

THE FRAUDSTERS AMONGST US: TRENDS IN CRIME CLAIMS

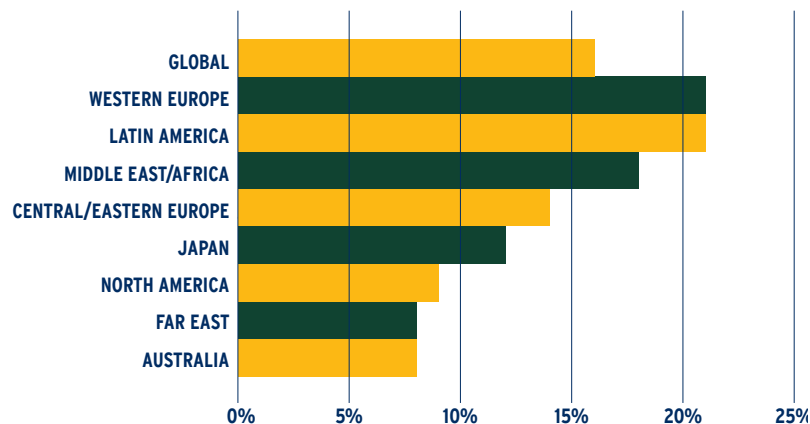
Over the past two years, the global financial crisis has produced a bonanza of fidelity losses. As we look to future growth and expansion, now is an opportune time to consider what lessons have been learned that might benefit us moving forward. Based on a study conducted by the ACFE, fraud has been a *significant threat* for a number of firms.

THE MANY FACES OF FRAUD

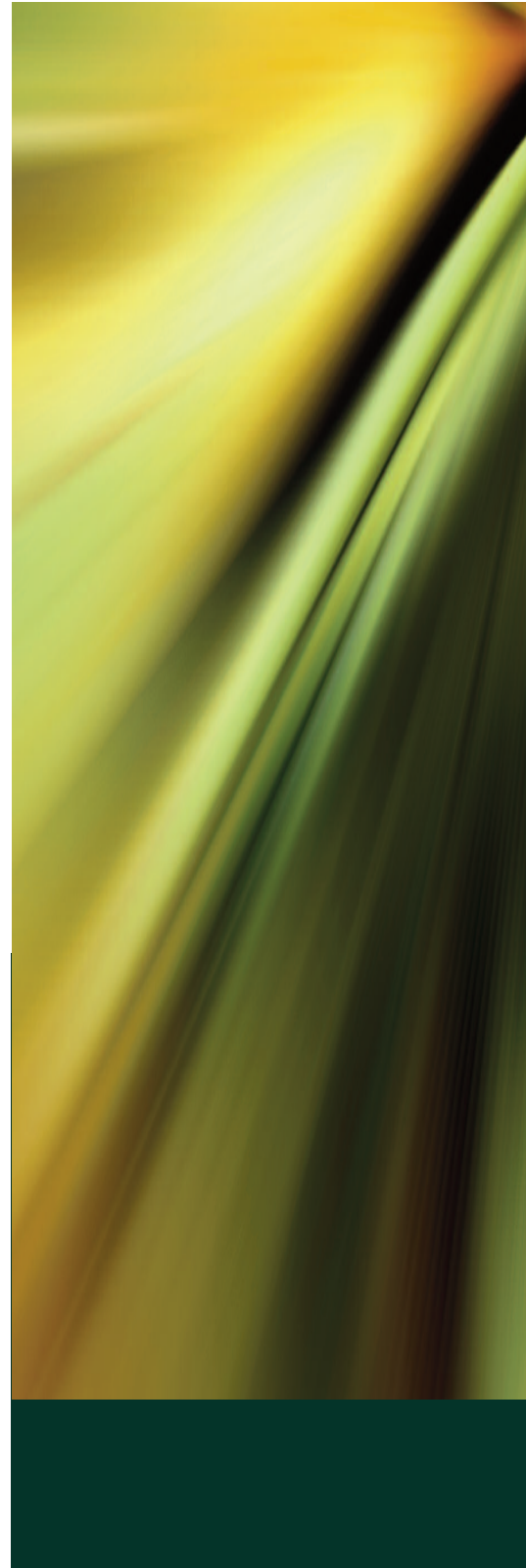
Fraud can occur in many contexts, from Ponzi schemes and falsifying expense reports and asset (mis)appropriation to cooking the books. In the context of this discussion, fraud often involves the participation of a trusted individual or group within the firm in the commission of the crime for their own personal benefit.

