ERNST & YOUNG
Quality In Everything We Do

9th Global Fraud Survey

Fraud risk in emerging markets

Contents

Foreword

Ernst & Young has a strong tradition of contributing to the world's leading corporations' understanding of fraud. We know fraud to be a complex and constantly evolving subject that takes many different forms both within and between markets. Given the ongoing growth of globalization, our practitioners and multinational clients asked for greater insight on the different perspectives of companies on fraud between developed and emerging markets.

This report is the result of interviewing and listening to over 500 corporate leaders, including Chief Executive Officers, Chief Financial Officers, Chief Risk Officers, Internal Audit Directors, and business unit directors. They represent many of the world's major organizations.

Since our 8th Global Fraud Survey in 2003, corporations have expended significant resources to assess and improve their internal controls. The concentrated efforts of those charged with governance, internal and external auditors, regulators, law enforcement and others, have led to considerable progress in preventing and detecting fraud. Corporations believe that they are better positioned to deter and detect fraud than ever before.

Despite this belief, there is little evidence that clearly indicates fraud has reduced. In fact, one in five of the companies that we interviewed experienced significant fraudulent activity in the past two years.

Managers, in both developed and emerging markets, recognize local business practices and behavioral norms may differ in new markets from their historical experience and from those for which existing internal control systems were designed. Senior managers, regardless of location, express more anxiety about fraud risk exposure in emerging markets than in developed ones. Yet three-quarters of the fraud experienced by survey respondents has happened in their developed country operations.

Are companies looking at the correct risks? Are they taking the appropriate measures to address them? Our findings suggest that more must be done.

Fraud and its associated reputation risk continue to be a focus for businesses globally. We hope that this survey prompts discussion in your organization regarding the ways in which you can make anti-fraud measures more comprehensive, contributing positively to the pursuit of new opportunities in all markets.

This survey was conducted in 2006 on behalf of Ernst & Young's Fraud Investigation & Dispute Services practice. We would like to acknowledge and thank all respondents for their time and insights.

David L Stulb
Global Leader, Markets
Fraud Investigation & Dispute Services

Steven J Kuzma
Global Leader, Strategy & Operations
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Executive summary

Robust internal controls remain the first line of defense against fraud for companies in all markets, but anti-fraud controls are not always integrated under an anti-fraud program or separately monitored for operating effectiveness.

- Internal controls are still the most likely factor to prevent and detect fraud. Nearly 90% of respondents believed controls were sufficient within their organization to identify and investigate fraud promptly
- Half of the respondents now investigate fraud with a desire to identify and improve control weaknesses, marking a dramatic increase from the 8th survey
- However, over 40% of respondents are without a formal or documented anti-fraud policy, which is virtually unchanged from our last survey. Evidently, the focus on internal controls over financial reporting has not yet resulted in the adoption of formal anti-fraud policies.

Even companies that have anti-fraud programs could benefit from making these programs more comprehensive and extending them to all foreign operations.

- Most organizations acknowledge they don't communicate their anti-fraud stance and policies to agents, intermediaries and joint venture partners
- For up to a quarter of companies' foreign operations, the effectiveness of anti-fraud programs is limited by poor communication and/or insufficient training.

Developed country respondents are more likely to have suffered significant fraud at home or in subsidiaries in developed countries, and yet management admits greater unease about fraud exposure in emerging markets.

- Some 60% of respondents in developed countries believe their operations are at greater risk to fraud in emerging markets
- Of the respondents that recently suffered a significant fraud, 75% experienced a fraud in their developed country operations, while 32% experienced a fraud in an emerging market
- One in five respondents elected *not* to invest in certain emerging markets as a result of fraud risk assessments
- Over a quarter of respondents fail to consider anti-fraud measures explicitly when they invest in a new market.

Companies operating in emerging markets may be underestimating the risk of financial statement fraud.

- Respondents consider bribery and corruption as the greatest fraud risk in emerging markets
- Yet our experience demonstrates that managers can cause significant financial statement errors in business units at remote locations
- The move towards International Financial Reporting Standards (IFRS) will drive changes to accounting practices, particularly in emerging market countries. Where these standards negatively impact financial results, the risk of financial statement fraud may increase.

Organizations turn to local external specialists when there are allegations of fraud.

- One in three respondents would prefer to turn to external specialists where the fraud took place
- This preference may reflect the company's recognition that external advisors would have a better understanding of local laws and customs and an appreciation of the importance of independent investigators when a fraud may impact the financial statement, or when investigative findings will need to be shared with regulators.

Our findings

Internal controls need to be bolstered by formal anti-fraud policies

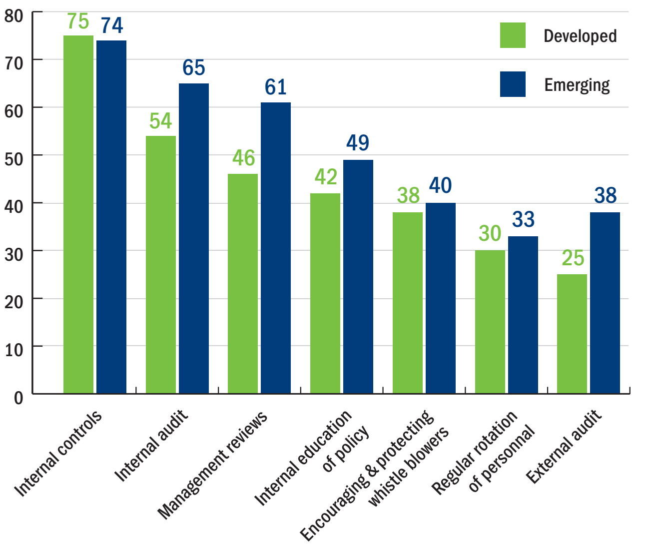
Fraud takes many forms, and, as we shall see later, perceptions of the most prevalent type of fraud vary in developed and emerging markets. For the purposes of this survey, we have organized the many possible fraud schemes into four general categories: internal fraud in collusion with third parties; corruption and bribery; financial statement fraud; and misappropriation of assets.

