Economic Crime in Japan: The Present State and Response Measures

Internally perpetrated fraud

82% Japan

61% Asia Pacific

56% Global
PwC conducted the 2014 Global Economic Crime Survey with respondents from over 95 countries. In this report, we have focused our analysis on the results from Japan, and we compared our analysis with the Asia Pacific region¹ and the aggregated responses from around the world. The overall Japan results appear positive on its surface, however, upon further examination, it is apparent that Japanese companies have significant room for improvement in the area of effectively detecting and monitoring fraud.

¹ The countries included in the Asia Pacific region are Australia, China (excluding Hong Kong), Hong Kong / Macau, India, Indonesia, Japan, Malaysia, New Zealand, Papua New Guinea, Singapore, Thailand, and Vietnam.
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Survey demographics
Survey Period: August 2013 – October 2013
Survey Approach: Online multiple choice survey
Total Respondents: 5,128 responses from over 95 countries (Of which, 906 responses from Asia Pacific region, 75 responses from Japan)
Respondent Demographic:
[Global] 50% were senior executives of their respective organizations, 35% represented listed companies and 54% represented organizations with more than 1,000 employees
[Japan] 32% were senior executives of their respective organizations, 55% represented listed companies and 65% represented organizations with more than 1,000 employees (Industries range from Communications, Retail and Consumer Goods, Transportation and Logistics, Insurance, Pharmaceuticals and Life Sciences, Manufacturing, Automotive, Financial Services, etc.)

*Percentages discussed in the report are rounded to the nearest round percentage. For this reason, the overall percentage may not equal 100 percent.
The number of Japanese companies reporting fraud is low. Are fraud incidents truly infrequent in Japan?

Fraud in Japan – a significant problem?

Japanese businesses are reporting lower levels of economic crime than their counterparts in Asia Pacific and globally, but fraud still appears to be a significant issue. Of the Japanese companies that took part in our survey this year, 15% reported that they had been the victim of fraud of some kind in the past two years compared to 32% reported in Asia Pacific and 37% reported globally (Figure 1). While these results may appear promising for Japanese companies on its surface, the results may reflect that fewer economic crimes are being detected or the unwillingness of respondents to report higher numbers. The lack of effective detection of fraud at Japanese companies is consistent with our own experience of developing and testing internal controls and investigating and remediating cases of economic crime in Japan.

Figure 1. Companies Reporting Fraud

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>15%</td>
<td>75</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>32%</td>
<td>906</td>
</tr>
<tr>
<td>Global</td>
<td>37%</td>
<td>5,128</td>
</tr>
</tbody>
</table>
Once detected, it appears that Japanese companies are able to identify multiple incidents of fraud within their organizations. Japanese businesses are reporting lower levels of economic crime than businesses in most other countries around the world, but when organizations were asked to report the number of incidents suffered in the past two years, Japanese businesses identified more instances of fraud. When asked the number of fraud related instances which their organization suffered, the majority of Japanese businesses (55%) indicated that they suffered between 11 and 50 instances of fraud. This response is high compared to the instances suffered by the majority of Asia Pacific and globally, whereby 63% and 61% respectively, reported experiencing less than 10 instances of fraud (Figure 2).

Results of our survey indicate that the effects of these frauds are reported as being more severe in Japan than in Asia Pacific generally and globally. The overall estimated loss from incidents of economic crimes reported by Japanese companies are higher than companies in Asia Pacific and globally. Of the businesses reporting instances of fraud in the last 24 months, the highest percentage of Japanese companies (36%) reported total economic losses between 100,000 and 1 million US dollars, and the highest percentage of companies in Asia Pacific (35%) and globally (32%) reported total economic losses of less than 50,000 US dollars (Figure 3). Based on these responses, the approximate economic damage from fraud appears to be more severe for Japanese companies compared to companies in Asia Pacific and globally.
The overall response seems to suggest Japanese executives are optimistic in their perception of economic crimes occurring in their organizations. Specifically, executives believe the occurrence of asset misappropriation, accounting fraud, bribery and corruption, procurement fraud, and human resource fraud will likely not occur in their own organizations. Conversely, economic crimes such as cybercrime, IP infringement, money laundering, and insider trading seem to be at the forefront of executives' concerns. Yet, perception does not always match with the reported reality in relation to the types of fraud being perpetrated (Figure 4). For example, 69% of Japanese businesses believe asset misappropriation was an unlikely occurrence in their own company. However, the survey results show that of the Japanese companies which reported experiencing fraud in the last 24 months, 91% of Japanese companies experienced cases of asset misappropriation. The second most prevalent economic crime among Japanese companies was bribery and corruption, but this fraud was also considered low in executives' perception of actual likelihood. 33% of Japanese executives see intellectual property (“IP”) infringement as a threat contrasted with 20% for Asia Pacific and 18% globally. The results are consistent with what we have witnessed in the Japan market as we have seen Japanese companies have increasing interest in protecting their IP, and the revenues due under licensing arrangements over the past two years.
Figure 4. Types of Economic Crimes Likely to be Experienced