PREVALENCE OF SIGNIFICANT FRAUD

Question: Has your organization experienced a significant fraud in the last two years? Yes.



Source: 11th Global Fraud Survey¹



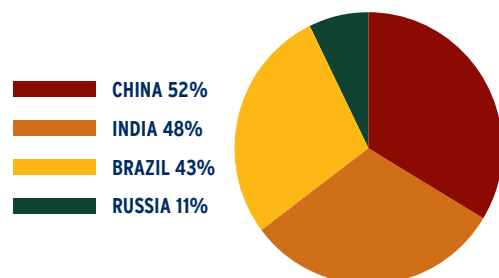
THE WORLD AS WE KNOW IT: LOCATION, LOCATION, LOCATION

Current statistics suggest that companies lose 5% of their annual revenue to fraud, with the median loss at least one million dollars.² We have long held that half of all of the fidelity or crime losses that we report on behalf of our global clients originated abroad (outside the U.S.). In acknowledgement of this trend, the biannual report from the Association of Certified Fraud Examiners – probably the most reputable survey on fraud – went international in 2010.³

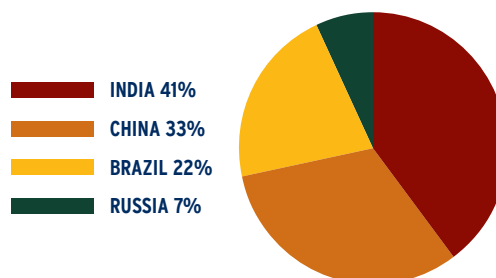
Much of the world’s investments focus on four key markets: Brazil, Russia, India and China (BRIC), each of which presents unique challenges from an anti-fraud perspective, sometimes making the goal of consistent internal policies and procedures a moving target.

BRIC COUNTRY FRAUD DIFFERENTIALS

Conducts pre-acquisition due diligence:



Conducts post-acquisition due diligence:



Source: 11th Global Fraud Survey, “BRIC country trends.”⁴

PAYING THE VAT (VALUE-ADDED TACTICS) FOR INTERNAL ANTI-FRAUD CONTROL

At many firms, the financial crisis wreaked havoc with many business plans and corporate results, while putting financial pressure on internal compliance and fraud-avoidance programs. The result may have been a contraction of fraud-prevention resources just when frauds were multiplying – exacerbated by corporate downsizing and the financial pressures – which sometimes led to a reduction in internal audit staff and/or the end to the segregation of sensitive duties in the interest of expense control.⁵

With today’s sharpened focus on anti-bribery and anti-corruption laws around the globe, it may be that this short-term trend of reduced or short-term funding for fraud prevention is

coming to an end. We also now have more corporations focusing on enterprise risk management (which almost by definition should include a fraud risk assessment).⁶

As a control, data now exists regarding reductions in median loss as well as the duration of the fraud. There is also analysis available on effectiveness of these controls based on size of organization as well as by geographical region.⁷

