

global economic crime survey 2005

Australia

Introduction



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I am pleased to present the Australian results of the third biennial PricewaterhouseCoopers' Global Economic Crime Survey. The 2005 report provides an unmatched insight into the growth, impact and future of economic crime in Australia and across the globe.

It also incorporates two additional areas of focus surrounding the effectiveness of fraud risk management systems and the profile of fraudsters. These additional areas were explored in order to provide a greater understanding of the effectiveness of preventative measures

and to expose the backgrounds and motivations of a fraudster.

The growing global fraud epidemic, combined with rapid economic growth, a heavy reliance on state-of-the-art technology, and strong competition have left many organisations as high risk targets of economic crime. This survey is one of the most comprehensive assessments of the nature and impact of economic crime around the world and provides organisations with evidence to support the growing need to implement a robust fraud risk management framework.

In undertaking this survey, 3,634 interviews were conducted across 34 countries. The following is a summary of our findings in the context of the Australian business environment.

Australian findings – Executive Summary

1. Fraud, a fact of business life

- Fraud is a fact of business life in Australia with 63% of organisations in Australia having experienced economic crime in the past two years. This represents a 16 percentage point increase on the results of our 2003 survey.
- The level of economic crime in Australia was 18% above the

global average and 24% above the Asia-Pacific average.

2. Categories of economic crime

- Of the reported crime over the past two years, asset misappropriation and false pretences (deceiving others in order to obtain a financial gain) are most prevalent, affecting 78% and 58% of respondents respectively.

3. Does size and industry matter?

- Over the past two years, industries which reported the highest levels of economic crime were services (74%), trade (71%) and manufacturing (60%). The services industry encompasses government, construction, gas and water supply, telecommunications and other services. The trade industry covers wholesale and retail.
- 100% of organisations with more than 5000 employees and 33% of organisations with less than 200 employees reported incidents of economic crime over the past two years.

4. Cost – Intangible V's bottom line

- The survey results indicate that on average Australian organisations suffer greater losses to economic crime than the global average. The average total loss from fraud reported by Australian organisations was A\$3,074,543, higher than the average global losses reported of A\$2,368,877.
- Over 54% of respondents cited intangible costs, such as reputation and effect on staff morale, as being of a medium to high cost to their organisation.

5. The perpetrators

- 67% of perpetrators of economic crime were employed internally by the organisation. 54% of those held positions of middle management or above.
- The typical perpetrator profile in Australia is of a male, 41 to 50 years of age whose highest level of education is high school or less. However, the global trend indicates that perpetrators are getting younger and their level of education higher.

6. Reaction and Recovery

- 58% of respondents affected by economic crime were able to recover at least part of the amounts

lost. 74% of organisations are now insured against fraud.

- Of the funds recovered, 37% were recovered from the perpetrator and only 16% from insurance claims.
- 59% of companies dismissed the chief perpetrator and 54% laid criminal charges. Of those charged, 25% were sentenced.

7. Prevention and Detection

- Initial methods of detection have changed dramatically over the past two years. In the past, 53% of organisations detected economic crime by accident. In 2005 this represented only 4% of cases. Organisations now have a greater awareness of their exposure to economic crime and appear to be more proactive in their efforts to detect it. While the traditional avenues of internal and external audit and tip-offs retain their vital roles in detecting economic crime, new alternatives such as whistleblower hotlines and corporate security are now also providing results.

8. Moving forward – the future

- 44% of companies would be willing to increase their fraud avoidance measures over the next two years.

Action points

- Know where your fraud risks are. The risks vary for different sized organisations, different types of organisations and different industries. Consider conducting a fraud risk assessment.
- Be proactive around fraud prevention and detection. Consider introducing consistent specific measures such as:
 - Pre-employment screening
 - Transaction analysis incorporating fraud profiling
 - Whistleblower systems
 - Awareness / education programs and staff surveys
- Be aware of the value of evidence. Consider appointing professional external investigators when incidents arise.
- Review fidelity insurance arrangements. Explore fidelity cover arrangements with your broker. Ensure policy limits and deductibles are appropriate in the context of your risk appetite. Be aware of policy exclusions, conditions and claim preparation requirements.
- Regular review of the internal controls environment. Assess procedural weak points and take regular corrective action.



