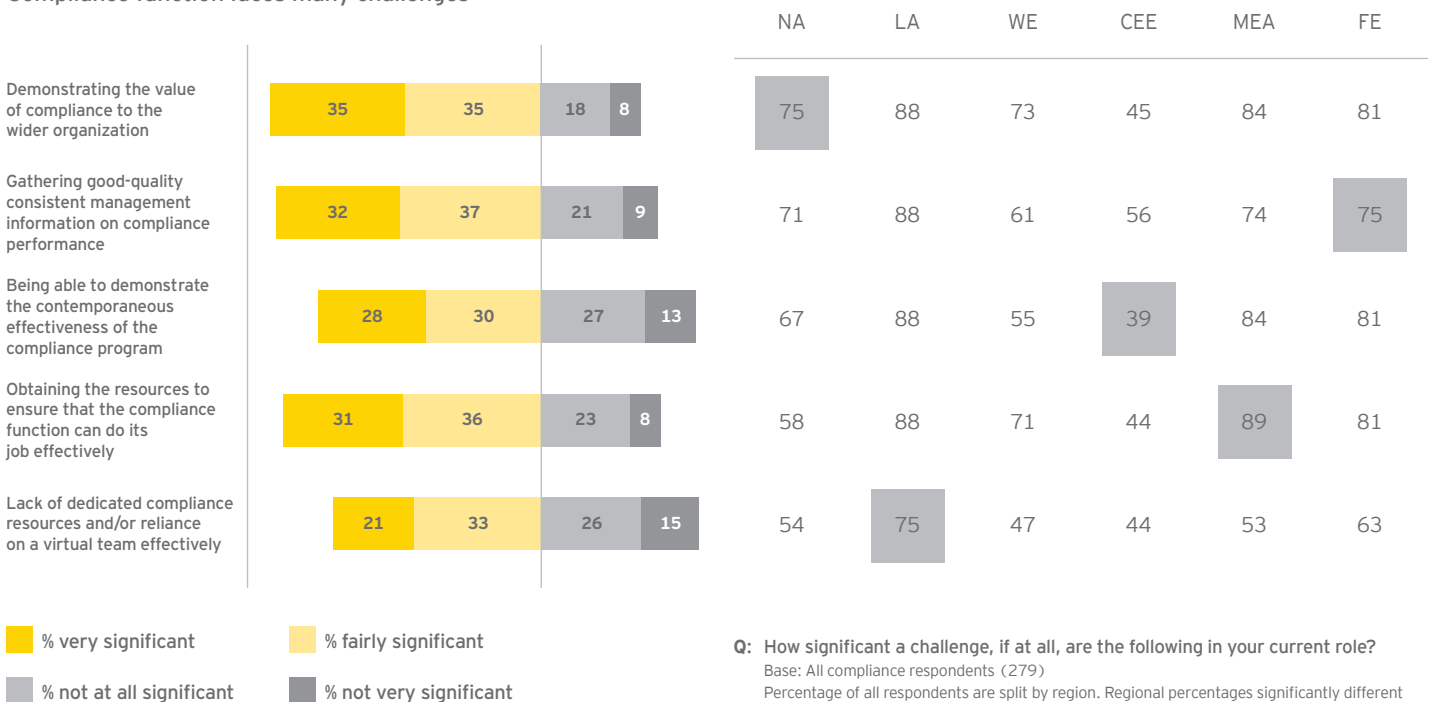
Chief Compliance Officer, Australia

In a large multinational enterprise, the task of tracking and assessing compliance across a range of businesses is daunting enough given the penalties for failure. However, as a relative newcomer, the compliance function faces the extra hurdle of demonstrating its value as it competes for resources.

Results require resources

This was the greatest challenge identified by our compliance respondents. Without adequate resources, the function's ability to communicate effectively within the business and take action against aberrational behavior is significantly diminished. The competition for resources also reduces compliance's ability to gather the current management information required to do its job, making it harder still to demonstrate value to the rest of the business. This seems to be a fairly uniform response, with only Central and Eastern Europe consistently responding differently (Figure 14).

