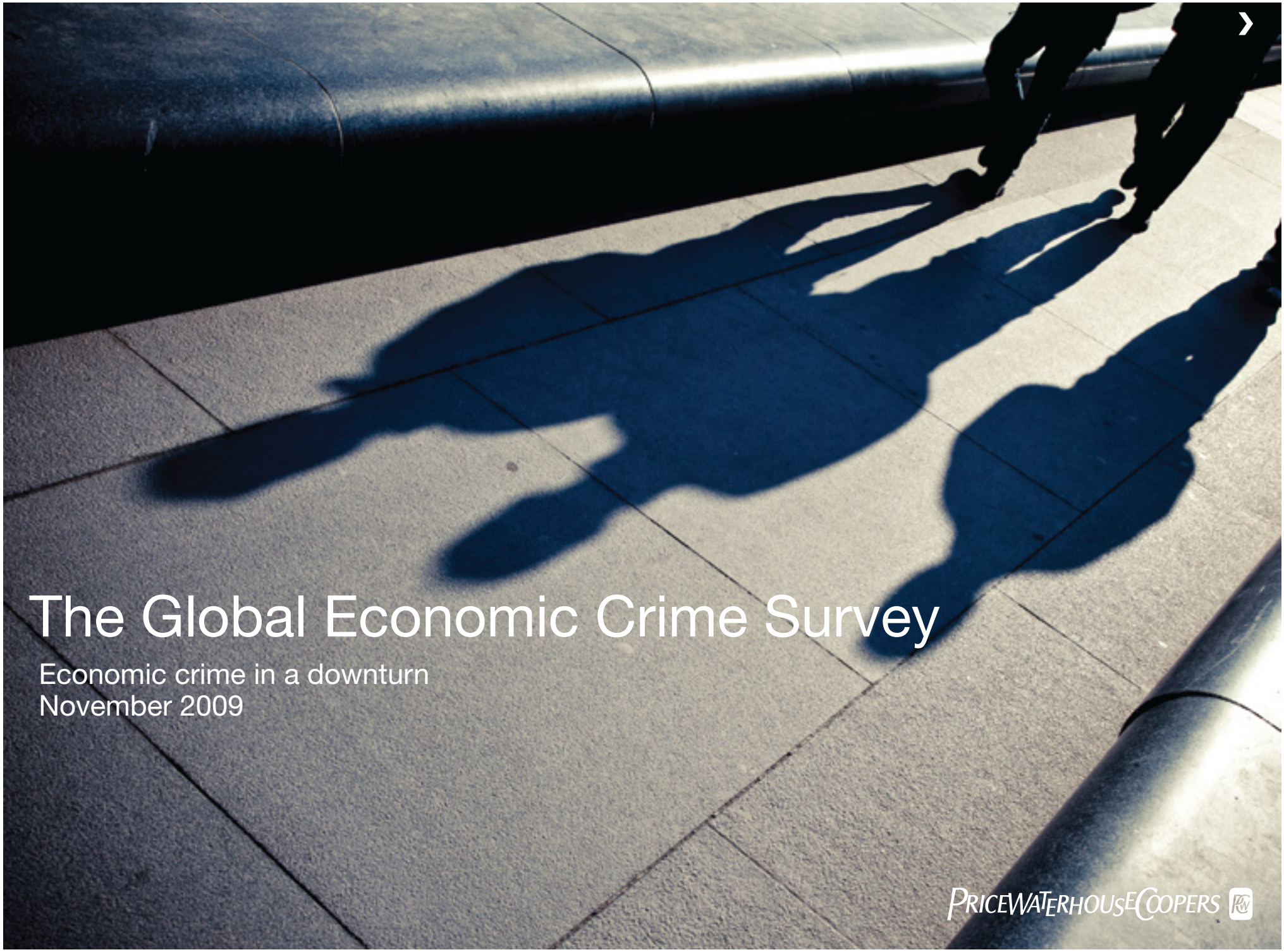

The Global Economic Crime Survey

Economic crime in a downturn
November 2009

PRICEWATERHOUSECOOPERS

Introduction

We are pleased to present our fifth Global Economic Crime Survey. Our 2009 survey scrutinised fraud and associated integrity risks during a period in which most territories around the world experienced either a dramatic economic downturn or at least a significant slowdown. Against this backdrop, the survey investigated the root causes of economic crime, and the way in which it affects businesses worldwide.

Economic crime is a truly global phenomenon. Over 3,000 senior representatives of organisations in 54 countries (including respondents spread from Australia to Venezuela) completed our web-based survey. To enable us to determine long-term trends, respondents were asked a number of 'core' questions on fraud. They were also asked a number of other questions specifically on the fraud threats that emerge in an economic downturn. With 62% of respondents reporting that their organisations had suffered a decline in revenues during the last 12 months, we were able to obtain some valuable insights into the types and causes of fraud in an economic downturn. Further details of the survey demographics are presented in the 'methodology and acknowledgements' section of this report.

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We are particularly grateful for the assistance of the INSEAD business school with the scope, content and subsequent interpretation of the survey data. Their involvement has added an extra dimension to the survey, bringing significant value to this year's report. We would like to take this opportunity to thank Professor Douglas Frank of INSEAD business school for his insights and contribution to the survey.

The aim of the 2009 survey was primarily to:

- Assess corporate attitudes towards economic crime in the current economic environment, particularly to understand how economic crime changes during an economic downturn; and
- Understand and explore the trends in relation to economic crime and the reasons why these might arise.

The 2009 survey was based on the following research strategies:

1. **Survey of organisation executives.** This survey delivers findings in which executives report their own experiences in the fight against economic crime. We surveyed the respondents to obtain information on the different types of economic crime, the impact of such economic crime, both financial and in terms of collateral damage, and the concrete causes of economic crime, as well as the range of remedial actions taken.
2. **Questions related to fraud in a downturn.** Our survey gives in-depth insights into fraud faced by organisations in times of economic downturn. Our focused investigation into this area has enabled us to understand the impact the downturn has had on levels, types and causes of economic crime.
3. **Analysis of trends over time.** Since beginning these surveys, we have continued to ask a core group of questions, and additional questions as appropriate to reflect current issues likely to be impacting businesses around the world. Because our data now encompasses a 10-year period, we are equipped to identify and assess long-term developments and trends in the fight against economic crime.

We have divided the report into the following sections:

- **Fraud thriving in the downturn** – in which we outline topical areas of interest arising from an economic downturn and the heightened risk of fraud, as well as the key themes arising from the core survey questions.
- **A deeper dive into 'the statistics'** – where we take a closer look at the statistics and at trends related to victims, types and perpetrators of fraud, the underlying causes and factors behind fraud and the impact on management and regulatory bodies. This section also highlights differences in results reported by respondents across the world.
- **The fraud horizon** – here we identify fraud trends in the future, as well as what organisations may be able to do to combat them.

Our survey shows that economic crime continues to be a serious issue affecting organisations worldwide, despite increasing regulatory actions. This is particularly so today, in an environment where the global economic downturn has significantly increased pressures on organisations and individuals to perform, creating more incentives for frauds, and generating more opportunities for fraudsters to perpetrate their crime.

In this climate, we are continuing to develop our knowledge and understanding of fraud and its perpetrators. With this insight, we are able to recommend what organisations can do when it comes to tackling fraud. We are very grateful to all the respondents and organisations that participated in the survey, without whom we would not have been able to produce this report. Crucially, we hope that our findings will further assist readers in their ongoing fight against economic crime.

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Economic crime thriving in the downturn

Fraud – pervasive, persistent and pernicious

One in three respondents reported economic crimes in the last 12 months within their organisations in the country in which they were primarily based. The survey data shows that the incidence of economic crime varies by territory; some countries, mainly those in emerging markets, experienced much higher levels of fraud than the average, as much as 71% in one country (see table under 'the global picture' section); by industry sector, some (notably insurance, financial services and communications) reporting higher levels of fraud than others; by size and type of organisation. But no organisation is immune.

