

# Economic crime: people, culture & controls

The 4th biennial Global Economic Crime Survey  
**Canada**



Fraud remains one of the most problematic issues for businesses worldwide regardless of their country of operation, industry or size. According to the **PricewaterhouseCoopers (PwC) Investigations & Forensic Services' Global Economic Crime Survey 2007**, economic crime levels remain high despite the fact that many companies have invested significantly to implement fraud controls. Of the companies surveyed worldwide, 43% reported that they were victims of economic crime in the last two years—an essentially static level compared to PwC's 2005 survey and an increase of 6 percentage points over 2003 results. Companies suffered an average direct loss of US\$2.4 million—an increase of US\$700,000 from US\$1.7 million reported in 2005 (see Figure 1).

Over half (52%) of the Canadian companies surveyed in 2007 reported being a victim of economic crime. This is a decrease of 3 percentage points from the 2005 results and an increase of 6 percentage points from 2003, with companies suffering an average loss of US\$3.7 million. This figure

represents a significant increase of US\$3.1 million over the US\$600,000 average loss reported in 2005.

These consistently high figures may be partly due to the “fraud controls paradox”: the notion that when controls are implemented in an organization, the number of frauds detected increases almost immediately. However, the deterrent effect is not immediately visible. Another possible explanation is an increase in corporate transparency and a greater willingness by companies to admit that fraud has occurred.

**PwC's Global Economic Crime Survey 2007** provides insights into the perceptions, awareness and impact of economic crime around the world. More than half of companies surveyed worldwide in the insurance, retail and consumer, and government and public sector industries reported suffering from fraud in the last two years. Our findings show that no industry is immune from the risks posed by economic crime (see Figure 2).

The fight against fraud is a constant struggle. Our biennial PwC study continues to show that companies must constantly re-evaluate all fraud risk management activities and impose a culture that supports them to assess and manage risk, maintain a competitive advantage and earn the confidence of all shareholders. Taking a proactive approach and planning ahead, instead of reacting after the fact, is the most valuable move a business can make to avoid being a victim of fraud.

### The changing awareness of fraud

Asset misappropriation, the theft of tangible assets with a defined value, had the highest number of reported incidents globally over the past two years (30%) yet respondents have perceived asset misappropriation as less of a threat since 2003. Global respondents perceived corruption and bribery to be the most prevalent economic crime in their business (22%). Although Canadian companies correctly perceived asset misappropriation as being the most prevalent, the actual

Figure 1: Companies reporting fraud (2003 – 2007)

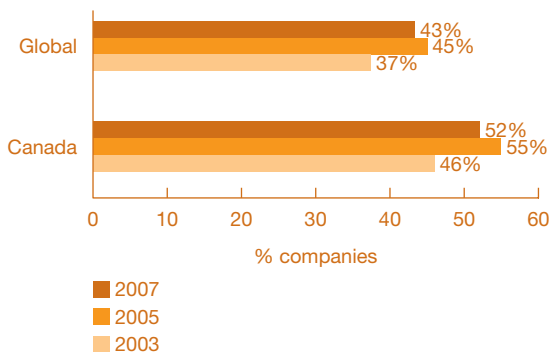
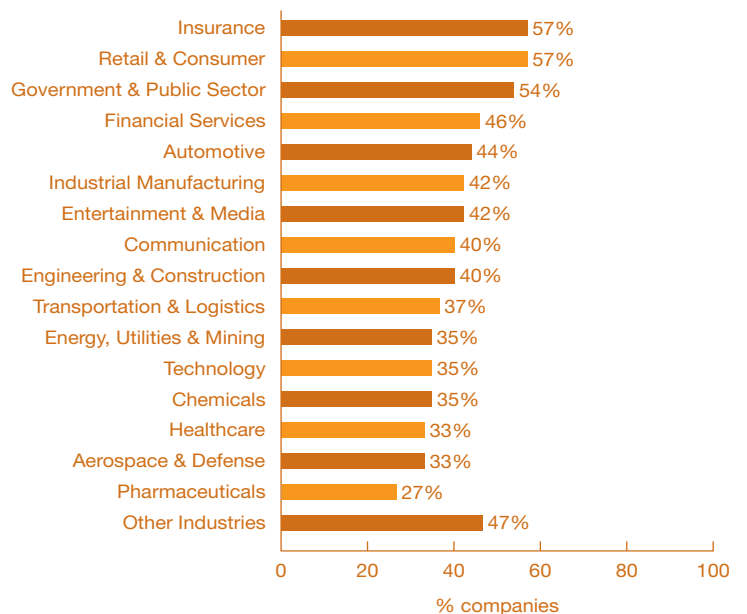


