Investigations and Forensic Services

2007 global economic crime survey

Latin America supplement

Introduction

We are pleased to present PricewaterhouseCoopers' 2007 Global Economic Crime survey: Latin America supplement. While the Global survey is based on 5,428 interviews performed in 40 countries, the Latin America survey is comprised of 310 company executive responses from Mexico, Argentina, Brazil and Chile.

This is the fourth biennial edition of this survey, and is the largest study of its kind now available worldwide. Our survey reveals that fraud remains one of the most problematic issues for business worldwide, including Latin America. Relying on internal controls alone are not enough to detect fraud; an ethical corporate culture plays an equally important role in deterring it.

The term "economic crime" used in this survey includes acts perpetrated by individuals or groups of individuals seeking their own and improper benefit through instruments that produce losses to corporations; it encompasses fraud of several types including asset misappropriation, corruption and bribery, money laundering and accounting fraud, among others.

Section 1: The statistics

Fraud—a most problematic business risk

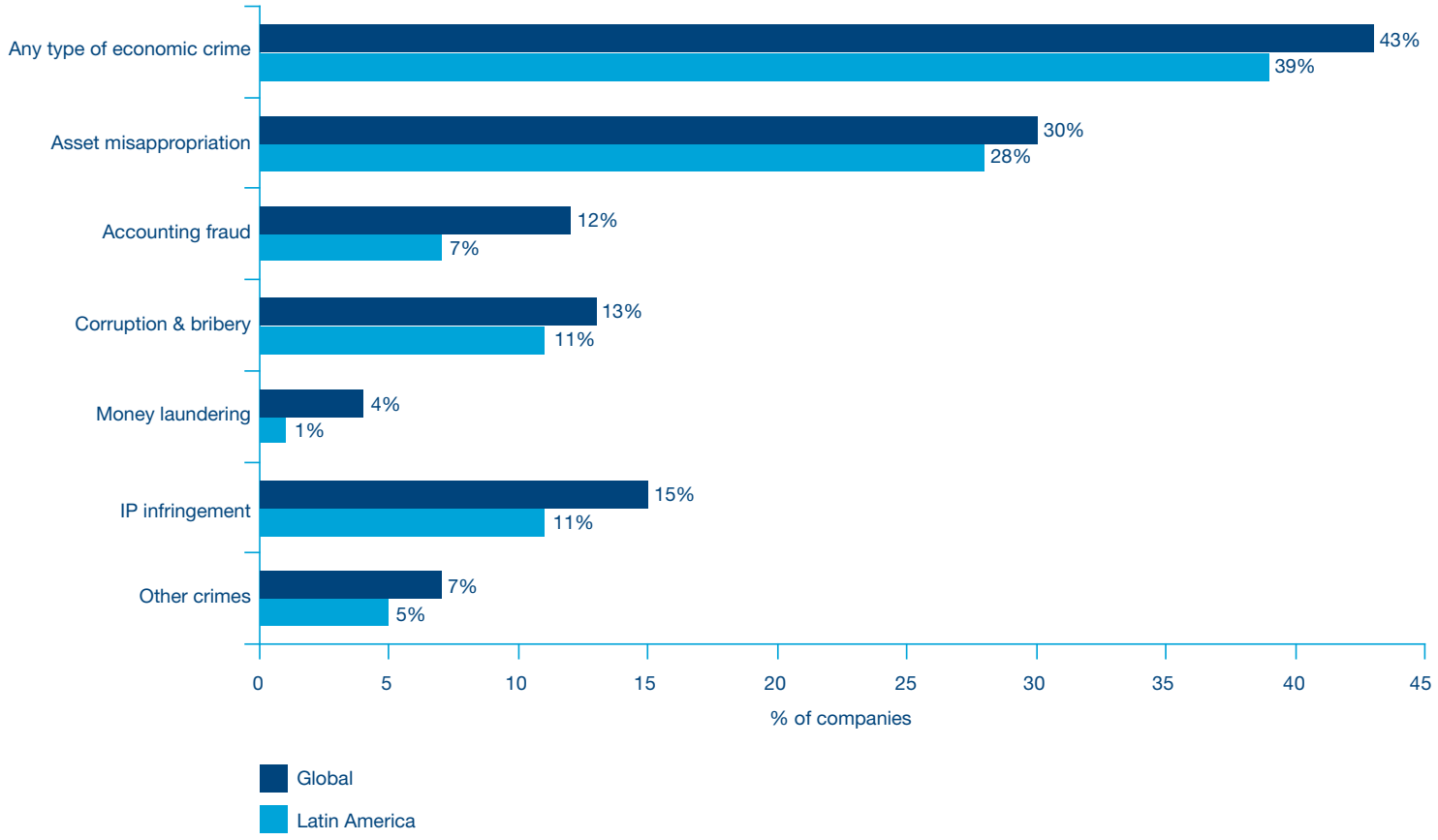
Fraud remains one of the most problematic issues for businesses worldwide, with no abatement regardless of a company's country of operation, industry, sector or size. Fraud continues to be a global issue, although the global reporting of fraud declined from 45% in 2005 to 43% in 2007. The percentage of Latin American companies reporting fraud compares to the results of global companies; over 39% of the companies interviewed reported suffering one or more significant economic crimes.