Of the 3,037 respondents to our survey globally, 905 (30%) reported having experienced at least one incident of fraud in the last 12 months alone. Not surprisingly, the global economic downturn has significantly affected most organisations, with 62% of respondents having reported a decline in financial performance over the last 12 months and 40% of all respondents saying that the risk of economic crime had risen due to the recession. Indeed, almost half of our respondents believed that the incidences and cost of fraud

(43% and 42%, respectively) experienced in the past year were greater compared to 12 months ago.

Given the 40%-60% split in views as to whether the recession had increased the risk or the incidence of economic crime, we expected that the 38% of organisations reporting no impact of a downturn would have better, that is lower economic crime experience. We found, however, that organisations that had not suffered from an economic downturn reported similar levels of economic crime as compared to those whose businesses had declined. We also expected that respondents reporting a stable level of financial performance would have reported fewer frauds, but they report the same frequency of incidents as the 62% of respondents reporting a decline. This demonstrates that all organisations, whether or not suffering a decline in financial performance in a downturn, are at risk of economic crime. Hence, we conclude that economic crime remains a pervasive business risk, which does not discriminate among

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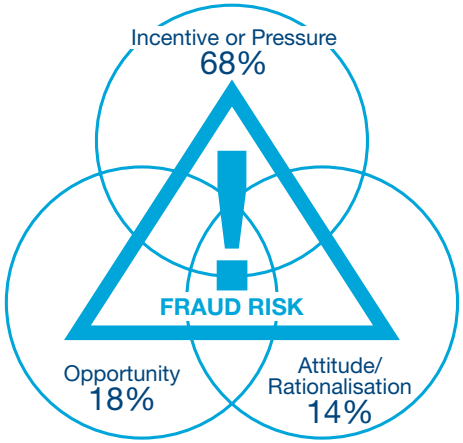
its victims based on the relative degree of their financial performance. However, our survey results show that those organisations suffering from a downturn reported notably higher levels of one type of economic crime, that is accounting fraud, which we address later in this report.

Fraud practitioners often point to three factors that are commonly found when fraud occurs (Fraud Triangle). First, perpetrators of fraud need an *incentive* or *pressure* to engage in misconduct. Second, there needs to be an *opportunity* to commit fraud, and third, perpetrators are often able to *rationalise* or justify their actions. Our survey probed deeper into the impact of these three factors and found that among the respondents who believed that there is a greater risk of fraud in the current economic environment:

- 68% attributed greater risk of fraud to increased 'incentives or pressures';
- 18% reported that 'more opportunities' to commit fraud was the most likely reason for greater risk of fraud; and
- 14% believed that people's 'ability to rationalise' was the main factor contributing to greater risk of fraud (see figure 1).

Figure 1: Fraud triangle

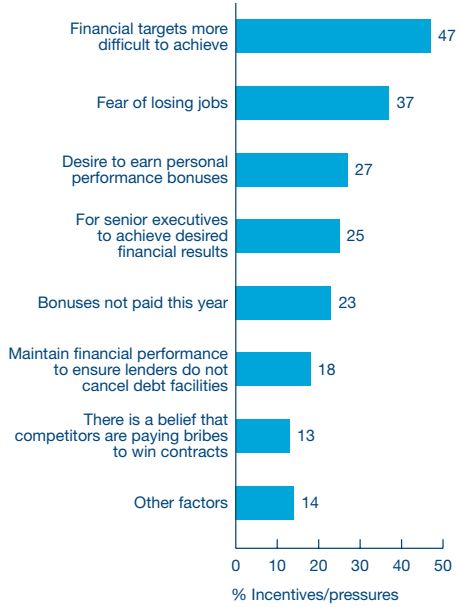


Interestingly, among the respondents who believed that there is a greater risk of fraud in the current economic environment, two-thirds felt that increased incentives or pressures are the most likely underlying cause. The most commonly reported factor contributing to these increased pressures and incentives was that *'financial targets were more difficult to achieve'*, covering both individual targets and those for the business as a whole.

Clearly, in an economic downturn, financial targets are more difficult to achieve, and are often over ambitious. Organisations would therefore be well advised to be realistic when setting their targets, as well as being more prepared to adjust targets downwards when faced with evidence of a downturn. Our survey highlighted that no industry or organisation is immune to fraud and it would appear that the current economic situation is leading to severe, often cut-throat competition. Individuals feel under pressure to achieve targets when times become difficult, or when it seems impossible to achieve targets. Furthermore, an individual's personal position may be threatened by reductions in pay or the risk of possible unemployment. Consequently, the temptation to inflate revenues, and/or omit expenses, is more likely to overrule ethical values.

Our survey revealed that a key factor resulting in increased pressure to commit fraud is job security. Of the respondents who believed that underlying pressures or incentives are the main drivers for greater fraud risk, 37% reported that *'People are afraid they might lose their jobs'* (see figure 2). Furthermore, when employees are terminated, those who remain employed feel increasingly pressured where they feel that their own jobs are under threat. Employee termination and additional cost reduction measures may be inevitable in a downturn, but management should consider whether such actions could, in turn, compromise the organisation's ability to fight economic crime.

Figure 2: Factors contributing towards increased incentives/pressures to commit fraud



% respondents who believe increased incentives/pressures are the most likely reason for greater risk of economic crime in a downturn

Among the 40% of respondents who believed that there is a greater risk of fraud in the current economic environment, 18% identified increased opportunities for committing fraud as the root cause (see figure 1). In this respect, *'Staff reductions resulting in fewer resources deployed on internal controls'* was identified as the main contributory factor (62%, see figure 3). Financial difficulties in a downturn

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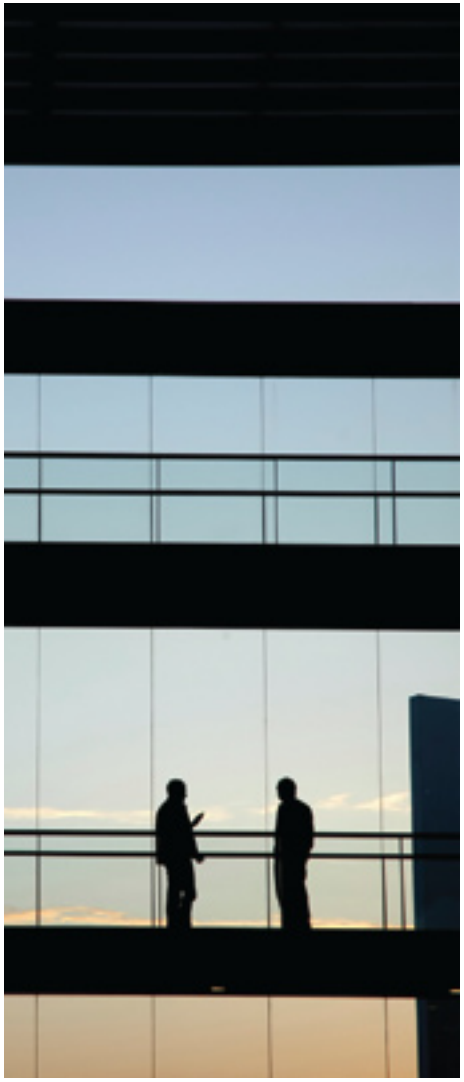


force organisations to reduce costs and explore areas where efficiencies can be generated. Staff reductions can result in reduced segregation of duties and less monitoring of suspicious transactions and activities. This, in turn, weakens the internal control environment and is often likely to result in more opportunities to commit fraud.

