Economic crime: people, culture & controls

The 4th biennial Global Economic Crime Survey
South Africa

Introduction

Our survey reveals that fraud remains one of the most problematic issues for business worldwide. Despite the attention by regulators and investment companies in controls, the actual level of economic crime and the associated financial and non-financial damages have not decreased – one out of every two companies globally, fell victim to economic crime in the past two years.

While companies continue to develop systems and controls to both detect and deter economic crime, fraud controls alone are not enough. A company's ethical culture plays an equally important role in deterring fraud.

To help industry leaders understand and confront the threat of economic crime, PricewaterhouseCoopers undertakes a biennial, worldwide study into the impact of fraud on business. Working in conjunction with the Economic Crime Research Centre at Martin-Luther-University in Germany and the international research agency, TNS Emnid, this pioneering research project remains the most comprehensive survey of economic crime available to businesses.

Methodology

The 2007 survey was conducted in 40 countries between April and July 2007. Over 5,400 computer assisted interviews were conducted with CEOs, CFOs and other executives who have responsibility for economic crime prevention and detection within their respective companies.

More than half of the respondents (55%) are members of the executive board or company management, or stated that their main responsibility was in the field of finance.

The country specific survey for South Africa was based on interviews conducted with 103 companies, 71% of which were listed companies.

Falling prey to economic crime

In South Africa, 72% of companies reported that they had fallen prey to economic crime in the past two years, in comparison with 43% globally.

While the number of South African companies that have fallen prey to economic crime in the past two years remains much higher than that which is experienced globally, South Africa has experienced a decline in economic crime over the past two years, at a rate higher than that experienced globally.

The 72% affirmative response for South Africa equates to a 13% decrease on the 2005 survey results, with a 4% decrease being reflected in respect of global responses.

Figure 1a: South African companies subjected to economic crime in the past two years: 2007

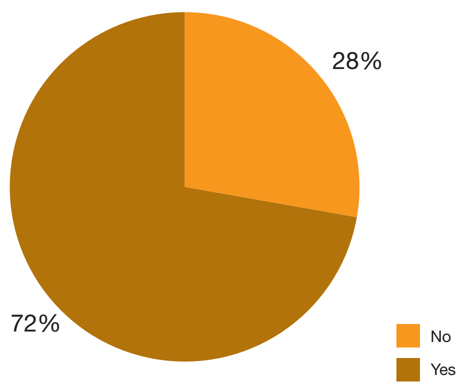


Figure 1b: South African companies subjected to economic crime in the past two years: 2005

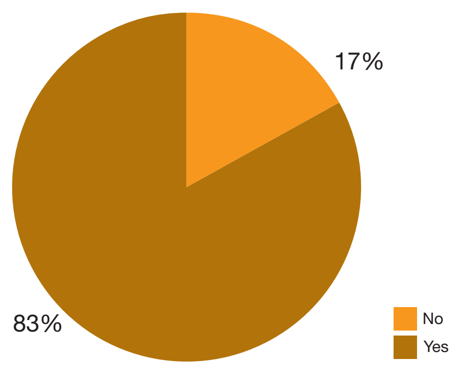


Figure 2a: Global companies subjected to economic crime in the past two years: 2007

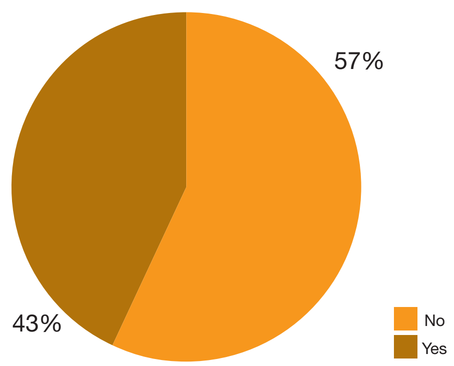
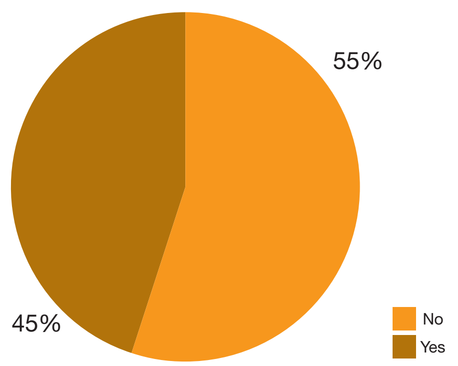


Figure 2b: Global companies subjected to economic crime in the past two years: 2005



72% of companies in South Africa have fallen prey to economic crime in the past two years – a 13 percent decrease from our previous survey.