Asset misappropriation remains the most prevalent fraud with the largest incidence rate of 28% in Latin America; IP infringement and corruption and bribery follow in prevalence each with incidence rates of 11%.

The changing awareness of fraud

Why have crime trends maintained steady at a certain level and not seen a reduction? One explanation is that once fraud detection controls were implemented by the company, fraud was detected. However, time is needed to reflect the complete effect of these controls. Perpetrators must also be aware of these controls and the consequences of conducting fraudulent activities. Another explanation is that corporations are increasingly more transparent in their admission of fraud detection.

Actual incidences 2007

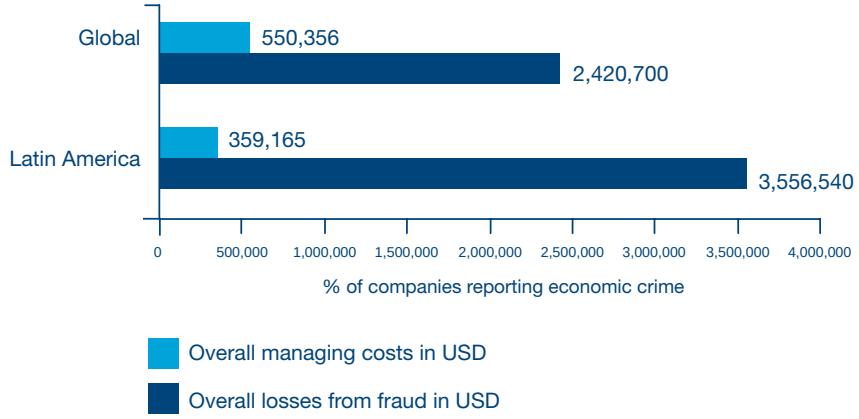


The cost of fraud

The average loss from fraud per company increased over 40% in two years from roughly $1.7 million in 2005 to approximately $2.4 million US dollars in 2007. The average loss was $3.6 million for Latin America. As referenced in its country report, Mexico experienced more than a 300% increase in the average cost related to fraudulent activities, from $0.5 million in 2005 to $2.3 million in 2007.

In addition, over 80% of our respondents who suffered fraud also stated that this had caused significant damage to their business. These direct costs are associated with mitigating and addressing fraud and include non-economic factors of the company's reputation and employee morale. However companies may consider these costs insignificant and a normal part of doing business.

