

Speech 17 May:

Step for step implementation of fraud resilience programme

Training and Enhancing Awareness of Employees in Fraud Resilience Programmes.

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Dear ladies and gentlemen, dear Oleg,

I strongly believe that one of the most effective ways of implementing fraud resilience is in training of your employees. Of course, external and internal audits, procedures and compliance, due diligence on third parties, pre-employment check of potential employees, this is all very important. But I believe that the key is in making your employee more aware of doing ethical business and the role of leadership in giving the right example. I will explain this further in my presentation.

At first, I will argue that **Organizations need to invest in training their employees to make them aware of fraud and ethical behavior** and to explain to them why having an Ethical Code of Conduct and compliance to such code is of crucial importance. Once you have the Code of Conduct, you need to train your staff in how to use this code of conduct.

Secondly, I will explain to you why the Fraud Triangle is a good concept about thinking of fraud, but that we are missing a crucial item, **the Psychological contract**. Breaching of this contract will result in disappointment with employees and might lead to occupational fraud.

Thirdly, I will argue that training is useless unless **the leadership** of the organization will give the right example. And I realize that especially this third point will be most difficult to implement in Russia, with its difficulties to doing business in a transparent and ethical manner.

But before I will go into this further, some words about **my background**. As you have heard from the introduction, I am an auditor by profession but always worked in Financial Advisory, latest as the Managing Partner of FAS of Deloitte CIS. Now, I have my own accounting and consulting firm, and I focus mainly on special investigations, such as due diligence and fraud investigations. However, my real **vocation is in training**. I am associated with Nyenrode Business University, the leading executive education organization in the Netherlands, and the largest educator of auditors, with their Nyenrode School of auditing and controlling. Furthermore, I am associated with Centre for Creative Leadership, here in Moscow. CCL is focusing on providing leadership training, a fascinating topic. So, you can see why I am so happy here presenting my speech: now I can combine my two passions: talking about the importance of **training** in an area which is part of my professional background: **fraud**.

My first point is: If you want to establish a fraud resilient organization, you need to invest in training your employees better. They need to understand the ethical and transparency manifest of your organization, and they need to know how to report if they see anything unusual. Recent studies show that 65% of fraud is discovered by tips of employees, accidentally stumbling upon them. By making your employees more aware of the way how your organization conducts ethical business, having and educating them in maintaining the code of business ethics and conduct and helping them to enhance

this, by proper whistleblower procedures, compliance, and leadership giving the right examples, you make your organization more resilient against fraud.

There is always an interesting discussion when talking about training employees in fraud prevention. Because: if we teach them how fraud works, can we not give them ideas and then implement these 'tips' themselves? You all know the saying: You cannot afford not to train your people. Training might be expensive; not training can be more expensive. I have always learned that you should make your decisions based on the majority of the people, and that is the ones who are honest and loyal and trustworthy to the company. Fraudulent people will find their way anyway, with or without training. And of course, your staff is the best prevention against fraud.

I am talking mainly about occupational fraud or staff fraud: that kind of fraud that employees can perform because of their position within a company or organization. So I am speaking about fraud from within the organization, by your own employees. By definition, this type of fraud is then committed by the employees of the organization. As we have said before, 65% of this type of fraud is discovered by tips from employees of that same organization.

In looking at occupational fraud, I believe it is also important to look beyond the own organization, but to look especially to service providers, outsourcing, consultants etc. as well. How good your Ethical Code of Conduct might be, you might see that your employees are cooperating, knowingly or not, with fraud. Recently we have seen this with Ikea, and I have seen this recently as well in an investigation, where a large (and very ethical) multinational which was accused by one of its competitors in doing unethical business in Russia. Obviously, this is very sensitive so I cannot go into much detail, but the issue was related to business partners who were importing goods into Russia (not my client themselves) by avoiding import taxes and vat. Not uncommon in Russia, I believe. When the executive board asked me to commission the investigation, I convinced them not only to look at the business practices of this partner, but especially towards the attitude of the staff of the client themselves. Because, in my opinion, the real question was not in regards to the business partner, but if employees from my client actively or passively, knowingly or unknowingly, cooperated with the business partner in their unethical behavior. We all know how employees can be pressured by clients (and how employees are being rewarded by sales targets). What our investigation found was that although my client did not do anything wrong, there was a shocking lack of understanding of their employees in how (fraudulent) business could be conducted in Russia (and especially with importing goods in Russia). Unknown, they helped their client with such unethical business, by providing documents, stamps and signatures for the usage of such practices. Obviously, one of our recommendations was to train the staff of this organization in ethics and picking up fraud signals. Next time when they get such request from any client, we need to ensure that they will not cooperate with this.