Figure 14
Compliance function faces many challenges

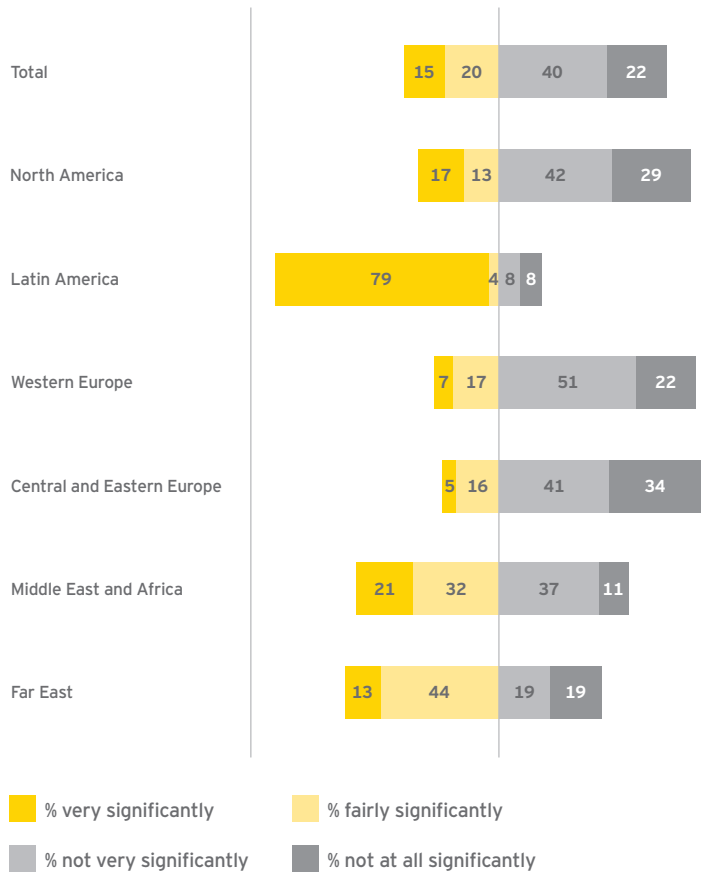




This relative lack of standing may also explain why a quarter of companies have not carried out a compliance performance assessment in the last 12 months. In fact, 14% have never conducted one.

There appears to be a significant contrast between how the head offices of companies perceive the level of compliance with policies around their organizations and how subsidiaries know they are operating. A relatively small proportion of respondents from Western Europe and North America (home to the headquarters of many of the multinational organizations) considers there to be significant variation in the level of compliance around their organizations. This contrasts sharply with the far higher proportion of respondents from more developing markets such as Latin America, Africa, Asia and the Far East (Figure 15). More than 40% of our respondents' companies carried out no regular assessments of performance against compliance policies. This apparent lack of awareness of what is happening on the ground should be a matter of significant concern.

Figure 15
Geographic variations in adherence to policy



Q: How significantly does adherence to your internal compliance policies vary between different business units or geographic locations?

Base: All compliance respondents (279)

The "Don't know" percentages have been omitted in order to allow better comparison between the responses given.

“We need to coordinate the compliance activities across our geographical units and functions to ensure that internal policies are consistently applied.”

Chief Compliance Officer, Sweden

BRIC country trends

Comparisons between Brazil, Russia, India and China (the “BRIC” countries) are frequent. When it comes to the attitude of respondents to dealing with fraud, bribery and corruption risks, our survey reveals some interesting trends.

While respondents in all four countries appear to be showing more maturity in how coordinated their anti-fraud efforts are ...

- ▶ Effective coordination between compliance, internal audit and legal: India 96%, Brazil 92%, China 88%, Russia 82%

... Russia appears to lag behind the group in key areas:

- ▶ Confidence in internal audit: India 94%, Brazil 92%, China 80%, Russia 62%
- ▶ Availability of hotlines: Brazil 88%, India 74%, China 62%, Russia 30%
- ▶ Maintenance of a fraud database: Brazil 93%, India 64%, China 39%, Russia 26%
- ▶ Embedded processes to promote adherence to international anti-corruption legislation: Brazil 92%, India 66%, China 56%, Russia 28%

However, all four countries could do better with regard to due diligence procedures:

- ▶ Always, very or fairly frequently conducting pre-acquisition due diligence: China 52%, India 48%, Brazil 43%, Russia 11%
- ▶ Always, very or fairly frequently conducting post-acquisition due diligence: India 41%, China 33%, Brazil 22%, Russia 7%

Various business issues such as moves to “cloud” computing, operating from virtual locations, expansion into new markets and the increased volumes of business data appear to have been driving the compliance agenda recently (Figure 16). Recent high-profile instances of data leakage have driven data security to the forefront of the compliance agenda.