Types of Economic Crimes Likely to be Experienced
(Responses from all companies)

- Human Resources fraud
- Espionage
- Competition Law / Anti-trust Law
- Mortgage fraud
- Procurement fraud
- Insider Trading
- Tax Fraud
- Money Laundering
- IP Infringement
- Cybercrime
- Bribery and corruption
- Accounting fraud
- Asset misappropriation

Types of Economic Crimes Experienced
(Responses from companies reporting fraud)
Cybercrime and its potential dangers

As the world becomes increasingly interconnected, it is imperative for companies to pay more attention to cyber security. Based on PwC's global report, cybercrime was the fourth most reported economic crime globally. Although no Japanese companies reported experiencing cybercrime, 40% believe they will be victim to cybercrime in the next 24 months. This response is higher than the responses from global (30%) and Asia Pacific (26%), reflecting Japan’s awareness of cybercrime and its potential threats. Japan shares a similar concern for the rising cybercrime threats as other parts of the world where reputational damage, service disruption, theft or loss of personal identifiable information, investigation, enforcement costs, as well as regulatory risks are areas of concern (Figure 5). However, the potential monetary loss from cybercrime is an area where Japanese companies appear to be more optimistic than other parts of the world.
Figure 5. Concern on the effects of cybercrime activity

- **Reputational Damage**
  - Very Concerned: 45%
  - Concerned: 37%

- **Actual Financial Loss**
  - Very Concerned: 17%
  - Concerned: 43%

- **Legal, Investigation and/or Enforcement Costs**
  - Very Concerned: 9%
  - Concerned: 61%

- **Regulatory risks**
  - Very Concerned: 16%
  - Concerned: 51%

- **IP theft, including theft of data**
  - Very Concerned: 25%
  - Concerned: 31%

- **Service disruption**
  - Very Concerned: 29%
  - Concerned: 45%

- **Theft or loss of personal identifiable information**
  - Very Concerned: 43%
  - Concerned: 40%

- **Others**
  - Very Concerned: 3%
  - Concerned: 1%
In response to the UK Bribery Act, Japanese companies appear to be taking a wait and see approach.

Understanding fraud risk

Many Japanese companies have a system of internal controls, but when asked how often their organization performed a fraud risk assessment in the last 24 months, companies which did not conduct a fraud risk assessment during that period was 28% for Japan, slightly more than the 24% of companies in Asia Pacific and 25% of companies globally (Figure 6). For Japanese companies that had not conducted an assessment at all, the majority of respondents selected “Not sure what a fraud risk assessment involves” (67%) when inquired about the lack of action. Considering how this response is significantly higher than the overall responses reported globally (30%), it seems Japanese companies must first understand the importance and overall process entailing fraud risk assessments.

Figure 6. How Often Fraud Risk Assessment was Performed

<table>
<thead>
<tr>
<th>Region</th>
<th>Not at all</th>
<th>Once</th>
<th>Annually</th>
<th>Every six months</th>
<th>Quarterly</th>
<th>More often</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>28</td>
<td>5</td>
<td>39</td>
<td>7</td>
<td>9</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>24</td>
<td>12</td>
<td>33</td>
<td>6</td>
<td>10</td>
<td>3</td>
<td>12</td>
</tr>
<tr>
<td>Global</td>
<td>25</td>
<td>13</td>
<td>32</td>
<td>6</td>
<td>9</td>
<td>4</td>
<td>12</td>
</tr>
</tbody>
</table>