Losses and managing costs



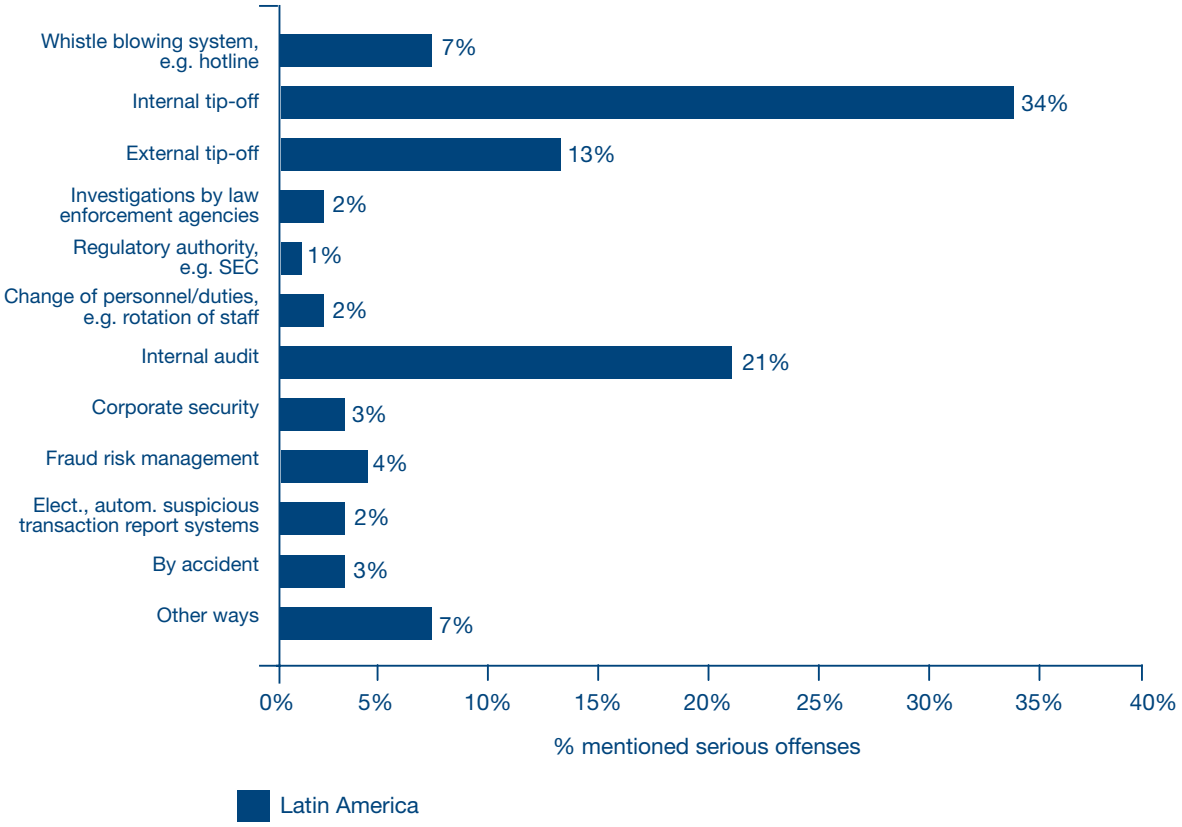
Means of detecting fraud

In Latin America, 57% of frauds were initially detected by chance (defined as 'tip-off' external/internal, 'by accident,' and whistle blowing systems), as compared to 48% on a global basis. Similar to the global results of less than 2%, no incidents in Latin America were reported to have been initially detected by external audit or the audit committee.[1]

The chart below indicates that the internal controls of the organization, represented by internal audit, corporate security, rotation of personnel and electronic systems of detection were responsible for 28% of the cases; in approximately 21% of the reported frauds, the internal audit function was the means by which the fraud was initially detected. This percentage is not unusual as the internal audit function's role may encompass the responsibility of fraud deterrence and detection.

Corporate culture characterized by tip-offs and whistle blowing systems represented 54% of cases. This supports the view that, aside from the implementation and improvement of internal control mechanisms, the value of strong risk management activities at both the cultural and control level remains unquestionable. In addition, companies that make use of ethical guidelines and compliance programs are much less vulnerable to economic crime.

Initial detection



[1] No incidents were reported; therefore these detection methods were not included in the graph.

