

The 2007 Oversight Systems Report On Corporate Fraud

Five years after the landmark Sarbanes-Oxley (SOX) Act took effect, a national survey of fraud examiners finds that three-quarters of respondents feel institutional fraud is more prevalent today than it was in 2002.

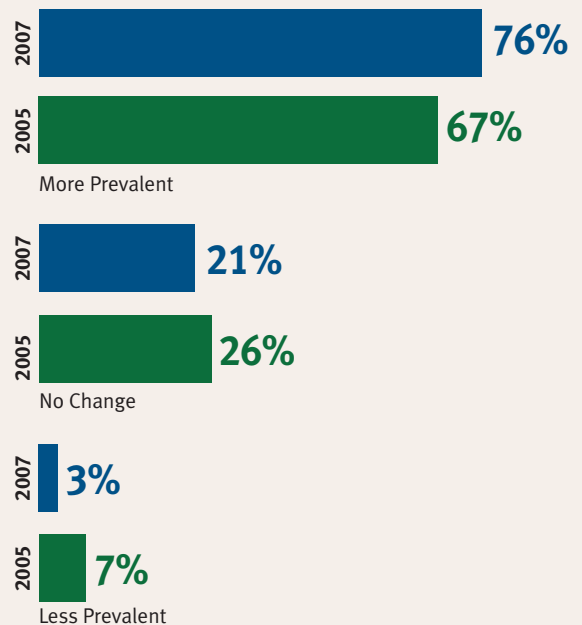
This significant finding is alarming because when asked to reply to the same query in 2005, merely two-thirds of respondents indicated fraud was more widespread over the preceding five years which included the stock market bubble of 2000 and the accounting scandals of 2002. Surprisingly, only three percent think fraud is less prevalent, while the remaining 21 percent of respondents feel there has been no change in the amount of institutional fraud (see: Institutional Fraud on the Rise).

The survey, which tracks the financial trends, risks and major fraud concerns businesses face today, was released by Oversight Systems. In addition to the perceived growth of institutional fraud, the 2007 report finds double-digit increases among respondents as to which fraud presents the greatest risk to companies. Forty-one percent identified expense and reimbursement schemes, up 12 percent, and 35 percent selected bribery/economic extortion, up 10 percent from 2005. Inventory and non-case asset misuse was also up seven percent with 27 percent of respondents reporting it of greatest risk. Frauds perceived to be less of a risk were conflict of interest, down seven points from 2005, but still identified by 56 percent of respondents and billing schemes, down 9 points to 22 percent.

The survey results indicate that an eye-opening 56 percent of respondents have personally observed financial misconduct in the past year. However, when asked how honest American business is today, 76 percent of those surveyed answered

Institutional Fraud on the Rise

All signs point to the increasing prevalence of institutional fraud as compare to five years ago. More than three-quarters of respondents felt fraud is more prevalent today, nearly a double-digit increase from 2005.



“generally honest.” One in five of the responding examiners felt U.S. companies were dishonest.

“This survey indicates the checklist approach to compliance is not effectively reducing fraud,” said Patrick Taylor, CEO of Oversight Systems. “By revising their guidance, the SEC is driving companies to address fraud based on risk, the greatest of which

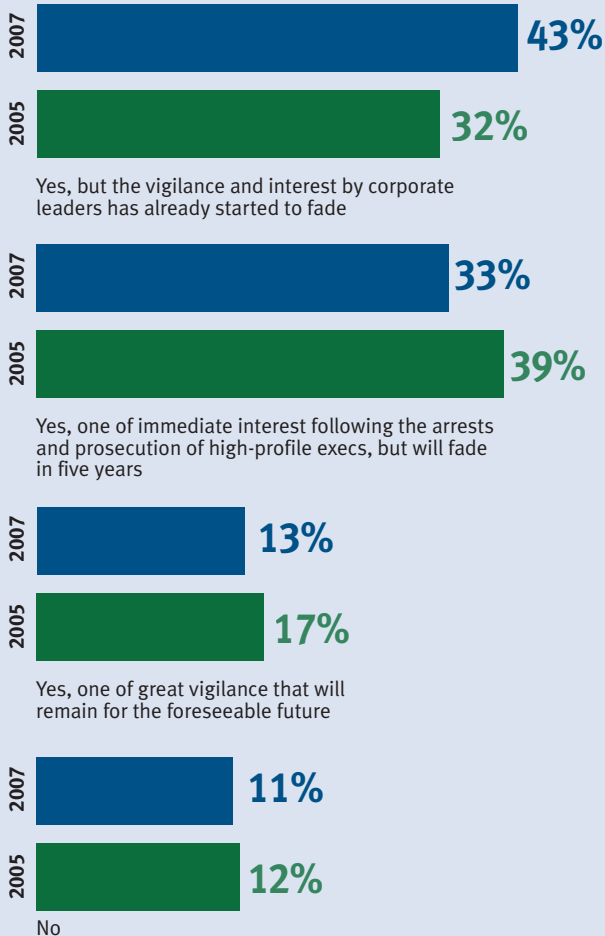
is management override of controls. Financial professionals will be able to evaluate their vulnerability and focus the full power of their monitoring and auditing capabilities on preventing the fraud that could cripple their business.”