We asked company leaders to consider a set of factors important in fraud prevention, and to identify those most likely to detect fraud. Respondents in both developed and emerging market countries consistently identified internal controls as the key factor to preventing and detecting fraud (Figure 1). The survey findings indicate a response to regulatory requirements globally, and a continued focus on internal controls.

With the exception of internal controls, emerging market company respondents were consistently more likely than those in developed countries to have confidence in the effectiveness of these measures at preventing fraud – particularly internal audit, external audit and management review.

Confidence levels among developed country respondents reflect the recent headline-grabbing scandals in their home markets, where massive frauds were uncovered at previously well-respected companies. Overall, however, nearly 90% of respondents believe their internal controls are sufficient to identify and investigate fraud promptly.

Figure 1 Companies see internal controls as key to fraud prevention



Q: How likely are each of the following factors to prevent fraud? (High rating – % respondents giving 8, 9 or 10 on a 1-10 scale)
Sample Base: Respondents in Developed Markets (360), respondents in Emerging Markets (226)

“ Most important is a culture of internal controls starting from the top showing what controls are necessary to avoid fraud.”

Head of Internal Audit, Brazil

You can find perhaps the most startling evidence that senior managers have heightened sensitivity to the effectiveness of their internal controls in our respondents' views on the reasons for investigating fraud. In our 2003 Global Fraud Survey, investigating fraud was primarily driven by a desire to determine the extent of the fraud and bring an end to it, and to a lesser extent, to deter others and make financial recoveries. Today, managers are under no illusions as to where their exposure lies – given the same choices, over 50% now investigate fraud with a clear desire to identify and improve internal control weaknesses, hence, preventing future frauds. Other motivations are comparatively unimportant.

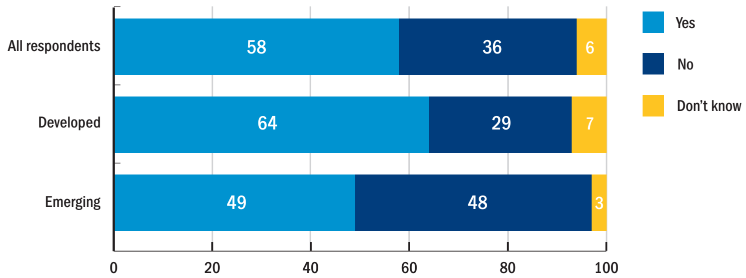
The focus on internal controls appears to have benefited companies across markets and industries, going beyond regulatory compliance to result in improvements to business processes and management. But we also believe that such controls are just one element of a company's comprehensive anti-fraud effort, you can not control fraud out of existence. A strong internal controls environment should also include a formal anti-fraud policy to maximize its effectiveness – a policy that is regularly communicated to employees, partners and suppliers around the world.

On a global basis, over 40% of companies do not have a formal anti-fraud policy (Figure 2). This finding varies somewhat among different company segments. Among larger companies, with revenues greater than U.S.$1bn, 29% do not have an anti-fraud policy; 18% of SEC registrants, regardless of size and location, do not have a formal anti-fraud policy.

Comparing these findings with our earlier survey indicates the prevalence of anti-fraud policies has not significantly increased since 2003 (Figure 3). At that time, 53% of respondents had formal anti-fraud policies, compared with 58% in 2006.

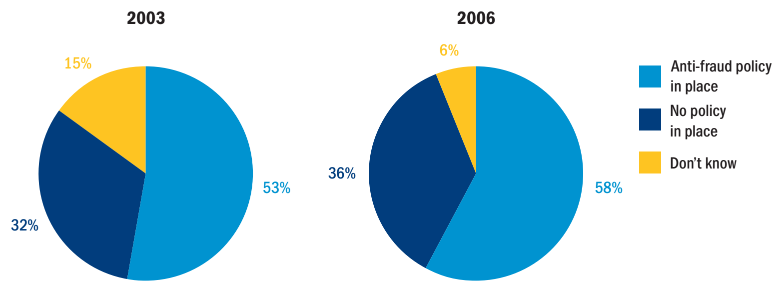
It is clear to us the implementation of corporate governance guidelines and the focus on internal controls has not automatically extended to the adoption of a formal anti-fraud policy. However, we have no evidence the focus on internal controls might have diverted management attention. Given the scale and growing complexity of fraud, the need to make fraud a priority in its own right remains.

Figure 2 Do companies have a formal anti-fraud policy?



Q: Does your organization have a formal or documented anti-fraud policy? (% respondents)
Sample Base: All respondents (586), respondents in Developed Markets (360), respondents in Emerging Markets (226)

Figure 3 Change in prevalence of anti-fraud policies over three year period



Q: Does your organization have a formal or documented anti-fraud policy?
Percentage of all respondents

A formal anti-fraud policy:

- is specific to the individual company and its operations
- guides employees through complex issues, including facilitation payments, commission fees, gifts and conflicts of interest
- provides a channel for employees or third-parties to report fraud
- establishes procedures to govern the escalation of fraud allegations, guiding important resourcing decisions.

