

The background of the slide is a photograph of a blue-painted wooden door, slightly ajar, set in a rural landscape. The door is made of vertical wooden planks and has two horizontal wooden bands with metal fasteners. To the right of the door, a wooden fence is visible, and the background is filled with lush green trees and foliage. The ground in the foreground is covered with straw or hay.

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Ten things about fraud control

How executives view the
“fraud control gap”

Deloitte Forensic Center
November 2007

Deloitte Forensic Center

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Ten things about fraud control:

Many companies have become more focused on preventing and detecting fraud over the last several years due to new regulatory requirements, board pressure and increased media coverage. But in the absence of detailed standards for fraud controls, diversity of practices has increased. This has left some companies uncertain if their practices are comparable with those of their peers or if they are missing out on some successes achieved by leading organizations.

To address these questions, the Deloitte Forensic Center, in the summer of 2007, formulated a survey and engaged a professional survey firm to conduct it, receiving responses from 277 senior executives involved in fraud control. We asked these executives to rate their company's effectiveness in key areas of fraud control. The questions were designed to identify the practices of leading organizations in a variety of aspects of fraud control.

This booklet provides an executive summary of our analysis of the results of the survey, highlighting the key ways in which companies differentiate themselves in their approach to fraud control. A full report, *How Executives View the "Fraud Control Gap"*, is available upon request.

This study reveals a substantial "fraud control gap" between more effective and less effective companies. We believe the results will be of great interest to senior executives, boards of directors, audit committees, internal auditors and others concerned about managing the business risk of fraud, preserving corporate assets and reputation and protecting investors.

We identify areas in which less effective companies could enhance their fraud control performance by adopting the practices of their more effective peers. Our study also shows that even the more effective companies have significant opportunities to raise their effectiveness in several important aspects of fraud control.

Overview of Methodology

- We surveyed 277 senior executives involved with fraud control, drawn from functions including internal audit, compliance, finance, risk management and legal.
- Executives participating in the survey came from a broad range of industries including financial services, manufacturing, technology, media & telecommunications, energy & resources, life sciences & healthcare, retail, real estate, public sector, transportation and other industries.
- The executives surveyed represented small, mid-sized, and larger companies: 46% of executives were from companies with \$1 billion or more in annual revenues, 31% from companies with \$100 million to less than \$1 billion, and 23% from companies with less than \$100 million.
- Sixty-four percent of respondents said their company was subject to the Sarbanes-Oxley Act, 36% said they were not.
- To analyze their different approaches, companies were categorized into those that were more effective at fraud control and those that were less effective. Companies were considered as “more effective” when executives gave their companies an average rating of 3.5 or greater (on a five-point scale) on their effectiveness in four areas: preventing internal fraud, detecting internal fraud, preventing external fraud, and detecting external fraud; “less effective” companies were those receiving average ratings of less than 3.5.
- Using this definition, 41% of executives considered their companies as more effective at fraud control overall, while the remaining 59% of executives considered their companies to be less effective. There were few differences across industries in the ratings of fraud control effectiveness, with the exception of financial services. The financial services industry has had more regulatory pressure to control fraud over the years, including legislated programs after the savings and loan crisis of the 1980s. This may explain why 53% of executives at these firms rated them as more effective at fraud control.

Executives at more effective companies gave their companies far higher ratings on all aspects of fraud control

Chart 1: Effectiveness of Fraud Control

Percent of Companies Responding “Very Effective” (4 – 5 on 5-point scale)

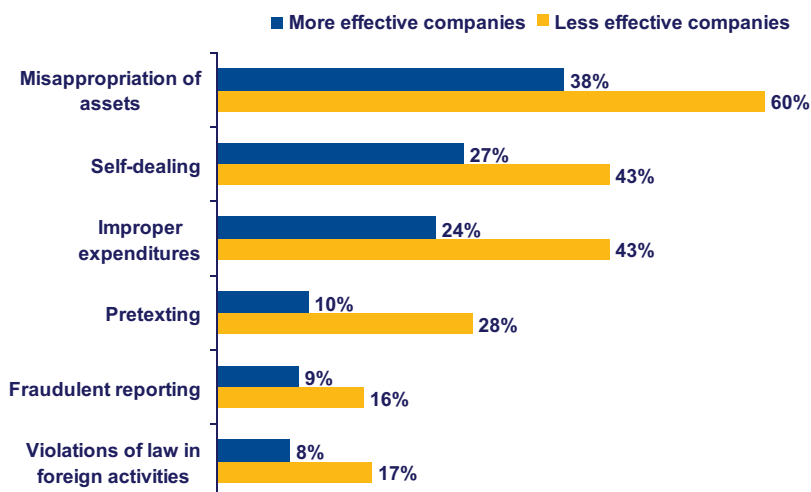


- Executives at more effective companies rate their companies’ effectiveness very highly for preventing and detecting internal fraud.
- Less effective companies trail far behind. The “point spread” between more effective and less effective companies for preventing internal fraud was 71 percentage points. For detecting internal fraud it was 76 percentage points.
- Both groups of companies rate themselves significantly less effective in dealing with external fraud than with internal fraud, an opportunity for improvement.

