

South Africa

# Economic crime in a downturn

The Global Economic Crime Survey  
November 2009

# Introduction

Our 2009 survey addresses economic crime and its associated integrity risks, in a time when most, if not all territories, have felt the effects of an economic downturn or, at the very least, a significant slowdown.

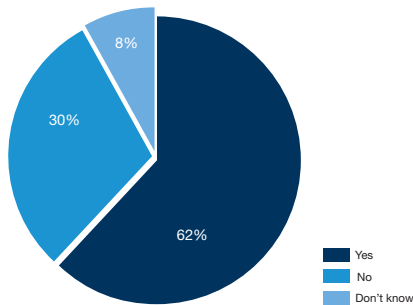
This year, senior representatives of 3,037 companies in 55 countries participated in the survey. The INSEAD Business School assisted us with the scope, content and interpretation of survey data and the PwC Global Economic Crime Survey continues to be the world's leading

research programme into economic crime.

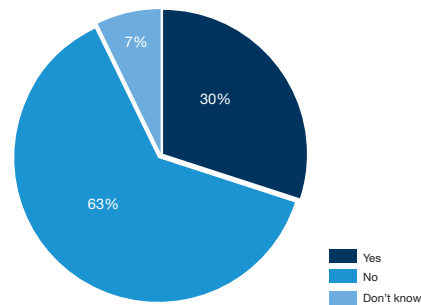
The results of this year's survey serve as evidence of the fact that fraud is pervasive, persistent and pernicious. Despite increasing regulatory actions and anti-fraud controls, economic crime continues to be a threat.

In fact, 62% of respondents in South Africa indicated that they had fallen victim to economic crime within the last 12 months, compared with 30% globally.

**Figure 1: South African respondents subjected to economic crime over the past 12 months**



**Figure 2: Global respondents subjected to economic crime over the past 12 months**



We believe that the consistently higher figures presented for South Africa are indicative of a culture in which transgressions are divulged and increased transparency is promoted.

## Economic downturn and the heightened risk of fraud

The results reflect that the global economic downturn has significantly affected most respondents. The 65% of South African respondents that reported a decline in financial performance in the last 12 months is comparable with the 62% reported globally.

62% of the respondents reported having been the victim of economic crime in the past 12 months.

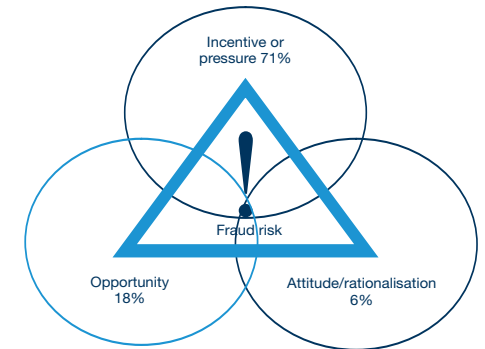
Organisations must increase their vigilance over risks and relative controls during arduous economic times – these measures are not a luxury – they are a necessity.

Fraud practitioners point to three factors that are commonly found when fraud occurs (the Fraud Triangle). First, perpetrators need an incentive or pressure to engage in misconduct. Second, there needs to be an opportunity to commit fraud, and third, perpetrators are often able to rationalise or justify their actions.

Our survey looked in detail at the impact of these three factors. Of South African respondents, 78% believed that the risk of economic crime in the current economic circumstances was greater, compared with 40% globally.

Of respondents that believed that the risk of economic crime was greater, 71% felt that increased pressures and incentives were the most likely causes for the greater risk of fraud, compared with 68% globally.

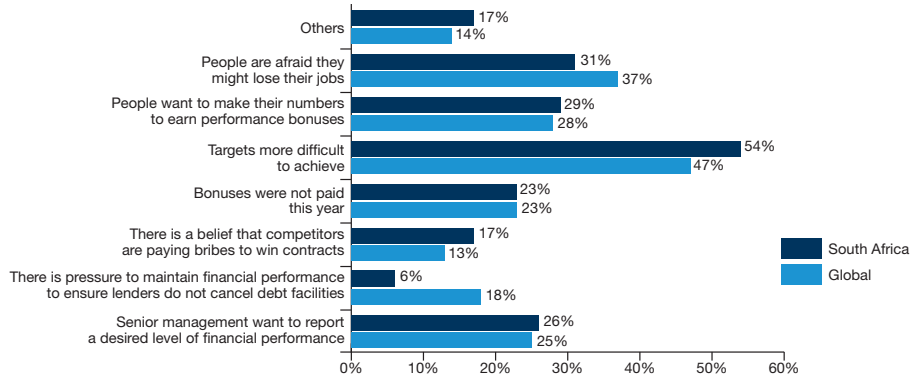
**Figure 3: The Fraud Triangle**



The most significant contributors to increased pressures and incentives were targets that are more difficult to achieve (54%) and a fear that people might lose their jobs (31%).