TOP 10 ANTI-FRAUD CONTROLS

Type of Control	Reduction in Loss	Reduction in Duration
Hotline	59.2%	35.0%
Employee Support Programs	59.0%	16.7%
Surprise Audits	51.5%	36.8%
Fraud Training for Employees	50.0%	27.8%
Fraud Training for Managers/Execs	50.0%	27.8%
Job Rotation/Mandatory Vacation	46.8%	33.3%
Code of Conduct	46.6%	37.5%
Anti-Fraud Policy	40.0%	27.8%
Management Review	40.0%	50.0%
External Audit of ICOFR ⁸	34.9%	37.5%
Internal Audit	30.6%	41.7%

Source: 2010 Report to the Nations on Occupational Fraud and Abuse

TIPS TOP THE LIST

When it comes to detecting fraud in our organizations, the most reliable tool, as evidenced by the graph above, is not the traditional internal controls but rather tips, including whistleblowers.⁹ This will be important to consider in light of the new whistleblower “bounty” provisions in the Dodd-Frank Act.¹⁰ We currently await the specific rules for implementing what is widely referred to as the global “bounty program” for whistleblowers in the new Act, where a tipster to the Securities Enforcement Commission (SEC) can collect 10 – 30% of a resulting SEC penalty when the penalty exceeds \$1 million. But the significance of this tool is only likely to become *more* important in the future. This leads us to believe that it may be timely to review one’s hotline protocols (including how any resulting investigation is handled).

CONCLUSIONS

It makes sense for an organization to invest in fraud prevention to protect both its assets and its reputation around the world. A uniform and consistently applied anti-fraud program is a challenge, but one that can pay dividends as companies grow globally with new products and new business partners in new markets. Information on the most successful tactics can inform one’s global strategies for growth and expansion.

In addition to controlling and containing risk, a well-structured risk transfer program in the form of fidelity bonding (or crime coverage) also serves the needs of companies small and large, when even the best fraud prevention initiatives fail.

CONTACTS

For additional information you may contact our Practice specialist on this subject:

Steve Leggett

212 915 0694

leggett_sr@willis.com

or one of the following Executive Risks professionals:

Atlanta, GA

Charles Maxell

404 224 5123

charles.maxell@willis.com

Denver, CO

Jim Iacino

303 218 4039

jim.iacino@willis.com

Radnor, PA

Matt Schott

610 254 5642

matt.schott@willis.com

Boston, MA

David Goldstein

617 351 7498

david.goldstein@willis.com

Los Angeles, CA

Brendan Dolan

949 930 1765

brendan.dolan@willis.com

San Francisco, CA

Michael Mahoney

415 291 1535

mike.mahoney@willis.com

Chicago, IL

Brian Gauen

312 621 4855

brian.gauen@willis.com

New York, NY

Steve Pincus

212 915 7940

steve.pincus@willis.com

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¹ Ernst & Young's 11th Global Fraud Survey, Figure 1, entitled "Recent experiences of fraud."

² Summary of Findings from the ACFE 2010 Global Fraud Study.

³ The title changed from "Report to the Nation on Occupational Fraud and Abuse" to "report to the Nations..." and includes fraud data from 106 countries. More than 40% of the fraud cases that they examined occurred outside the U.S.

⁴ Ernst & Young's 11th Global Fraud Survey.

⁵ A discussion of the erosion of anti-fraud and anti-corruption policies at some companies can be found in the E&Y Survey in the key finding section, "Doing more with less."

⁶ Standard & Poor's announced in May 2008 that it would include a commentary on Enterprise Risk Management (ERM) in its credit reports, regardless of size and industry, with formal scoring of ERM capabilities of non-financial organizations beginning as of 2009. See *Willis Alert*, "**ERM and the Rating Agencies**."

⁷ See pages 20-23 in the 2010 Report to the National on Occupational Fraud and Abuse.

⁸ "External Audit of ICOFR" indicates independent audits of the organization's internal controls over financial reporting.

⁹ Also from the Summary of Findings; this has been consistent since 2002 when the ACFE began tracking fraud detection methodologies. Tippers may include clients and customers as well as one's own employees.

¹⁰ Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act includes a provision for "securities Whistleblower Incentives and Protection."