Executives at more effective companies anticipated that instances of fraud were much less likely to occur over the next 12 months

Chart 2: Likelihood of Types of Fraud over Next 12 Months

Percent of Executives Fraud is Somewhat, Very, or Extremely Likely

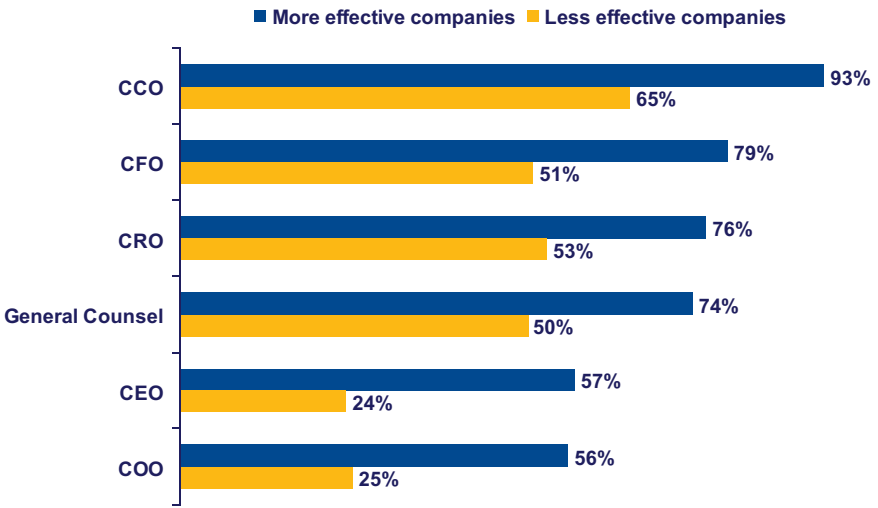


- The proportion of executives anticipating misappropriation of assets at their company was 22 percentage points lower at companies more effective in fraud control.
- More effective companies also reported lower likelihood of the most damaging kinds of frauds, such as fraudulent reporting and violations of law in foreign activities (“FCPA violations”).
- The fact that nearly 10% of more effective companies and over 15% of less effective companies considered fraudulent reporting and FCPA violations to be somewhat, very, or extremely likely indicates a continuing concern relating to these very serious fraud risks.

At more effective companies, senior executives—especially the CEO—were much more likely to be very involved in fraud control

Chart 3: Involvement of Executives in Fraud Control

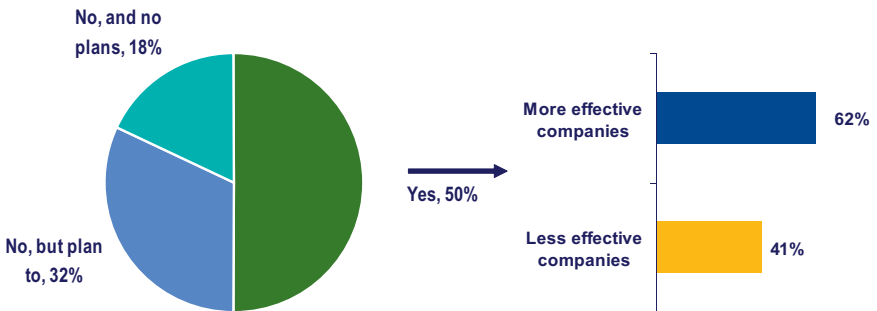
Percent of Executives Responding “Very Involved” (4 – 5 on 5-point scale)



- At more effective companies, a higher proportion of senior executives are involved in fraud control, including chief compliance, financial and risk officers, the general counsel, CEO and COO.
- The greatest difference arises with CEO involvement. At more effective companies, the CEO is more than twice as likely to be “very involved” in fraud control than at less effective companies.
- The point spread between more and less effective companies for involvement of senior executives is much less than the point spread for the outcomes reported in chart 1, so executive involvement appears to be part but not all of what drives higher fraud control performance.

More effective companies were much more likely to have a formal fraud control policy/strategy

Chart 4: Does Company have Formal Fraud Control Policy/Strategy?

