

Economic crime: people, culture & controls

The 4th biennial Global Economic Crime Survey
Australia



Introduction

I am pleased to present the Australian results of the PricewaterhouseCoopers Global Economic Crime Survey 2007.

Published every two years, the 2007 Survey is one of the most comprehensive assessments of global economic crime. It surveys 5,400 companies across 40 countries in industries including automotive, energy utilities and mining, financial services, industrial manufacturing, retail and consumer services, transportation and logistics.

The Survey provides insight into the nature and extent of economic crime in Australia, the Asia-Pacific region and globally. It also provides valuable insight and practical advice on how companies can protect their reputation, finance, staff, technology and intellectual property from the threat of economic crime.

Malcolm Shackell
Partner
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Australian Survey: Key Findings

Nature of Australia's economic crime

The Survey has shown that economic crime is a persistent fact of Australian business life. Asset Misappropriation remains the most prevalent economic crime risk to businesses in Australia, while IP Infringement has grown to become the second most prevalent risk. Over 50% of economic crime incidents in Australia involve these threats.

Half of all Australian businesses report that they have experienced an economic crime incident within the last two years and almost a quarter of these events have involved direct losses of over AU\$1.5 million.

The Perception gap

The Survey has highlighted a marked 'perception gap' in Australia between risk management controls that are perceived to be effective and controls that actually are effective in detecting economic crime.

The Survey also shows that the most successful risk management frameworks are those supported by the use of proven fraud control techniques such as:

- a formal reporting/whistleblower mechanism
- proactive transaction testing, and
- regular fraud risk assessments.

Collateral damage

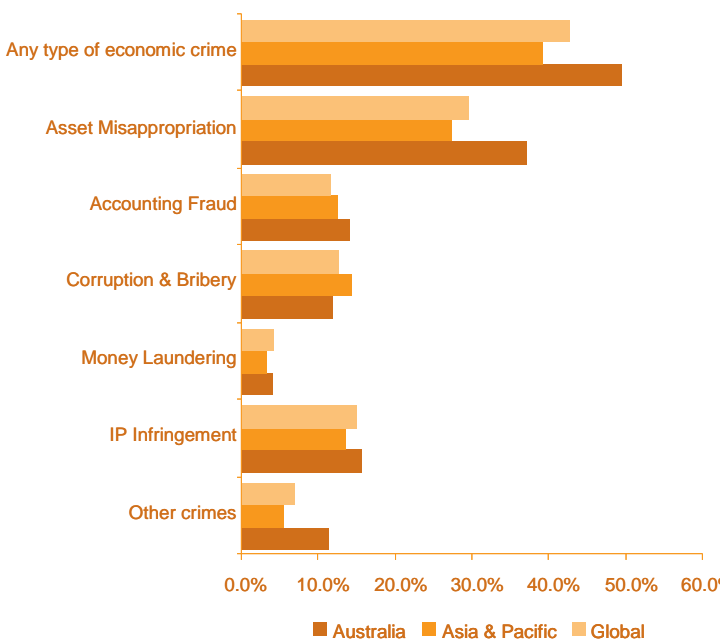
The cost of economic crime extends beyond monetary loss. The impact of collateral damage resulting from economic crime incidents is commonly underestimated.

Emerging risks

New economic crime risks have emerged for Australian businesses with increased exposure to global markets, legislative changes, and the increasing sophistication of economic crime. Particularly, emergent risks facing Australian businesses are:

- Foreign Corruption and Bribery
- Money Laundering, and
- IP Infringement.

1 Actual incidences 2007



Economic crime is a persistent fact of Australian business life.

Mitigating the risk

Australian companies can mitigate their risk exposure by ensuring that the fraud controls they have in place are integrated into 'business as usual' practice, adequately addressing both present and future risk, providing the right corporate culture and swift reporting of suspected economic crime.

Economic Crime: A Fact of Business Life

The 2007 PricewaterhouseCoopers Global Economic Crime Survey reveals that economic crime remains a fact of life for business in Australia.

Half of the Australian companies surveyed experienced an incident of economic crime, compared with 39% in the Asia-Pacific region and 43% globally.

Types of Australia's economic crime

Asset Misappropriation and IP Infringement are the most prevalent

economic crime risks faced by Australian organisations.