Perceived prevalence

As in 2005, corruption and bribery was perceived to be the most prevalent economic crime in South Africa, with a result of 30% in 2007 and 29% in 2005.

Also of significance, is the fact that 9% of South African respondents considered Money Laundering to be prevalent, in comparison with the 5% response in 2005. This trend is mirrored in the global results in that there is a 71% increase in the perception that Money Laundering is prevalent globally.

Only 26% of companies perceived asset misappropriation to be prevalent, but 62% of companies reported suffering actual incidents of asset misappropriation in the last two years. Despite the fact that respondents perceived asset misappropriation as less of an economic crime threat since the 2003 and 2005 surveys (and all other fraud threats as higher than in previous years), it is actually the most common incident of economic crime reported by companies. This is the only category of economic crime, globally in which perceived prevalence underestimated actual incidents.

Actual incidence

South African companies that suffered economic crime reported an average of 23 incidents during the past two years, in comparison to the eight suffered by their global counterparts. This is an increase of 110% on the number of incidents reported by South African companies in 2005.

Figure 3: Perceived prevalence of economic crime

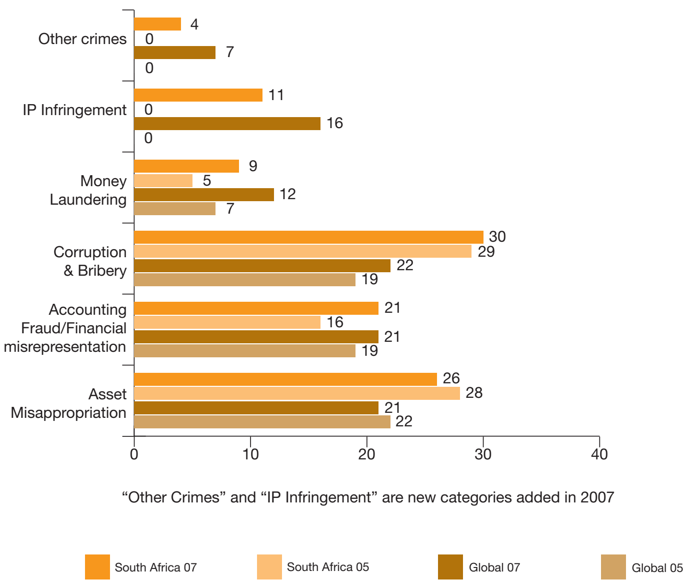
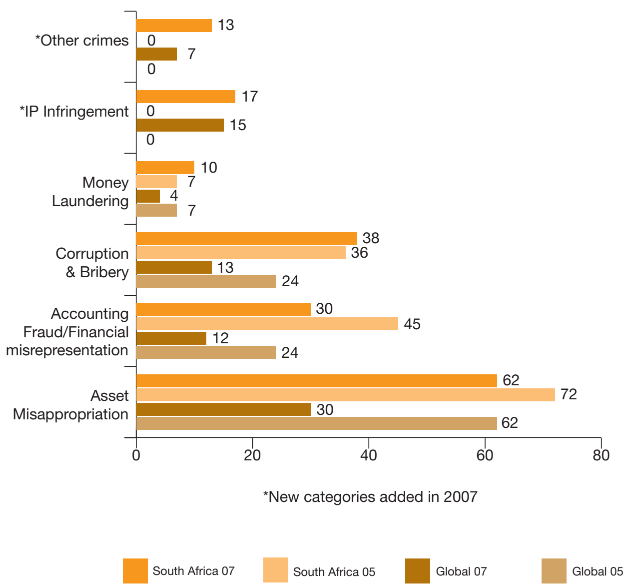
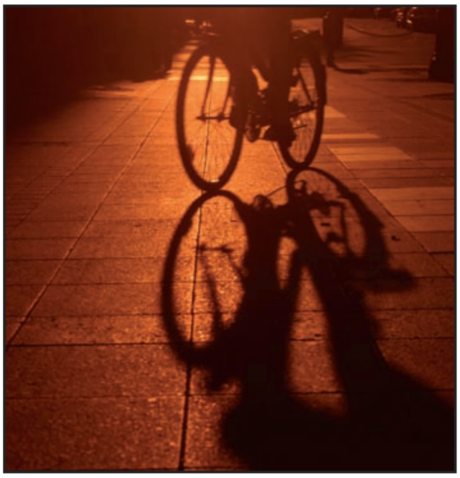