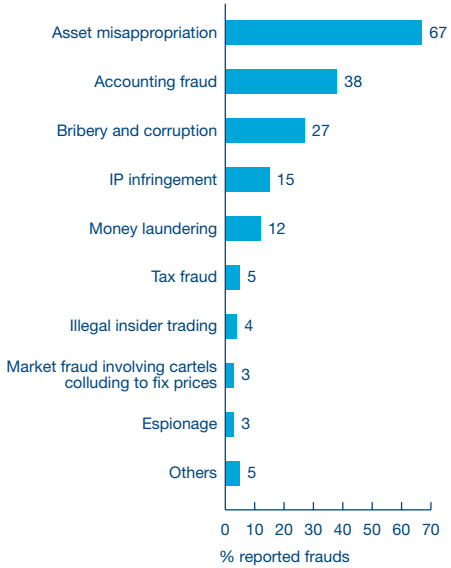
Figure 3: Factors contributing towards creating more opportunities to commit fraud

% respondents who believe more opportunities constitute the most likely reason for greater risk of economic crime in a downturn

Sharp rise in accounting frauds

Economic crime takes on many different forms, some more common than others. Figure 4 shows the types of economic crime suffered by those respondents who reported experiencing economic crime in the last 12 months.

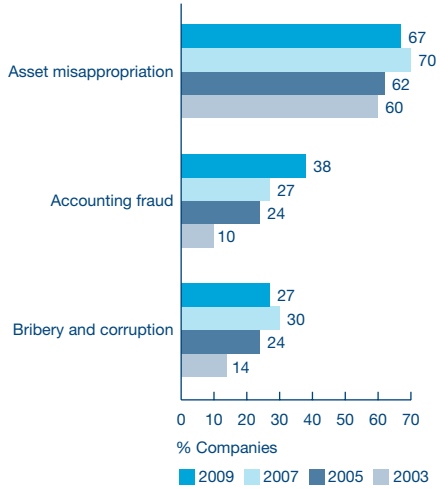
Figure 4: Types of economic crimes



% respondents who experienced economic crimes in the last 12 months

Figure 4 shows that the three most common types of economic crimes experienced in the last 12 months were asset misappropriation, accounting fraud and bribery and corruption. Figure 5 shows the trend in these three main types of fraud reported in our last four surveys.

Figure 5: Trends in reported frauds



% respondents who experienced economic crimes

Two-thirds of those respondents who have experienced economic crime in the last 12 months reported having suffered asset misappropriation (see figure 5). This type of fraud – the most prevalent since we began these surveys 10 years ago – covers a variety of misdemeanours and while it is the hardest to prevent, it is arguably the easiest to detect.

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However, in our 2009 survey, accounting fraud has become increasingly prevalent. Of those respondents who reported economic crime in the last 12 months, 38% reported experiencing accounting fraud. This form of economic crime has significantly increased since 2007 (see figure 5), and this appears to be linked to the economic cycle.

The survey results highlight that accounting manipulations are most common within listed organisations and least common in family-owned organisations. When we looked at the factors prevalent in this type of fraud, respondents pointed to *'financial targets being more difficult to achieve'* (47%), and *'senior management wanting to report a desired level of financial performance'* (25%).

Accounting fraud encompasses a variety of fraudulent actions including accounting manipulations, fraudulent borrowing/raising of finance, fraudulent application for credit and unauthorised transactions/rogue trading.

Accounting fraud – a case study:

There have been allegations by a whistle-blower of earnings manipulation at a subsidiary, XYZ Plc/Inc/Ltd/SA (it could happen anywhere). The organisation has operations in 140 countries, has 55,000 employees and a turnover of $33.6bn.

What actions are needed to investigate?

- Appoint an independent counsel and forensic team with the right skills and experience.
- Set the scope correctly/seek independent advice on scope.
- Look beyond the allegations – consider other areas of the business/individuals indirectly implicated by allegations.
- Engage fully with the audit firm as to the scope and approach and allow them access to the detailed results.
- Do not let time pressures dictate actions, delay the audited results, if necessary.

Globally, 27% of respondents experiencing economic crime reported having experienced bribery and corruption cases in the last 12 months (see figure 5). The risk of bribery and corruption is present in most transactions and in all territories in which an organisation operates, but of particular concern are dealings with government officials in emerging markets, where bribery and corruption is more prevalent, and where an

organisation uses sales agents and distributors, and therefore control is reduced.

In recent years there has been a sea change in attitudes towards bribery and corruption globally, resulting in increased regulatory enforcement. Regulators are taking an increasingly dim view of organisations and individuals that have paid or received bribes in order to secure contracts and business

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With FCPA enforcement on the rise, countries around the world are:

- Criminalising acts of corruption, as signatories to international anti-corruption frameworks such as the UNCAC and the OECD Anti-bribery Convention;
- Investigating and prosecuting individual executives, not just organisations;
- Collaborating with other governments to prevent transnational corruption;
- Creating anti-corruption bodies, such as a supreme audit board and specialised enforcement agencies;
- Creating effective legal systems for seizing, freezing and confiscating the assets or proceeds of a crime;
- Developing transparency in government operations and public procurement, and establishing enforceable codes of conduct for government officials.

Given this globalisation of anti-corruption, organisations should consider:

- Performing due diligence on their business partners, personnel and contracts involved in a new-market expansion;
- Streamlining and integrating payment systems to easily see where, why and how much money is being spent;
- Regularly testing payment systems and controls to ensure all expenditures are accounted for – at all times;
- Issuing clear organisation policy on what constitutes unacceptable behaviour, and enforcing the prescribed consequences;
- Thoroughly (and annually) training employees to address the impacts of international anti-corruption standards;
- Performing frequent field tests to determine whether employees understand organisation compliance policy.

licences. Readers will be aware of increased regulation in most parts of the world, partly as a result of pressure being brought to bear by organisations such as the OECD, United Nations and the World Bank, and anti-corruption prosecutors. This trend is likely to continue as more territories introduce or strengthen anti-corruption legislation and/or strengthen enforcement actions in response to global pressures.

Fraud detection – The tip of an iceberg?

Fraud risk assessments are essential for identifying potential fraud threats and weaknesses in controls that create opportunities to commit fraud. In our 2009 survey, 14% of reported frauds were detected through risk management measures, including preventative fraud risk assessments as against only 4% and 3% detected by these means in 2007 and 2005, respectively (see figure 7).

The following results were obtained when we asked our respondents to report how often their organisation has performed a fraud risk assessment:

Table 1: Frequency of fraud risk assessments

	Survey count	Percentage
Monthly	181	6%
Quarterly	351	11%
Every six months	354	12%
Once in the last 12 months	937	31%
Not at all	855	28%
Don't know	359	12%
Total	**3,037**	**100%**

In light of the apparent increase in the level of economic crime reported by respondents, it is alarming to see that, in the last 12 months, 28% of respondents did not perform a fraud risk assessment and another 31% performed this task just once. Organisations need to review their fraud risks on a regular basis – if they do not properly understand the risk of fraud inherent within their businesses, then how can they proactively take measures to combat it?

Our survey shows a correlation between reported frauds and the frequency of fraud risk assessments performed by organisations. Those that carry out fraud risk assessments also report more fraud. Conversely, those organisations that did not carry out any fraud risk assessments (28% of all respondents), detect less fraud (26%, see figure 6). In other words, if you look for fraud you will find it.

Figure 6: Correlation between % of respondents experiencing economic crime and frequency of performance of fraud risk assessments

% respondents who experienced economic crimes in the last 12 months

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As noted earlier, 43% of the respondents who reported fraud believed there has been an increase in the level of economic crime compared to 12 months ago. However, 63% of respondents have made no change to the frequency of fraud risk assessments in the same period. Since fraud is not a static threat, organisations continually need to assess their fraud risks. The importance of addressing fraud risks should be conveyed from the top down, with the objective being to develop a robust anti-fraud framework.