Section 2: The issues

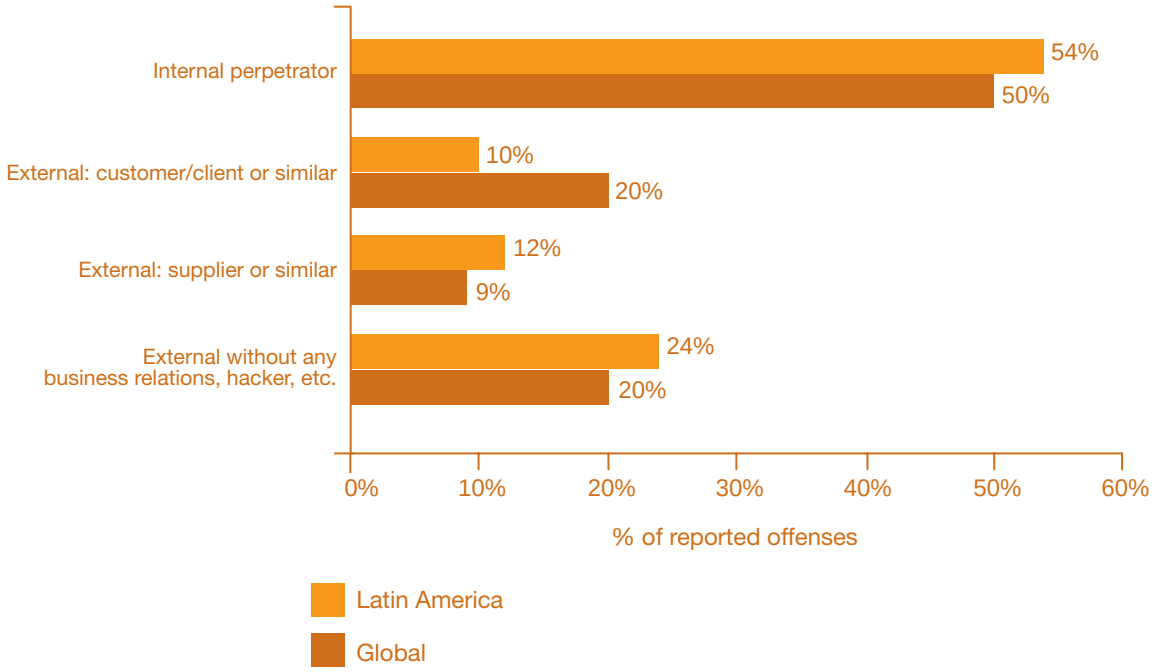
Who are the fraudsters?

You can't judge a book by its cover when it comes to fraud. A fraudster can sit at the corporate headquarters or work on the shop floor. Perhaps for the employee sitting at the corporate tower the pressure is from Wall Street. Alternatively, for the person working on the shop floor, the pressure might be a personal situation that causes him or her to misappropriate the company's assets. Regardless of the situation or the environment that causes a person to take part in such activity, fraud is the result. However from experience, the higher up in the organization the person committing the fraud is, the greater the losses due to fraud are likely to be.

The 2007 survey indicates that over half, approximately 54% of those committing improprieties were internal perpetrators. The results are consistent with the global results in this regard.

Down considerably from the previous survey in which approximately 45% of companies reported the perpetrator to be part of middle management, the current survey indicates that only 19% formed part of middle management. Also, generally speaking in Latin America, typical fraudsters are individuals that have increased exposure to financial pressures: 93% of the fraudsters are male, 37% are between the ages of 31 and 40 and 44% have between 3 and 5 years in the company. In addition, 54% have an education of high school or less and 41% have a college degree.