Figure 2: Companies reporting fraud – by industry sector (global)



percentage of reported incidents was 43%—much higher than the perceived level of 27%. In the case of accounting fraud, money laundering and IP infringement, the perceived level of incidences was greater than the actual number of incidents (see Figure 3).

## The cost of fraud

In addition to the direct financial losses reported, this survey shows that businesses must deal with the “management costs,” which result from a significant fraud. This can include such things as reallocating management time, which adds to the possible costs of litigation in retroactive action, managing a possible PR campaign and dealing with renewed regulatory oversight and demands. Global respondents who were victims of fraud estimated these costs to be an average of US\$550,000 over the past two years. Canadian respondents, however, estimated these costs to be an average of US\$1.2 million.

It is important to also consider the collateral damage that can result from fraud. These are the costs that derive from damage to the company’s brand and customer trust, the share price and shareholder trust, the company’s relationships with its suppliers, and to staff morale, which can precipitate a loss in productivity. Almost half (42%) of Canadian respondents who suffered from fraud claimed it had caused collateral damage within their company.

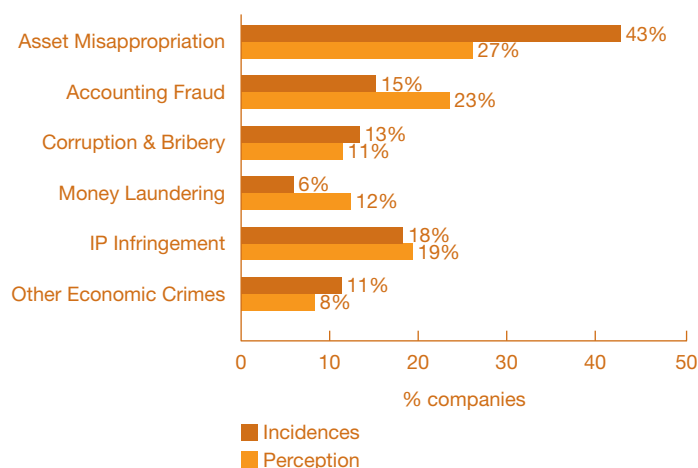
## Recovery of stolen assets

Compared to results in PwC’s 2005 survey, this year’s results show that Canadian companies were slightly less successful in recovering financial losses. Of the Canadian companies surveyed, 30% managed to recover more than 60% of their losses, which is 6 percentage points higher than the global recovery rate (24%), but 7 percentage points lower than the 2005 Canadian recovery rate (37%).

There are many reasons for this relative failure to recover lost assets. Companies are reluctant to embark on long recovery processes if they are uncertain of success. However, it may be worthwhile to pursue the assets as it is not always possible to form a realistic view of the chances of recovery until the process gets underway. A business can create a culture of deterrence if it imposes a corporate policy that always attempts to recover assets from the perpetrator.

Many companies choose to employ fidelity (or other types) of insurance against fraud. Our research shows that insurance can have a positive impact: companies surveyed worldwide claimed that they were 33% more likely to recover more than 60% of their lost assets than those without insurance. More than two-thirds (69%) of the Canadian companies surveyed reported having insurance coverage—significantly higher than the 39% reported globally.

Figure 3: Comparison of incidences and perception (Canada)



Despite efforts to strengthen and implement controls, over half of Canadian companies surveyed reported being a victim of economic crime, with the average loss increasing significantly to US\$3.7 million

## Means of detecting fraud

In 2007, 39% of frauds detected by Canadian companies surveyed were uncovered by chance and internal or external tip-off. This represents an increase of 14% over the 25% reported in 2005. An additional 14% were detected by internal audit. Global respondents surveyed stated that 41% of frauds were detected by chance.