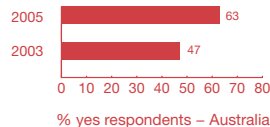
Organisations clearly need to consider whether their current prevention mechanisms remain appropriate to their potential risks.

Australia and Economic Crime: The complete picture

1. A fact of business life

The 2005 Global Economic Crime Survey highlights the fact that economic crime is a growing problem in Australia. This is supported by the startling increase in the number of companies (up 16 percentage points from 47% in 2003 to 63% in 2005) that have been subject to economic crime over the past two years.

Figure 1: Has your organisation been subject to economic crime over the past two years?



Further, Australian companies that were subject to fraud during the previous two years reported an average of 15 incidents of economic crime per organisation. Globally the average number of incidents reported per organisation was eight.

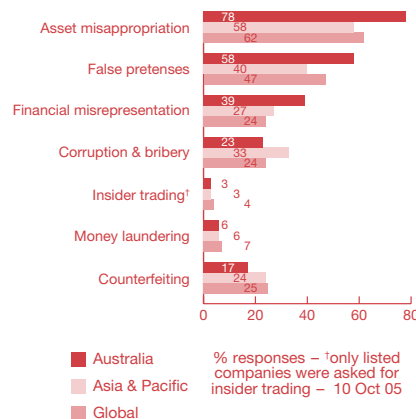
The relatively high reporting rate in Australia may be driven by a number of factors including the flattening of organisational structures, the rapid growth of some sectors and the speed with which technology has been developed and adopted into payments and channels.

The increase may also be explained by a heightened level of awareness of fraud as part of good corporate governance, and correspondingly high detection rates.

2. Categories of economic crime

The most prevalent reported frauds were in the categories of asset misappropriation (78%) and false pretences (58%). The incidence of asset misappropriation and financial misrepresentation crimes has increased significantly since the 2003 survey.

Figure 2: What type of crime has your organisation been subject to?



More Australian organisations experienced money laundering incidents in 2005 (6%), than in 2003 (0%). This may be explained by the heightened awareness and increased focus on money laundering and terrorist financing in Australia and globally during the past two years.

Interestingly, the number of reported incidences of corruption and bribery has increased from 1% in 2003 to 23% in 2005. This supports our observation that organisations are

now more willing to recognise that such incidences take place and report such occurrences.

Case study: sales and inventory fraud

The sales director of an electronic product manufacturer resigned from his position when confronted with irregularities in sales figures for the organisation. A PwC investigation into the sales director's activities was undertaken.

This investigation discovered that a significant proportion of sales invoiced to particular suppliers had been falsely created, allowing the misappropriation of inventory from the warehouse.

The fraudulent sales invoices were later credited by the sales director as 'non-inventory return credits'. The inventory itself had been collected by an associate of the sales director and the sale proceeds shared between them.

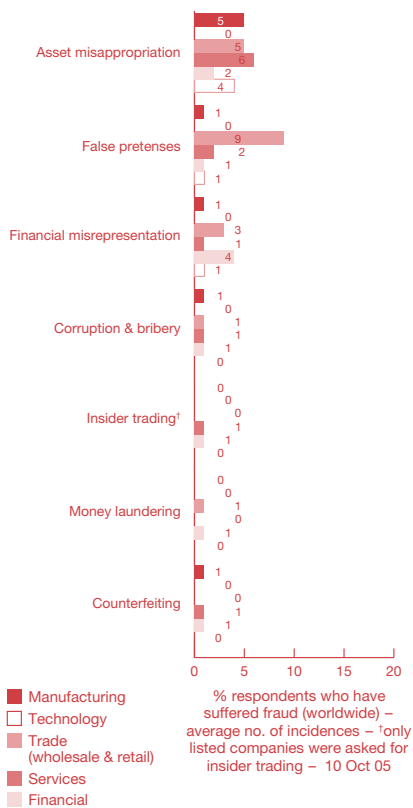
3. Does size and industry matter?