Relationship of the perpetrator to the company



The role of controls

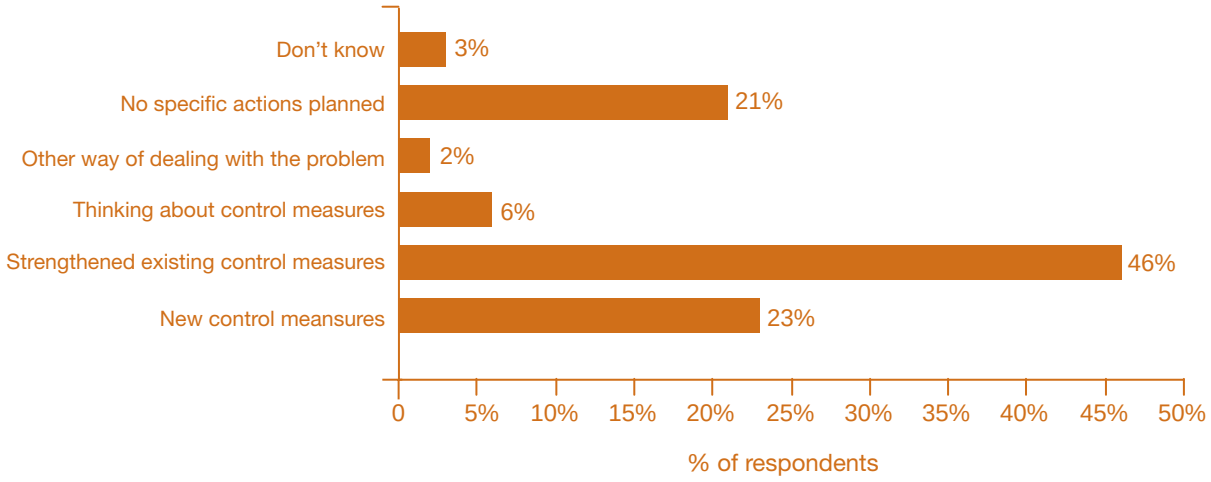
There is no arguing that controls play an important role in a company's fight against fraud deterrence and detection. Initially, one might expect that a company that has controls in place would immediately be less prone to fraud. This is not necessarily the case. You must look for fraud in order to find it.

It is important to mention that in Latin America the role of internal controls is certainly unlike the role of internal controls in the United States. Over the past 5 years, the Sarbanes Oxley Act has called for tighter controls and stricter regulations related to internal controls. This same Act requires CEOs and CFOs to establish and maintain internal controls and makes them accountable to evaluate these controls and measure their effectiveness.

Consistent with the global results, the companies in Latin America reported that internal controls existed in approximately 97% of companies as a means for the detection and deterrence of acts of economic crime. Furthermore, the survey indicates that internal controls were either strengthened or new control measures were implemented in 46% and 23%, respectively, of companies in Latin America as a means of dealing with the issue of economic crime.

Furthermore, 39% of the companies in Latin America rated internal controls as being an extremely effective measure for combating the economic crimes.

How the company deals with economic crime



The impact of fraud controls

The measures that the companies in Latin America are taking in an effort to detect and prevent economic crime are as vast as the controls being implemented globally. The below listing depicts these mechanisms:[2]

Comparable to the global results, the table below presents both the controls which are in place in a majority of the companies as well as those that are not commonly present in Latin America nor globally. It is with the latter group that companies in Latin America have room for improvement with respect to fraud deterrence and detection. Particularly, the chart below indicates that currently only 45% of companies surveyed in Latin America had a whistle blowing system or hotline in place. Despite the fact that this percentage is consistent with the global figure of 42%, it is unfortunately only 2% better than it was two years ago. This is a testament to the fact that certain companies, both in Latin America and globally, have not fully appreciated the benefits of having these controls in place.

Another paramount aspect of fraud risk management is an effective Audit Committee and incorporating fraud training as a control mechanism. However, as the chart below illustrates, only 57% of the companies in Latin America have an Audit Committee in place and a lesser percentage, only 29%, have specific fraud training within their own companies.

	Latin America	Global
Internal controls	97%	90%
External audit	90%	87%
Internal audit	89%	81%
Ethical guidelines/Code of conduct of organization	88%	79%
Staff selection tests	86%	62%
Corporate security	69%	52%
Compliance program/management	68%	61%
Vendor monitoring	65%	52%
Audit committee	57%	48%
Fraud risk management	48%	47%
Information from publicly available sources	45%	46%
Whistle blowing system/hotline	45%	42%
Change of personnel/duties	42%	38%
Electronic, automated system	41%	32%
Anti-corruption programs/policy	33%	32%
Consultation of fraud prevention	31%	31%
Comp. own special forensic analysis tech.	29%	20%
Comp. own specific fraud training	29%	30%
Others	13%	10%

weighted—% companies—multiple answers

[2] Figures total more than 100% as respondents were allowed to provide more than one answer.

The role of corporate culture

Corporate culture plays an important role when considering economic crimes. Culture and differences among countries must be considered when seeking to implement controls and policies that are designed to detect fraud in a subsidiary of a multinational company with operations in Latin America.