These results show that controls alone are insufficient to take full advantage of the detection mechanisms that a proactive management team can create within the company. Management can substantially impact the levels of fraud detection. The value of strong fraud risk management activities at both the cultural and control level remains unquestionable. Companies with a higher number of fraud risk management activities had a higher chance of detecting fraud. Those with more controls not only detected more fraud, but they were also able to more accurately assess the associated losses.

According to our research, companies that had more controls were also more likely to have taken professional advice from law enforcement officers, lawyers or forensic accountants to ensure their fraud risk management tools closed gaps between systems, and were effective and efficient. Companies that lack such advice and fraud awareness may face a cycle of deceptive security, neither knowing the risks they face, nor realizing their vulnerability to new types of fraud. Companies with fewer controls detect fewer instances of fraud; as a result, they have less insight into the effectiveness of their existing fraud risk management measures.

## From fraud detection to fraud prevention

Over the past two years, 62% of Canadian companies surveyed have strengthened existing controls or implemented new measures. Almost all (93%) of Canadian respondents indicated that measures currently present in their company were

introduced due to the US Sarbanes-Oxley Act 404 and Canadian Multilateral Instrument 52-109. Yet of these respondents:

- 36% did not have a whistleblower hotline;
- 35% did not have an audit committee;
- 50% lacked adequate fraud risk management techniques;
- 67% did not have specific fraud related training; and
- 20% did not have specific actions planned to deal with economic crime.

While carefully implemented and regularly updated controls can themselves be effective in detecting and deterring fraudsters, our research shows that it is the culture of the company—one that supports a holistic compliance program working in conjunction with a clearly understood, and practiced, code of ethics—that is the true foundation of an effective antifraud regime. The key is not only receiving correct, professional advice on effective compliance and detection

**37% of the fraudulent acts committed in Canada were by members of middle management or above**



programs, but also ensuring that company ethic guidelines are practical, realistic and that they incorporate the explicit norms of criminal law appropriate to the country of operation.

We believe key antifraud controls should include the following:

1. Governance—oversight by the audit committee and board;
2. Fraud risk assessments;
3. Code of business conduct and ethics;
4. Incident reporting mechanisms;
5. Investigative protocol;
6. Remediation protocol;
7. Hiring and promotion policies and procedures; and
8. Management evaluation and testing.

### The typical perpetrator

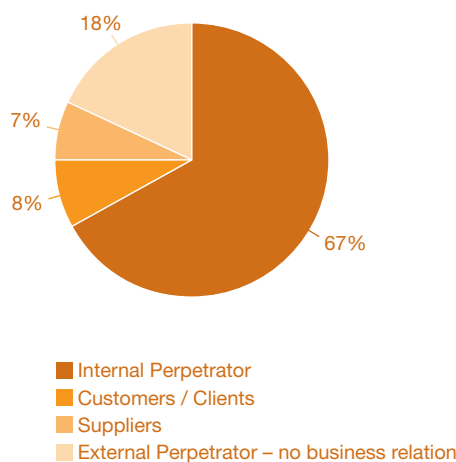
According to our 2007 results, 67% of the Canadian companies surveyed that reported incidents of economic crime stated employees were the main perpetrators of the most serious fraud offences (see Figure 4).

The typical perpetrator was male (88%), between the ages of 31 and 40 (41%), had a high school level of education or less (79%) and had been with the company for six years or more (42%). Only 37% of the acts committed in Canada were by members of middle management or above, showing a decreasing number of frauds being detected among individuals higher up the corporate ladder. This may be due to the fact that senior management figures are more likely to commit complex economic crimes, such as accounting fraud, which are harder to detect. Conversely, “simple” frauds such as asset misappropriation, which are often easier to detect, can be perpetrated in an unsophisticated manner by staff across the entire organization.

More than half (59%) of Canadian companies identified financial incentive (i.e. greed) as the key motivation for perpetrators to have committed fraud. Less than half (44%) of Canadian companies surveyed believed the perpetrators had a low temptation threshold and 42% believed individuals lacked awareness of values or wrongdoing (see Figure 5).

