

The 2005 Oversight Systems Report On Corporate Fraud

From the conviction of former WorldCom CEO Bernie Ebbers to the acquittal of HealthSouth's Richard Scrushy, corporate fraud continues to make headlines. Four years after Enron's collapse, financial integrity remains a key issue for corporate America. *The 2005 Oversight Systems Report on Corporate Fraud* surveys fraud examiners to report the trends, risks and major concerns that businesses face today.

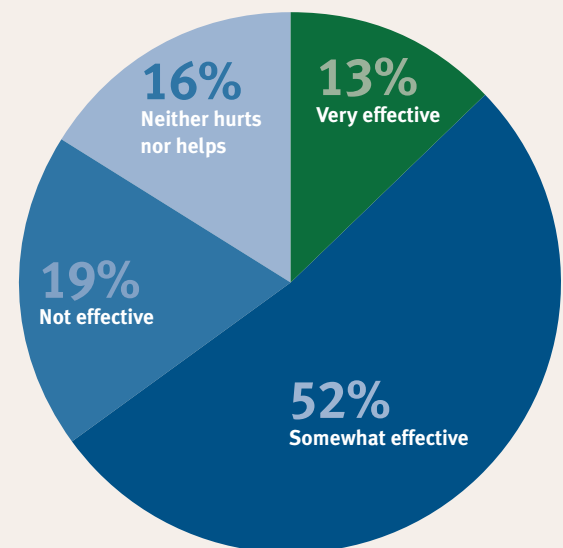
While most fraud examiners view Sarbanes-Oxley (SOX) as an effective tool in fraud identification, few think it will change the culture of business leaders.

Nearly two-thirds of respondents (65 percent) indicate that SOX has been somewhat or very effective in identifying incidences of financial-statement fraud. Only 19 percent of those surveyed found SOX to be ineffective or serve to prevent fraud identification (see: SOX Helps Crack Financial Crimes graph).

Although respondents agree that SOX serves to identify fraudulent activity, they do not feel the recent cultural change among U.S. business leaders toward institutional integrity and fraud prevention in the wake of account scandals will stick. Only 17 percent feel there will be a shift among business leaders to institutional integrity and fraud prevention for the foreseeable future. The remainder of respondents possess a more stark outlook, reporting that interest in such actions will fade in the next five years (39 percent); that vigilance has already begun to fade (32 percent); or that there has been no change among business leaders (12 percent) (see: Executive Report graph pg. 2).

SOX Helps Crack Financial Crimes

How effective has Sarbanes-Oxley (SOX) been in helping to identify incidences of financial-statement fraud?



"The findings of this survey foreshadow a real need for continued vigilance among executives toward institutional fraud," said Patrick Taylor, CEO of Oversight Systems. "SOX legislation and the intense focus on corporate scandals have helped battle this type of white-collar crime, but professionals seem to be worried that the C-suite might quickly lose interest in policing corporate fraud."

“The pendulum of corporate culture and attitudes toward integrity swings back and forth,” said Dana Hermanson, Dinos Eminent Scholar Chair of Private Enterprise at Kennesaw State University. Hermanson is also an advisor to Oversight Systems and co-author of the COSO-sponsored research report *Fraudulent Financial Reporting: 1987-1997. An analysis of U.S. Public Companies*. “We could see very little corporate fraud in the next seven or eight years, but then another boom-and-bust economic period could ignite another wave of financial scandals, which would lead to further accounting and governance reforms.”