Figure 4: Actual incidence of economic crime



26% of companies in South Africa perceived asset misappropriation to be prevalent, but 62% of companies reported suffering actual incidents of asset misappropriation in the past two years.



Many of the controls that companies have implemented are focussed on procedures to deliver accurate financial reporting and do not explore other areas of potential fraud risk, for which specific fraud risk management controls and activities are needed.

There has been a marginal increase in the number of cases of corruption and bribery being reported, although, significantly, there has been an increase in the number of money laundering and IP infringement cases, which have been reported for the first time this year.

Detection

We compared business' current effectiveness in detecting fraud with their collective performance in our previous study. The result is continuing evidence of the intractability of fraud – and its apparent immunity to management's attempts to control it.

In 2007, 36% of frauds were detected by chance, an increase of 7 percentage points over two years.

There are a number of explanations for this disappointing statistic. It may be that there has been insufficient time for companies to embed updated controls into their operations and, as a result, the controls require yet more time for their deterrent effect to penetrate the psyche of the potential fraudster.

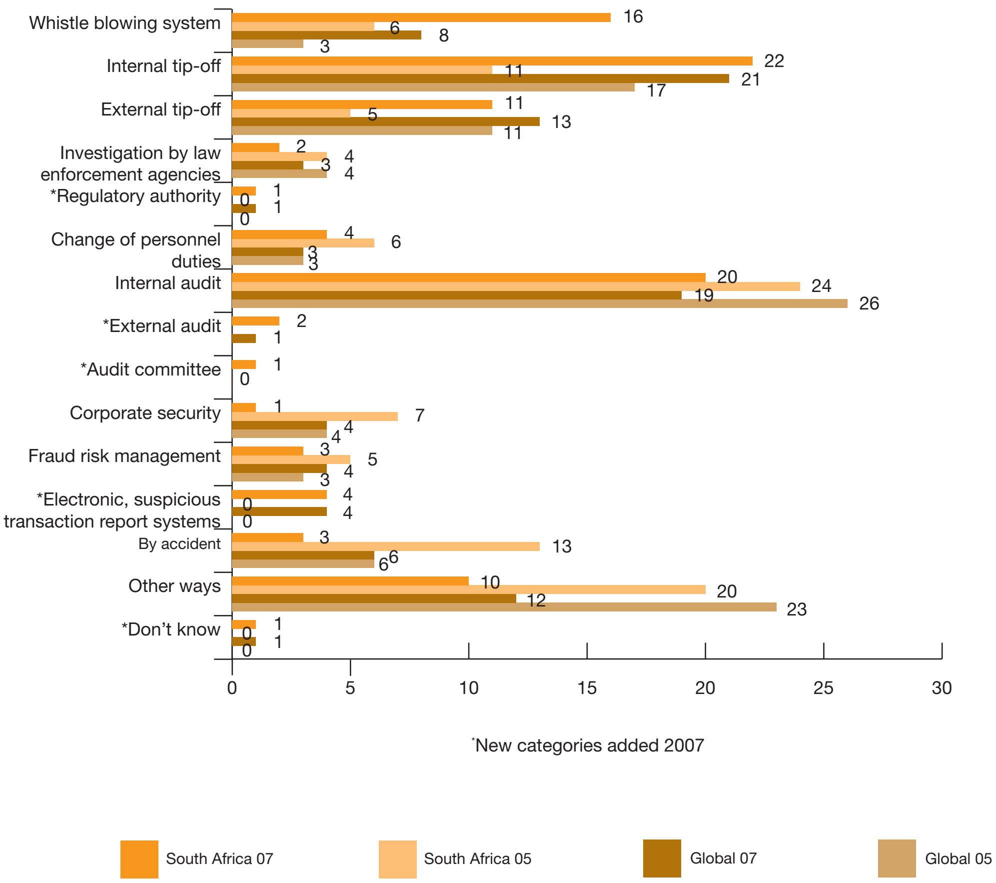
It may also be however that companies are investing so much in controls to guard against financial reporting risks and frauds that management's attention has been diverted from other important areas of fraud risk management and compliance, such as sales practices which may fall foul of anti-corruption laws.