A great deal of work remains to be done to better manage fraud risk in both developed countries and emerging markets by creating anti-fraud policies with appropriate standardized procedures. Ensuring compliance throughout the organization, and through vendor and customer networks, will prove beneficial.

Whistleblowers – how helpful are they?

- the worldwide debate continues regarding the importance of encouraging and protecting whistleblowers as an anti-fraud measure
- whistleblowers gained prominence in the U.S., playing a key role in the Enron and WorldCom scandals
- since 1987, thousands of whistleblower claims have been filed in the U.S. under the *qui tam* provisions of False Claims Act, with some $9.6 billion in settlements and judgments awarded to the U.S. Government
- healthcare and procurement fraud make up the vast majority of whistleblower claims
- for SEC registered respondents in our survey, a program to encourage and protect whistleblowers is considered to be the third most important factor in fraud detection
- however, among non-SEC registrants surveyed, whistleblower programs falls to sixth out of a possible eight fraud detection factors
- whistleblower hotlines have raised data privacy concerns outside the U.S.
- when whistleblowers complain of being discriminated against in the U.S., approximately 97% of their cases brought under the relevant Sarbanes Oxley Act provisions, and reviewed by the U.S. Department of Labor, were dismissed
- U.S. First Circuit Court of Appeals has ruled that Sarbanes Oxley Act whistleblower protections do not extend to foreign workers employed by overseas subsidiaries of U.S. companies.

42%

of companies do not have a formal anti-fraud policy

Anti-fraud policies need a comprehensive scope and global reach

Pressure, Opportunity, and Rationalization. The three sides of the widely accepted "fraud triangle" help illustrate how and why fraud is committed. Effective anti-fraud policies must address each of these factors, and should be tailored to the operations, both domestic and international, of the company concerned.

In their efforts to reduce fraud risk, companies have focused on limiting the opportunities for fraud by enhancing internal controls. Yet international expansion poses fraud-related challenges for corporations. The development of internal controls in new operations abroad can sometimes lag behind standards set in the home country. Different local business practices, particularly in emerging markets, make it particularly important for companies to consider the pressure and rationalization sides of the triangle.

Companies cannot afford to be satisfied with a program that exists merely on paper, or one that relies too heavily on anonymous hotlines. Indeed, since our last survey, respondents appear to place less reliance on whistleblowers as an anti-fraud measure, possibly reflecting a more comprehensive approach to anti-fraud programs.

Once a robust anti-fraud program is created, communicating the company's stance to employees and external business partners is critical. Corporate leaders have a responsibility to create the appropriate tone at the top of the organization, and to be prominent spokespeople for their anti-fraud program.

The "Fraud Triangle"

Many studies suggest that employees who commit fraud generally do so because there is opportunity, pressure, and rationalization.

A perceived **opportunity** for fraud exists when an employee believes they can override anti-fraud controls, for example, because the individual is in a position of trust or is aware of weaknesses in the control environment. Fraudsters can often **rationalize** their actions because they can justify to themselves the circumstances that allow them to commit a dishonest act. And even otherwise honest individuals can commit fraud in an environment that imposes sufficient **pressure** on them, whether this originates from sources inside or outside the organization.

This framework is a useful tool for those seeking to understand and manage fraud risks. It has been generally accepted by the auditing profession in its consideration of an auditor's responsibility for fraud detection.

Do anti-fraud policies cover third parties and intermediaries?

Given the increasing interest in anti-bribery and anti-corruption initiatives among regulators and law enforcement agencies worldwide, the risks facing corporations have never been greater. Government agencies in most European countries have gained additional legislative authority to conduct corruption investigations with the adoption of the OECD Anti-Bribery Convention. Regulators are now cooperating more effectively on both domestic and cross-border corruption investigations.

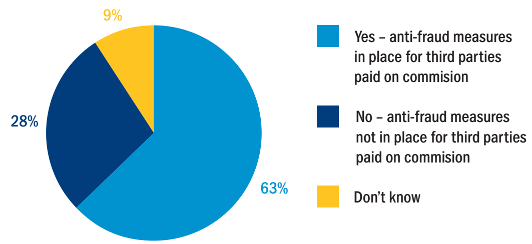
In the U.S., for example, the Department of Justice and the SEC cooperate closely on Foreign Corrupt Practices Act investigations. Both agencies have fostered strong ties to regulators and law enforcement agencies abroad. Public interest in investigating corruption remains strong in the U.S. and is growing elsewhere.

71%

of organizations who work with third party or intermediaries pay them on a commission or success fee basis – but under two thirds have specific anti-fraud measures in place to deal with the increased fraud and corruption risks associated with these arrangements

It is evident to many companies that working with third parties and intermediaries is critical to achieving growth in international markets. Competing for talented resources, particularly in emerging markets, often requires paying commissions or success fees. We see this confirmed in the survey results – more than 70% of companies pay intermediaries on this basis. Under two-thirds of these organizations have anti-fraud measures in place to manage these associated risks (Figure 4).

Figure 4 Anti-fraud measures need to be more comprehensive



Q: Does your organization have specific anti-fraud measures in place that apply to intermediaries or agents that are paid on a commission or success fee basis? (% respondents) Sample Base: All who pay third parties on commission basis (193)

“ We have to be sure that our suppliers are doing what they agreed to do, which is supplying us with the products that meet our specifications and that it’s done legally and ethically.”

