

Bulgaria

# Economic crime in a downturn

The Global Economic Crime Survey  
December 2009



## Introduction

We are pleased to present the 2009 PricewaterhouseCoopers Global Economic Crime Survey results – the largest study of its kind now available worldwide. Our web based survey was completed by senior representatives of 3,037 companies in 54 countries, including 59 leading companies within Bulgaria, providing us with unparalleled depth of insight into the impact of economic crime on business around the world.

Our survey reveals that economic crime remains one of the most problematic issues for business worldwide. Across the globe, 30% of companies have been the victims of economic crime in last 12 months. In Bulgaria, one fourth of our respondents (25%) have suffered from economic crime in the past year, compared to 36% in Central and Eastern Europe. Our survey indicates that in Bulgaria, as it is in the rest of Central and Eastern Europe, much more fraud remains undetected than is actually revealed.

We have also discovered that the nature of fraud has changed as a result of increased economic and financial pressures, namely the need to achieve high targets and fear of losing one's job. This is a new situation for Bulgarian companies and they will need to consider how to balance between the need to reach targets and the pressures this is creating on employees and management versus adjusting the effectiveness of their internal controls.

Finally, there is a mindset that Bulgarian companies need to address if fraud is to be prevented in the future – people are prone to commit fraud as they believe that others do it as well. This stresses the need for a clear “tone at the top”, followed by strong corporate communication and decisive action against identified fraud.

### Fraud – a major business risk in Bulgaria in a situation of economic downturn

Our 2009 economic crime survey reveals that 25% of the companies surveyed in Bulgaria reported being subject to one or more significant economic crimes in the last 12 months, compared to 34% for Central and Eastern Europe and 30% globally.

33% of Bulgarian companies have been subject to 10 or more incidents of economic crime in the last 12 months.

The global economic downturn has significantly affected most organisations, with 73% of our Bulgarian respondents reporting a decline in financial performance over the past 12 months compared to 68% for Central and Eastern Europe and 62% globally.

60% of Bulgarian companies have stated that the cost of fraud has gone up during the same period, compared to 43% in Central and Eastern Europe and 42% globally.

### Reasons for committing fraud

78% of Bulgarian companies have claimed that increased pressures and incentives was the greatest

contributor to heightened risk of economic crime during the last 12 months, compared to 71% in Central and Eastern Europe and 68% globally.

In difficult economic situation Bulgarian companies are setting more difficult targets to achieve (68%) and competitors are paying bribes to win contracts (57%). In addition, the fact that people are afraid they might lose their jobs (43%), and people “bending the rules” to ensure they qualify for their performance bonuses (38%) are believed to be the main contributors to increased pressure, which in turn contributes to heightened risk of economic crime.

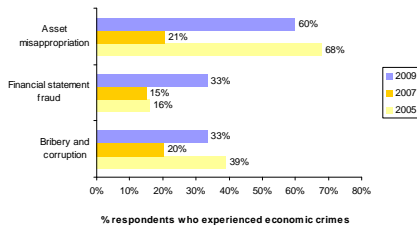
Given that 75% of surveyed companies reported that staff reductions have resulted in fewer resources deployed on internal controls, it appears that Bulgarian companies need to revise their set targets and ensure that employees are motivated and committed to the business objectives of the organisation.

## Types of economic crimes

Asset misappropriation continues to be the most common type of fraud reported in Bulgaria. It is our experience that these are among the easiest fraud to detect as they involve the taking of items with a defined value.

It is interesting to note, however, that our 2009 survey reveals a changing face of economic crime - financial statement fraud has doubled compared to the 2007 results, from 15% to 33%, although the global (38%) and Central & Eastern European incidences (43%) are higher than the numbers reported for Bulgaria.

### 1.1 Companies reporting suffering actual occurrences of fraud (2005 - 2009)



This clearly identifies a positive aspect related to combating against fraud. The increasing number means that more and more companies are now

more equipped to detect financial statement fraud, which has traditionally been a complex economic crime to detect and understand.