You need to educate your staff in how to conduct ethical business, and how to report if they see any unethical practices of their fellow employees. I realize this is a very difficult point to implement in Russia. People do not want to report about behavior of their superiors, especially when they feel that such reporting can have negative effects on themselves. People are afraid that their complaints will get to the leadership of their own department. One multinational found that the most effective whistleblower channel actually was the idea-box. All staff knew that this box was emptied by the HR department, which they found was doing a very good job. They trusted that department, and used this as a channel to report breaches in ethical conduct and fraud. My argument is: the more transparent the organization (and its leadership), the better these kinds of compliance works.

Coming back to the trainings: It is not very difficult to set up such trainings.

First of all, you need to have a good code of conduct and these needs to be explained to all staff. Why is it important to conduct business in an ethical and transparent manner? Leadership needs to explain this to its employees. I believe this explanation should mainly be around reputation and perception, not so much around financial benefits for the organization. All things the same, people will like to work for or with an honest organization.

Secondly, people need to become aware of the code of conduct by means of training, this can be done on line as well, and mainly, I believe, by discussions with their leadership. I would not so much recommend formal training. I think it would be much more effective to organize small meetings with management and to discuss practical and real-life issues. The problem with formal things like code of conducts is that they are black and white. This you can do, and that not. Ethics seems to be black and white: there is no orange light in ethics. However, life teaches us differently. Every aspect of ethical and unethical behavior is to be seen in the light of its specific situation. You are not allowed to drive to the red light, but if it is your wife next to you, half way in delivering your baby? Having such discussions with leadership will help the employees to understand better not only the letter of the code of conduct, but especially the intentions.

Thirdly, employees must see that the company is very seriously in complying with their code of ethics. I was very proud to read in the newspaper that Basic Element fired a director of one of their subsidiaries because of fraud. Or in the case of IKEA. Too often, organizations are afraid of communicating once they have discovered fraud. But the signal of telling that someone is fired because of fraud is one of the strongest signals you can make towards to employees.

And lastly: make sure you hire people that are the right kind of people for your organization. I always say: hire on attitude, train on skills. You can always train a person in new skills, but not in changing his or her attitude. I spoke with one general manager of a multinational who was looking for a CFO, and one of the candidates candidly described to him how he could evade taxes. It is clear that my client did not hire this CFO. Make sure that management is involved in the hiring process, do reference checks and ask ethically focused questions. Ask your candidate: how would you deal in a situation where you can sell a substantial deal to a new client, one this organization has been dreaming on for years, but you need to pay a kickback. How would you deal with such situation?

Another related issue is doing background checks on candidates with a specific focus on ethical behavior. I know the story of an international bank which has been defrauded by its former director. The bank did not press charges (in the end) and the person is still working in another financial institution. If that employer would have done a background check, including checking references, it would have come out.

So my first step in becoming a fraud resilient organization: implement a code of ethics and conduct and ensure that your staff is aware and is trained in behaving ethically.

However, there is no need to start with training your employees and with explaining your code of conduct **if you do not treat your employees fair in the first place**. And that brings me to my second point of my speech today.

My second point I want to make is that I absolutely believe that people are honest, nobody is born dishonest. Some people have other ethical standards, or principles. Societies might have other

standards. We have heard to today about the Fraud Triangle, the relationship between Opportunity, Pressure/Incentive and Rationalization.

This particularly is worrying me. For two reasons:

1. Especially in Russia, it's very easy to see both the pressure/incentive and the rationalization. Where as in the US, the pressure/incentive is sometimes described as "Boobs, Booze and Bingo", referring to the fact that most occupational fraud comes from people with a (financial) problem caused by sex, alcohol or gambling, both the pressure/incentive and the rationalization in Russia is more mundane. It is expensive to life and raises a family in Russia, to have your children goes to a good school, to secure your future yourself. In my opinion, this is not an 'incident' by part of live. And with rationalization the same. Because if you think everybody else is doing it as well, why should you not? Russia is very high on the ranking of countries with 'economical crime' and this might for potential fraudsters a rationalization in itself.
2. However, my second worry about the fraud triange is that is blames it all on the fraudster, and not on the organization. Of course, you should not give them the opportunity, but in most cases, in order to do a normal job, there are opportunities to fraud. I think there is something missing and I will explain this hereunder.

