Corporate Fraud: Stop History from Repeating Itself

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We have all heard the adage about "history repeating itself." Unfortunately, history keeps repeating itself in corporate fraud matters. Beginning in 2001 for instance, there were a series of massive corporate frauds in the United States that tainted business. During a very short period, Enron was found culpable in a massive scheme in which earnings were overstated during a four-year period by US$586 million and by creating limited partnerships to hide US$3.1 billion in debt. This case was quickly followed by WorldCom in early 2002, when that company overstated profits by booking US$3.8 billion in normal operating expenses as capital expenditures. This chapter in U.S. corporate fraud continued in 2002 with the exposure of similar massive frauds at Global Crossing, Tyco International, AOL Time Warner, Bristol-Meyers Squibb, and Quest Communications International, to mention just a few.

Despite the legislative response to the wave of corporate frauds, which resulted in much stricter corporate guidelines with the passage of the Sarbanes-Oxley Act of 2002 and amendments to the U.S. Sentencing Guidelines, significant and massive global corporate fraud continues to this day. In fact, the Association of Certified Fraud Examiners (ACFE) in their 2008 Report to the Nation on Occupational Fraud and Abuse projected that U.S. organizations alone lose 7 percent of their annual revenue to fraud, equating to US$994 billion in losses. Further, according to PricewaterhouseCooper's Global Economic Crime Survey 2005, globally there has been a 140 percent increase in the number of companies reporting financial misrepresentation, a 133 percent increase in the number reporting money laundering, and a 71 percent increase in the number reporting corruption and bribery.

It is not surprising, therefore, that in 2009 it was learned that the chairman for Satyam Computer Services, India's fourth largest IT company whose clients included 185 Fortune 500 corporations, had cooked the company books in a series of elaborate transactions including forgery, inflating expenses, stripping assets, and manipulating income, inventory value, and profits, dating back to 2001. The losses estimated to be US$1.5 billion is two and a half times the sum of the Enron scandal. As a further example of the continued massive corporate defalcations, multiple business units within Siemens were exposed in a massive company-wide corruption scheme in which US$1.4 billion in illegal payments were made to obtain business worldwide between 2001-2007.

So what are the essential elements if companies are to break this historical downward spiral of continued corporate-wide frauds that are having greater impact not only on the company and its employees, but also investors, other financial institutions, and the world's economy? The answer is very complicated, otherwise companies would not be faced with this awful potential problem. There are and have been many internal controls and anti-fraud tools that could be applied as prevention. There are three areas, however, that are critical to changing the organizational culture: tone from the top, employee education, and identifying and acting on fraud incidents.

It has been reported that despite the growing number of companies reporting fraud around the world, nearly 80 percent did not consider it likely that their company would suffer from a fraud incident. So it is easy to understand how companies may develop a false sense of security and not establish the appropriate preventative measures. It cannot be emphasized enough that for any organization to develop a strong anti-fraud culture, the expectations regarding ethical behavior must be communicated, understood, and driven from the top of the organization downward. It is essential, therefore, for every organization to have a written code of conduct that clearly and concisely articulates the company's ethics and values. The board and senior management must commit to, adopt, and live by these standards through their daily actions and communications throughout the organization.

In order to ensure that the anti-fraud culture is adopted throughout the organization, employees must be educated. They need to know what is considered acceptable and unacceptable behavior in the workplace. Employees also need to know and be given the tools to identify and prevent fraud, and more importantly, they need to be encouraged to participate in bringing illegal and unethical behavior to the attention of the appropriate company representative. The continual flow of communications and actions of top management in support of the company's established code of conduct and ethical standards in concert with a strong employee training program is the fusion needed for a viable and robust anti-fraud program.

Despite the efforts of many companies to proactively reduce fraud through internal controls, the ACFE has reported that tips (whistleblowers) and anonymous complaints were the leading contributors for detecting corporate fraud. To continue to build upon an ethical, transparent, and anti-fraud corporate culture, it is critical to provide a channel for fraudulent behavior to be reported. One avenue is to establish a hotline with a third-party professional. The ACFE reported in its 2008 Report to the Nation that companies with fraud hotlines cut their losses by more than 50 percent per scheme. Conversely, the American Institute of Certified Public Accountants (AICPA) has noted that despite the effectiveness of anonymous hotlines as an anti-fraud detection method, only 36.8 percent of companies surveyed in 2004 had an anonymous hotline.

By developing a strong message from the top of the organization; training and empowering employees to identify fraud and participate in the exposure of corporate fraud; and finally providing a channel for fraud detection, businesses will be well on their way to reducing the crippling fraud losses cited annually by the ACFE.

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