Figure 16
Data security is a top concern for compliance



Q: Thinking about the next 18 months, which one or two of the following will be the most significant compliance issues for your business?
Base: All compliance respondents (279)

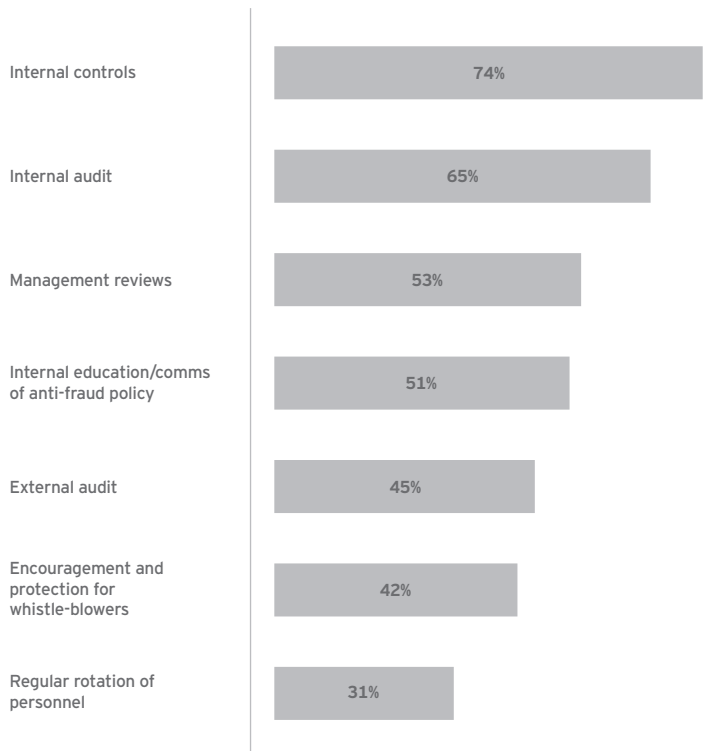


VI. Internal audit

Arguably no one department needs to do more with less than internal audit. The department is increasingly seen as a key corporate defense against fraud. Expectations on internal audit are high, but departmental budgets have failed to keep pace with the changing and expanding nature of their role. Heads of internal audit have sought to prioritize their workloads to enable them to handle the many conflicting demands upon them. However, heads of internal audit must ensure that staff have sufficient knowledge and training to be able to make the right decisions to recognize and handle instances of fraud or corruption.

Internal controls and internal audit continue to be seen as a company's main line of defense against fraud by the vast majority of respondents (Figure 17).

Figure 17
Factors that can help mitigate fraud risk



Q: On a scale of 1 to 10, where 1 is "not at all likely" and 10 is "extremely likely," how likely are each of the following factors to prevent fraud?
Shown: percentage giving 8, 9 or 10 scores.
Base: All respondents (1,409)

“The biggest barrier to Internal Audit being an effective anti-fraud force is management override.”