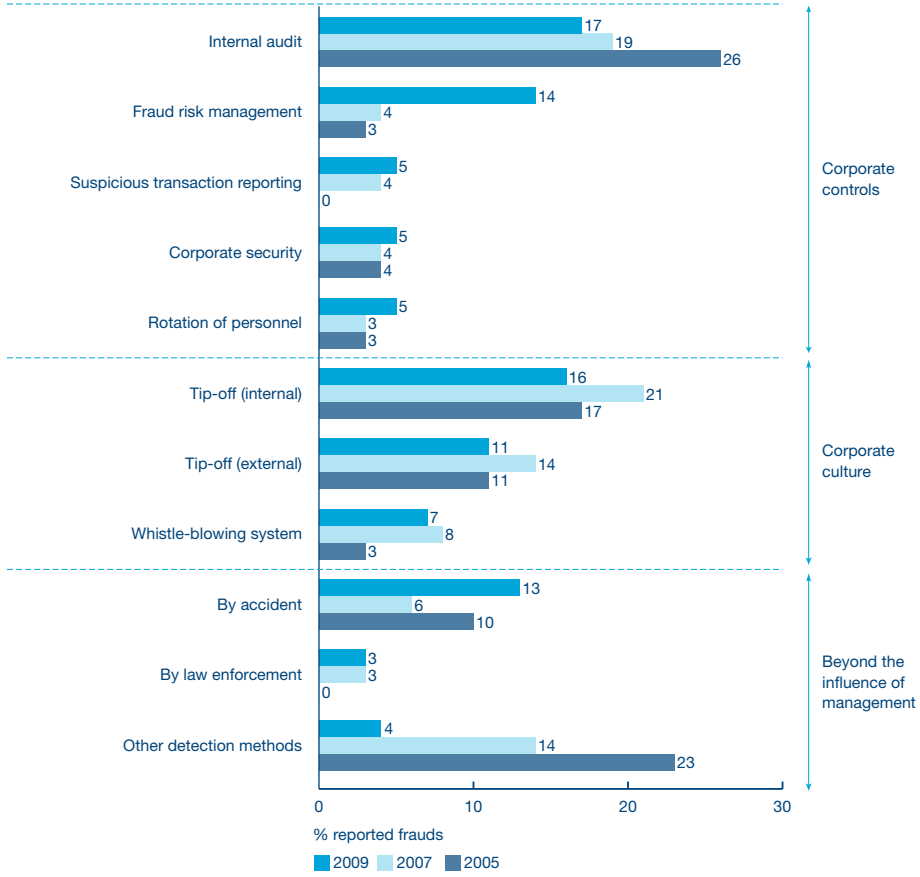
A comprehensive fraud risk assessment should:

- Identify the potential inherent fraud risks.
- Assess the likelihood and significance of occurrence of the identified fraud risks.
- Evaluate which people and departments are most likely to commit fraud and identify the methods they are likely to use.
- Identify and map existing preventive and detective controls to the relevant fraud risks.
- Evaluate whether relevant controls and processes are effectively designed to address identified fraud risks
- Identify and evaluate residual fraud risks resulting from ineffective or non-existent controls.
- Respond to residual fraud risks.

Our survey statistics also show that 17% of the frauds reported were detected by internal audit (see figure 7), which emerged once more as the means by which most frauds were detected. As noted earlier, almost two-thirds of those who suffered economic crime in the last 12 months believed that the opportunities to commit fraud have increased with reduced resources deployed in internal controls. Perhaps the detection of fraud incidences has fallen with reduced staff within the internal controls team. As such, it is apparent that, if there had not been any reductions in internal control staff levels, more frauds could have been detected.

While internal audit remains key to the detection of fraud, there is a clear trend in recent surveys – internal audit is consistently detecting less of the frauds reported (see figure 7). Anti-fraud controls, especially risk management, were reported having detected more frauds in our current survey. Thus the combination of an anti-fraud culture and effective anti-fraud controls, as we recommended in our 2007 survey report, appears to be improving the detection of economic crime.

Figure 7: Detection methods



% respondents who experienced economic crimes in the last 12 months for 2009; and in the last 2 years for 2007 and 2005

Globally, 7% of frauds were detected through formal whistle-blowing procedures. This may suggest either the ineffectiveness or the absence of such procedures, which could be due to a lack of support within organisations, insufficient publicity and/or leadership not being seen to take whistle-blowing seriously.

A deeper dive into 'the statistics'

The depth and breadth of our research allowed us to drill down deeply into the responses we obtained, before grouping data and comparing it in the following ways.

The global picture – fraud reporting differs from territory to territory

Of the 3,037 respondents globally, 905 (30%) reported having experienced fraud in the last 12 months. However, the level of fraud reporting differs significantly from territory to territory. Table 2 illustrates the wide variation of reported frauds by territory.

Organisations in territories where relatively low levels of fraud were reported have either failed to detect it or have been reluctant to report it once uncovered.

Table 2: Of the territory respondents, percentage that reported fraud

Territories that reported high levels of fraud (40% or more)	% Organisations
Russia	71%
South Africa	62%
Kenya	57%
Canada	56%
Mexico	51%
Ukraine	45%
UK	43%
New Zealand	42%
Australia	40%
Territories that reported low levels of fraud (20% or less)	**% Organisations**
Italy	19%
Sweden	19%
Singapore	18%
India	18%
Indonesia	18%
Switzerland	17%
Finland	17%
Romania	16%
Netherlands	15%
Turkey	15%
Hong Kong	13%
Japan	10%

While there are some exceptions, our survey shows relatively few frauds being reported by respondents in Asia and some territories in Scandinavia. Conversely, respondents in Eastern and Western Europe were among those reporting the highest incidence of fraud. Those territories where more than 40% of respondents reported fraud consisted of a mix of developed economies and emerging territories.

The bigger the organisation, the harder the fall

Size matters when it comes to the number of incidences of fraud reported. The respondents to our survey were employed in small, medium and large organisations, in almost equal proportion as shown in the survey demographics in the methodology and acknowledgements section of the report. Our survey shows a correlation between the size of the organisation (as measured by the number of employees) and reported incidences of fraud in the last 12 months. In our 2009 survey, 46% of organisations with more than 1,000 employees reported having experienced at least one incident of economic crime (see figure 8).

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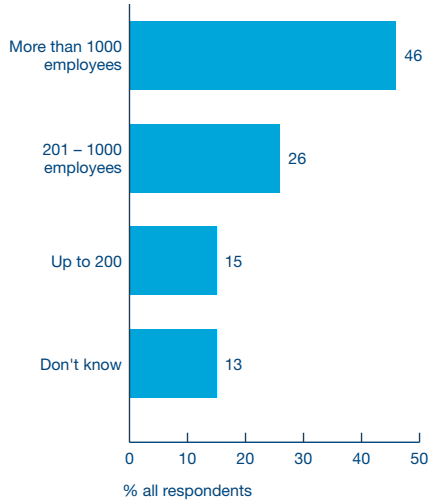
Figure 8: Large organisations report more frauds



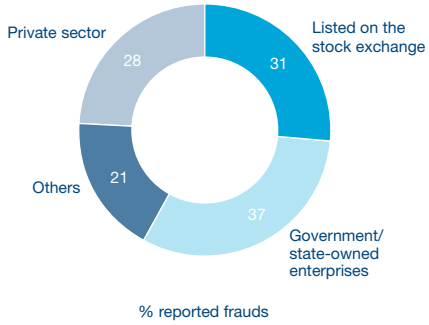
% respondents representing different sizes of organisations

This has been a consistent picture in all of our previous surveys, where the larger organisations report the highest number of frauds. Figure 8 shows that organisations with more employees are more likely to report at least one fraud event. This is not surprising since "the bigger the bag of 'apples' the more likely it will contain at least one rotten one". In addition, larger organisations will typically be the ones with the most robust fraud detection structures. That said, it is also worth remembering that there are more places to hide in large organisations. In other words, there may be even more frauds taking place in those organisations – but they have, for the time being, escaped detection.

Organisation type – do government/state-owned enterprises have a greater threat of economic crime?

The results of our survey show a possible link between the type of organisation and the level of economic crime experienced. Between 21% and 37% of organisations, when grouped by type, reported having suffered economic crime in the last 12 months (see figure 9). This underlines the fact that all organisations are susceptible to fraud. Those in government/state-owned enterprises, however, reported the highest level of economic crime (37%). They also believed themselves to be exposed to the greatest risk of economic crime (47%) in the current economic climate.