CFO, Canada

Anti-fraud policies need to be communicated

Organizations with anti-fraud policies are communicating them to their own employees, but primarily in their home markets, with less attention to management and staff in emerging markets. Yet the risk from employees using differences in local business practices to rationalize the use of bribery – bribery they know is illegal in their home country – is significant.

Less than half of the companies with anti-fraud policies, however, communicate their fraud policies to their suppliers and customers, while even fewer communicate them to agents/intermediaries and joint venture partners (Figure 5). When, for example, a marketing promotion or sales effort by a third-party affiliate in an emerging market can eventually draw attention from home country enforcement agencies, the importance of extending compliance regimes throughout supply and distribution networks is clear.

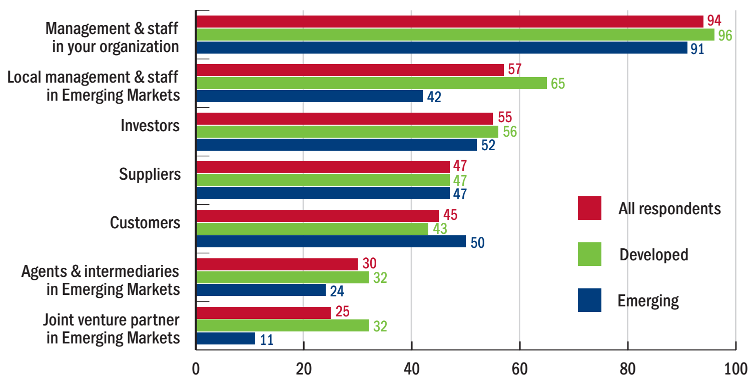
Our interpretation of these findings is that the majority of organizations should review the implementation of their anti-fraud policies to ensure they can protect their operations at all the key points where they are exposed to the risk of fraud, including suppliers and agents.

Training is fundamental to the success of an anti-fraud policy

By building on clear and consistent communication, training provides another key element in a company's fraud risk management program. A number of findings from the survey suggests more work needs to be done in this area (Figure 6).

Of all companies surveyed, alarmingly 72% do not provide their employees with training to understand and implement the organization's anti-fraud policy.

Figure 5 Majority of organizations fail to thoroughly communicate their anti-fraud stance

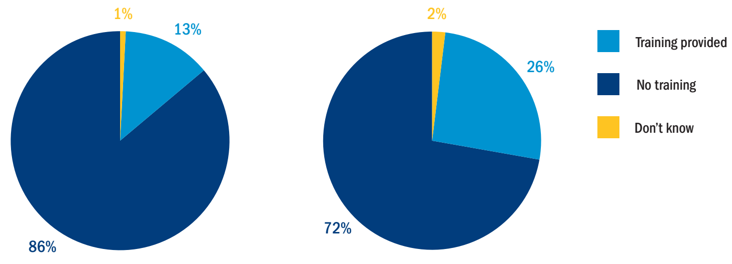


Q: Does the organization communicate its anti-fraud stance and policies to any of the following stakeholder groups?
Percentage of all organizations with a formal or documented anti-fraud policy (346), in Developed Markets (234), in Emerging Markets (112)

Figure 6

Are all employees trained on the difference between facilitation fees and corrupt payments?

Are all employees educated on anti-fraud policies?



Q: Are employees within your organization trained on the difference between facilitation fees and corrupt payments? (% of all respondents, 586)
Q: Are employees provided with formal training to help understand and implement the organization's fraud policies? (% of respondents with international links, 531)

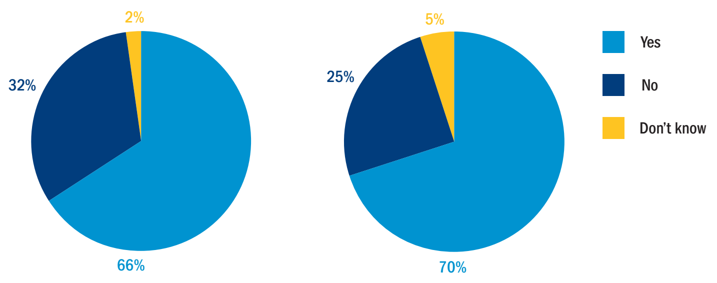
Yet even companies that commonly pay facilitation fees, and who have an anti-fraud policy that they communicate to management and staff, have much progress to make (Figure 7). Nearly one-third of companies regularly paying these fees fail to train their employees properly. And one-quarter of companies making the effort to communicate their anti-fraud policy to employees do not provide any formal training to help them understand and implement it.

Fraud is a complex issue, particularly against the backdrop of different markets, industry practices, cultures, national laws and regulatory regimes. It is essential for an organization to identify its view of appropriate ethical behavior and provide guidance to employees. Even where guidance is codified or based on principles, documents alone are rarely sufficient to ensure employees understand and comply with the policy.

Figure 7

Where facilitation fees are common practice, do employees receive anti-fraud training?

Where organizations communicate anti-fraud policies to their people, do they also provide training on how to implement them?



Q: Are employees trained on the difference between facilitation fees and corrupt payments (% respondents where facilitation fees are common, 117)
Q: Are employees provided with formal training to help understand and implement the organization's anti-fraud policies? (% of respondents communicating policies to local management and staff, 200)

Appropriate guidance should deal with examples and situations typical to the activities of the corporation and its operations. For example, while some countries and corporations make no distinction between a facilitation fee and a bribe, some corporations do. The distinction is not always readily apparent, yet 86% of companies that paid facilitation fees do not provide this policy for employees.