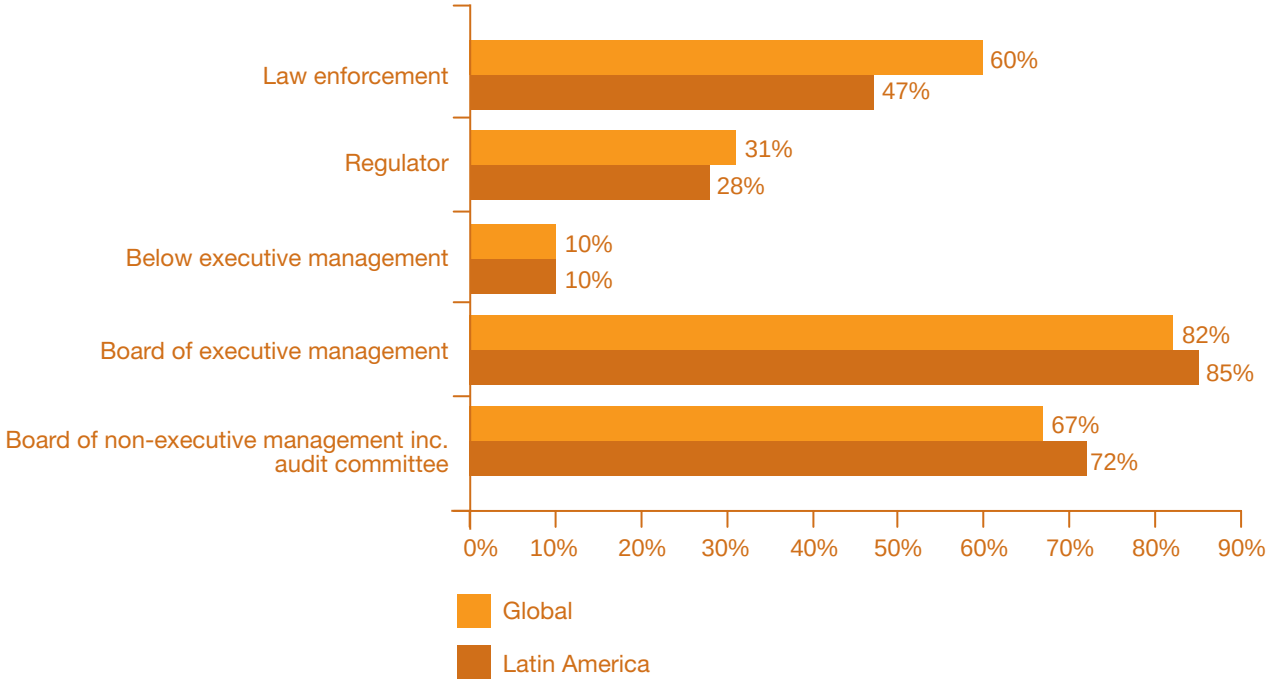
As a reference, our survey indicates that approximately 28% of companies in Latin America are listed on a United States stock exchange. Similarly, approximately 23% are listed on a stock exchange outside the United States.

Our survey results show that companies in Latin America view ethical guidelines and the corporate culture of the organization to be an effective means against economic crimes. Specifically, 35% believe that these are very effective.

Interestingly, our research revealed that economic crime offences[3] were reported to law enforcement in less than half of the cases in Latin America as compared to approximately 60% globally. The survey results indicate that the perception that reporting the offence to the authorities continues to present a danger of collateral damage and remains on the minds of executives in companies in Latin America.

Globally, companies that reported offences to the authorities not only suffered less collateral damage, but also fewer interruptions to their outside business relations.

Highest level to which the offence was officially reported



[3] Defined as any economic crime, by way of example: asset misappropriation, accounting fraud and corruption.

Section 3: The emerging markets

This section combines the experiences of experts who contributed to the Global Economic Crime Survey research program (i.e., senior executives with responsibility for, and experience of, investing in these markets) with our own experiences of helping companies to identify and control fraud threats worldwide. PwC defined the following countries as the "Emerging Seven" or "E7": Brazil, China, India, Indonesia, Mexico, Russia and Turkey. In other words, these countries are developing markets that offer the most significant investment opportunities. With increased opportunity, one must be aware of increased risks, including corruption, staff security and integrity, as well as the legal environment in which these countries operate.

