

Japanese Economic Crime Survey 2007

Fraud in Japan – An Improving Situation?



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Japanese businesses are reporting lower levels of economic crime than their counterparts in AsiaPacific generally, and indeed globally, but fraud remains a significant problem. Of the Japanese companies that took part in our survey this year 27 percent reported that they had been the victim of fraud of some kind in the past two years, down from the 37 percent reported in the previous survey in 2005 (fig 1). However, despite this apparently healthy reduction, economic crime is an issue affecting one in four Japanese businesses. Our survey also found that the average number of instances of fraud reported by Japanese companies had also decreased, down to 2.4 in 2007 from 3.0 in 2005.

Of course, the results could simply reflect fewer economic crimes being detected or the unwillingness of respondents to report higher numbers. However, if instances of economic crime in Japan are decreasing, the effects of these frauds are reported as being more severe in Japan than in AsiaPacific generally or globally.

The average loss from an instance of fraud was reported by Japanese

companies as JPY 665 million (US\$5.7 million) compared to JPY 165 million (US\$1.4 million) in AsiaPacific generally and JPY 278 million (US\$2.4 million) globally. Other fraud related damage was also reported as greater in Japan than elsewhere with collateral damage to brand, reputation, staff morale and the companies general position being at least 25 percentage points higher than in either AsiaPacific generally or globally (fig 2).

The perception of fraud in Japan

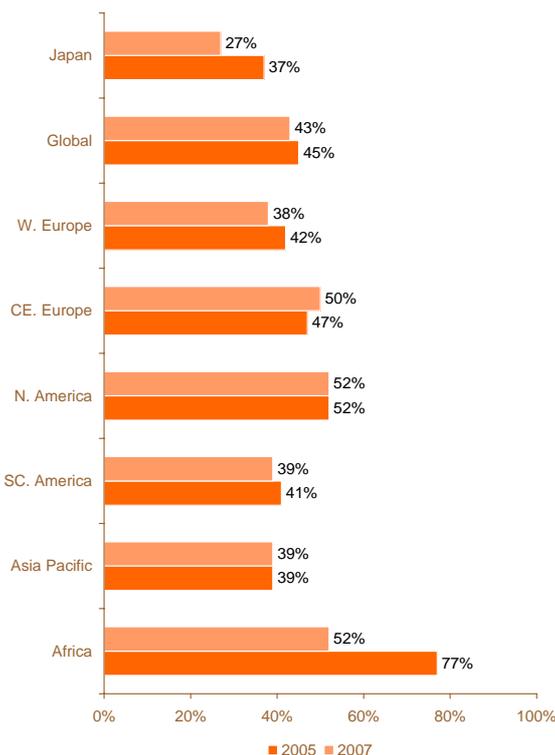
It is interesting to note that whilst the number of reported instances of economic crime in Japan is declining the perception of the majority of respondents to our survey (79 percent) was that fraud in Japan is actually on the increase. It is possible that recent media attention given to high-profile fraud cases, coupled with an increased willingness of businesses to discuss problems more openly, and to seek independent assistance, is giving rise to a general perception that fraud in Japan is increasing.

Perception does not always match with the reported reality in relation to the types

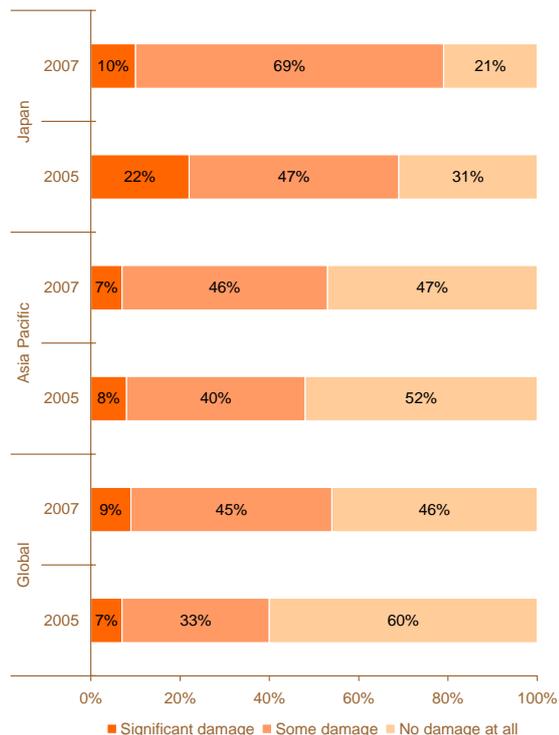
of fraud being perpetrated as well (figs 3a and 3b). For example, respondents believed asset misappropriation to be only the fourth most prevalent form of fraud in Japan (17 percent) but the survey results show that it is actually the second most prevalent form of economic crime (34 percent). The extensive media coverage of accounting fraud over the past two years, as mentioned above, may have given rise to the perception that this type of fraud is the most prevalent form of economic crime in Japan (31 percent) but the survey results showed that it actually only ranked in third place (12 percent).