Legend: Not at all, Once, Annually, Every six months, Quarterly, More often, Don’t know.
The UK Bribery Act came into effect on July 1, 2011. When asked how they responded to the UK Bribery Act, 13% of Japanese companies made a change to its policies, which was approximately half the response rate of Asia Pacific (23%) and globally (26%) (Figure 7). Japanese companies understand the regulatory environment is changing, but they appear to be employing a wait and see approach before implementing more robust policies, processes, and controls. In the event of an increase in bribery and corruption related enforcement, it would be expected that Japanese companies would take more robust steps to enhance their anti-corruption compliance programs.

**Figure 7. Response to UK Bribery Act effective July 1, 2011**
The discovery and prevention of fraud is an area in which Japanese companies appear to have made a considerable investment, with all companies responding to our survey having some system of controls in place. Of the companies surveyed, 81% had a whistleblower hotline compared to 71% in Asia Pacific and 62% globally (Figure 8). The survey results show that 43% of respondents, whose organizations possess whistleblower capabilities, believe their programs are only slightly effective at preventing and detecting fraud (Figure 9). The strong belief that Japanese companies have only slightly effective whistleblower programs is another indicator that Japanese companies are failing to detect fraud in their organizations. As long as companies have ineffective or slightly effective whistleblower programs, companies will not know the actual prevalence of fraud in their organization. These companies should take immediate steps to identify gaps and enhance their programs, and until they do, companies may not be able to accurately measure monetary or reputational damages due to fraud.

**Figure 8. Implementation of Whistleblower Mechanism**

<table>
<thead>
<tr>
<th></th>
<th>Implemented</th>
<th>Not Implemented</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>81%</td>
<td>17%</td>
<td>1%</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>71%</td>
<td>22%</td>
<td>7%</td>
</tr>
<tr>
<td>Global</td>
<td>62%</td>
<td>30%</td>
<td>8%</td>
</tr>
</tbody>
</table>

**Figure 9. Effectiveness of Whistleblower Mechanism**

<table>
<thead>
<tr>
<th></th>
<th>Very effective</th>
<th>Effective</th>
<th>Only slightly effective</th>
<th>Not effective</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>10%</td>
<td>28%</td>
<td>43%</td>
<td>3%</td>
<td>16%</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>9%</td>
<td>41%</td>
<td>27%</td>
<td>7%</td>
<td>16%</td>
</tr>
<tr>
<td>Global</td>
<td>10%</td>
<td>40%</td>
<td>28%</td>
<td>7%</td>
<td>16%</td>
</tr>
</tbody>
</table>
Fraud is predominantly an internal issue

It is clear that internal actors play a more significant role in economic crimes for Japanese companies compared to external actors. 82% of respondents for Japanese companies reported being perpetrated by an internal actor compared to 61% for Asia Pacific companies and 56% for companies globally (Figure 10). Considering the prevalent involvement of internal actors in incidents of fraud, these results highlight the importance of implementing a strong system of internal controls to prevent and detect internal fraud issues. It should be noted that it is more difficult to control the actions of third parties. Therefore, companies should also have a robust process for onboarding, risk assessing, and monitoring relationships with third parties.

Figure 10. Main Perpetrator of Fraud

(Respondents who experienced economic crime during the survey period)
Investigating and remediating – what to do when economic crime is discovered

In order to properly address the issue of controls, a company must first understand exactly where a problem lies. It is therefore important that a company is adequately prepared to carry out an internal investigation, or appoint specialist forensic accountants to do so on the company’s behalf, when fraud is detected. The size and scope of the internal investigation should be specifically tailored to the issue, taking into account other important factors such as regulatory requirements. An appropriate response to instances of fraud is being increasingly demanded by regulators, shareholders and other stakeholders and how a company acts in such a situation is the subject of continued media focus.

Once the issue, the nature of any fraud scheme that may have been involved, and its impact are fully understood, appropriate remediation can be designed and implemented. Remediation can take many forms including additional or improved controls, increased staff awareness of policies and procedures or formal training. Appropriate sanctions should be taken against management or staff involved in fraudulent activities as part of a company’s demonstration of commitment to an ethical corporate culture.
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