The State of Fraud Prevention

In the wake of several corporate misdeeds and accounting scandals, Congress passed the historic SOX corporate reform act in 2002. Tracking perceived cultural change in U.S. business leaders toward integrity and fraud prevention five years later, more than one-third (43 percent) of fraud examiners indicated corporate vigilance and interest by executives has already started to fade. Just one-third of respondents indicated immediate concern by business leaders following the arrest and prosecution of high-profile executives, with fading interest over the next five years. Only 13 percent indicated a perception of great corporate vigilance with it remaining evident for

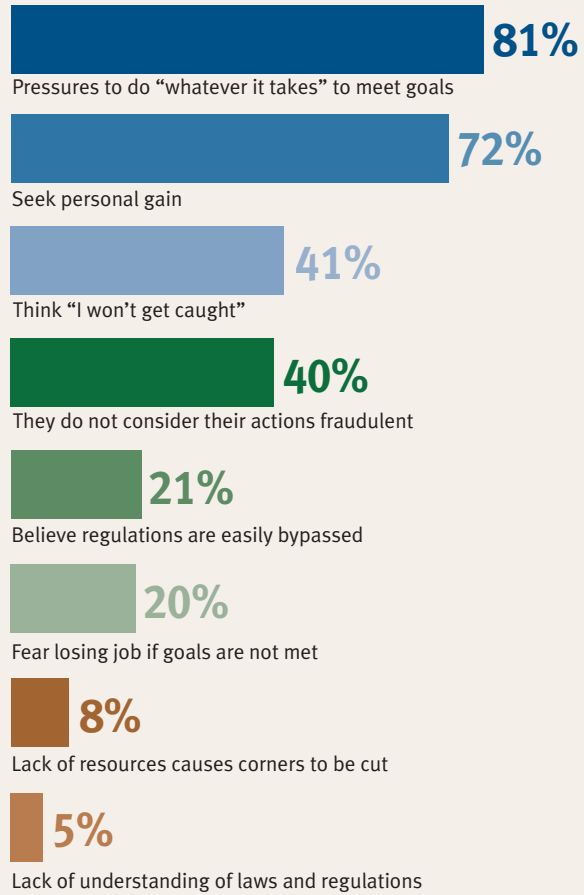
A Culture of Corruption?

Institutional integrity following the accounting scandals of 2002 has begun to fade. When asked if there is a cultural change in U.S. business leaders toward integrity and fraud prevention, executives answer as follows:



Reasons Why

When asked why executive fraud occurs, respondents overwhelmingly identify “pressure to meet goals” and “personal gain.”



the foreseeable future, while 11 percent saw no change in institutional oversight (see: A Culture of Corruption?).

Why Fraud Happens

Participants were asked to select the three main reasons institutional fraud occurs. Four out of five fraud examiners conspicuously chose the pressure “to do whatever it takes to meet goals” as the most common reason behind institutional deceit. Executives seeking personal gain was identified as another major cause of fraud (71 percent), followed by the mentality that “I won’t get caught” (41 percent) and the delusion that they do not consider their actions fraudulent (40 percent). Just five percent indicated that a lack of understanding laws and accounting regulations was a reason behind such fraud (see: Reasons Why).

“Culture is everything when it comes to fraud and fraud prevention,” said Dana Hermanson, Dinos Eminent Scholar Chair of Private Enterprise at Kennesaw State University. “If there is a culture of never missing targets, some people will cheat to make the numbers. Their rationalization is that they are just doing what the top people want them to do. Directors and executives need to clearly communicate that ethics come before making targets. If this message is not consistently communicated, then the organization is headed for trouble.”