Controls alone are not enough to take full advantage of detection mechanisms created within a company. It is vital that employees be both encouraged and facilitated to do the right thing – which is a function of culture as opposed to control.

Monetary losses

The immediate response of most executives to an instance of fraud is "How much has this cost us?" Typically,

Figure 5: Means by which the case was initially detected



this question is directed towards the actual monies stolen, and our study has shown these amounts are substantial. In fact, in South Africa the average loss from fraud over two years per company was $1,088,082.

In some cases, this is a perceived cost, and in our experience, most likely an undervaluation. There are many cases where the respondents to our research were simply unable to put a figure to their losses except to say that they were "significant".

It is also worth recalling that in some instances, for example, in cases of money laundering there is no immediate financial cost to the firm since it was merely a channel for attempts to legitimise the proceeds of crime. Similarly, corruption & bribery may see the payment of cash or gifts to secure a contract or favour, but these are in themselves, not "losses" to the company.

Perpetrators of fraud

It is generally accepted, by criminologists and fraud investigators that three things must be present for a fraudster to set to work:

- the opportunity to commit fraud;
- the incentive to commit fraud; and
- the fraudster's ability to rationalise their own actions.

The survey shows that while fraud is committed by people at every level and in practically every department – "figureheads" within South African businesses are responsible for 17% of all reported frauds and have been in the company for an average of seven years.

Criminological research indicates that most fraudsters tend to be risk-takers, very decisive, extroverted, career or success oriented individuals. Paradoxically, it is precisely these traits that are so highly prized in management recruitment.

"Figureheads" are responsible for 17% of all reported frauds and have been in the company for an average of seven years.

Our 2007 study reveals that the demographics of a typical fraudster remain unchanged from our previous research in 2005. He is male (76% cases) and between 31 and 40 (45% cases). Their education levels are spread across the spectrum, with 64% being educated up to high school level and 36% having a bachelor's or postgraduate degree. Similarly, their position in the company was spread across all grades, with 39% of perpetrators falling within middle or senior management.

Figure 6: Financial losses from tangible fraud

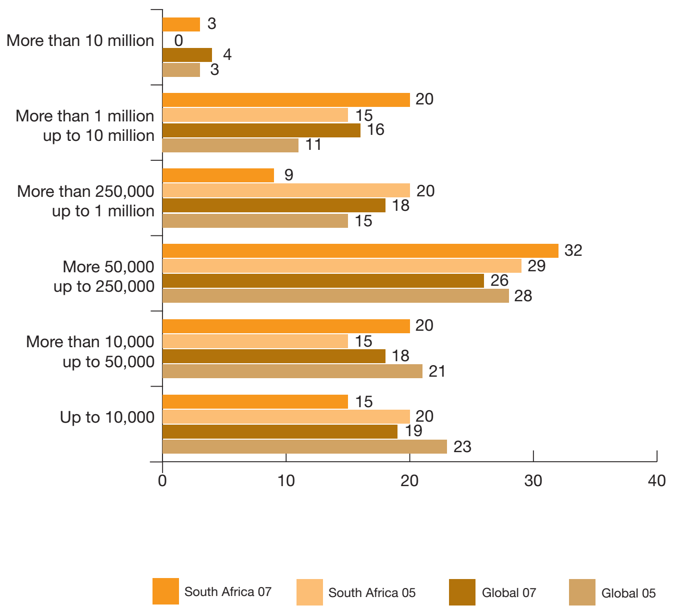
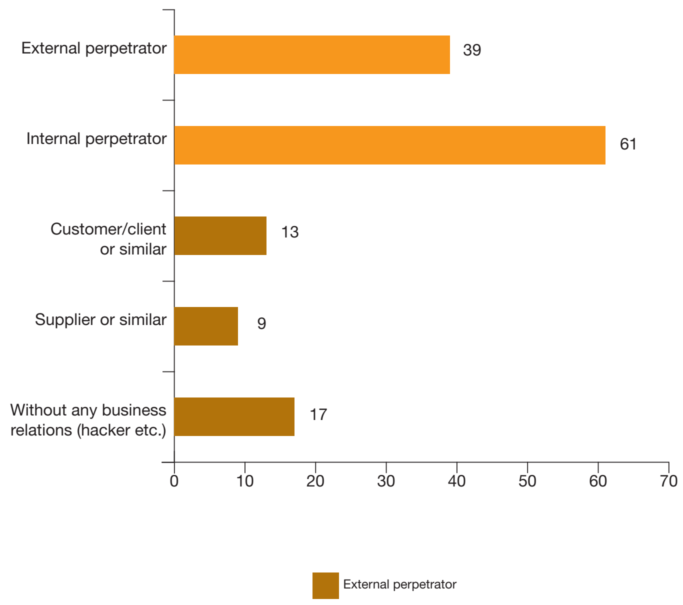