Figure 9: Frauds reported by various types of organisations



% respondents representing individual organisational types

In light of this, it is interesting that government/state-owned enterprises should also be the most satisfied with current regulations (32% thought that regulatory/legal authorities were quite or very effective). While these organisations may be the target of certain fraudsters, the survey suggests that the main factor contributing to such high levels of fraud in government/state-owned enterprises is a lack of internal fraud prevention know-how and/or fraud prevention procedures.

This is supported by the fact that a relatively large proportion of the frauds in government/state-owned enterprises (18%) were detected by accident, with just 5% being uncovered through formal whistle-blowing procedures. One-third of government/state-owned enterprises detected fraud through informal procedures (via tip-offs). This is higher than the global average of 27% (and perhaps due to a lack of trust in formal procedures). In addition, although 47% of government/state-owned enterprises' respondents believed that they were at a greater risk from fraud, only 22% increased the frequency of their fraud risk assessments.

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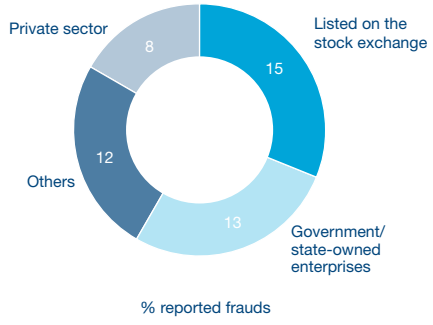
The government/state-owned enterprises are consistently plagued by cost issues. Many of these organisations have been presented with increasingly tough cost-reduction targets in recent years, and these are becoming even more onerous in the current economic climate.

While government/state-owned enterprises are most likely to report fraud, listed organisations are most exposed to repeat attacks (15% of listed organisation respondents experienced 100-plus incidences of fraud in the last year – see figure 10).

Figure 10: More than 100 incidences of fraud reported by various types of organisations

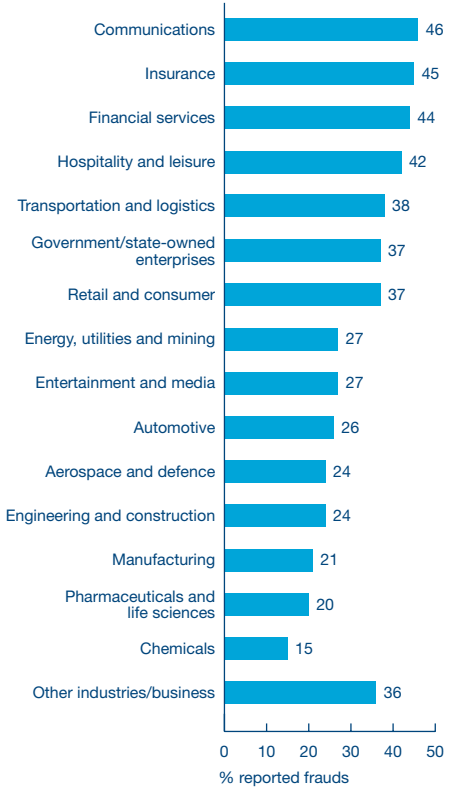


% respondents representing individual organisational types

No industry is immune

Turning to the most fraud-prone industry sectors, a pattern that will be familiar to readers from our previous surveys emerges:

Figure 11: Fraud reported by industries



% respondents representing individual industry sectors

The industry sectors that reported having experienced most economic crimes are communications, insurance, financial services, and hospitality and leisure. These industries tend to be targeted by fraudsters because of their product or service; equally, organisations in these industry sectors tend to have more robust and proactive anti-fraud measures. In effect, they both suffer and detect more fraud than other sectors.

In 2007, the top four industries reporting fraud were insurance, retail and consumer, government/state-owned enterprises, and financial services. Indeed, due to the nature of their business, insurance and financial services have reported consistently high levels of fraud over the last 10 years. The 2009 survey also shows that financial services is the sector that has experienced the largest increase in fraud (56% of respondents reported an increase in the number of incidences in the last 12 months). This compares with the average global figure of 43% of organisations across all sectors reporting an increase over the same period.

Relatively high levels of bribery and corruption were reported by respondents in the engineering and construction industry (47%),

and energy and mining industry (43%). These industries are renowned for their exposure to bid rigging and 'kickbacks'. Organisations in these sectors clearly need to pay particular attention to this area over the coming years.

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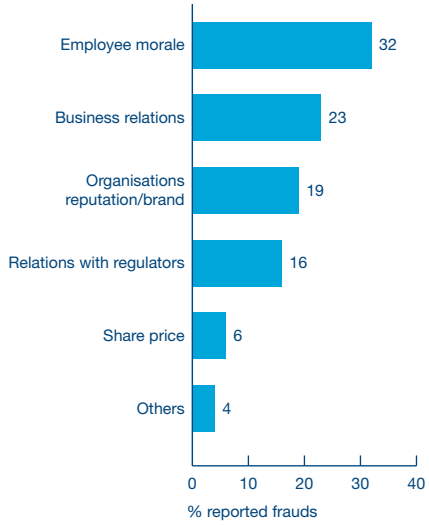
Beyond the financial consequences

Of the respondents that reported incidences of fraud over the last 12 months, 27% said that the direct financial impact of this exposure was more than US$500,000. But the cost of fraud varies, depending on the type of fraud suffered. One-quarter of the respondents who reported accounting fraud believed that it had cost them more than US$1 million in the last 12 months. By contrast, among respondents reporting incidences of asset misappropriation, only 17% believed that it had cost them over US$1 million. In view of the high incidence of accounting fraud reported by our respondents, the comparatively costly financial impact of this exposure is evidently a significant problem for many organisations.

However, the fallout from fraud is not simply the direct cost. Our survey also investigated the collateral damage suffered by organisations and asked about the impact economic crime had on their reputation/brand, share price, employee morale, business relations, and relations with regulators (see figure 12). Interestingly, most respondents do not see collateral damage to cause significant impact, perhaps because it is very difficult to quantify such costs.

Figure 12: Collateral damage



% respondents who experienced economic crimes in the last 12 months

However, most damaging, according to our survey, is the impact of fraud on employee morale (reported as 'very significant' or 'significant' by 32% of respondents). In reality, it is impossible to quantify the cost of this type of collateral damage (or any other type), but it should be of real concern to organisations – no one likes to see headlines about fraud within the business, and this type of coverage can put off, not just employees, but also investors, suppliers, customers and potential recruits.

Building a zero-tolerance culture

Senior executives reported less fraud than other employees, suggesting that they may not be sufficiently aware of the full extent of economic crimes in their organisation. However, fundamental to the fight against fraud is the attitude and ethical stance demonstrated by those at the top. If organisations want to get the 'tone at the top' right, senior executives need to be better informed about the fraud risks they are facing.

Our survey further revealed that just 26% of senior executives reported an incidence of economic crime in their organisation in the last 12 months. By contrast, 34% of respondents other than senior executives reported an incidence of economic crime in the same period. Either senior executives are not reporting incidences of crime or they are not being made aware of certain types of economic crime.

While smaller-value frauds may not be escalated to senior management, it is the case that even a relatively minor incident can cause significant reputational damage. We strongly believe that senior executives should take an active interest in fraud risks within their organisation. By doing so, and by demonstrating the highest ethical behaviour, together with robust disciplinary action where the perpetrators of fraud have been identified, the right 'tone from the top' can be established. Conversely, senior executives who appear unconcerned about fraud within their organisation may – through a lack of attention and focus – unwittingly foster environments where certain types of fraud are perceived to be permissible.

Establishing the right 'tone at the top' is acknowledged to be key in the fight against fraud. Certainly, one useful deterrent for economic crime has proved to be a corporate governance structure, setting out robust escalation procedures through which employees can report their concerns on a confidential basis, secure in the knowledge that anyone found to have committed fraud will be severely dealt with.