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Dana Hermanson
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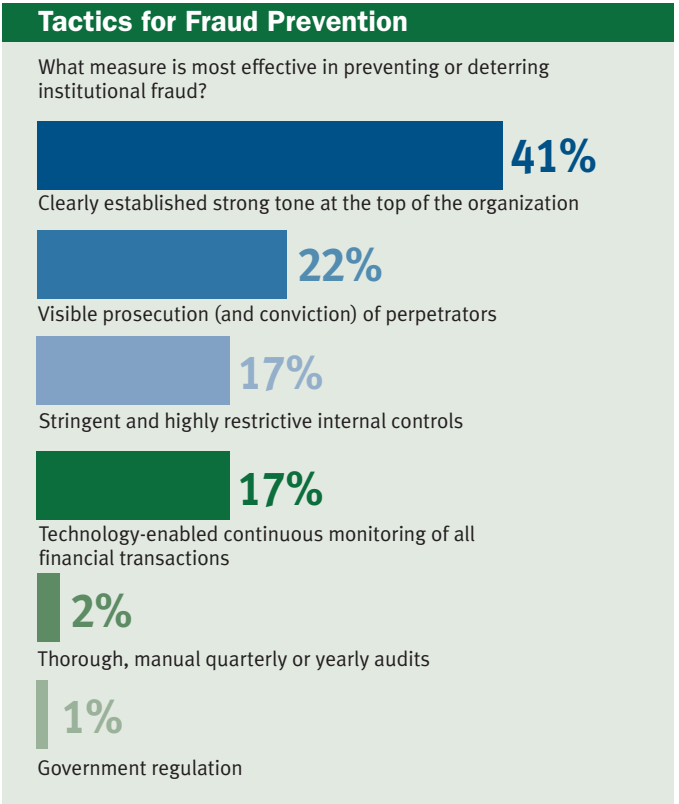
The Role and Views of Fraud Examiners

SOX has altered the role of fraud examiners. Nearly all participants (95 percent) explain that their duties have changed with the implementation of SOX legislation, with 47 percent reporting that fraud examiners play a major role in the management of corporate integrity. Additionally, nearly one-third (29 percent) of respondents feel their work in fraud detection has become secondary to SOX compliance.

Stopping Institutional Fraud

Forty-one percent of professional fraud examiners identified the need for a strong tone from the top of the organization as the most effective means in preventing or deterring institutional fraud. Visible prosecution was the next most popular response garnering 22 percent support, followed by internal controls and technology-enabled monitoring, each receiving support from 17 percent. Manual quarterly audits and government regulation received only minimal support, earning two and one percent, respectively (see: Tactics for fraud prevention graph).

However, when asked what single change would result in the greatest reduction of domestic institutional fraud, opinions were more mixed. An employer pressing charges against



employees who commit fraud garnered the most support with 39 percent. The trend of prosecution continued with 32 percent of respondents identifying convictions and hefty sentencing as the next most popular response. Moreover, an additional seven percent would like stiffer laws to increase corporate transparency.

“Stiff penalties and thorough prosecution send a strong message to employees. First, employees are less likely to go along with rogue executives who orchestrate financial reporting schemes. Second, a company’s prosecution of fraudulent employees establishes the corporate attitude that fraud will not be tolerated,” Hermanson said.

The State of Institutional Fraud

The findings discount skeptics who see fraud as no worse today than in previous years. Two-thirds of respondents (67 percent) said institutional fraud is more prevalent today than five years ago. Only seven percent think fraud is less prevalent, while the remaining 26 percent of respondents feel there has been no change in the amount of fraud (see: Institutional Fraud on the Rise).

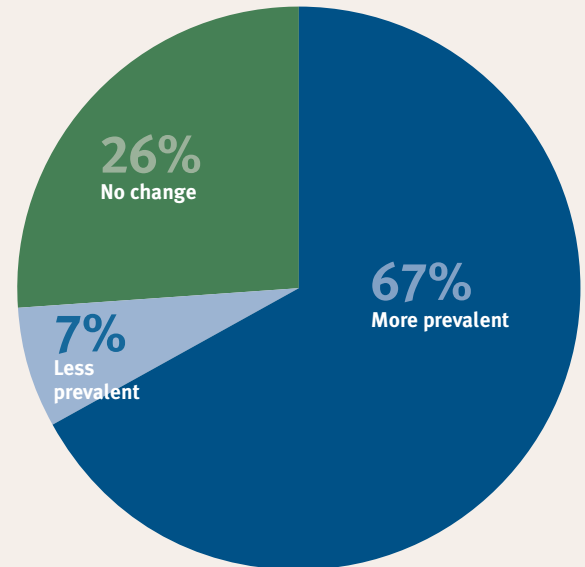
“The risk of financial statement fraud is real and not going away.”
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Participants were asked to select the three forms of institutional fraud that present the greatest risk to companies. Respondents identified conflicts of interest (63 percent), fraudulent financial statements (57 percent) and billing schemes (31 percent) as most threatening. Examples of fraud that garnered at least 20 percent support were expense and reimbursement schemes (29 percent), bribery/economic extortion (25 percent) and inventory and non-cash asset misuse (20 percent) (see: Risky Business graph).