Stopping Institutional Fraud

When asked to identify the measure most effective in preventing institutional fraud, 43 percent of the professional examiners identified the need for a strong tone from the top of the organization. Other deterrents included visible prosecution and technology-enabled monitoring, both receiving 15 percent support, followed by stringent internal controls. Whistle-blower protections garnered a notable 12 percent score in curbing fraud. Interestingly, traditional preventative actions including thorough quarterly/annual audits and government regulation barely registered any support as fraud deterrents (see: Leadership from the Top).

Paying the Penitence

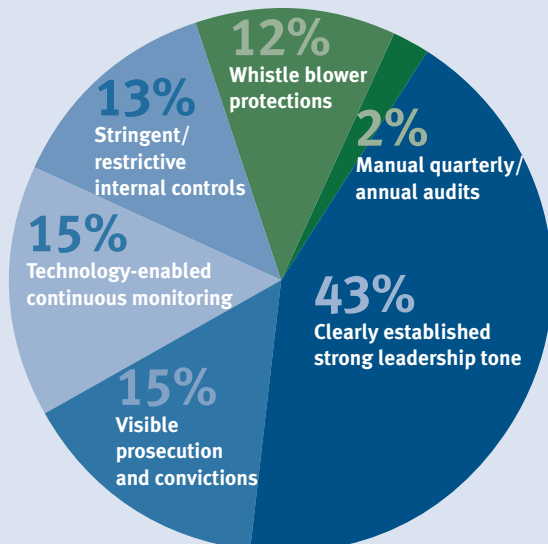
Following lengthy and high-profile court cases of several corporate executives during the past five years, the attitude of fraud examiners regarding the consequences of those guilty of deceit is stringent. Three-quarters of respondents felt corporate fraud would decrease if white-collar criminals were prosecuted and sentenced in the same manner as violent offenders with 79 percent supporting this stricter form of prosecution and sentencing of corporate wrongdoers.

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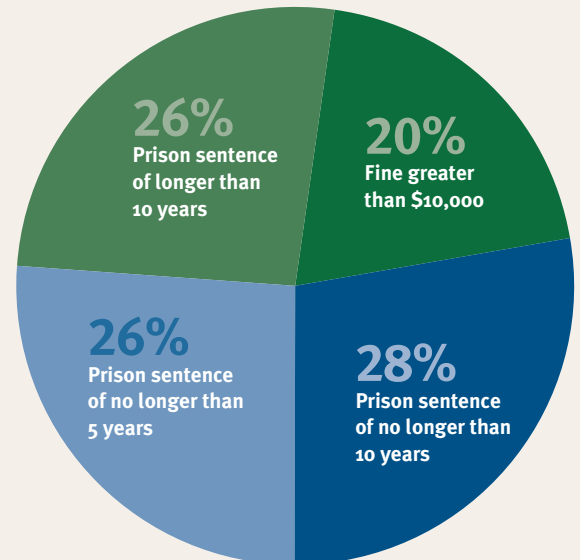
Leadership From The Top

When asked what measure is most effective in preventing or deterring institutional fraud, nearly half report company leadership is the most effective means. Interestingly, no respondents believe government regulations deter fraud.



Lock 'em Up!

When asked the appropriate punishment for executive stock option fraud, four out of five respondents would send crooked execs to the big house.



When asked which crime deserves a stricter punishment – either an executive defrauding shareholders through stock options fraud or a middle manager defrauding a company through accounts payable manipulation – the majority of examiners (58 percent) said they should be punished equally. All other respondents indicated the executive should receive the harsher penalty.

Stories about stock options fraud have become all too common. Although it is agreed that those committing the fraud need to be punished, respondents' opinion on the proper punishment is divided. Some 28 percent thought that a prison sentence of no longer than 10 years was fitting. Those feeling a prison sentence of more than 10 years, and those feeling less than five years in prison each garnered 26 percent support. Another 20 percent backed a fine of more than \$10,000 for executive stock option fraud (see: Lock 'em Up!).

About the 2007 Oversight Systems Report on Corporate Fraud

Through a combination of an invitation-only online survey and survey intercepts, 86 fraud examiners participated in this survey during late 2006. Survey participants include anti-fraud professionals such as internal auditors, independent auditors, law enforcement officials, investigators and management consultants.

This study follows the April release of the *2007 Oversight Systems Financial Executive Report on Sarbanes-Oxley*, which found executives were bullish on the use of continuous monitoring in SOX compliance. Also recently released was the *2006 Oversight Systems Financial Executive Report on Shared Service Centers*, a survey of financial executives that found more than half of respondents report their shared service centers are well short of achieving their operational goals.

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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