Developing a formal anti-fraud policy, therefore, is only the first step towards protecting a company's operations and reputation. To be relevant and effective, companies must clearly communicate their policy to all appropriate stakeholders, and further supplement it with quality training and support mechanisms, such as help lines.

"We also need to help employers build ethics and integrity. Codes of conduct and conflict of interest statements are often created but seldom tailored to a particular workplace. Once people truly understand how codes apply to them, to their work and their behavior, they are better able to embrace and implement them."

Huguette Labelle, Chair of Transparency International

Perceptions of fraud in emerging markets

“ *Our greatest risk lies in rapid growth in emerging markets, combined with immature fraud prevention and detection systems, and only a limited understanding of fraud risks.*”

Head of Internal Audit, Canada

26%

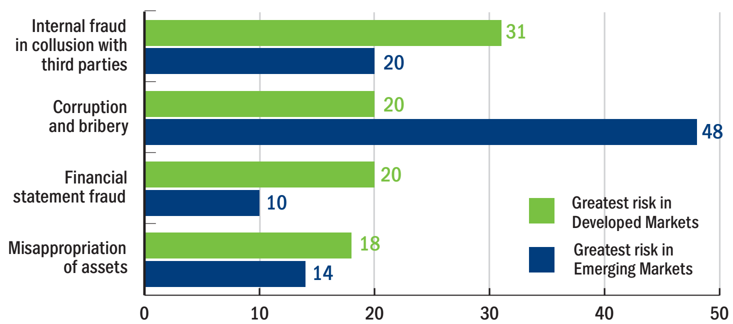
of companies globally describe fraud as prevalent in their business sector

On a global basis, a quarter of our respondents believe fraud is prevalent in their own business sector. Respondents from emerging markets think fraud is slightly more prevalent than their developed country counterparts: 31% say that it is extremely or fairly prevalent in their sector, compared with 23% in developed countries.

Respondents identified the types of fraud they considered to hold the greatest risk to their organization. Respondents from developed markets see the greatest risk as coming from within the organization, whether through collusion, financial mis-statement or theft. The greatest risk identified in emerging markets, however, is corruption and bribery; almost 50% identified this as the most threatening, followed by internal collusion with third parties (Figure 8).

We asked respondents from developed and emerging markets to identify where the greatest risk of fraud was in their organization. Both developed (60%) and emerging market (86%) companies told us this risk lies primarily in emerging markets – the higher finding from emerging markets suggests the risk of fraud in emerging markets is even more significant than developed country respondents perceive (Figure 9).

Figure 8 What types of fraud pose the greatest risk in Emerging Markets?



Q: Which of the following types of fraud do you consider to be the greatest risk to your organization?
Percentage of all respondents (586)
‘Other’ and non-responses not shown

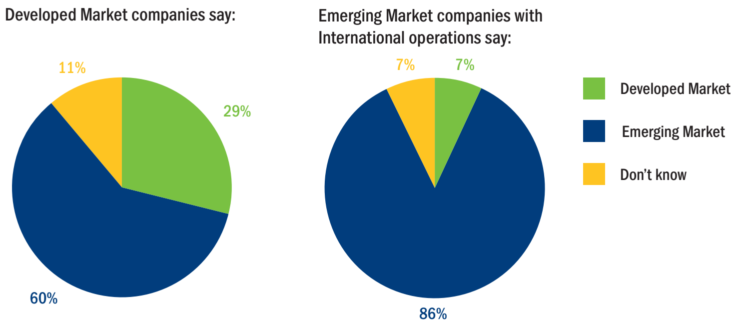
Is there a perception gap about fraud in emerging markets?

Our survey found nearly 20% of respondents had suffered significant fraud in the past two years.

However, our findings indicate developed country companies with links to emerging markets actually *experience* fraud more in their home market than elsewhere. We asked those respondents, whose companies had experienced a significant fraud, where the fraud took place. Some 75% of these had experienced fraud at home, while 32% had experienced fraud in an emerging market.

Is there more fraud in developed markets or does this apparent ‘gap’ between perception and experience suggest effective anti-fraud policies implemented in developed countries have not yet been properly introduced to overseas operations? It could be argued the implementation of more robust policies in these markets would have led to more fraud being detected, and a consequent narrowing of the ‘gap’. Expanding the geographic reach of these policies is essential both to reduce fraud risk and increase the likelihood of timely detection.

Figure 9 Material fraud is perceived to be most likely to occur in Emerging Markets



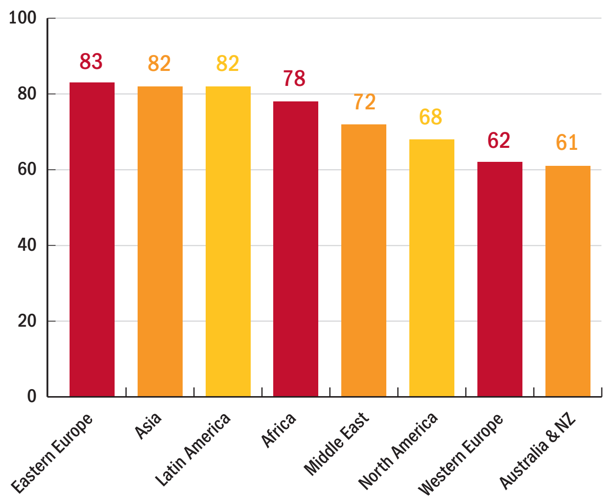
Q: In which of the following areas of your organization globally, would material fraud be most likely to occur?
Percentage of all respondents in Developed Markets (360), respondents in Emerging Markets with International Operations (171)

Fraud in emerging markets – a hidden cost of investment

For many companies, growing their emerging market operations is not a choice; it is a necessity. Many organizations make investment decisions based on multiple criteria, and now include fraud risk among them.