At the same time, increased financial statement fraud is closely linked to the pressures brought about by the current economic climate, such as the desire to maintain KPI's and financial targets for various reasons (to maintain debt covenants, to make targets / budgets, bonuses, etc.)

33% of those experiencing economic crime, reported to have suffered corruption and bribery in the past 12 months. What is the true incidence of corruption and bribery? Part of the difficulty in assessing the real levels of this type of fraud relates to the nature of this crime. Corruption and bribery is often reported in the media and has been a hot topic in Bulgaria and Central & Eastern Europe for a number of years. Hence, it is much more in the public eye than other types of economic crime such as asset misappropriation or financial accounting fraud. On the other hand, corruption and bribery can be difficult to detect thus potentially reducing the number of reported cases.

### The cost of fraud

Fraud is a costly business. Globally, the average cost of economic crime



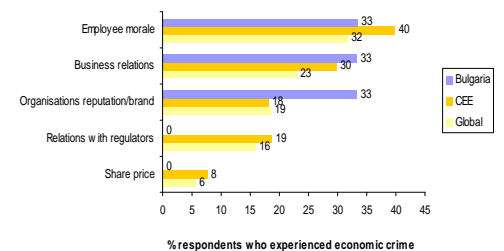
per company over the last 12 months was approximately USD 898,000, while the total loss reported by all companies surveyed is USD 756 million. The average cost of fraud in the CEE region is even higher – USD 1.2 million. Within the above context it would seem that the direct loss per incidence in Bulgaria is relatively lower – approximately USD 454,000 (with total direct losses of slightly above USD 6 million). However, even these levels of direct losses are significant for Bulgarian companies, given that 56% of our respondents were small companies with up to 200 employees. Furthermore, 60% of those experienced fraud estimated that the cost of fraud has increased in the last 12 months.

While the direct reported costs of economic crime are considerable by themselves, one should not ignore the

collateral damage from fraud, i.e. damage to a company's brand and customer trust, to the share price and shareholder trust; to the company's relationships with its suppliers; and to staff morale which can result in loss in productivity. Although difficult to quantify, collateral damage can be a significant cost to a business.

All Bulgarian companies that suffered fraud reported collateral damage to their business.

### 1.2 Organisations reporting significant collateral damage in 2009



The most serious types of collateral damage reported were impaired business relations, damage to the company's reputation as well as declining working morale. These are reported to be the areas of greatest impact of economic crime.

### Means of detecting and preventing fraud

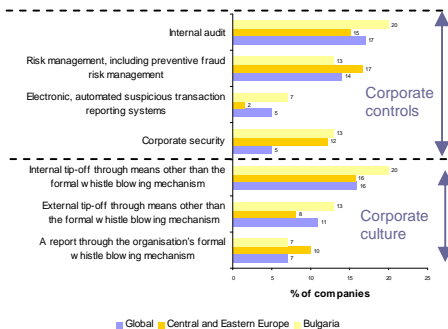
The means by which fraud is detected can be split into two broad categories: detection by chance and detection through means within management's influence and control, such as risk management and internal audit. Worryingly, one third of reported cases of fraud in Bulgaria were detected by chance (a combination of internal/external tip-offs and accidental detection). If chance is a major variable in the detection of fraud, there is a danger that many cases of fraud may go undetected.

Same is the situation in Central & Eastern Europe where 32% of economic crimes were detected by chance, while globally, the role of "chance" in fraud detection is at 40%.

Discussing about the various ways that can be influenced and controlled to a certain degree by management, internal audit has strengthened its

position as one of the most effective tools for detecting fraud, marking an increase of 7 percentage points vs. 2007 results, coming out at 20%. The other most important ways of fraud detection were identified as: risk management (including preventive fraud risk management), and corporate security (13% each) which indicates that more Bulgarian companies have started to implement formal fraud detection mechanisms in contrast to "chance".