New ventures—new opportunities for fraud

Within Latin America, Brazil and Mexico are included within the E7. The survey indicates that the frauds which emerging markets are susceptible to are consistent to those which pose a risk to companies operating in the United States or globally. Rather, the difference that exists between countries in the emerging markets and the rest of the world is the extent to which internal controls and other preventative measure exist or efficiently exist in these countries.

Because companies in the United States have moved quickly over the last couple of years to take advantage of the growth opportunities afforded in these countries, certain operational processes have fallen short in safeguarding against certain fraud risks which may exist in more stable and developed markets.

Specifically, from our experience, it is not uncommon for a plant or office in Latin America to have a different accounting system from their parent domiciled elsewhere. This may represent a risk because different accounting systems do not allow for transparency and this may increase the opportunity for misconduct to occur and remain undetected.

Based on our experience in Latin America as well as the results of the study, we understand that conflicts of interest may be a significant risk given the commonness of doing business with family and friends.

Be prepared

As investments in Latin America continue to grow, so do the risks that a business may face when entering a new market. For businesses entering the emerging markets, we recommend understanding the particular fraud risks in this chosen market, particularly if you are a listed company and subject to anti-corruption laws like the Foreign Corrupt Practices Act ("FCPA"). In addition, prepare fraud risk management programs that specifically address these fraud issues in particular, rather than expecting your own country's models to be effective worldwide. Along these lines, conducting rigorous due diligence prior to any acquisitions, partnerships or joint ventures could save you the costs of withdrawing once the program has been established for some time, and fraud has been identified. Be prepared for action if you find a business partner, an acquisition, a joint venture partner or a member is behaving inappropriately.

The perception and the realities of fraud in Latin America

The chart below contains the types of economic crimes mentioned by the interviewees, encompassing the real incidence and the perception[4] incidence as prevalent in the market.

Note two significant differences:

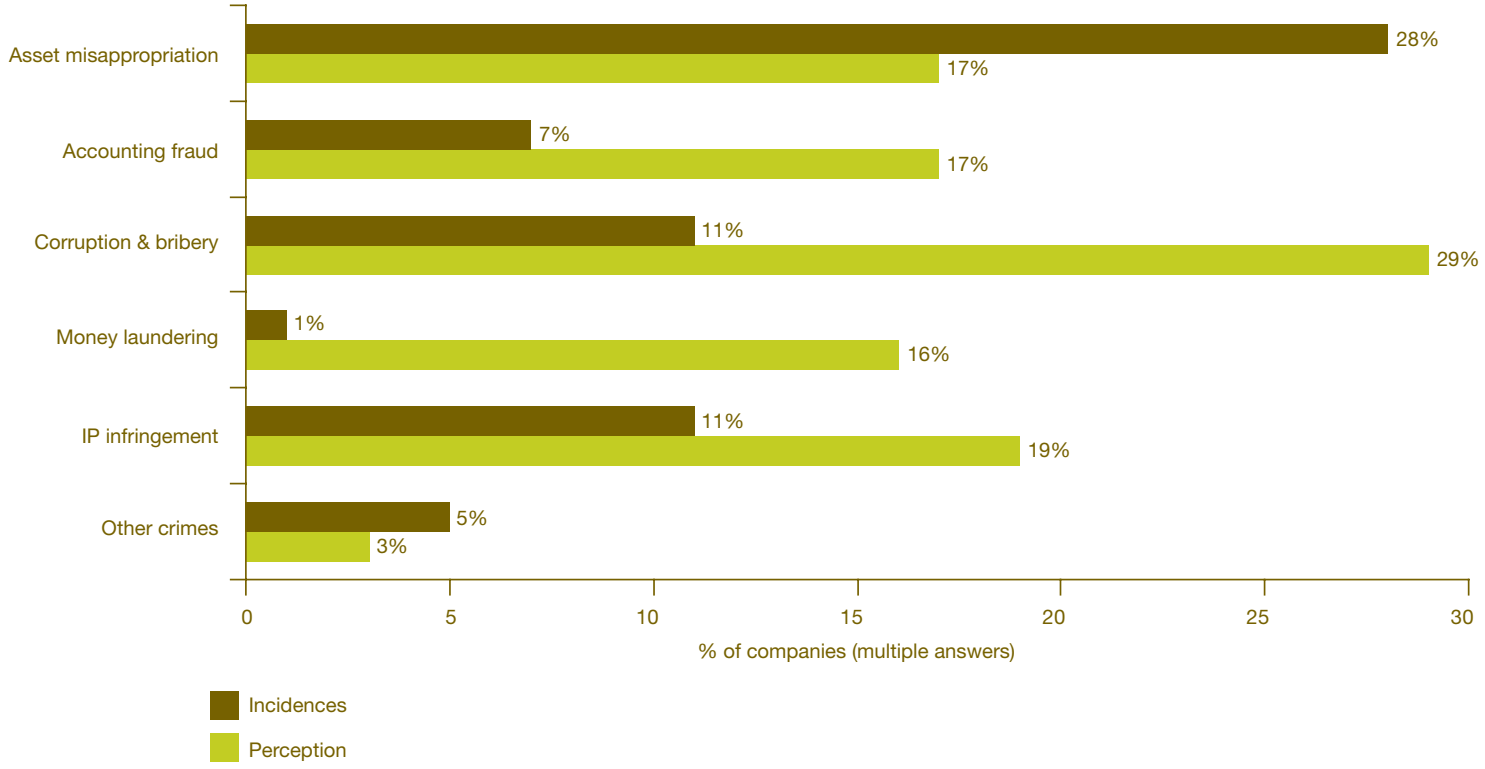
1. The perception incidence (29%) is more than double the real incidence (11%) for corruption and bribery; and
2. There is a smaller perception incidence (17%) of asset misappropriation cases in relation to the real incidence (28%).