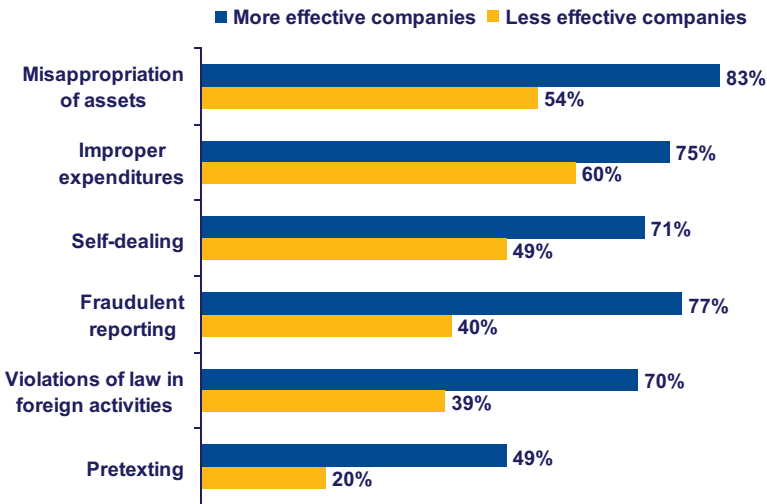


- As previously occurred with whistleblower hotlines, formal fraud control policies or strategies are quickly becoming the norm, especially at more effective companies.
- Half of the respondents overall said their companies have a formal fraud control policy or strategy, with another 32% planning to implement one.
- 18% of respondents said their companies don't plan to have a formal fraud control policy. Given the overwhelming adoption by other companies, that approach may become hard to justify to those charged with governance.

The fraud control policy/strategy at more effective companies was much more likely to address specific types of fraud

Chart 5: Types of Fraud Addressed “Extensively” in Fraud Control Policy/Strategy

Base=Companies with Fraud Control Policy/Strategy



- Over 70% of executives at more effective companies said most fraud topics were addressed extensively in their organization’s fraud control policy/strategy. There was much less consistency at less effective companies.
- Less effective companies appear to address everyday frauds more extensively than more serious ones. Misappropriation of assets is addressed extensively by 54% of less effective companies while fraudulent reporting and violation of law in foreign activities are addressed extensively at 40% or less of such companies.
- Newer fraud risks, such as pretexting, are addressed less extensively by both groups of companies. Improved processes for identifying and addressing new fraud risks may be needed.

More effective companies were much more likely to report that their fraud risk assessments contained key features

Chart 6: Characteristics of Formal Fraud Risk Assessments

Percent of Executives who "Agree Strongly"

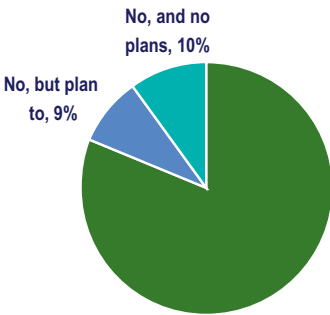
Base=Companies Conducting Fraud Risk Assessments



- Seventy percent of executives at more effective companies said they conducted formal fraud risk assessments, compared to 38% at less effective companies.
- For those who did conduct fraud risk assessments, more effective companies dealt with all aspects of fraud risk assessment more effectively, but still had significant room for improvement.
- For the critical issue of management override of internal controls, which commonly occurs with serious frauds such as fraudulent reporting, 63% of executives at more effective companies agreed strongly that their risk assessment addressed this issue compared to only 31% at less effective companies.

The whistle-blower hotline at more effective companies was twice as likely to be considered very effective

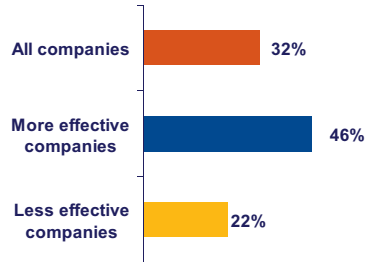
**Chart 7:
Existence of
Whistle-Blower Hotline**



**Effectiveness of
Whistle-Blower Hotline**

Percent "Very Effective" (4 – 5 on 5-point scale)

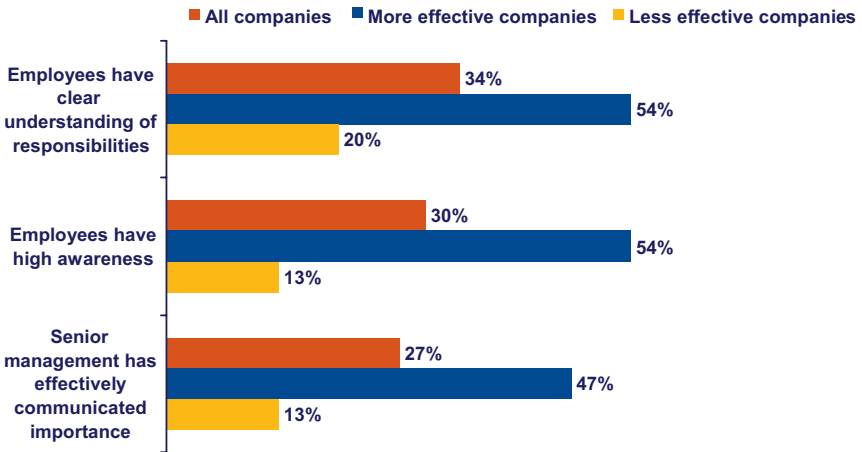
Base=Companies with Whistle-Blower Hotline