While insufficient company controls appear to have played a significant role in over one-third (36%) of fraud cases, we must consider the importance of a company’s culture and how the employee relates to it. If a fraudster has the opportunity to operate in an environment that lacks a strong corporate culture, even the best control systems cannot always effectively detect and prevent fraud. A company’s culture is therefore vital in establishing an ongoing, effective fraud risk management program.

**Figure 4: Fraudsters’ relation to the company (most serious Canadian offences)**



**Figure 5: Reasons for committing fraud (Canada)**



Figures total more than 100% as respondents were able to provide multiple answers.

## Fraud risks in the emerging markets

For many companies, the potential offered within developing markets (i.e. Brazil, China, India, Indonesia, Mexico, Russia, and Turkey—a group which PwC terms the “Emerging Seven” or “E7”) are so great that businesses often need to move quickly to take advantage of the available opportunities. But it is during these times of dynamic change that businesses are particularly vulnerable to fraud. Over the past two years, the average loss reported by companies operating in the E7 amounted to more than double the level reported by all the companies surveyed (i.e. US\$5.1 million for E7 companies compared to US\$2.4 million for all respondents). Yet, almost half (45%) of the companies operating in the E7 did not factor economic crime as a risk prior to their investing in E7 countries.

The types of fraud that pervade the E7 are no different than those found in developed economies. The difference is the extent to which they permeate businesses due to the unique legal, political, social,

economic and cultural environments these companies operate in. The effectiveness of the internal controls and common cultures that these businesses possess to mitigate such risks also affect the chance of fraud. We recommend that businesses looking to invest in the emerging markets exercise a high degree of caution and a strong fraud due diligence process. The costs of implementing such risk management steps upfront will be far lower than the price businesses will pay in managing or addressing a fraud scenario once it has taken place.

## Fraud in the future

Fraud levels have remained high and have not changed significantly over the past four years, yet companies continue to be confident in their fraud controls. When asked, 47% of Canadian companies and 52% of global companies surveyed think it is very unlikely that their organization will be a victim of economic crime in the next two years. This gap between perception and reality is concerning. As our results show at the beginning of this survey,

companies are still facing significant financial loss as a result of economic crime with the Canadian average loss increasing significantly since 2005.

Companies must be constantly vigilant. Our findings reinforce the need for companies to continue strengthening their internal control measures and their overall corporate culture with clear and ethical guidelines. Companies must also develop and implement a comprehensive antifraud regime that meets best practices and punishes perpetrators regardless of their position or function.

## The PricewaterhouseCoopers Investigations & Forensic Services Practice - Dealing with fraud and financial investigations with speed, sensitivity and discretion

Corporate crime poses a real and substantial threat to the stability of any business. Dealing with fraud and financial investigations requires more than simple know-how: it requires speed, sensitivity and discretion. We appreciate the need to stop illegal activity while safeguarding your company's assets and reputation, preventing recurrences and arriving at a resolution with as little disruption as possible to the regular flow of business. Our services include:

- Fraud investigation;
- Forensic accounting;
- Fraud risk management;
- Computer forensics;
- Electronic discovery;

- Intelligence screening;
- Money laundering investigations; and
- Asset recovery services.

PricewaterhouseCoopers' international network of Investigations & Forensic Services professionals includes Investigative Forensic Accountants, Certified Fraud Examiners, former financial regulators, law enforcement officers, computer forensic technicians and asset recovery specialists. We have the technical skills, knowledge and hands-on experience necessary to investigate white collar crime and advise on managing and mitigating risk—including ways to identify and analyze vulnerabilities.

PwC provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 140,000 people in 149 countries work collaboratively using Connected Thinking to develop fresh perspectives and practical advice. In Canada, PricewaterhouseCoopers LLP and its related entities have more than 5,200

partners and staff in offices across the country.

Our diverse background and skill-sets will benefit you in your investigations and forensic undertakings, regardless of how big or small the project.

## Contact

For more information contact:

**Steven Henderson**  
416 941 8328  
steven.p.henderson@ca.pwc.com

or visit:

[www.pwc.com/ca/ifs](http://www.pwc.com/ca/ifs)

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