Head of Internal Audit, South Africa

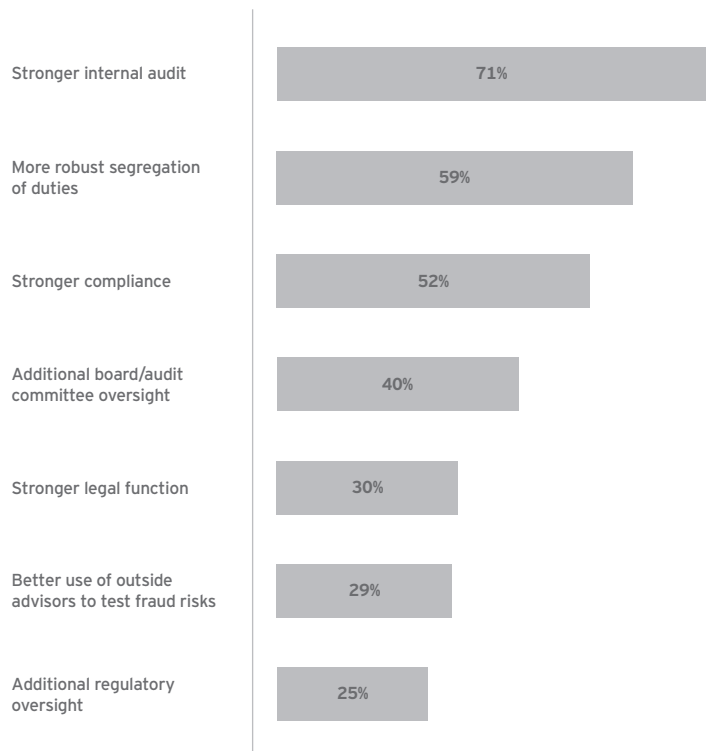
Countering management override

As indicated by nearly 60% of our respondents, companies find that one of the greatest challenges in countering fraud is that unscrupulous management may override otherwise effective internal controls.

A stronger internal audit is still considered by our respondents to be the most effective means of detecting such fraud (Figure 18). However, internal audit faces a difficult balancing act: they must be diligent and robust in conducting their assessments, but they should not foster a culture of mistrust with management. It is important that the internal auditor maintains an appropriate degree of professional skepticism. Beliefs about management integrity should be set aside because override is not necessarily by consistently dishonest executives, but also by “good executives gone bad.”

Figure 18

Mechanisms to detect frauds involving management overrides



Q: Speaking generally about frauds where management override of existing controls might have occurred, what do you believe would have been the best mechanisms to detect these frauds sooner?

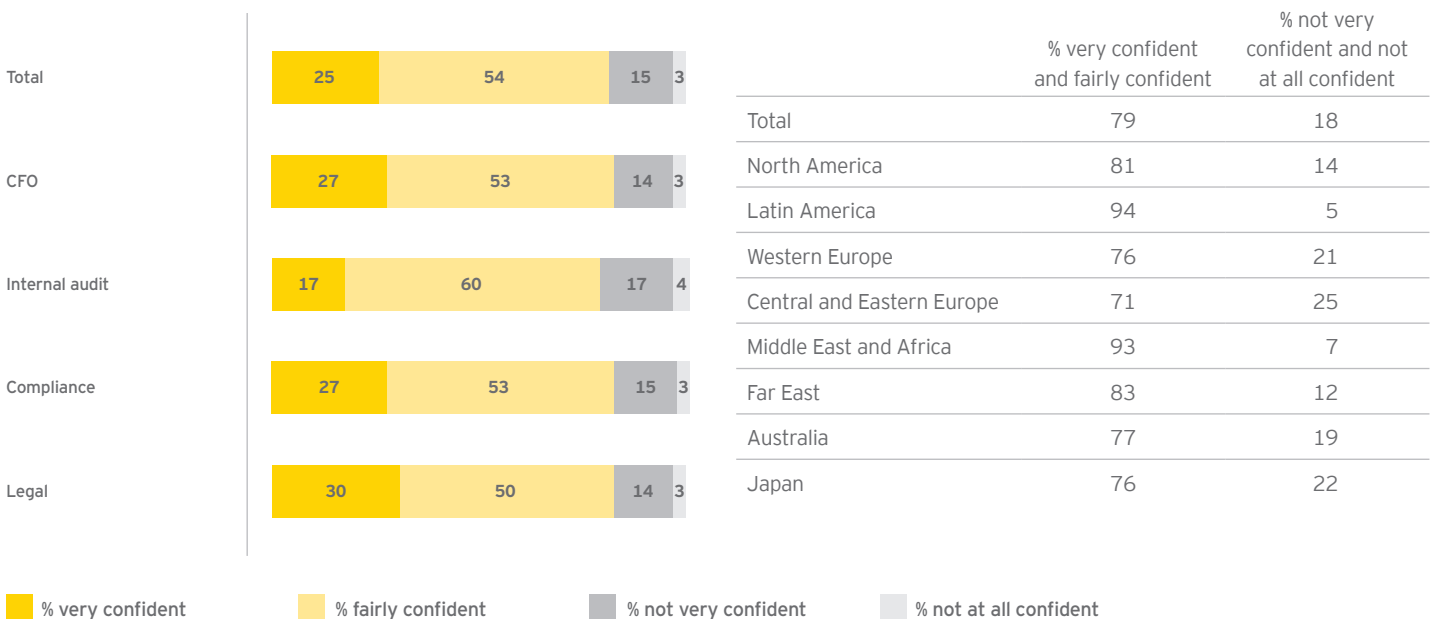
Base: All respondents (1,409)



Our legal respondents appear to have higher expectations of internal auditors than the other finance and compliance professionals interviewed.