In previous surveys, the financial services industry reported the highest levels of economic crime. The 2005 survey illustrates that this position is now occupied by the services industry with 74% of organisations being affected. This is followed by the trade industry with 71% of organisations experiencing fraud. The financial services industry recorded the lowest level of economic crime, with only 53% of organisations being affected. This is one of the more surprising results of the 2005 Australian survey and highlights the growth of economic crime in less regulated industries.



Asset misappropriation and false pretences are the most prevalent economic crimes suffered by business. However the perception is that these offences are less prevalent than they actually are.

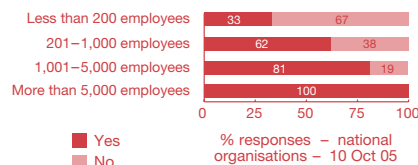
Figure 3: The 2005 survey illustrates that all industry and organisation types are vulnerable to various types of fraud.



type of economic crime reported was false pretences and financial misrepresentation, respectively.

All organisations with more than 5000 employees and 33% of organisations with less than 200 employees reported incidents of fraudulent activity over the past two years. Based on the survey results, there is a strong correlation between the size of an organisation and the number of fraud incidents with the risk of economic crime potentially increasing as the employee number (size) of the organisation grows.

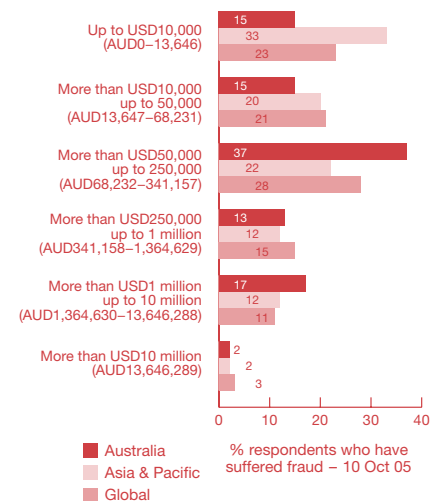
Figure 4: Has your organisation been subject to economic crime over the past two years?



Respondents were asked to provide estimated values for total tangible losses from certain types of economic crime such as asset misappropriation, counterfeiting and false pretences, where the highest individual losses recorded were A\$920,300, A\$773,500 and A\$613,100 respectively.

During the survey period, organisations reported an average of 3.5 incidences of counterfeiting (which includes breaches of patents or copyright, product and software piracy and the illegal acquisition of trade secrets). This category of fraud also reported the greatest single monetary loss.

Figure 5: In monetary value, how much do you think your organisation may have lost through these types of economic crime?



Over the last two years the financial services industry has been subject to regulations like the Financial Services Reform Act, and the Basel II Accord which may have been an impetus for organisations in this industry, to increase their fraud control and awareness environment.

The most prevalent type of economic crime committed in the services industry was asset misappropriation. In the trade and financial services industries, the most common

4. Cost – Intangible V's bottom line

The 2005 results also provide a 'real' insight into the impact economic crime has on different industry groups. This impact is measured in terms of both the monetary costs and the more intangible effects of economic crime.

The survey results indicate that on average Australian organisations suffer greater losses to economic crime than the global average. The average total loss from fraud reported by Australian organisations was A\$3,074,543, higher than the average global losses reported of A\$2,368,877.

In analysing total losses by industry, it was observed that 100% of the financial services industry that reported economic crime cited a total

monetary loss greater than US\$10 million (A\$13.6million), while 57% of the services industry and 43% of the manufacturing industry that reported economic crime, reported total losses of between US\$250,000 and US\$1 million (A\$341,000 and A\$1.4 million).

From an average loss perspective, the industry reporting the highest total monetary loss was the financial services industry which incurred on average a A\$45.7 million loss. The majority of losses in this industry were through counterfeiting (A\$15.5 million), perhaps reflecting the extent of credit card fraud.

Frequently, the intangible effects of economic crime are often overlooked because they are hard to measure, quantify and substantiate to management. However, the intangible effects of economic crime are progressively becoming more visible to organisations with 71% of respondents reporting that major incidents of economic crime have resulted in a decline in staff morale and motivation. Furthermore, 41% of organisations reported that their brand and reputation had been affected by incidents of economic crime.