- Whistle-blower hotlines were reported to be in place at 81% of companies surveyed with another 9% planning to install them. Ten percent had no plan to install a whistle-blower hotline.
- Only 32% of executives surveyed considered their whistle-blower hotline to be very effective.
- Since tips are the primary way in which frauds are detected, according to the Association of Certified Fraud Examiners, and whistle-blower hotlines are a key control addressing the risk of management override, improving the effectiveness of such hotlines appears to be a significant opportunity and a potential concern of those charged with governance.

Most effective companies are more likely to do a better job of training employees about fraud control

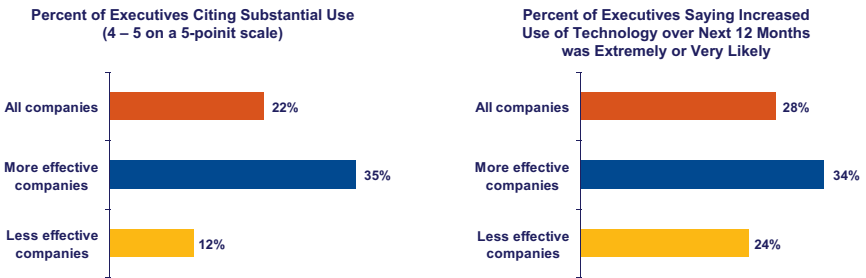
Chart 8: Assessments of Fraud Control
Percent of Executives who "Agree Strongly"



- Executives at more effective companies were several times more likely than those at less effective companies to agree strongly that their employees had a clear understanding of their responsibilities for fraud control.
- Only 13% of executives at less effective companies agreed strongly that senior management had effectively communicated to employees the importance of fraud control.
- Even at more effective companies, the scores in this area approximate only 50%, suggesting substantial opportunity for improvement.

More effective companies are three times as likely to use technology substantially in fraud monitoring

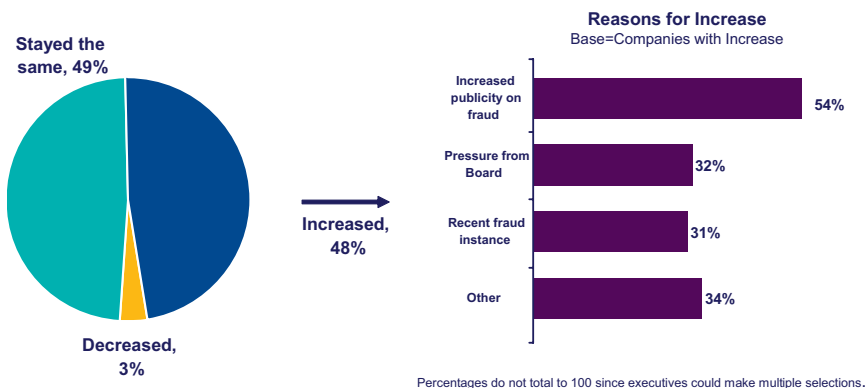
Chart 9: Use of Technology in Fraud Monitoring



- Thirty-five percent of executives at more effective companies said their companies used technology substantially in ongoing fraud monitoring, compared to only 12% of those at less effective companies.
- The two groups of companies were more consistent in their future plans. Twenty-eight percent of executives overall said increased use of technology for fraud monitoring was extremely or very likely.

Roughly half the executives reported an increase in resources devoted to fraud, with increased publicity the reason cited most often

Chart 10: Change in Resources Devoted to Fraud over Last 12 Months



- Forty-eight percent of executives reported an increase in resources devoted to fraud over the last 12 months.
- Of these, 54% cited increased publicity on fraud as a reason for the increase in resources.
- Pressure from the board of directors and a recent instance of fraud were cited as additional reasons.

To Learn More

To request the full report, *How Executives View the “Fraud Control Gap”*, please contact the Deloitte Forensic Center at www.deloitte.com/us/forensiccenter or dfc@deloitte.com.

The video program discussing these findings can be viewed at www.deloitte.com/us/forensiccenter or can be ordered from the Deloitte Publications web site.

Document Reference Number: 7365

Video Reference Number: 7391

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