Intellectual property (“IP”) infringement was reported as being the most common economic crime suffered in Japan (48 percent), an increase from 2005 (28 percent) and a move up the rankings from second place. We have seen Japanese companies become increasingly willing to protect their intellectual property, and the revenues due from license arrangements, over the course of the past two years and expect this trend to continue for at least the next two years.

1. Companies reporting fraud



2. Significance of collateral damage from economic crime



Fraud is not just somebody else's problem

It is clear that Japanese companies consider fraud as something that is more likely to happen to someone else. Despite 79 percent of respondents believing economic crime is increasing in Japan only 12 percent think it likely that their own company will be subject to it over the course of the next two years (fig 4). It is noteworthy that in the 2005 survey only 21 percent of respondents believed their company would be subject to fraud with the actual result being some 6 percent higher.

Fraud discovery and prevention – having controls is not enough

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 91 percent had a whistleblower hotline, 90 percent an internal audit function, 83 percent a code of conduct

and 81 percent a compliance function, as well as a range of additional initiatives and systems. Also, the majority of respondents (80 percent) believed that the introduction this year of the Financial Instruments and Exchange Law (commonly referred to as "JSOX") would have an impact on the measures companies take to prevent or investigate instances of economic crime.

Whilst it is not unusual for companies in AsiaPacific, as well as globally, to use external consultants to provide advice on fraud prevention (33 percent and 31 percent respectively) only 5 percent of Japanese companies have done so. It is therefore interesting to note that only 10 percent of Japanese respondents rated their company's measures for discovery and prevention of economic crime as very effective, compared to 17 percent in AsiaPacific and 19 percent globally.

The survey results showing that some of the discovery and prevention measures at Japanese companies are not as effective as they might be, correlates with our own experience of investigating and remediating cases of economic crime in Japan.

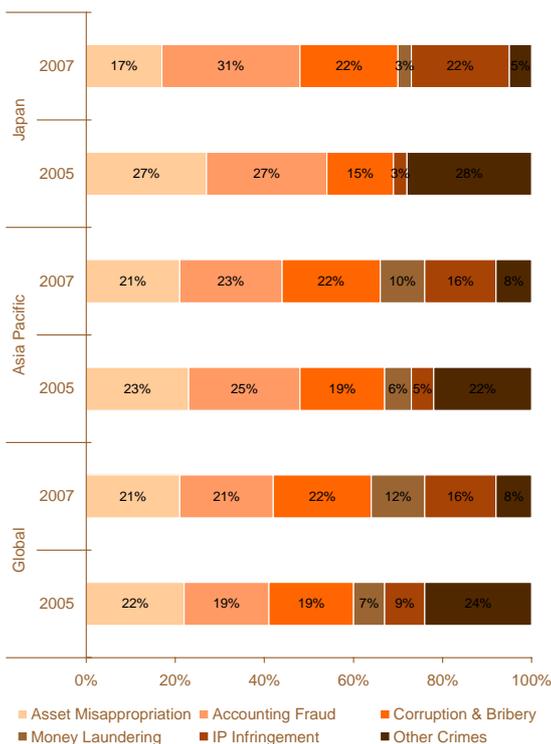
The human element is as important as the control framework. For example, we have seen controls bypassed and policies and

procedures ignored, thereby supporting a climate where fraud can be perpetrated. A system of controls needs to be supported by ethical guidelines that are understood and acted upon by all management and staff as well as a corporate culture that encourages people to act in an ethical manner and report abuses. We have seen whistleblower hotlines used to good effect by staff at companies operating in Japan and anticipate that this will continue to increase as staff become more confident that their complaints will be handled confidentially.