In the first difference, it is possible that the respondent's opinions about the market in Latin America were influenced by the increased news of potential corruption cases in these countries, which was very intense during the period of this survey, specifically in Brazil.

Experts investing in Latin America perceive corruption and bribery as the most prevalent fraud type in the market. Conversely, in Brazil and Mexico, many categories of fraud have a perceived occurrence which may be higher than reality. Noted as a cause in the perception of corruption is the media attention to this type of misconduct. Also noted is that certain executives might be disinclined to come forward about the occurrence of corruption in their organizations. It appears that the perception of executives in Latin America with respect to corruption and bribery as compared to survey responses varied by approximately 18%.

In the case of asset misappropriation, the relatively low publication of news about this type of crime by companies may explain the discrepancy between the actual cases and the perception of incidences.

How the company deals with economic crime



[4] Real incidence refers to cases of economic crime suffered by companies and informed by the respondents. Perception Incidence refers to the respondents' perception about types of economic crimes that would be the most common in the set of companies, not only in their respective companies

It does not come as a surprise that generally speaking, there is a higher occurrence of companies asked to pay a bribe in the emerging markets, than there is globally or in the United States. In Latin America, companies were asked to pay a bribe in 48% of companies in Brazil and 28% of the companies in Mexico.

Regarding money laundering, the result can be explained by the minor susceptibility to this type of crime for the majority of the companies surveyed in Latin America.

Fraud of any type, be it corruption and bribery, asset misappropriation, or financial statement fraud, is costly and unsettling. Therefore, any way you look at it, deterrence is the preferable road to take. Preventing fraud, prior to it flourishing and grabbing your organization, should be the objective of any and all fraud deterrence programs.

The future of fraud

The future of fraud and how we handle cases of fraud lies in the hands of us all. Certainly in the emerging markets, instances of fraud have increased over the last couple of years although the study shows that company executives are complacent with regard to their existing fraud control systems. Furthermore, these executives classified the risk of falling victim to an economic crime over the next couple of years as low.

Whether the organization is categorized as belonging to an emerging market, a developed market, is in the public or private sector, it will always be at risk of fraud. Our intent is not to represent that one can ever eliminate the risk of fraud entirely, rather to provide insight into what organizations should be aware of and do in order to identify and offset certain risks. Among some of the key elements for accomplishing this is the implementation of effective internal controls, a culture that rewards behaviors that prevents and deters fraud, and one that penalizes behaviors that defy the culture. The right combination of deterrence, detection and investigation expertise is the most robust measure against the establishment of an effective anti-fraud program.

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