As we have seen, the impact of fraud on employee morale can cause collateral damage. Furthermore, of the respondents who attributed greater levels of fraud to increased rationalisation within their organisations,

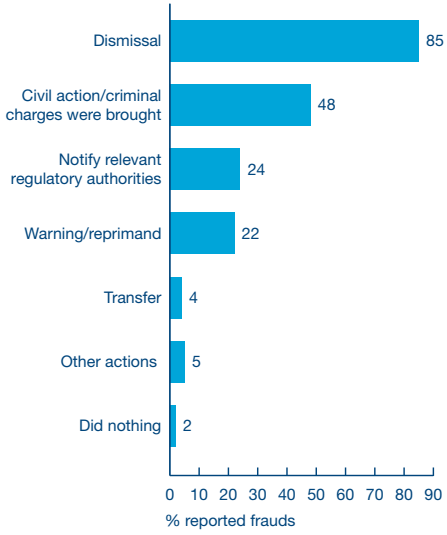
Continued ❯

35% identified 'others do it so it's okay' as being a contributory factor. These results emphasise the importance of effective communication (a zero-tolerance policy) between management and employees where attitudes to fraud are concerned.

When the appropriate message from senior management is not conveyed and/or reinforced through appropriate actions and behaviours, fraud can have a much more damaging impact on an organisation. The complex cultural challenges that arise in the fight against fraud can only be overcome if the workforce has been equipped with the right skills. A crucial part of this process involves senior management empowering and motivating employees 'to do the right thing, because it is the right thing to do'.

Once a financial crime has been identified, there are a variety of actions that can be taken by an organisation. Our survey shows that, in the majority of cases, internal perpetrators tend to be dismissed. Interestingly, levels of dismissals for these crimes have doubled in the last two years (85% in 2009 – see figure 13, 40% in 2007). In effect, organisations looking for a reason to reduce labour and its associated costs in the economic downturn, have been presented with 'easy pickings'.

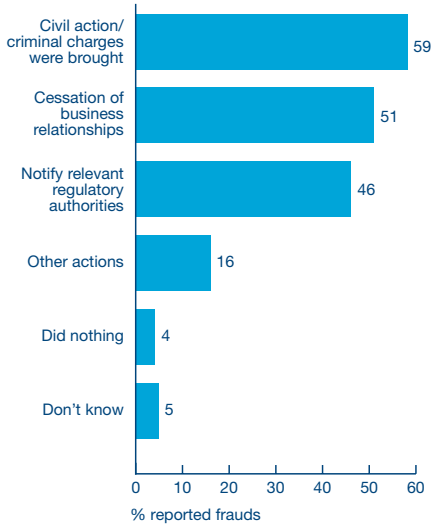
Figure 13: Actions brought against internal fraudsters



% respondents who experienced economic crimes in the last 12 months

But although there has been an increase in the number of dismissals, another 22% of respondents reported issuing only warnings or reprimands. This may reflect the varying severity of frauds that were uncovered by these organisations but, if a fraudster believes that the punishment for committing the crime will be minimal, he or she may be encouraged to perpetrate it. For external perpetrators, the majority of organisations chose to bring civil and/or criminal charges (59%), to terminate the business relationships (51%) and/or notify the relevant regulatory authorities (see figure 14).

Figure 14: Actions brought against external fraudsters



% respondents who experienced economic crimes in the last 12 months

Compensation structure – is this a breeding ground for frauds?

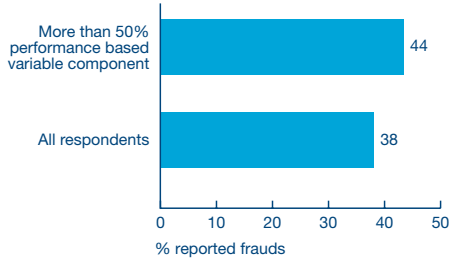
Our survey shows that among respondents who reported economic crime, 12% said that, in their organisation, the senior executive compensation includes more than 50% based on performance, that is, variable component, whereas 11% said that the senior executive compensation had no variable component. In organisations where senior executive compensation includes a performance-based variable component of more than 50%, 36% reported having suffered fraud. In contrast, where there was no variable performance-based component, only 20% reported having suffered fraud. This stark contrast may suggest that there is a correlation between the two. Additionally, it appears that each of the most common types of fraud – asset misappropriation, accounting fraud, and bribery and corruption – are most prevalent when there is a higher variable component in the senior executives' compensation structure. It may, at first sight, seem odd that higher levels of asset misappropriation, for example, arise where the senior executives receive a relatively high performance-based compensation. However, in times of economic uncertainty, and faced with increased personal financial pressures, it could be that some individuals are tempted to increase their earnings by foul means, possibly because of perceived unfairness of their own earnings compared to those of senior executives.

Continued ❯

Among organisations where senior executives' compensation structure includes more than a 50% variable component, 44% of those reporting fraud in the last 12 months suffered accounting fraud, whereas, from all respondents, 38% of those reporting fraud experienced accounting fraud (see figure 15).

Organisations need to be aware of the apparent heightened fraud risks in this situation. They should implement appropriate controls and monitor closely to combat the risk.

Figure 15: Accounting fraud reported by all respondents versus those who reported that the senior executives' compensation includes more than 50% performance-based variable component

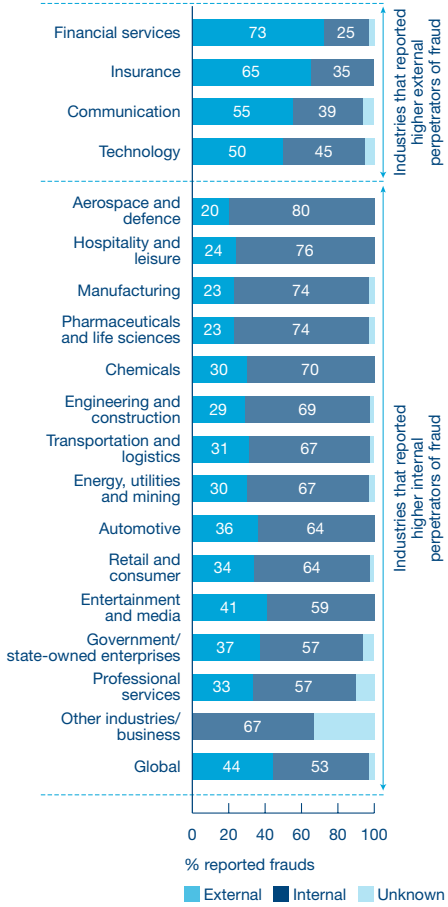


% respondents who experienced economic crimes in the last 12 months and % respondents from organisations where senior executives' compensation includes more than 50% performance-based incentives

Know your enemy

As with previous surveys, the split between internal and external perpetrators of economic crime was fairly evenly matched. Organisations that suffered from economic crime reported that 53% of perpetrators were internal and 44% were external. However, when we reviewed the responses by industry sectors, we found that there were four industries (financial services, insurance, technology and communications) that reported their most significant frauds being committed by external perpetrators. Respondents from these four industries alone represent 28% of all responses to our survey. Respondents from all other industry sectors reported suffering the most significant frauds at the hands of internal perpetrators.

Figure 16: Perpetrators of fraud – by industry



% respondents representing individual industry sectors

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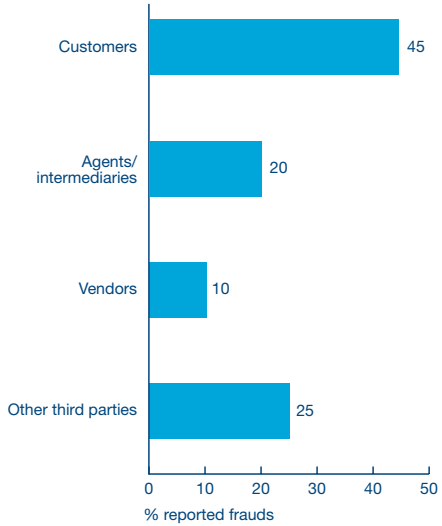
Of the respondents who reported attack by external perpetrators, 45% had suffered fraud by customers and 20% by agents/intermediaries (see figure 17).