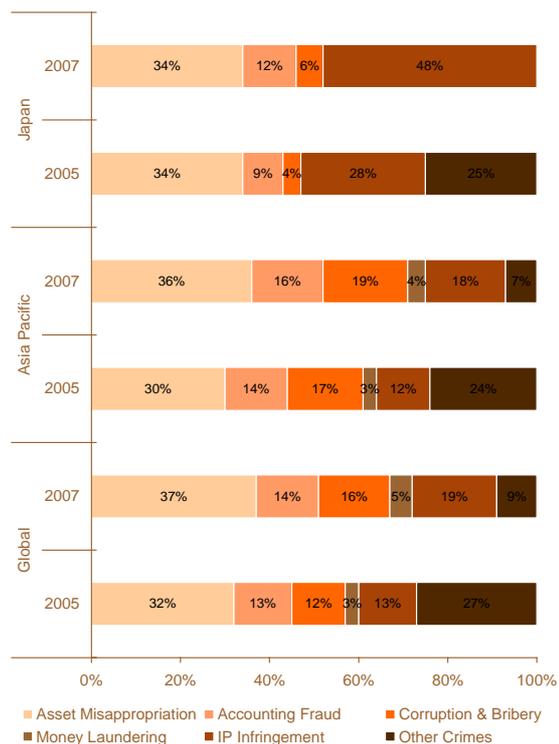
Investigating and remediating – what to do when economic crime is discovered

Our survey showed that when companies had been subject to economic crime the remediation was generally to introduce or strengthen existing control measures (fig 5) but 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

3A. Type of economic crime considered to be the most prevalent



3B. Type of economic crime reported as most prevalent



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 is 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.

No action is not an option

The survey results showed that 40 percent of Japanese companies have no plans for dealing with the problem of economic crime (fig 5). This is a matter that should be addressed as a matter of urgency. Action taken to prevent, or at least reduce, fraud not only helps protect a company's assets but also, and perhaps more importantly, its reputation.

Survey demographics

The 2007 Global economic Crime survey results are based on interviews conducted in 40 countries with 5,400 companies. The respondents were CEO's, CFO's and other executives who were responsible for the prevention and/or detection of economic crime within their companies.

The Japanese survey included 130 companies, which were randomly chosen from the largest 2,000 companies in Japan.

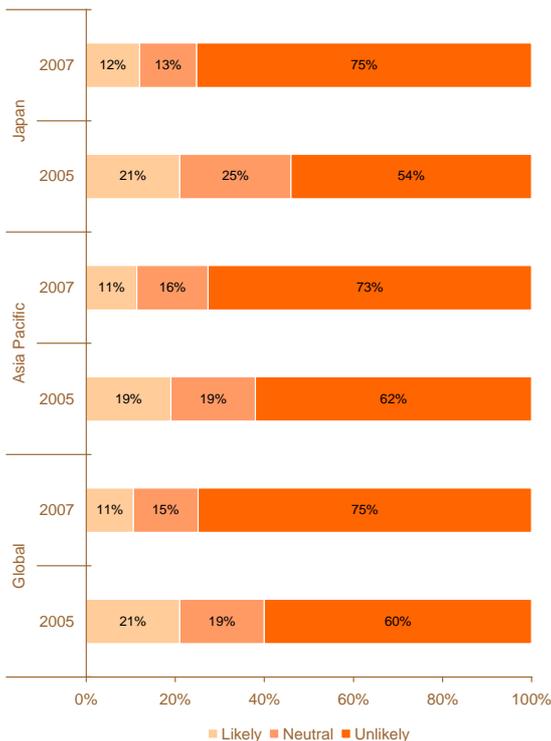
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4. The risk of own organization being subject to economic crime over the next 2 years



5. How companies dealt with the problem of economic crime