### 1.3 Methods of detecting fraud



The percentage of the cases initially detected through a whistle blowing system is approximately 7% both for Bulgaria and globally. Although slightly higher, the Central & Eastern Europe level follows the same trend – at around 10%. Generally, this may suggest that whistle blowing

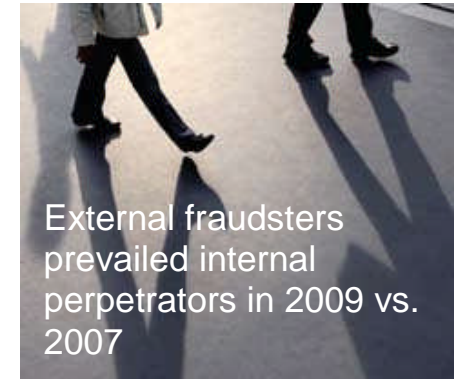
programmes are either not in place or are ineffective.

Our survey highlights that the incidences of economic crime are not "one-off" cases – 33% of those who suffered fraud had faced more than 10 incidences over the last 12 months. In addition, 53% of the respondents reported an increase in the number of incidences during the surveyed period. These results are an alarming signal suggesting that companies have no adequate mechanism in place to prevent the recurrence of fraud. This can somehow be corroborated to another finding: 39% of the Bulgarian respondents have not performed a fraud risk assessment in the past 12 months.

### The typical perpetrator

The bitter experience of 40% and 55% in our 2005 and 2007 surveys respectively was that the fraud perpetrators were insiders. This, while disappointing, was not surprising, as fraudsters operating within a company have a stronger understanding of the business, as well as the strengths and weaknesses of the controls in place to prevent and detect fraud.

In this year's survey the majority of the industry sectors reported that in Bulgaria the most significant frauds



were committed by external perpetrators (73%). This change in the profile of the typical perpetrator is observed in Central & Eastern Europe as well (59%), while on the global level the split between internal and external perpetrators (44%) were more evenly matched.

In the case of fraud committed by external parties, 36% of Bulgarian companies reported that the main perpetrators were the company's customers and 18% reported that they were agents or intermediaries. Another 36% reported "others", which may have included government employees, organised groups and other unknown individuals. This is higher than both the Central & Eastern Europe (more than two times) and global figures.

The majority (67%) of the internal perpetrators were junior staff members (higher than the global average of 42%). Compared to the global results as well as those from Central & Eastern Europe as a whole, Bulgarian companies have not experienced fraud perpetrators occupying middle management positions. However, more than one third of the most serious offences in Bulgaria were committed by senior management (vs. 14% globally). This is indeed a concern, as it defines the wrong kind of “tone at the top” and hinders fraud awareness and prevention efforts as a whole.

### Dealing with fraudsters

An important step in creating a corporate culture that does not tolerate fraud is consistent and rapid action when an economic crime is detected. When staff understand the consequences of their potentially fraudulent actions, and that detection is certain and inevitable due to sophisticated and effective systems and controls, this serves to deter most fraudsters.

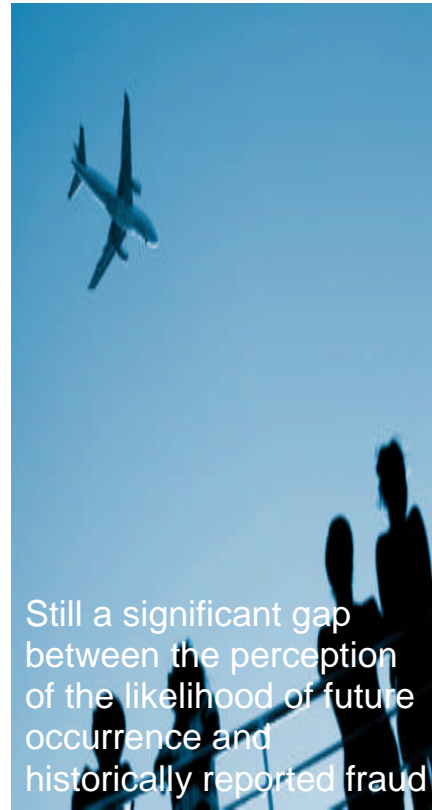
In our view, once an incidence of economic crime has become known, it is vitally important to signal to staff that all the perpetrators are treated the same way, regardless of their

position within the company, and that there is zero tolerance for economic crime, regardless of the reasons.

