

# Audit Committee Brief



## *Fraud, Corruption and the Audit Committee: Protecting Reputation and Value*

Imagine two similar companies that are publicly alleged to have engaged in a significant incident of fraud or corruption, such as bribery of foreign officials.

Company A takes a proactive approach to managing fraud and corruption risks, has world-class—but not infallible—antifraud and anticorruption processes, has a good relationship and strong record with its regulators, and has robust plans in place to investigate potential wrongdoing and to implement crisis communications to help protect the company's reputation.

Company B takes a reactive approach, is confident in its ability to deal with issues as they arise, and is a follower rather than a leader in implementing risk management and antifraud and anticorruption processes.

As an investor, which company would you believe better protects your investment? From an audit committee member's perspective, which company would you judge better able to demonstrate that you have fulfilled your duty of care as a director?

Of course, there is no guarantee that a better-prepared company will experience a more favorable outcome than one that chooses a reactive approach. But experience suggests that companies that manage their risks proactively may be less vulnerable to having their reputations harmed by allegations of wrongdoing, falling behind in the news cycle of reactions, and losing the support of regulators, customers, suppliers, investors, the general public, and even politicians.

Global media and the Internet enable news to travel faster and reach more people than ever before. The international nature of business and growing collaboration among regulators worldwide can expose companies to a greater number of regulatory regimes. These factors may increase both the likelihood and the potential impact of alleged wrongdoing on a company's reputation and shareholder value. Audit committee members may want to consider how their company manages its risks of fraud and corruption and whether today's risk environment merits a more proactive approach.

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“Protecting your entity’s reputation, value, and ability to operate may require antifraud and anticorruption processes that aim higher than the lowest permitted level (mere compliance).”

*Toby J. F. Bishop*

*Director, Deloitte Forensic Center  
Deloitte Financial Advisory  
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## Ten areas the audit committee can evaluate that may help mitigate reputational risks of fraud and corruption

There are many ways the audit committee, assisted by internal auditors or advisers, can seek to help management and the board of directors mitigate reputational risks that could arise from alleged fraud, bribery, or corruption. Below, we outline 10 items that can help the audit committee gauge the company's sophistication in this area and assess the scope for improvement.

### ***Integrating risk and strategy***

When risks and rewards are considered separately, it may be easier for those pursuing growth to omit or diminish consideration of reputation and compliance risks. Holding senior and operating management responsible for considering risks and balancing them with potential rewards can foster wise risk-taking. Does management consider risks in developing and implementing the company's strategies and business plans?

### ***Crisis management planning***

Has the company developed a crisis-management plan to react to allegations of major fraud or corruption? Does that plan include assigned responsibilities for management and advisers to help drive actions and communications that will sustain confidence? These plans can be valuable in implementing a robust response to allegations under severe time pressure and intense scrutiny from the media, regulators, investors, and law enforcement.

### ***Comprehensive risk assessment***

Risk assessment is the foundation on which effective antifraud and anticorruption processes are built. Does management conduct, document, and update an assessment of fraud and corruption risks periodically (typically annually)? Can management explain key fraud and corruption risks that may affect the company's reputation?

### ***Risk tolerance and mitigation planning***

Does the board understand management's level of overall risk tolerance and its level of risk tolerance for fraud and corruption specifically? Has the board determined its level of risk tolerance for these matters? Having the board determine risk tolerance is not easy, and the practice is not yet widespread, but if the board has done so, to what extent does it correspond to management's level? Are efforts to mitigate these risks designed to bring them within the risk tolerance level? Incidents of major fraud and corruption may indicate a gap between the risk tolerance level of the board and that of management, or between that of executive management and line personnel.

### ***Managing performance and compensation***

Is effective risk management an explicit element of performance assessment and compensation for executives and managers? Holding senior executives and line management accountable for managing ethics, compliance, and the fraud and corruption risks within their area of responsibility is likely to be more effective when it influences their compensation. This can be evaluated using objective measures, such as the results of an assessment by the internal audit function.