Figure 7: Perpetrator's relation to the company



High education levels and management positions should not be surprising as neither limits an individual's desire to increase their own material gain, and in some cases it may help in the circumvention of sophisticated control systems.

Investigating and dealing with fraudsters

An important step in creating a corporate culture that does not tolerate fraud is consistency of action when economic crime is detected. When staff understand the consequences of their potential foray into fraud, and that detection is certain and inevitable due to the sophisticated and effective nature of the risk management systems, this serves to deter most criminals.

In South Africa, we found that company offences were reported as follows:

- 88% reported to the Board of executive management
- 78% reported to law enforcement
- 77% reported to the Board of non-executive management (including audit committee)
- 26% reported to a Regulator
- 5% reported to levels below executive management.

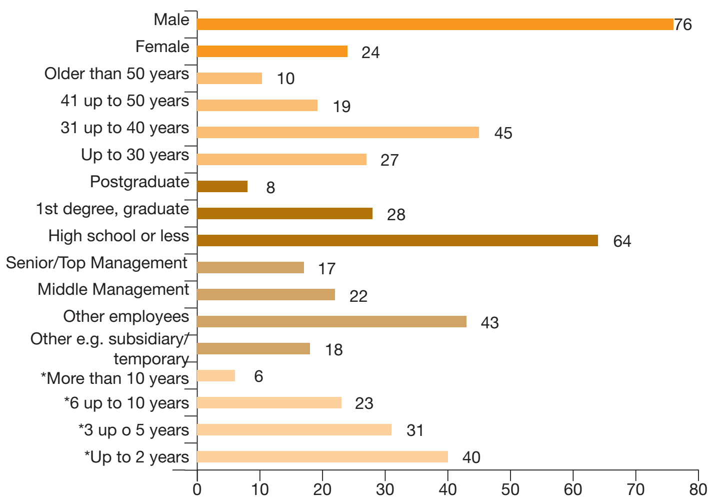
Our findings with regards to corporate reaction to the detection of fraud are interesting as in South Africa, 64% of respondents indicated that criminal action had been taken, compared to only 50% globally. Similarly, in South Africa 51% of respondents indicated that the perpetrator was dismissed, compared to 40% globally.

In South Africa, 30% of perpetrators were sentenced, with 32% of the cases pending, compared to results of 20% and 30% respectively, globally.

We recommend that companies consider the following points as they move forward in developing fraud control programs and strategies:

- Replace once-off risk mitigation programmes with fully integrated comprehensive compliance programmes.
- Proactively monitor vulnerabilities to fraud.
- Develop a strong ethical culture that is clearly evident to all employees.
- Be sensitive to the issues that individual employees might have to confront, such as the wrongdoing of a colleague.
- Take all the precautionary steps possible to deter fraudsters – and those who merely contemplate the crime. A comprehensive understanding of fraud risks sources and controls provides a foundation for making informed decisions.