Once a company confirms a suspected fraud, appropriate action against the perpetrator is essential in order to deter other potential fraudsters and to show stakeholders in the business that the organisation will not tolerate such malpractice.

As far as the actions taken against perpetrators of fraud, either insiders or external parties, our Bulgarian respondents had split ideas. Internal perpetrators were usually dismissed (33%), civil action and/or criminal charges were brought (27%) or relevant regulatory authorities were notified (27%). However, the combination of insiders escaping with a warning or a reprimand (27%) or the company doing nothing (7%) adds up to more than one third of Bulgarian respondents, and this is much higher than the global or Central & Eastern European numbers.

In 53% of cases where the fraud was committed by external perpetrators victims have notified relevant regulatory authorities or the business relationship with an external perpetrator was terminated (27%) or criminal or civil charges were filed (27%).



Still a significant gap between the perception of the likelihood of future occurrence and historically reported fraud

### Fraud in the future

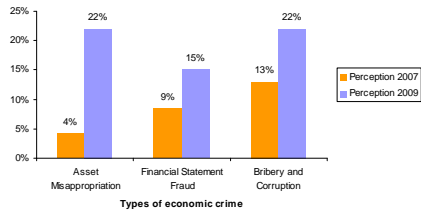
Fraud remains a serious problem. On a global scale, levels of economic crime have not dropped significantly over the course of this decade and despite that, companies remain

confident – as they have in our previous studies – that their controls will limit their exposure to fraud in the future. Although there has been an increase in the perception levels, the results show a significant gap between the perceptions of the likelihood that fraud will occur in the future compared with the reality of incidence of fraud historically reported. Bulgarian companies display a degree of complacency about the dangers of economic crime. 4.2% of all respondents in 2007 thought that it is quite likely that they will experience asset misappropriation in the next 2 years. However, in our 2009 survey, 15% of all respondents had been victims of asset misappropriation in the past 12 months.

However, there is not such a gap with financial statement fraud where the perception in 2007 was 8.5% and the reality in 2009 was that 8.4% of all respondents had actually suffered this type of fraud in the preceding year. Bribery and corruption is the economic crime where perception of risk outweighs reality. In 2007, 13% of all the respondents perceived that they could be susceptible to bribery and corruption in the next 2 years and in our current survey only 8% reported to have suffered fraud in the last 12 months. This could be explained by

the fact that this fraud can be difficult to detect.

#### 1.4 Perception of types of economic crime (2007 - 2009)



The fight against fraud is a constant struggle. Our study continues to show that in order to assess and manage its risks, a constant re-evaluation of all fraud risk management activities is necessary.

Equally importantly, companies must strive to establish a culture that supports anti-fraud controls with clear and ethical guidelines, showing that every perpetrator, no matter what their position and function in the company, will be subject to equivalent sanctions.

As with all crimes and unwanted business risks, a move from fast reaction and rapid response to proactive prevention is the most valuable move, and this can only be achieved through a disciplined and planned approach of forming a strong anti-fraud culture stemming from top

management (i.e. the right kind of “tone at the top”), the right fraud prevention strategy, controls that are tailor-made around the processes, business needs, resources and skills of the organization, and middle managers and employees whose awareness, training and readiness in the face of the challenges brought about by economic crime are best in their class.



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The survey on economic crime in the Bulgaria is part of the PricewaterhouseCoopers Global Economic Crime Survey 2009.  
The survey demographics and definitions of economic crime can be found in the global economic crime survey 2009 report.

The global report is available at [www.pwc.com/crimesurvey](http://www.pwc.com/crimesurvey)

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