### ***Evaluating the tone at the top***

Does the audit committee evaluate employees' perceptions of the tone at the top periodically (leading practice is annually), using techniques such as an employee survey? A professionally designed and independently administered survey may serve as an early warning system, alerting the audit committee to a tone that falls short of its expectations. Deloitte's [June 2011 Audit Committee Brief](#) discusses this in more detail.

### ***Whistleblower system benchmarking***

Does the audit committee review an evaluation of the whistleblower system that benchmarks its performance against industry-specific statistics? A benchmarking analysis may help identify an underperforming whistleblower system, enabling remediation. In our experience, below-average use most often arises in hotlines that are not effectively communicated to employees and other potential users, or where users lack confidence that reports will be addressed appropriately without retribution.

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## Recent News

On June 21, 2011, the PCAOB issued a [concept release](#) to solicit public comment on potential changes to the auditor's reporting model. The concept release discusses several alternatives to supplement the current auditor's report and to "increase its transparency and relevance to financial statement users." These alternatives are not mutually exclusive, and a revised auditor's reporting model "could include one or a combination of these alternatives or elements of these alternatives."

The PCAOB is seeking public comment from issuers, audit committees, and other interested parties on potential changes to the content and form of the auditor's report on financial statements. In addition, the PCAOB may, on the basis of the comments received, consider other ideas that are not addressed in the concept release. Comments on the concept release are due September 30, 2011. The alternatives presented in the concept release and the changes resulting from this process could significantly alter the auditor's report and the role of the auditor. For additional information, please read the June 28, 2011, issue of Deloitte's [Heads Up](#).

## **Leveraging transaction monitoring and data mining**

Has the company implemented computer-assisted transaction monitoring and data mining targeted at its key fraud and corruption risks? These tools are especially valuable in entities with a large volume of transactions and potentially high-impact fraud and corruption risks, such as violations of the Foreign Corrupt Practices Act or the U.K. Bribery Act that became enforceable on July 1, 2011. Today's technology, combined with skilled evaluation of anomalies, can enhance deterrence and detection capabilities in this area significantly.

## **Regulatory relationships**

Does the company have a good relationship with regulators, such that regulators may be more supportive if the company has to investigate alleged wrongdoing? Companies of all sizes are vulnerable to additional costs, restrictions on operations, or potential shutdown if regulators decide they cannot be trusted to investigate themselves. A cooperative relationship and a strong record with regulators can help avert turning a serious allegation into a regulatory crisis.

## **Investigative resources and protocols**

Financial investigations often involve locations on the other side of the world, involving a different language, different laws, and a different culture. Predetermining investigative resources and protocols can speed an investigation and also help reduce the risk of ineffective investigations. Has the audit committee identified in advance the legal, computer forensics, and forensic accounting resources needed to conduct internal investigations into serious allegations that may arise wherever the company operates? Has it approved a set of investigation protocols to help avoid reputational risks that can arise from inappropriate investigation methods? Do the company and its whistleblower system operator have a process to identify the correct parties to notify internally for different types of allegations? Does this process set forth investigation roles and responsibilities depending on the nature of an allegation?

## **Conclusion**

The audit committee can be valuable in probing management's decisions regarding the appropriate level of sophistication of the processes to help mitigate the reputational and financial risks of alleged fraud, bribery, and corruption. Management, the audit committee, and the board may have different views on the cost/benefit tradeoffs involved and the appropriate balance given the risk environment. Asking the questions set out above may help better define and mitigate reputational or financial risk in the event of allegations of fraud, bribery, or corruption.

## **Additional Resources**

Deloitte's June 2011 Audit Committee Brief: [Evaluating the Tone at the Top: Practical Suggestions for Audit Committees](#)

Deloitte's [Audit Committee Resource Guide](#)

Deloitte's [Whistleblowing and the New Race to Report](#)

Deloitte's [Corporate Resiliency: Managing the Growing Risk of Fraud and Corruption](#)

Deloitte CFO Insights: [Whistleblowing after Dodd-Frank: New Risks, New Responses](#)

Deloitte's Center for Corporate Governance Page: [Antifraud Programs and Controls](#)