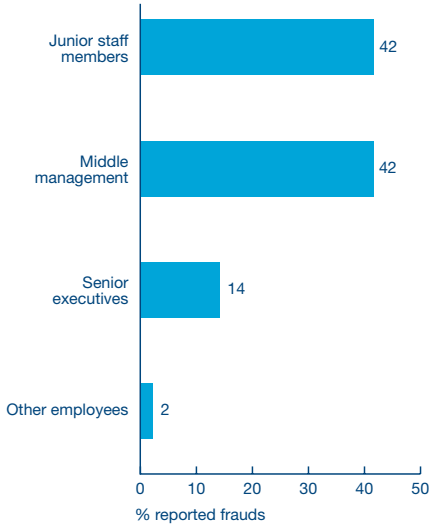
Figure 17: Profile of external fraudsters



% respondents who reported that an external person was the main perpetrator of fraud

The survey also found that the profile of the internal fraudster is changing rapidly. Economic crimes committed by middle managers have risen very strongly, now accounting for 42% of all internal frauds, up from 26% in 2007 (see figure 18).

Figure 18: Profile of internal fraudsters



% respondents who reported that an internal employee was the main perpetrator of fraud

The rise in frauds being committed by middle management could be viewed in the context of increased financial pressures in the current economic climate. Of respondents who said fraudsters increased ability to 'rationalise' their actions was the most likely cause of fraud, 70% believed that crimes are committed to maintain living standards. Of this group, one in five believed these crimes are committed by those jealous of higher earners whose compensation or bonuses were believed to be unfair.

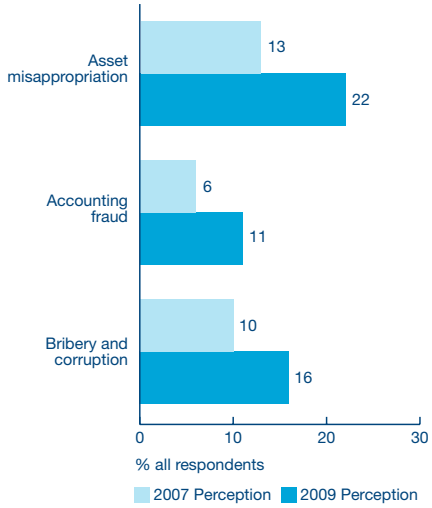
'Middle managers defraud employers to maintain living standards'

The fraud horizon

Respondents to our surveys have consistently estimated that their future fraud exposure is less than their current experience. With hindsight, however, this confidence is often shown to have been misplaced.

When asked about the most likely fraud threats in the next 12 months, respondents to our survey identified asset misappropriation, accounting fraud and bribery and corruption. Hardly surprising since these types of economic crimes were, after all, the most commonly experienced frauds over the last 12 months. However, as we explore later, such expectations have often been shown to be incorrect in the past – and may well prove to be so in future.

Figure 19: Trends in perception of fraud



% all respondents' perception over the next 12 months for 2009; and over the next 2 years in the 2007 survey

Overall, there has been an increase in perception levels around the three most common types of fraud. 22% of all respondents believe that their organisation is susceptible to asset misappropriation within the next 12 months. Similarly, 11% and 16% of all respondents believe that their organisations may suffer accounting fraud or bribery and corruption, respectively (see Figure 19). This is consistent with the overall greater fraud risk in the current economic climate – more fraud is expected to lie ahead.

While general awareness of the susceptibility to economic crime has increased, the findings of our surveys over time typically highlight a gap between perception and reality.

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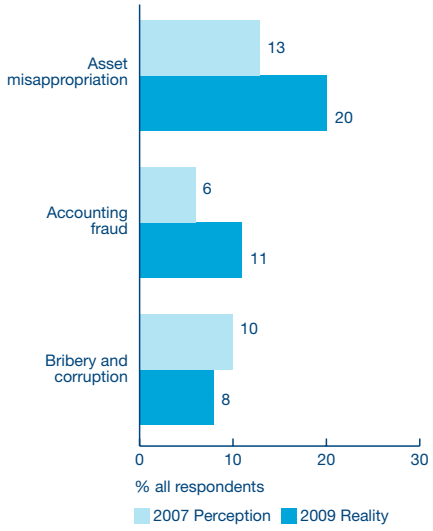
Figure 20: Perception in 2007 vs Reality in 2009



% all respondents' perception over the next 12 months for 2009; and over the next 2 years in the 2007 survey

Figure 20 shows that 13% of all respondents in 2007 thought it was likely that they would experience asset misappropriation in the subsequent two years. However, in our 2009 survey, 20% of all respondents (67% of those who reported experiencing economic crime – see figure 4) had been victims of asset misappropriation in the last year alone. There is a similar gap with the perception and experience of accounting fraud where the perception of risk was only 6% in 2007, while the reality in 2009 was that 11% of all respondents (38% of those who reported experiencing economic crime – see figure 4) had actually suffered this type of fraud in the preceding year.

Bribery and corruption is the only economic crime where perception of risk outweighs reality. In 2007, 10% of all respondents considered themselves to be at risk from bribery and corruption in the subsequent two years. However, according to our current survey, only 8% of all respondents (27% of those who reported experiencing economic crime – see figure 4) actually suffered this type of fraud. Certainly, bribery and corruption has received extensive media coverage during recent years and has therefore come onto the radar of the larger multinationals. Consequently, more organisations are taking pre-emptive measures to prevent bribery and corruption, or is it simply that they have not been caught yet?

In our survey, respondents were asked who they thought is most likely to perpetrate a fraud – external or internal fraudsters – in the next year. Fascinatingly, for 10 of the 12 fraud listed, respondents on a global basis expect external fraudsters to be the main perpetrators in the year ahead. The reality is, of course, that while some organisations will continue to face threats from external fraudsters, a significant threat lies within the organisation. This rose-tinted view needs to be promptly addressed, otherwise, organisations will struggle to implement adequate detective and preventive internal procedures.

Methodology and acknowledgements

Methodology

Our fifth Global Economic Crime Survey was conducted between July and November 2009. A total of 3,037 respondents from 54 countries completed our online questionnaire. The participants were asked to respond to the questions regarding (a) their organisation and (b) the country in which they are located.

Table 3: Participating territory counts

Asia Pacific	**652**	**Western Europe**	**1,243**	**Central & Eastern Europe**	**589**
Australia	75	Austria	34	Bulgaria	59
Hong Kong (and China)	67	Belgium	62	Czech Republic	83
India	145	Cyprus**	1	Hungary	53
Indonesia	50	Denmark	105	Poland	63
Japan	73	Finland	52	Romania	55
Malaysia	65	France	52	Russia	86
Middle East countries*	14	Germany***	17	Serbia	4
New Zealand	85	Greece	96	Slovakia	69
Philippines**	1	Ireland	91	Turkey	52
Singapore	51	Italy	90	Ukraine	65
South Korea**	1	Netherlands	76	**Africa**	**145**
Thailand	25	Norway	75	Ghana	27
South & Central America	**275**	Portugal**	1	Kenya	53
Argentina	39	**Spain**	**55**	Namibia**	1
Brazil	62	Sweden	78	South Africa	63
Chile	76	Switzerland	129	Sierra Leone**	1
Dominican Republic**	1	UK	229	**No primary country specified**	**10**
Ecuador**	1	**North America**	**123**	**TOTAL**	**3,037**
Mexico	94	Canada	52		
Peru**	1	USA	71		
Venezuela**	1				

*Middle East countries included participants from Israel, Jordan, Kuwait, Oman, Saudi Arabia and UAE.

**These are individual participants from 10 countries who found our survey and participated in it online.

***500 participants were surveyed separately in Germany. Visit http://www.pwc-wikri2009.de/ to read the German survey results.