This theory is known for 50 years, but I think we are missing one important factor. And this factor I want to take from the concept of **Psychological Contract**. The Psychological Contract is a concept which is used in Human Resources Strategy. It claims that the relationship between the company and its employee is not only regulated by its formal labor contract, but also by another, unwritten and unsigned contract. This contract consist of the expectations of the employer and employee, for example that the employer will provide for a safe and stimulating work environment, for career development, for interesting and challenging work etc. The employee will provide for his energy, intellect, innovative skills, business development possibilities, network etc. These are expectations which are normal at the beginning of any relationship. However, if the employee is getting disappointed by the employer, and there is a breach of this psychological contract, then the employee will lose its loyalty to the company and will be easier to conduct unethical behavior, including fraud. And in my experience, I do see too many companies who do not take into consideration these expectations. They promise on forehand exiting work and career development (including training) but when it proves that the employee does not get the promotion he deserves, for example because of economical situation, than the employee gets demotivated. Especially when he sees that leadership does not 'suffer' because of the economical situation.

I have seen this specifically when I was engaged by an investment company to investigate fraud in one of their investee companies. Soon it emerged that the fraud was performed by the general director himself, being unhappy with the initial promises of the employer/investment company and soon finding out that the company was overselling and under delivering their conditions and growth potential. This also included the fact that the investment company was short of money and did not have the possibilities to invest further in the growth of the investee company. This growth was an important part of the bonus of the general director and he now saw that he could not realize this growth. This resulted in less loyalty and unethical behavior. Again, here I saw that in most fraud cases, there are two sides of the coin, and breaching expectations from the side of the employer is often one of the reasons why fraud takes place.

So my second step and advice is: if you want to be a fraud resilient company, make sure that you respect this 'Psychological Contract' with your employees.

But even if you have trained your staff and if you do treat your employees well, your organization will still not be fraud resilient **if the leadership will not give the right example**. This is my **third** step. And I realize this is perhaps the most difficult part of becoming a fraud resilient organization. I have often been engaged in situations where foreign multinationals bought a share in an existing Russian company. If this would be a full takeover, the situation is different, but in case when this is a minority share, or even a majority but with the current owner/manager still in charge, this might lead into a clash of what I would like to call 'transparency'. Obviously, the new foreign shareholder is very much interested to weed out some of the unethical business practices, such as paying kickbacks. But in practice, this is much more difficult, as the perception is that this might hurt the business. Obviously, it is very important to stop these kind of practices, not only because of the ethical implications, but also because this gives the wrong signal if it continues: now its not only the local owner who agrees, but also the new foreign shareholder. I strongly prefer a direct and clear action: by stopping all unethical business practices. Even if this hurts the short term business of the company. We have conducted many discussions with foreign companies, and each of them said the same: better to walk away from dirty deals and win business on your own merits than to bribe yourself into a deal. I see this in many situations where the actual competitive advantage is not the quality of the products, or the price, or the innovation, but the fact that they pay kickbacks. Sooner or later these companies will be replaced by companies who do understand that paying kickbacks cannot be your unique selling point. And more important, what kind of examples will this give to your sales force? It's easier for them to bribe a purchase manager than to find a good client which is really interested in the quality of the product. And then how to control the sales manager? If his company is bribing purchase managers, why not to use a small part for him?

The signal by the management to walk away from this all is very important. You cannot have a fraud resilient organization if the leadership themselves is giving the wrong example. In most leadership issues, but especially in fraud resilience, the tone from the top is determining your success in fighting fraud.

Conclusion

Ladies and gentleman, in my speech I have proposed three steps in making your organization better against fraud.

First of all, I have argued that you need to train your staff on how to behave ethically and how to be aware of fraud and how to report them. As I have mentioned, 65% of fraud cases are discovered not by professionals, such like internal auditors and forensic specialists, but by your own staff. Use this source, first of all to train them how to you want them to conduct business, and also how to report if they see any situation that is not correct. Also hiring the right staff is part of this. Hire on attitude, train on skills.

Secondly, I have explained my ideas about the Psychological Contract. With this, I mean that as long as you respect the unwritten rules on how to treat your employees fairly, they will stay more motivated. I strongly believe that fraud is especially committed by people who are unhappy with their current situation in the company. Something which they most likely were not when they started to work for you.

Thirdly, leadership must give the right example. It is of utmost important that the leadership is completely clean and considers doing ethical business continuously. You cannot be a little ethical, or expecting that your staff understands that leadership are allowed to do things differently than their employees.

closing remarks: I am not naïve. I have seen many, many situations where companies have been defrauded, especially by their own employees. But in many of these situations, they were working in an environment which I could not exactly call 'clean'. Where there was no clear Code of Conduct. Or they have been treated unfairly. Obviously, not that I want to say that this is correct, but just in order to make the nuance. And in situations where leadership did not give the right examples. And I do realize that Russia is a very difficult market and it is very, very easy to give in to the short term advantages of not doing non-ethical business.

Your employees are your tool number 1 for preventing and fighting fraud. I would say, make use of this incredible source of strength!

Thanks you for your attention.

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