“The risk of financial statement fraud is real and not going away,” Hermanson said. “However, the perception of increased fraud may stem from Sarbanes-Oxley’s effectiveness in

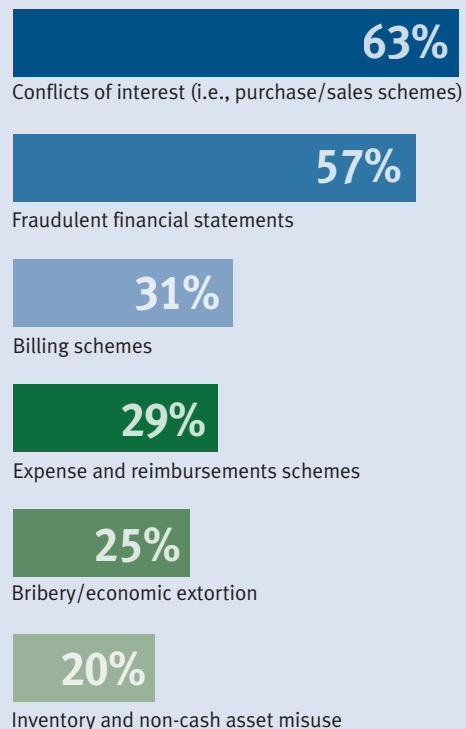
Institutional Fraud on The Rise

Do you think institutional fraud is more or less prevalent today than five years ago?



Risky Business

What specific types of institutional fraud present the greatest risk to companies today?



uncovering weaknesses in internal controls and the potential for fraud. SOX compliance gives auditors and executives a better position to evaluate a company's financial reporting system. Instead of only inspecting the outcome, financial reports, SOX forces companies to understand the financial reporting process as well. And like the manufacturing quality movement of the past, SOX pushes companies toward monitoring each step in the process to drive out errors and weaknesses."

Identity Theft Update

Identity theft is one of the more prevalent forms of fraud known by the average American. A February 2005 Federal Trade Commission report states that for the year 2004, the commission received more than 635,000 reports of consumer fraud and identity theft, with identity theft accounting for 246,570 of the complaints (39 percent).

Twenty-two percent of respondents think the justice system must get tougher on the identification and prosecution of identity thieves. Additionally, 19 percent believe that the federal government needs to pass national identity-theft-protection legislation and another 19 percent feel regulators and consumers must work together to manage consumer information.

Some respondents believe that individuals are the first and most important line of defense. Taking ownership of one's own personal information was identified by 16 percent of respondents as the best way to reduce identity theft.

About the 2005 Oversight Systems Report on Corporate Fraud

A total of 208 fraud examiners participated in this survey, conducted at the Association of Certified Fraud Examiners' (ACFE) 16th Annual Fraud Conference and Exhibition. Dedicated to reducing business fraud world-wide, the more than 34,000 members ACFE make up the world's premier provider of anti-fraud training and education. Survey participants include anti-fraud professionals such as internal auditors, independent auditors, law enforcement officials, investigators and management consultants.

Other Oversight Systems Reports

The 2005 Oversight Systems Financial Executive Report on Risk Management, found that CEOs are placing a greater emphasis on risk management, although many companies are struggling to implement the necessary changes.

The 2005 Oversight Systems Financial Executive Report on Sarbanes-Oxley, found that nearly half of financial executives feel the biggest issue related to compliance is the need to maintain the morale of the employees responsible for compliance.

The 2004 Oversight Systems Financial Executive Report on Sarbanes-Oxley, released in December 2004, showed that most financial executives were torn on the cost vs. benefits of Sarbanes-Oxley compliance, and it has been cited in the *Public Company Accounting Oversight Board (PCAOB) Release No. 2005-009*, a policy statement regarding implementations of auditing standards.

All these research studies can be downloaded for free by visiting www.oversightsystems.com/survey.

About Oversight Systems, Inc.

Errors in day-to-day financial transactions consistently result in adjustments, reversals and rework. Oversight Systems drives defect-free financial processes to eliminate these extra costly efforts. Increasing the quality of financial operations leads to accelerated, more accurate closes and validates policy compliance. Our software inspects each step of every financial transaction in real time for errors and control violations, so companies can address these issues when they are less complex and less costly to correct. For more information, visit www.oversightsystems.com.

EDITOR'S NOTE:

Camera-ready charts and graphs of the findings from the *2007 Oversight Systems Financial Executive Report on Corporate Fraud* are available by contacting Brian Boudreaux at Oversight Systems.

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