This vote of confidence is not always shared by heads of internal audit themselves. A quarter of our respondents declared themselves very confident in internal audit's ability to detect fraud, bribery and corruption. While 30% of our respondents from legal and 27% of our CFOs and heads of compliance are in this camp, only 17% of heads of internal audit are very confident in their groups' abilities (Figure 19).

Figure 19
Corporate confidence in internal audit



Q: How confident are you that the internal audit function in your organization is effective in identifying incidents of fraud, bribery or corrupt practice?
 Base: All respondents (1,409)
 The "Don't know" percentages have been omitted in order to allow better comparison between the responses given.

“Fraud awareness training is only as effective as the audience it reaches.”

CFO, The Netherlands

This may be due to the modesty of internal auditors, but we believe it is more likely to be linked to a concern about being stretched thin in a time of cutbacks. In many cases, internal audit groups have been under new pressures, including increased fraud risks, resulting from the economic downturn. Yet 8 out of 10 of our internal audit respondents have seen the resources available to them remain static or fall over the last 12 months. Almost three-quarters expect the same situation in the next 12 months. Internal audit must therefore ensure that they manage the expectations of other governance stakeholders and highlight the inherent limitations on the assurance that they can provide when resources are constrained.

Equipping internal audit for the fight against fraud

Internal audit is seeing a shift in its patterns of work. It is moving from a risk focus to an operational efficiency focus as it copes with increased demands. Fraud is already taking up a fair amount of internal audit time in a quarter of companies – one in five of our internal audit respondents are spending more than 20% of their time on it. With more than 20% choosing to include fraud in the two areas of most significant risk for their business in the next 18 months, the issue of resources will become more pressing.

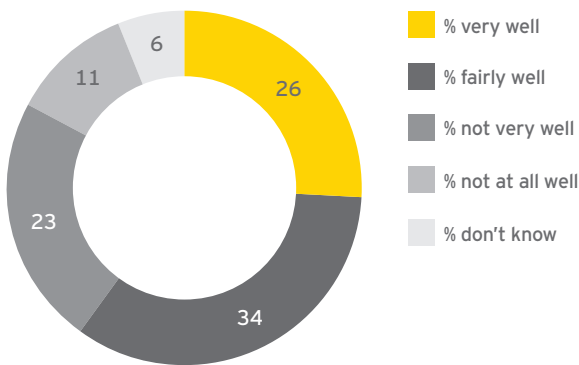
Training is one area that deserves a greater share of resources. Although internal audit is seen as the primary preventive defense, only a third of our internal audit respondents have been trained personally to conduct fraud investigations and only a quarter to conduct corruption investigations. In many cases, their first experience of such investigations was actually conducting one rather than learning how to do so. Learning on the job in highly sensitive situations such as fraud is fraught with risk.

A worrying proportion of internal audit respondents consider that they understand the US concept of attorney-client privilege fairly well. But privilege is complex and increasingly important given the way the US legislation is driving most anti-corruption enforcement; there is no room for error and “fairly well” is not well enough (Figure 20). Issues arising from local data protection laws make this situation even more complicated for companies operating in, for example, the European Union, where the data protection rules are among the most stringent in the world.

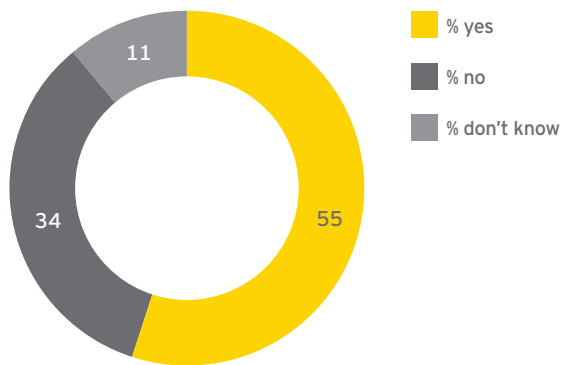


Figure 20
Understanding of privileged issues in an investigative context

Understanding attorney/client privilege



Policies in place for a privileged investigation



	% very well
North America	44
Latin America	77
Western Europe	22
Central and Eastern Europe	19
Middle East and Africa	29
Far East	10