We asked respondents whether or not they consider anti-fraud measures when they enter a new market. Overall, approximately a quarter of organizations entering a new market do *not* specifically address fraud risk as part of their decision-making process. In our view, this is an omission with potentially serious consequences. Fraud risk needs to be included as an essential element in the overall risk assessment for major investments, particularly across borders.

Figure 10 Anti-fraud measures are most likely to be considered for market entry in Eastern Europe, Asia and Latin America



Q: For which markets are anti-fraud measures explicitly considered?
Percentage of respondents who consider anti-fraud measures when entering a new market (390)

Indeed, our survey found that one in five organizations has made a decision *not* to invest in an emerging market as a result of a fraud risk assessment. Overwhelmingly, it is the respondents with a formal worldwide anti-fraud policy who have walked away from a potential investment following an assessment of the fraud risk.

Those companies we asked to identify the particular regions in which they considered these measures. Again, we see the greatest attention being given to investments in emerging markets, where risks are perceived as greater or, at best, less well understood (Figure 10).

Those companies entering new markets without the benefit of a fraud risk assessment, have a greater need to apply anti-fraud policies to prevent and detect fraud. However, as you might expect, we found those very organizations without a formal anti-fraud policy are more likely to enter a new market without considering fraud risk. Companies promoting an anti-fraud policy are almost twice as likely as those without one to include the fraud risk as part of the market-entry decision.

> *"We have more tools that allow us to know the developed countries in a better way. Therefore, when we enter a new market, we need more analyses and should spend time gathering the information we need. We simply need to take more preventative steps."*
>
> Head of Legal, Italy

27%

of respondents in organizations with links outside their home market do not yet consider anti-fraud measures when they enter a new market

Financial statement fraud in emerging markets – an underestimated risk?

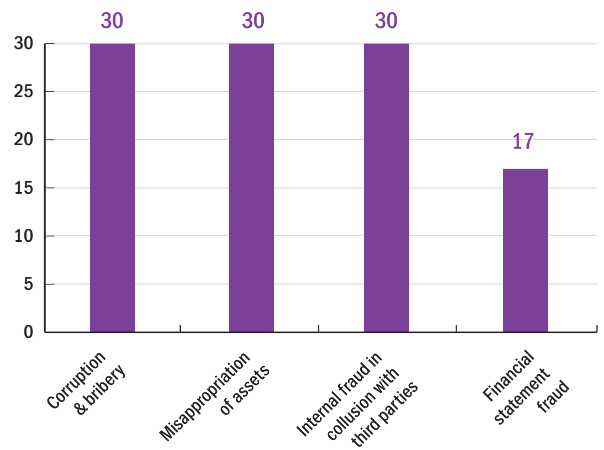
> *" Due to the underdevelopment of a risk management policy, local governance and regulations, we could be in a situation of the financial statements not reflecting the correct data."*
>
> Head of Accounts, Singapore

While occurring less often than other types of fraud, financial statement fraud frequently does the most harm to organizations. Respondents to our survey suggested risk from this kind of fraud was much more prevalent in developed countries than in emerging markets.

In Figure 8, on page 10, we see the risk of financial statement fraud is not the top priority for our respondents. Developed country companies tell us this type of fraud rates lower than internal collusion with third parties and on a par with corruption and bribery. For emerging market companies, financial statement fraud ranks behind other types of risk.

We also see financial statement fraud is taking place less frequently than other types of fraud in emerging markets. In absolute numbers, the instances of corruption or asset misappropriation in emerging markets far exceeded those of financial statement fraud (Figure 11).

Figure 11 Types of fraud taking place in Emerging Markets



Q: Which of the following types of fraud was the most significant to have taken place in Emerging Markets during the last two years? (% respondents)
Percentage of all who have experienced fraud in the last 2 years in Emerging Market or home country (61)

Are corporations underestimating the risk of financial statement fraud?

We believe these findings underestimate the risk of financial statement fraud. Management at local operating units in remote locations may feel pressure to report inaccurate results, have the opportunity to do so, and find it easier to rationalize. This practice may continue for some time before the inaccuracy is detected and may result in accumulated amounts that are material to the parent.

The findings resulting from internal investigations into this type of fraud can have a significant impact on prior conclusions relating to the effectiveness of internal controls over financial reporting, and can pave the way for class action litigation in some countries. Settlement costs can be staggering.

Compliance with increasingly complex accounting standards remains an issue, given the close attention given by regulators and investors. The U.S. registrants with international operations are well aware of the SEC's scrutiny of their international business units' compliance with U.S. GAAP. Foreign registrants are also reporting a close examination by the SEC of their reconciliations to U.S. GAAP.

In the rest of the world, IFRS implementation is a very positive step for investors and other capital-market participants. But, where the transition from local GAAP to IFRS might negatively impact a subsidiary's historical results, there is a real possibility leaders of local operating units could feel pressured to misinterpret or partially apply certain standards to bolster their results. Financial statement fraud risk may be higher during the transition than in the past. Effective accounting training in the new standards within the organization, particularly for finance professionals, along with testing of compliance will be critical.