The threat of IP Infringement in Australia is growing. Close to one fifth of Australian companies now regard IP Infringement as the most prevalent economic crime threat to their businesses and IP Infringement is now the second most prevalent risk of this nature.

Cost of Australia's economic crime

Nearly 25% of companies in Australia reported that an incident of economic crime has directly cost them in excess of \$AU1.5 million over the past 2 years. Of the direct monetary amount lost to economic crime by Australian companies, almost half of the money has never been recovered.

For certain crimes, the direct losses from an economic crime incident are only a small part of a far more extensive total. The true consequences of IP Infringement, for example, may be measured in terms of loss of sales revenue through counterfeiting or other infringement, an amount which will dwarf the direct cost of each incident of infringement.

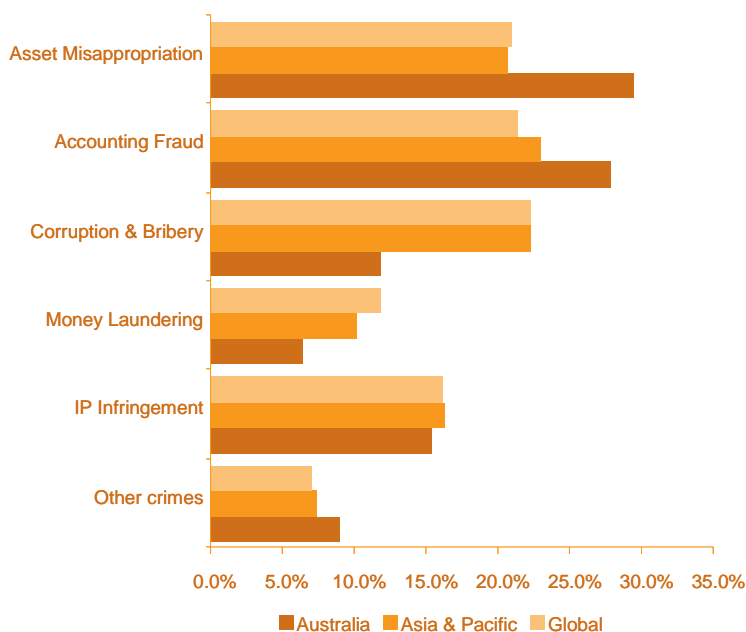
Nearly 40% of Australian companies report that the economic crime they experienced also resulted in collateral damage. Collateral damage from an incident of economic crime can include:

- decline of working morale
- impairment of business relations
- increased regulatory oversight
- distraction of management time
- time and cost of litigation and public relations, and
- damage to reputation.

In considering the impact of economic crime, Australian companies rated collateral damage significantly lower than companies in the Asia-Pacific region and globally.

In PwC's experience economic crime incidents absorb considerable resources, in terms of people, time and costs. These costs are often underestimated. For example, in Australia, only 39% of companies rated economic crime as being a significant or very significant distraction to management, compared with 63% in the Asia Pacific region.

2 Prevalence (perception)



Economic crime incidents absorb considerable resources, in terms of people, time and costs. These costs are often underestimated.

PwC's experience is that even a relatively minor matter can consume a significant amount of management time, ranging from the initial detection, internal investigations, external investigations, legal action and taking steps to prevent the action in the future.

Perpetrators

The Survey shows that a 'typical' perpetrator in Australia is male, aged between 31 and 40, and has been in his position with the organisation for an average of 5 years.

Perpetrators of fraud exist throughout the organisational hierarchy. Whilst the majority are below executive level, nearly a quarter were middle management. Senior executives represented almost 10%.

The Audit Perception Gap

There is a distinct perception gap between what Australian companies think is effective in detecting economic crime and what actually detects economic crime.

The Survey showed that very little fraud was detected by external audit, despite the perception of some 50% of respondents who considered external audit an effective measure to detect economic crime.

More than likely this reflects the fact that most economic crime is below the materiality threshold for external audit. It is important to note that whilst the primary purpose of external audit is not the detection of fraud, the external audit contributes to an environment that reduces the risk of fraud.

By contrast, three quarters of Australian companies do not consider fraud risk management as the most effective measure to detect fraud. Whereas, the Survey revealed that fraud risk management is actually the single most effective control for detecting economic crime.