Continued ❯

Table 4: Participating industry groups

	% organisations
Aerospace & Defence	1%
Automotive	4%
Chemicals	2%
Communication	2%
Energy, Utilities & Mining	7%
Engineering & Construction	7%
Entertainment & Media	3%
Financial Services	16%
Government and Public Sector	6%
Hospitality and Leisure	2%
Insurance	5%
Manufacturing	14%
Pharmaceuticals and Life Sciences	5%
Professional Services	6%
Retail & Consumer	9%
Technology	5%
Transportation & Logistics	5%
Other Industries/business	1%

Table 5: Organisation types participating

	% organisations
Listed on a stock exchange	43%
Private sector	42%
Government and public sector	10%
Others	5%

Table 6: Size of participating organisations

	% organisations
Up to 200 employees	32%
201 to 1,000 employees	33%
More than 1,000 employees	34%
Don't know	1%

Table 7: Function (main responsibility) of participants in the organisation

	% organisations
Executive management or finance	58%
Audit	12%
Risk management	5%
Compliance	4%
Security	4%
Advisory/consultancy	3%
Legal	3%
Operations and production	3%
Others	8%

Table 8: Job title of participants in the organisation

	% organisations
Senior executives	**52%**
Chief Executive Officer/ President/Managing Director	12%
Chief Financial Officer/ Treasurer/Controller	30%
Chief Operating Officer	2%
Chief Information Officer/ Technology Director	1%
Other senior executive	4%
Board member	3%
Non-senior executives:	**48%**
Senior Vice President/Vice President/Director	8%
Head of business unit	3%
Head of department	15%
Manager	15%
Others	7%

Table 9: Organisations where senior executive compensation includes a performance-based variable component

	% organisations
Less than 20%	24%
20% to 50%	36%
More than 50%	10%
No performance-based variable component	16%
Don't know	14%

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Terminology

Due to the diverse descriptions of individual types of economic crime in countries' legal statutes, we developed the following categories for the purposes of this survey. These descriptions were defined as such in our survey questionnaire.

Economic crime or fraud

The intentional use of deceit to deprive another of money, property or a legal right.

Asset misappropriation (including embezzlement/ deception by employees)

The theft of assets (including monetary assets/cash or supplies and equipment) by directors, others in fiduciary positions or an employee for their own benefit.

Accounting fraud

Financial statements and/or other documents are altered or presented in such a way that they do not reflect the true value or financial activities of the organisation. This can involve accounting manipulations, fraudulent borrowings/raising of finance, fraudulent application for credit and unauthorised transactions/rogue trading.

Corruption and bribery (including racketeering and extortion)

The unlawful use of an official position to gain an advantage in contravention of duty. This can involve the promise of an economic benefit or other favour, the use of intimidation or blackmail. It can also refer to the acceptance of such inducements.

Money laundering

Actions intended to legitimise the proceeds of crime by disguising their true origin.

IP infringement (including trademarks, patents, counterfeit products and services)

This includes the illegal copying and/or distribution of fake goods in breach of patent or copyright, and the creation of false currency notes and coins with the intention of passing them off as genuine.

Illegal insider trading

Illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, non-public information about the security. Insider trading violations may also include 'tipping' such information, securities trading by the person 'tipped', and securities trading by those who misappropriate such information.

Espionage

Espionage is the act or practice of spying or of using spies to obtain secret information.

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Financial performance

This can be defined as measuring the results of an organisation's policies and operations in monetary terms. These results are reflected in return on investment, return on assets and value added; typically, In the private sector, returns will be measured in terms of revenue; in the government/ state-owned enterprises, returns will be measured in terms of service delivery.

Fraud risk assessment

Fraud risk assessments are used to ascertain whether an organisation has undertaken an exercise to specifically consider:

(i) the fraud risks to which operations are exposed;

(ii) an assessment of the most threatening risks (i.e. evaluate risks for significance and likelihood of occurrence);

(iii) identification and evaluation of the controls (if any) that are in place to mitigate the key risks;

(iv) assessment of the general anti-fraud programmes and controls in an organisation; and

(v) actions to remedy any gaps in the controls.

Fraud triangle

Fraud triangle describes the interconnected conditions that act as harbingers to fraud: opportunity to commit fraud, incentive (or pressure) to commit fraud, and the ability of the perpetrator to rationalise the act.

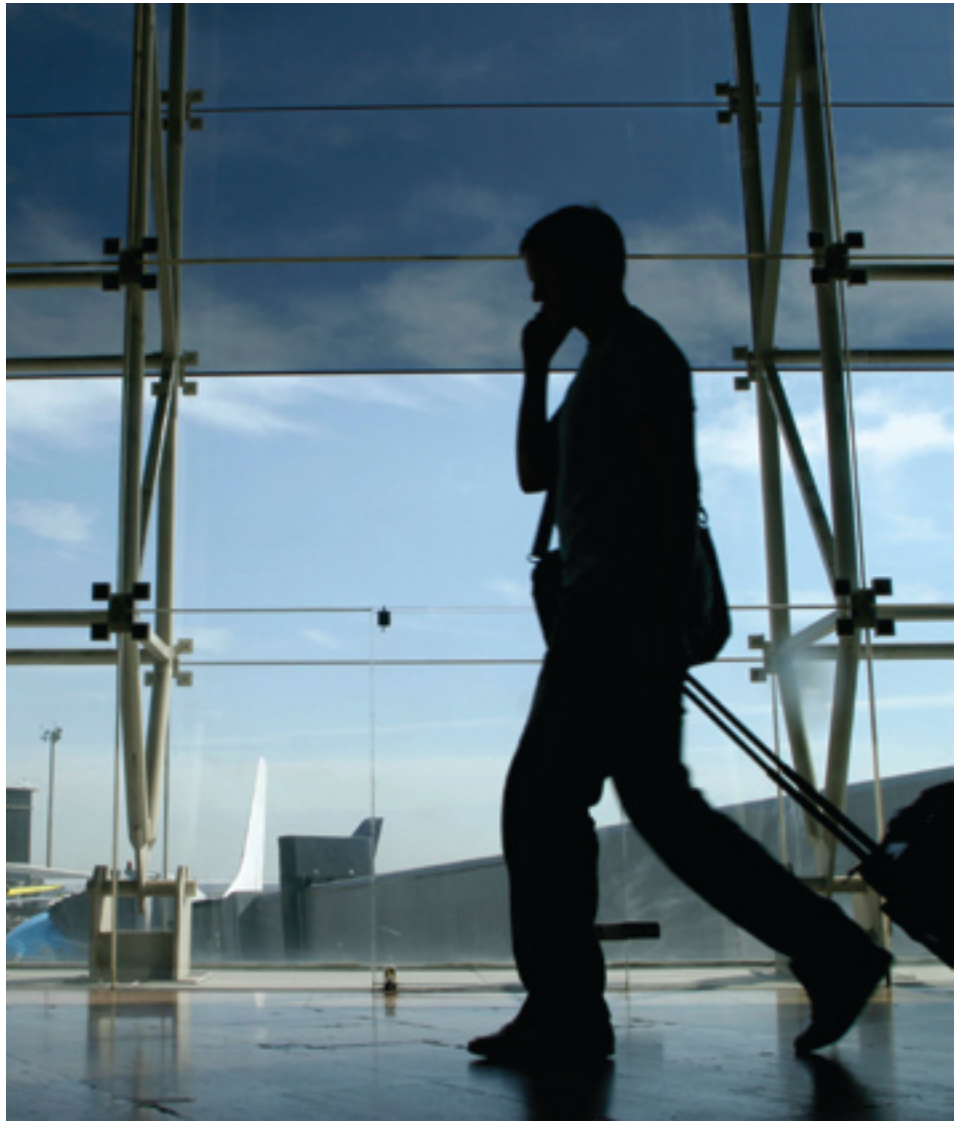
Senior executive

The senior executive (for example the CEO, Managing Director or Executive Director) is the main decision-maker in the organisation.

Note: *In some cases percentages may total more or less than 100 percent as respondents were able to provide multiple answers.*

About PwC Forensic Services

The Forensic Services group of the PricewaterhouseCoopers' global network of firms plays a lead role in addressing the life cycle of fraud and other avoidable losses, providing reactive investigative services and proactive remedial and compliance services to clients in the private and public sectors.



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