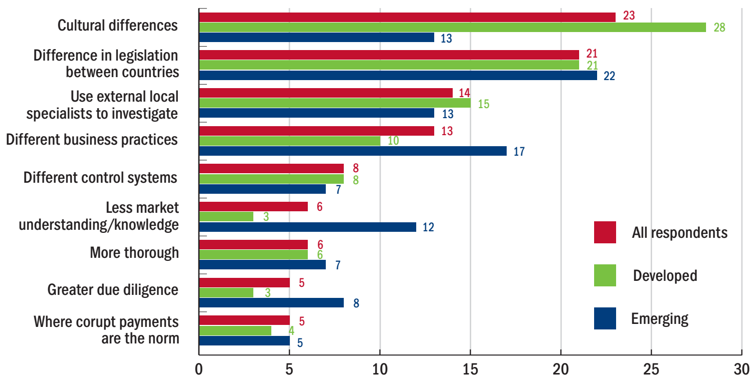
Approaches to fraud investigation in emerging markets

Just as the types of fraud differ across markets and industries, how to conduct an investigation is also influenced by where it takes place. Nearly 40% of companies use a different approach for investigating fraud in an emerging market than in a home market. For developed country companies, the key factors are differences in culture and legislation, as well as the preference for local external specialists. For emerging market companies, differences in legislation are the most important factor, followed by the need to take different business practices into account (Figure 12).

The importance of independence

When asked to identify how they would conduct a fraud investigation outside their home country, developed country respondents said they prefer and turn to external specialists in the country where the fraud occurred. This preference may reflect the belief that external advisors have a better understanding of local laws and customs, and an appreciation of independent investigators when a fraud may have financial statement impact, or when companies need to share investigative findings with regulators.

Figure 12 How is the approach to fraud investigations different in Emerging Markets?



Q: In what ways, would the approach be different?
Percentage of all organizations with differing approaches (201), in Developed Markets (131), in Emerging Markets (70)
This chart represents spontaneous responses to an open-ended question

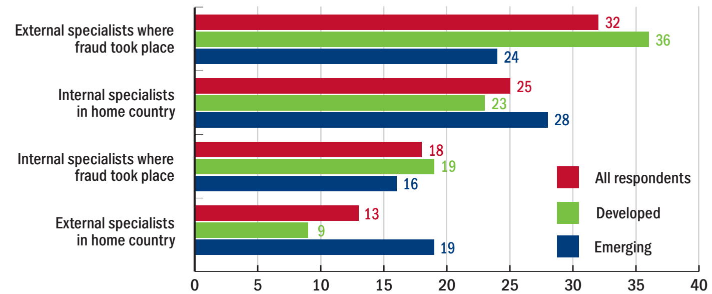
“The key fraud risk challenge in emerging markets is financial statement fraud. In an emerging market, companies tend to influence investors by showing wrong financial statements, inflating market prices so that they make more money.”

CFO, India

Among the other options, deploying internal specialists is the next most preferred resource. This is understandable given companies’ interest in getting a quick understanding of the scope of the problem, while also controlling expenses (Figure 13).

Allegations of fraud are dealt with in a more consistent and measured manner where escalation criteria are clearly set out. Some allegations may appear immaterial in amount but have a significant impact on the reputation of the company, particularly when associated with senior management. The level of escalation would determine the make up of the investigation team.

Figure 13 How do companies use specialists to investigate fraud outside the home market?



Q: In response to fraud incidents in countries outside the home market, which type of specialist advisors and investigators would you typically prefer to use?
Percentage of all organizations that have international links (531), in Developed Markets (360), in Emerging Markets (171)
Non-responses not shown

In many instances, asset misappropriation or embezzlement could and should be handled by corporate internal audit or security, often with support from the internal legal department. Factors in deciding whether or not to have external legal and accounting professionals in the team include balancing the availability and organizational familiarity of internal resources against the independence, incremental cost, and enhanced credibility of external resources.

When the alleged wrongdoing could have a financial statement impact, independent investigative resources may be more appropriate, especially for public companies, and those in highly regulated industries.

Challenges for the future

We asked respondents to comment on the key challenges facing their organization over the next two years in relation to fraud risk in emerging markets. In their own words, they addressed the main themes of our survey, including the need for strong internal controls, anti-fraud policies, the importance of communications and training, the risks from third-party relationships, and above all, the recognition that the risk of fraud requires a tailored, considered approach in emerging markets.

Internal controls and anti-fraud policies

"The implementation of global policies against illicit acts, and the maintenance of internal control systems."
CFO, Brazil

"Ensuring adequate controls are in place, which are all encompassing. Making sure you employ the right people."
CFO, South Africa

"To keep growing the market, it is equally important to have good internal controls and a process of detection of fraud."
Business Unit Director, India

"To manage growth within the industry while making sure that the policies permeate the industry and the people."
CEO, Netherlands

"To implement better fraud detection controls."
CEO, Mexico

Communications, training

"To uphold an 'it's not acceptable' culture ."
Head of Accounts, South Africa

"To provide clear guidelines which apply to all markets."
CFO, Sweden

"To train and increase the awareness amongst the people in the emerging market about the potential occurrence of fraud."
CFO, Hong Kong

"Educating our staff on how to prevent fraud is a priority, particularly key staff who handle business transactions."
Head of Corporate Development, Singapore

"Prevention through training through higher and middle level staff."
General Counsel, Poland

"To educate and bring out an awareness of fraud to minimize the risk."
Head of Legal, India

"To have more transparent procedures in our business relationships with clients. To think globally and act locally."
CFO, Italy

"Internal education not being proper; and internal people taking chances. Detect it early enough to prevent fraud."
CFO, South Africa

Third-party relationships

"Agents and joint ventures – there is the potential of corruption and bribery. The countries we deal with tend to be high on the corruption index of Transparency International."
Compliance Officer, U.S.