Combined with fraud risk management, tip-offs (either through a whistleblower mechanism or through informal means) internal audit and automated transaction reporting systems were most effective in detecting the vast majority of economic

crime in Australia. Close to 100% of economic crimes in Australia were detected by these methods.

Bridging the gap

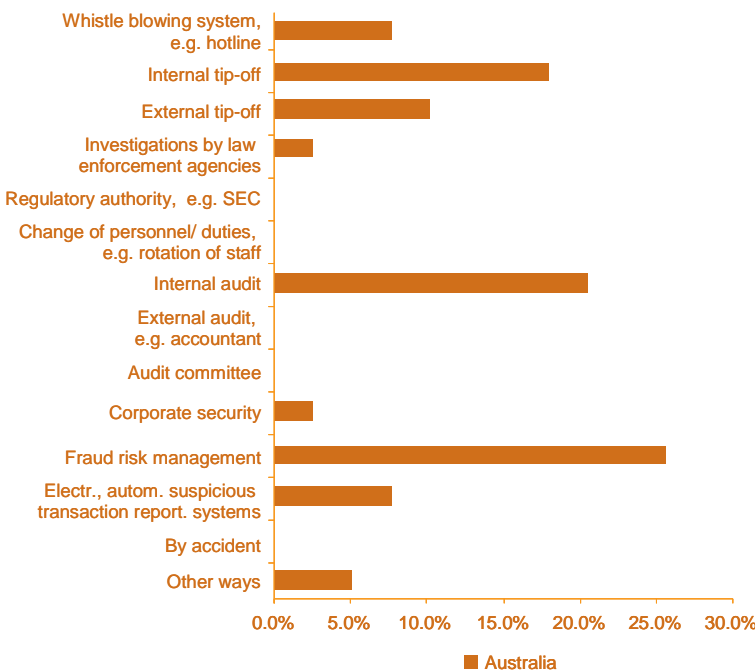
The Survey insights demonstrate the need among Australian organisations to develop fully integrated risk management frameworks, along with appropriate corporate guidance and training.

The Survey results reinforce the importance of the tip-off mechanism which in more than one third of the cases is how economic crime was detected. A robust, integrated fraud risk framework should include a widely-publicised whistleblower mechanism, effective fraud risk management controls, policies, and staff training to foster an environment in which tip-offs are encouraged and compliance is the norm.

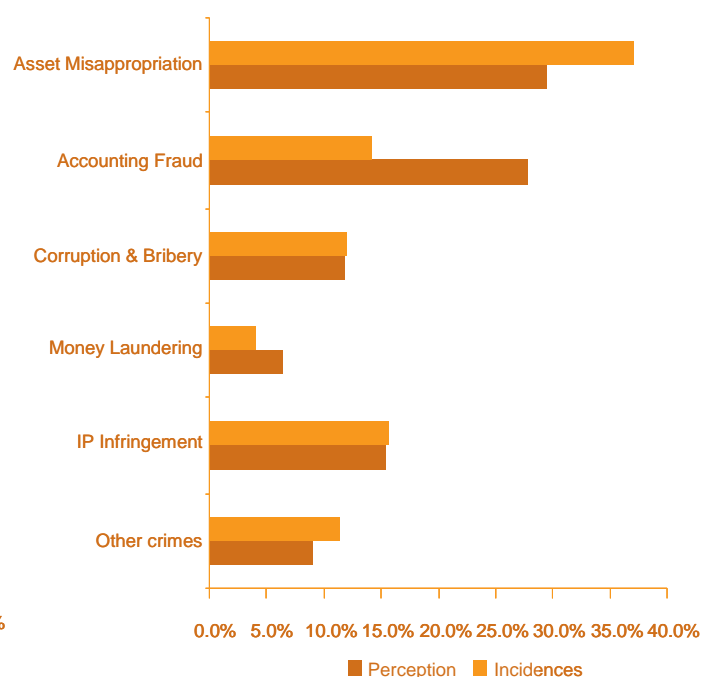
The numerous investigations into economic crime conducted by PwC in Australia and globally have also highlighted the importance of a sound corporate culture. We have found that an organisation's people are both its greatest

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3 Initial detection



4 Comparison of Perception and Incidences



weapon in combating economic crime and its greatest liability.