Figure 8: Perpetrator profiles



*How long the main perpetrator had been in his/her position at the time of detection

Figure 9: Company reaction to detecting fraud

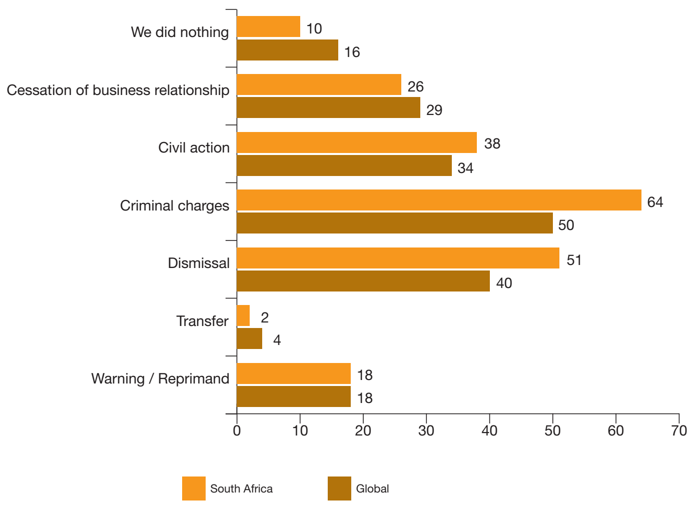


Figure 10a: Were any of the perpetrators sentenced – South Africa

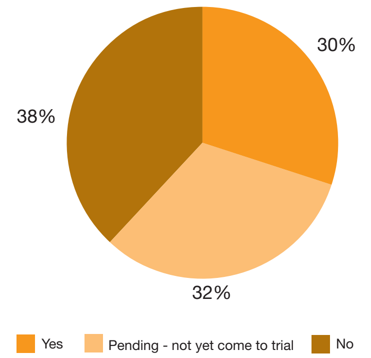
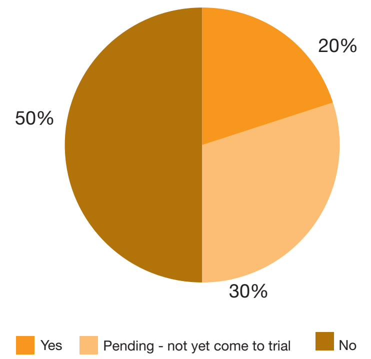


Figure 10b: Were any of the perpetrators sentenced – Global



What does the future hold?

Fraud levels have not dropped significantly over the course of this decade and companies continue to be confident that their controls will limit their exposure to fraud in the future. However, 23% of the respondents stated that they believe the threat from fraud will increase in the next two years.

This survey has shown that the controls that have been implemented will not be sufficient in mitigating the risk of economic crime on their own.

Our hopes rest in organisations establishing a culture that supports those controls with clear and ethical guidelines, engendering a loyalty to the organisation's brand, and showing that every perpetrator, no matter what their position and function within the company, will be subject to equivalent sanctions.

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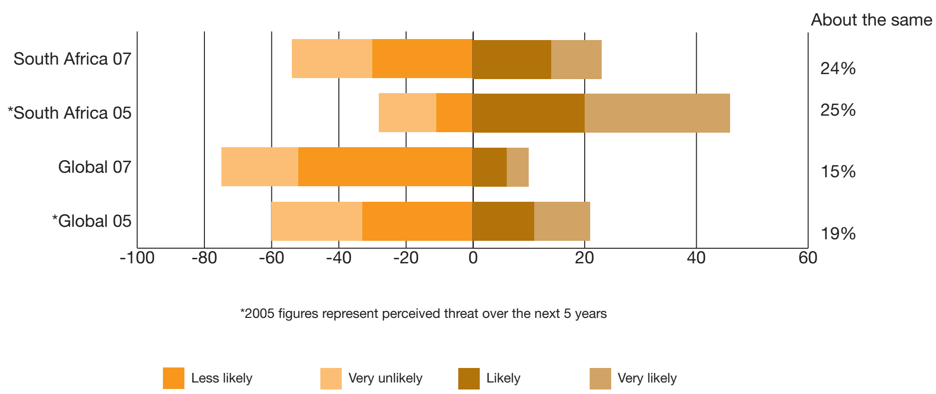
Figure 11: Perceived threat of fraud over the next two years



Controls on their own, will not be sufficient to mitigate fraud risk. Companies must establish a culture that supports those controls with clear and ethical guidelines.

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