"Control is becoming less easy due to more delegation to intermediaries."
Head of Accounts, France

"Credibility of information about contractors, about the financial situation of clients."
CFO, Poland

"Risk lies in some kind of connection, i.e. corruption, between your own people and suppliers in emerging markets."
Head of Internal Audit, Sweden

Addressing differences in local business practice

"Having a good understanding of the way in which business works in those markets. Going in with your eyes open."
Finance Controller, Australia

"To be clear in where we stand on these issues and to make adjustments to each country's cultural traditions and rules."
CEO, Sweden

"Not being there or understanding the language and culture. We don't know what business is like there. What might be good intentions on their part might not be done in Canada."
CFO, Canada

"Adopting to local methods and being locally aware."
Finance Controller, UK

"Being unfamiliar with the economic situation of another market."
Business Unit Director, China

"We have to function in cultures that are sometimes very foreign. To harmonize the company policies with local practice is our main challenge."
Head of Legal, Denmark

Going forward

Fraud remains an issue for global capital markets. Among our respondents, one in five experienced a significant crisis in the last two years.

Yet the drive for growth among the world's leading corporations will always lead to new markets, some particularly fraught with risk. Managing those risks is critical to success.

Fortunately, leading fraud risk management practices are emerging. Our survey results underscore what our experience has taught us:

- Building upon the focus on internal controls, companies should integrate anti-fraud controls into a formal, documented anti-fraud program
- 'Paper programs', existing only in their documentation, are of no use – compliance and enforcement are key
- An effective anti-fraud program aligns closely with the most significant fraud risks faced by an organization
- Companies should move from mere notification and education of policy and standards, toward a corporate culture that lives its ethical values worldwide – tone at the top is crucial
- Anti-fraud controls limiting the opportunity for fraud in established operations need to be implemented quickly in new operations in emerging markets, where differing local business practices raise the importance of focusing on the pressure and rationalization sides of the fraud triangle
- Establishing criteria to govern the escalation of allegations of fraud helps to assure the appropriate oversight and composition of investigative teams

These leading practices should form a critical element of your comprehensive approach to risk management. Being transparent to internal and external stakeholders about the risks faced and how your company handles them has never been more important.

Risk management, including the approach to managing fraud, has clearly become part of the essential fabric of the corporate governance structure, and we hope that this 9th Global Fraud Survey contributes to the dialogue on these important issues within your company.

"Firms need to continue to manage their responses to fraud in order to avoid being targeted as the weakest link."

Philip Robinson, Financial Crime Sector Leader, Financial Services Authority, UK

Survey approach

From February through April 2006 our researchers[1] interviewed senior decision makers in large organizations. The sample was structured to include respondents from key parts of the company including finance risk, internal audit and business unit leaders.

Interviews were conducted across 19 countries. In the survey analysis, eight of these countries have been considered to be emerging markets: Brazil, China/Hong Kong, India, Mexico, Poland, Russia, Singapore and South Africa.

In emerging market countries, interviews were conducted with companies that were both headquartered in the country and subsidiaries of foreign companies. Of those respondents that were located in an emerging market and headquartered in another country, 92% were not registered with the U.S. SEC.

Respondents from developed country companies were qualified to ensure that their organizations had operations or business links in an emerging market.

* For the purposes of this report, the findings for Australia, Canada and India have been weighted down to achieve consistent representation with comparable markets.

Job Title	Respondents
CFO/Financial Director	158
Head of Internal Audit	79
CRO/Risk Manager	69
Head/MD of Business Unit	38
CEO	28
Head of Accounts	28
Head of Legal	24
Finance Manager	23
General Counsel	22
Financial Controller	21
Security/Fraud Officer	15
Head of Audit	12
Treasurer	9
Tax Director	7
Compliance Officer	7
Head of Marketing	7
Head of Corporate Development	6
CIO	5
COO	3
Company Secretary	3
Other Senior Management	22
Total	**586**

Region/Country	Respondents
Americas	160
Brazil	25
Canada*	50
Mexico	25
USA	60
Europe and Africa	276
Denmark	25
France	25
Germany	25
Italy	25
Netherlands	25
Poland	26
Russia	25
Sweden	25
Switzerland	25
South Africa	25
UK	25
Asia	150
Australia*	50
China & Hong Kong	25
India*	50
Singapore	25
Total	**586**

[1] The telephone based survey was conducted by Taylor Nelson Sofres.

Industry Sector	Respondents
Retail and Wholesale	94
Diversified Industrial Products	83
Banking and Insurance	71
Asset Management	53
Consumer Products	40
Oil and Gas, Chemicals	37
Services	37
Technology, Telecoms and Entertainment	35
Automotive	26
Biotechnology and Pharmaceuticals	20
Transportation	19
Construction	18
Mining	12
Utilities	12
Real Estate	11
Other	18
Total	**586**

Sales	Respondents
$5 billion plus	53
$2 billion-$5 billion	74
$1 billion-$2 billion	71
$500 million-$999 million	86
Below $500 million	272
Revenue not reported	30
Total	**586**

Contact information

The Ernst & Young Fraud Investigation & Dispute Services practice has global reach. See below for a list of our country leaders. For more information, visit **www.ey.com/fids**.

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