Controls by themselves will not take full advantage of the detection measures in place. A strong ethical culture goes hand in hand with controls to facilitate the effectiveness of risk mitigation. For example, in the right cultural environment, an appropriate tip-off mechanism is a powerful tool for detecting economic crime and such a tool can only be effective where employees are encouraged to do the right thing.

Emerging Risks

Foreign corruption and bribery

Despite a number of well-publicised incidents involving Australian companies and foreign corruption, the Survey revealed that 50% of Australian companies have taken no actions to manage their exposure to bribery and corruption in foreign countries.

Compared with their global counterparts, half the number of Australian companies consider Foreign Corruption and Bribery

to be a prevalent threat. Australians also perceive Corruption and Bribery as a low economic crime risk when operating in foreign jurisdictions. Less than 5% of Australian companies surveyed believe they have been asked for a bribe in a foreign jurisdiction, compared to 20% of companies in the Asia Pacific region.

Despite having significant operations in foreign jurisdictions, Australian organisations may be under-prepared for the potential risks of economic crime, particularly corruption and bribery, in foreign jurisdictions. Globally, companies are far more aware of this risk. It is important that Australian organisations adjust their expectations to meet this reality and ensure the frameworks they have in place adequately deal with this threat.

Money laundering

The 2007 Survey found that 40% of Australian companies are unaware of measures or plans to take any specific action to deal with the risk of Money Laundering.

This is a significant result considering the introduction of the Anti Money Laundering

and Counter Terrorism Financing Bill in 2006 in Australia. This legislation takes a risk-based approach with stringent compliance responsibilities for relevant entities. Within two years the second tranche of this legislation will impact a broad cross-section of business from financial services to real estate agents and gaming.

It is imperative that organisations seek timely advice on their position as a result of the changes to the regulatory environment and that an appropriate anti-money laundering program is put in place.

IP infringement

The threat of IP Infringement continues to grow. In 2007 it has become the second most prevalent economic crime event for Australian businesses, occurring at levels that broadly match the Asia-Pacific region and globally.

The growth of IP infringement shows that economic crime continues to evolve to target more than just an organisation's physical assets. Increasingly, employees and ideas are at risk of being targets of

The true consequences of IP Infringement may be measured in terms of loss of sales revenue through counterfeiting or other infringement, an amount which will dwarf the direct cost of each incident of infringement.

economic crime and further measures are required to manage this threat.

The Survey results further support PwC's experience that the risk of IP theft is growing in Australia

Mitigating the Risk

Economic crime is here to stay. It is a fact of doing business in Australia, in the Asia-Pacific region and throughout the globe. Economic crime threats have continued to evolve in sophistication and nature. However, the Survey has underlined that a sound corporate culture, combined with a robust, tailored framework increases prevention and detection, and assists with mitigating economic crime risks.

A continued strong response and interest in the PricewaterhouseCoopers Global Economic Crime Survey is indicative of the heightened awareness of economic crime in Australia and globally. The cost and diversity of economic crime continues to grow and the regulatory environment in Australia has been dynamic in recent years.

In such a context, the risks posed to organisations in Australia continue to rise. It is clear that in the globalised and integrated world economy in which Australian businesses operate, the sophistication of the type and nature of economic crime being faced by companies will increase.

Organisations need to proactively seek to mitigate their risk exposure through an integrated risk management program which will:

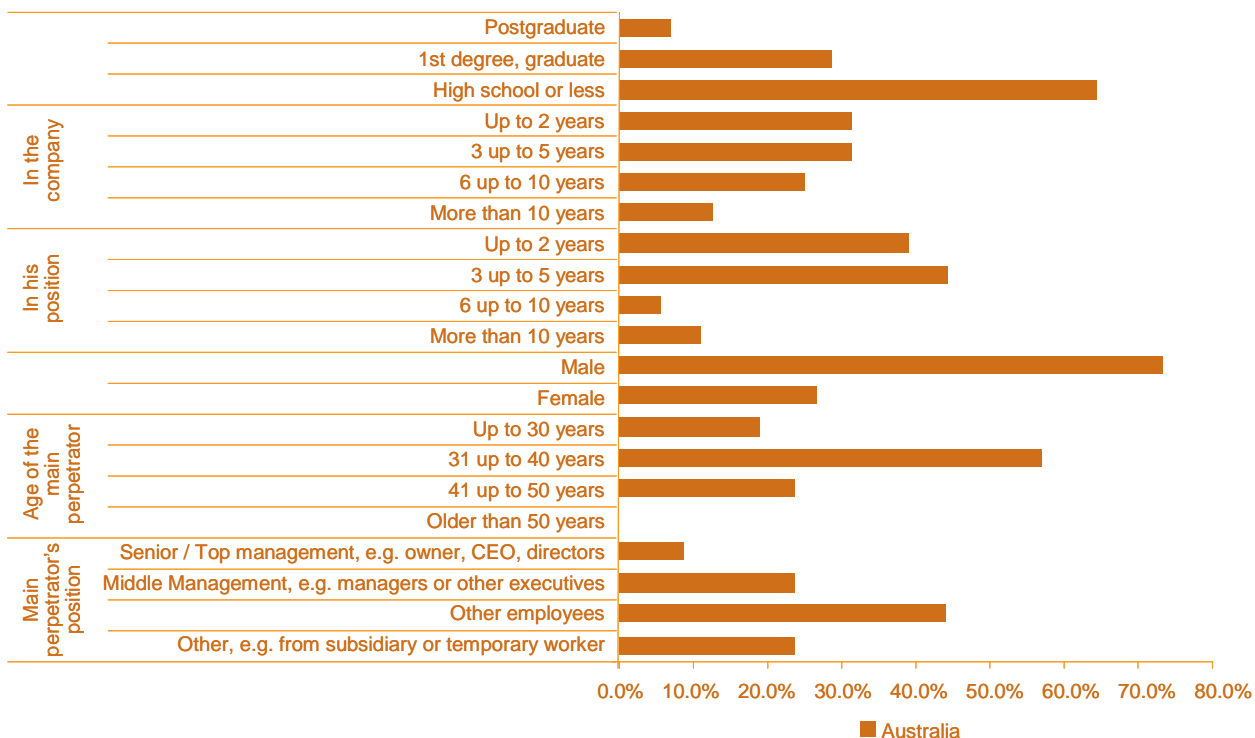
- ensure adequate internal controls exist to complement those put in place by external parties such as regulators and auditors. These controls should also be incorporated into 'business-as-usual' practices.
- cover present and emerging threats, not only in Australia but in all jurisdictions in which the company operates.
- be regularly reviewed.
- fully recognise the most effective means for detecting economic crime is through individuals reporting their concerns and so putting in place

appropriate mechanisms that create an environment the encourages reporting.

- in the event of an economic crime incident being detected, allow for swift action in securing the environment and proceeding with an investigation.
- reflect and reinforce an organisation's ethical culture. A sound ethical culture encourages company loyalty, facilitates reporting of concerns and consistently demonstrates the penalties for non-compliance.

Recovery of monies from economic crime remains a difficult task. Legal action can be time consuming, resource intensive and diverts resources from other activities. An appropriate fraud risk framework presents the best opportunity for Australian organisations to minimise their risks and manage the process after an economic crime incident is detected.

5 Perpetrator's profile



Demographics

The 2007 PricewaterhouseCoopers Global Economic Crime Survey interviewed 5,428 leading organisations globally, 894 in the Asia-Pacific region and 104 in Australia.

Interviews were conducted with representatives from various functions including finance, audit, legal, human resources, security, risk, compliance and at the CEO/Board level. Industries covered included aerospace and defence, automotive, chemicals, communication, energy, utilities and mining, engineering and construction, entertainment and media, financial services, government services/public services, healthcare, insurance, industrial manufacturing, pharmaceuticals, retail and consumer, technology and transportation and logistics.

Australian companies were chosen at random with an emphasis on the 500 largest organisations in the country. Results were compiled by independent experts and reported to PwC to protect the anonymity of those surveyed.

Further information pertaining to the survey demographics and definitions of economic crime can be found in the Global Economic Crime Survey 2007 at pwc.com/crimesurvey.

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