5. The perpetrators

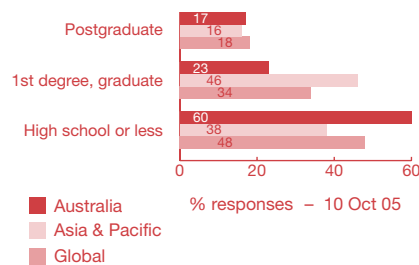
Typically, there are three types of fraud committed in and against organisations:

- Internal: employees and management
- External: customers and other third parties

- Collusive: internal and external jointly

The confronting reality for 67% of companies surveyed was that the perpetrator of economic crime was employed by the organisation itself, with 54% holding positions of middle management or above. In Australia, the typical perpetrator was male (87%), between the ages of 41 and 50 (53%) and educated to high school or less (60%).

Figure 7: What was the main perpetrator's highest level of education?



Respondents were also asked to categorise the reasons given by the perpetrators for committing an offence of economic crime. What is apparent from the responses is that the perpetrators low temptation threshold (49%), lack of awareness that they were doing the wrong thing (46%), and collaboration with external parties (32%) played a significant role in why offences were committed. This is important for organisations to consider in the context of fraud risk management, in particular their pre-employment screening and fraud awareness training procedures.

Case study: employee fraud

Anonymous letters were sent to two government agencies alleging that a government employee was involved in fraudulent activity. The suspect was a senior manager with control over finance, payroll, human resources and training operations.

PwC's initial investigations involved the recovery of deleted computer records and interviews with staff members who provided numerous leads. A wealth of information was uncovered, including evidence the suspect had:

- Falsely obtained employment with bogus qualifications and a false employment history
- A prior conviction
- Forged documents and falsified accounts
- Misused stolen employer assets
- Committed credit card application and expenses fraud
- Evaded income tax and conspired to defraud public revenue (FBT fraud)
- Collected unauthorised increases in salary and bonuses
- Been absent from duty and made claims for work not performed
- Colluded with a contractor to pay for services not performed.

A criminal brief of evidence was prepared for the police and evidence given at the trial of the offender. Assistance was provided to the organisation's legal advisors in handling the offender's dismissal resulting in a defeated 'unfair dismissal' claim. The offender was convicted and sentenced to a term of imprisonment.



The survey has revealed that 37% of organisations lost between US\$50,000 and US\$250,000 (A\$68,232 and A\$341,157) to economic crime and 42% of companies were unable to recover any of their losses.

6. Reaction and Recovery

The survey found that 59% of organisations dismissed the chief perpetrator of the offences and 54% of perpetrators were criminally prosecuted. Of those charged, only 25% were sentenced. It would seem that in many cases, the perpetrators of economic crime were not dismissed from employment and fewer still faced criminal consequences for their actions.

Even when economic crime has been detected and prosecuted, either civilly or criminally, it can still prove difficult to recover the assets. Of respondents who had experienced fraud, only 58% had succeeded in recovering at least some of the amount lost.

Of those, 37% were recovered from the perpetrator and just 16% from insurance claims, even though 74% of organisations are now insured against fraud. There may be many reasons for this apparent failure to recover lost assets. Companies may be reluctant to embark on long and expensive recovery processes with no certainty of success, in other words the risk of throwing 'good' money after 'bad'. This is particularly so in circumstances where the assets have been moved across jurisdictions. However, this view may result in lost opportunities to recover from the financial impact of fraud and does not send a clear message to potential perpetrators that every effort will be made to recover from them the organisation's losses.

7. Prevention and Detection

The survey revealed an increase in certain types of preventative measures being put in place by organisations.

Figure 8: Have the following measures for the discovery and prevention of acts of economic crime been present in your company?



For example, specific fraud training has increased from 29% in 2003 to 44% in 2005. The results of the 2005 survey also highlight at least two major points that should be front of mind when considering the type of prevention and detection measures Australia organisations have in place to combat fraud. Those are:

- Within Australia 67% of perpetrators were internal to the organisation and of those 54% at a middle management level or above; and
- A lack of values or awareness of wrong doing was a key motivation in the commission of economic crime in 46% of cases.