	% yes
North America	72
Latin America	64
Western Europe	50
Central and Eastern Europe	52
Middle East and Africa	53
Far East	58

Q: How well do you feel you understand the concept of attorney-client privilege and attorney work-product privilege?
Base: All internal audit respondents (331)

Q: Does your organization have policies in place to be followed in the event that it is decided to conduct a privileged investigation?
Base: All internal audit respondents (331)

“Management fears the unknown. You can have policies and procedures in place but often have very little idea of what is going on in remote parts of your business.”

CFO, United States

Internal audit seems to be taking a pragmatic approach to the challenge of reduced budgets and has adopted a targeted approach to managing the risks: 72% are narrowing audit scope to target key risks, 33% are using questionnaires to identify higher-risk entities, and 29% are conducting fewer local business unit visits.

The limits of a desk-bound approach

This risk-weighted approach to audit planning is broadly sensible. It is, however, reliant upon having a good-quality and up-to-date fraud risk assessment so that a narrower-scope audit program remains effective and addresses the critical risks. Additionally, internal audit's approach to its use of questionnaires and checklists should be considered carefully. Internal audit should revisit the questionnaires for any entities affected by a fraud or corruption event to ascertain whether the questionnaire appropriately categorized the fraud risk posed in that entity. The reliability of the questionnaire responses from the local markets also should be considered carefully. If something looks too good to be true, it probably is.

But however pragmatic internal audit's approach may be in terms of efficiency, there is likely to be a price to pay in terms of effectiveness. Four out of five of our internal audit respondents rate personal visits by internal audit staff, especially in emerging markets, as a very significant part of the fraud risk assessment process. Fewer visits can mean that risks are missed or that emerging market locations do not understand the significance of the risks to the parent company.

Conclusion – coordination, compliance and growth



Consistent with the experience of past recessions, companies have been struggling with an upsurge in fraud and corruption. Almost one in six of our respondents have experienced a significant fraud in the past two years. Yet despite the confidence shown in our past surveys during the years of prosperity, we have also found those charged with handling these issues to be ill-prepared.

Companies need to instill a collective culture of risk management with particular regard to fraud and corruption matters. More than three-quarters of board members are worried about personal liability, but this does not seem to have filtered down into effective risk management strategies in the rest of the business. Board pronouncements, well-publicized codes of ethics, and regular compliance training and reviews will go some way to educate employees, third parties and agents that everyone has a part to play in an effective anti-fraud and anti-corruption program.

This message must be driven from the top. According to our CFO respondents, less than half of the boards they reported to had actually made requests for key anti-fraud information in the last 12 months. However, it is only by demanding such data that directors can ensure that they are managing their own exposure and making the business aware of the importance of effectively addressing these risks.

Yet driving growth remains management's principal objective. More than half the respondents interviewed expect their companies to grow over the next 12 months. Those opportunities will often come in unfamiliar markets, making appropriate due diligence particularly important. Despite the many recent examples of the perils of ignoring the fraud and corruption dimension of these assessments, a fifth of companies still do not consider it as part of M&A due diligence, and a quarter never consider it in a post-acquisition review. Where an organization's responses are already inconsistent across geography and function, the addition of further complexity through acquisition can only make achieving a robust response more difficult.

The challenge now is to build on the foundations that have been established, coordinating the responsibilities and procedures that have been put in place and ensuring that the organization's plan for responding to fraud risk is robust and scalable to handle future growth. The current scarcity of resources and budget constraints have reduced the effectiveness of many fraud and corruption risk management frameworks and need to be rectified as quickly as possible.

A new period of growth will mean more challenges – more potential for fraud, more exposure to corruption and more interest from regulators. Companies need to use the coming months to tighten up the elements of their compliance and anti-fraud programs into robust procedures that give each department a clear role to meet these challenges while achieving sustainable, ethical growth.

Survey approach

Between November 2009 and February 2010, our researchers conducted a total of 1,409 interviews in the local language with senior decision-makers from large enterprises in 36 countries.

The sample was structured to hear from those who bear the responsibility for tackling fraud, and more than 85% of our respondents were either CFOs or head their company's internal audit, legal or compliance groups.

Participant profile – region and country

Number of interviews			
Central and Eastern Europe	353	Japan	50
Czech Republic	50		
Hungary	50	Latin America	100
Poland	50	Brazil	50
Romania	28	Mexico	50
Russia	50		
Turkey	50	North America	102
Ukraine	25	Canada	51
Baltic States†	50	US	51
Far East	150	Middle East and Africa	152
China (including Hong Kong)	50	India	50
Singapore	50	Middle East*	52
South Korea	25	South Africa	50
Vietnam	25		
		Australia	52
		Western Europe	450
		Austria	50
		France	50
		Germany	50
		Greece	25
		Italy	25
		The Netherlands	50
		Norway	25
		Spain	50
		Sweden	25
		Switzerland	50
		UK	50

† Latvia, Lithuania, Estonia

* UAE, Jordan, Egypt

Base: All respondents (1,409)



Participant profile – job title, sector and revenue

Number of interviews	
Job title	
CFO/finance director	403
Reports to CFO	89
Head of internal audit	313
Reports to head of internal audit	18
Head of legal	292
Reports to legal	15
Chief compliance officer (CCO)	223
Reports to CCO	56
Revenue	
More than US\$5bn	174
US\$1-5bn	506
US\$500m-US\$1bn	228
US\$100-US\$500m	341
Less than US\$100m	160
Above US\$1bn	680
Below US\$1bn	729

Sector	
Banking, capital markets and asset management	105
Consumer products/retail/wholesale	264
Insurance	34
Life sciences	86
Manufacturing/chemicals	208
Mining	24
Oil and gas	54
Telecommunications	24
Utilities	99
Automotive	84
Technology	50
Transport	68

Base: All respondents (1,409)

Contact information

The Ernst & Young Fraud Investigation & Dispute Services practice has global reach. See below for a list of our country/territory leaders. For more information, visit www.ey.com/fids.

Local contact	Name	Telephone
Global Leader	Managing Partner David Stulb	+44 20 7951 2456 +1 212 773 8515
Afghanistan/Pakistan	Shariq Zaidi	+92 21 3568 6866
Australia	Paul Fontanot	+61 2 8295 6819
Austria	Gerhard Donner	+43 1 21170 1050
Baltic States	Linas Dicpetris	+370 5 274 2344
Brazil	Jose Compagño	+55 11 2573 3215
Canada	Mike Savage	+1 416 943 2076
CESSA (Czech Republic/Hungary/Slovakia/Slovenia/Croatia)	Markus Lohmeier	+420 225 335 173
China	John Auerbach	+86 21 2228 2642
France	Philippe Hontarrede	+33 1 46 93 62 10
Germany	Stefan Heißner	+49 211 9352 11397
Hong Kong	Chris Fordham	+852 2846 9008
India	Arpinder Singh	+91 22 6665 5590
Indonesia	Fariaty Lionardi	+62 21 5289 4004
Ireland	Julie Fenton	+353 1 221 2321
Italy	Paolo Marcon	+39 02 7221 2955
Japan	William Stewart	+81 3 3503 2832
Malaysia	Philip Rao	+60 374 958 763
Mexico	Jose Treviño	+52 55 5283 1450
Middle East	Bob Chandler	+973 1751 4873
The Netherlands	Angélique Keijsers	+31 88 40 71812
New Zealand	Nick Paterson	+64 9 300 7098
Norway	Dag Eidsvik	+47 2400 2648
Philippines	Roderick Vega	+632 894 8342
Poland	Mariusz Witalis	+48 225 577 950
Romania/Bulgaria	David Smith	+40 214 028 485
Russia/Commonwealth of Independent States	Ivan Ryutov	+7 495 755 9738
Singapore	Lawrance Lai	+65 6309 8848
South Africa	Stuart Waymark	+27 31 576 8050
Southeast Europe (Turkey/Greece)	Dilek Çilingir	+90 212 368 5172
South Korea	TS Jung	+82 2 3787 6823
Spain	Ricardo Noreña	+34 91 572 5097
Sweden	Kenneth Johansson	+46 8 5205 9620
Switzerland	Michael Faske	+41 58 286 3292
UK	John Smart	+44 20 7951 3401
US	Jeff Taylor	+1 202 327 7239

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