In addition, the implementation of organisational ethics and codes of conduct have increased from 72% in 2003 to 95% in 2005. Importantly the implementation of whistleblowing systems has risen dramatically from 12% to 61%. The increase of whistleblowing systems reflects our experience with clients who have a heightened interest in this form of economic crime prevention. However, the survey also revealed that only 29% of organisations employed special forensic analysis techniques in order to identify economic crime.

Case study: whistleblower protection policy and set-up of an external hotline

A tertiary institution in Victoria required the development of a whistleblower protection policy and the implementation of an externally managed hotline that could receive disclosures from staff, students and the general public.

With the aid of external advice from PwC, the institution developed a whistleblower protection policy that complied with The Whistleblowers Protection Act (Vic) including a 1800 telephone number, PO Box and a database accessible on the organisation's web site for the receipt of disclosures. Experienced investigators manage the system, reporting disclosures to the organisation's whistleblower protection coordinator with recommendations for further action.

The survey revealed a wide range of techniques were successful in detecting fraud. The most common being internal audit (31%), or some for of tip-off (30%). Unlike 2003, organisations are far less dependant on the accidental discovery of economic crime.

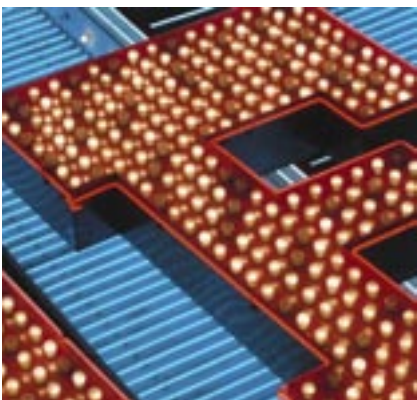
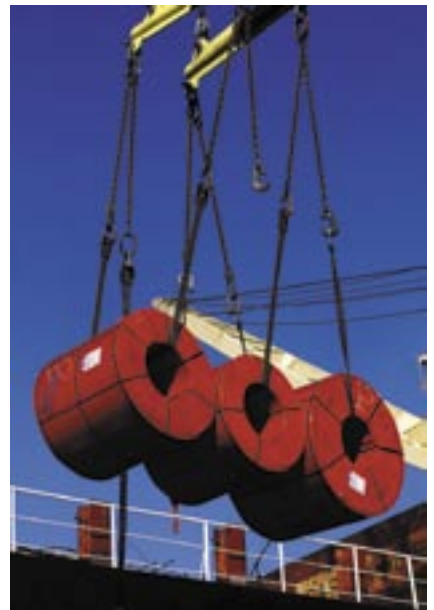


Figure 9: How was the case initially detected?



enterprise wide risk management program. Organisations need to consider putting in place fraud risk management strategies for employees and others to report suspicions of fraud. These mechanisms are likely to be in the form of whistleblower protection policies, 'hot-lines' and proactive fraud detection programs.

Supporting the fraud risk management program should be regular fraud detection including data analysis and data matching. Of course in the event that an organisation does discover they have been the victim of an economic crime, they need to be able to respond effectively and efficiently. Time is often of the essence and organisations need to put in place investigation plans to assist staff in responding to such incidents.

8. Moving forward – the future

Clearly organisations have economic crime control on their radar and expect that incidents of economic crime will continue to increase. This is demonstrated by the results of the PricewaterhouseCoopers Global Economic Crime Surveys of 2003 and more recently, 2005.

Over the next five years, it will be critical for organisations to prepare themselves to deal with the risk of escalating economic crime. Regular fraud risk assessments should be a critical part of an organisations



It is critical for organisations to prepare themselves to deal with the risk of economic crime in the future.

Demographics

The Global Economic Crime Survey interviewed 3,634 companies in 34 countries. In Australia 101 leading organisations participated. Organisations interviewed were randomly selected, with preference given to the 1,000 largest

organisations within Australia. Further information pertaining to the survey demographics and definitions of economic crime can be found in the Global Economic Crime Survey 2005.

The organisations surveyed had fewer employees than in 2003 and there were notable changes in the mix of

industries represented. The sample had fewer manufacturers (59% in 2003 as compared with 25% in 2005), and representation in the financial services industry was up by 11%.

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