## Economic crime in a downturn

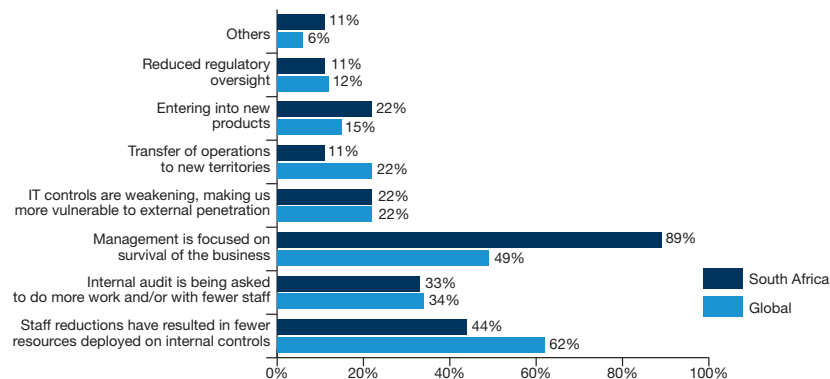
**Figure 4: Contributions to increased pressures and incentives to commit fraud**



*% respondents who believe increased incentives/pressures are the most likely reason for greater risk of economic crime in a downturn*

89% of respondents believed that management's focus on the survival of the business was the most significant contributor to the increased opportunity for fraud in the current economic environment, with staff reductions resulting in fewer resources deployed on internal controls following at 44% (compared with 49% and 62% respectively globally).

**Figure 5: Contributions to increased opportunity to commit fraud**



*% respondents who believe more opportunities constitute the most likely reason for greater risk of economic crime in a downturn*

Often, staff reductions can result in reduced segregation of duties, which in turn impacts on an organisation's ability to maintain a sound control environment, creating gaps in the system.

## The changing face of economic crime – global rise in financial statement frauds

Of South African respondents that suffered economic crime, 49% reported having suffered between one and 10 incidences, while 36% reported being the victims of between 11 and 100 incidences, compared with 68% and 20% globally.

Of concern is that 54% of respondents reported an increase in the number of incidences, while 31% believed that there had been no change in rate of occurrence (compared with 43% and 36% globally).

As with all previous surveys, asset misappropriation is most common, with 82% of respondents reporting that they had fallen victim to this type of economic crime. This figure is notably higher than the global average of 67%. Interestingly however, the 2009 survey reveals that globally, financial statement fraud has become increasingly prevalent over a 10-year period, while the converse is true for South Africa. Financial statement fraud in South Africa has

decreased from 45% in 2005, to 39% in 2009.

This could be because the effect of the global economic downturn has been felt later in South Africa and accordingly the increase in financial statement fraud normally associated with a downturn may be detected later than globally.

Types of financial statement fraud reported in South Africa are:

- Accounting manipulations: 18%
- Unauthorised transactions/rogue trading: 15%
- Fraudulent applications for credit: 13%
- Fraudulent borrowing/raising of finance: 8%

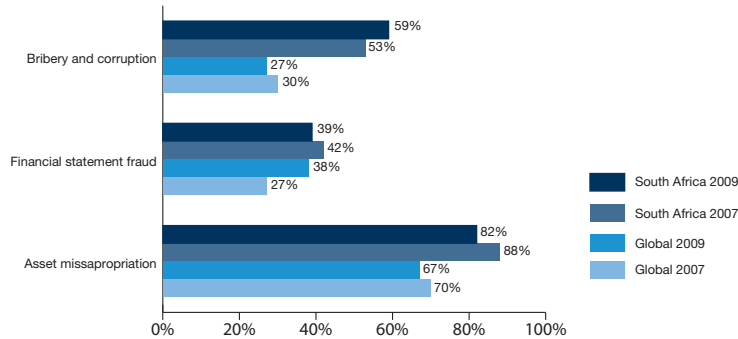
We have seen an increase in bribery and corruption from our previous surveys, despite a slight decline for 2009 globally. The trend in South Africa is an area for concern as it is not consistent with what is being reported in the rest of the world. 53% of respondents reported having experienced bribery and corruption in our 2007 survey and this figure has risen to 59% in 2009. We expect that reported figures could be higher in reality and that there may be a reluctance to report this type of economic crime given the negative media attention that has followed a number of high-profile bribery cases reported in recent years.



## Economic crime in a downturn

We have seen increased regulation in most parts of the world relating to bribery and corruption and we expect this trend to continue as more and more territories strengthen enforcement's actions in response to global pressures.

**Figure 6: Companies reporting actual occurrences of fraud**

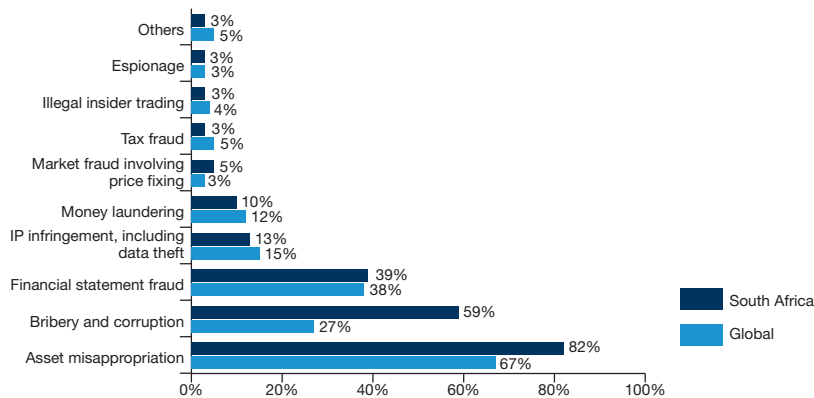


*% respondents who experienced economic crime in the last 12 months*

It is not surprising that the most significant category of economic crime suffered continues to be asset misappropriation, as this category is among the easiest to detect since it involves theft of items with a clear value.

Types of economic crime experienced by South African respondents in the last 12 months have been depicted in the graph below:

**Figure 7: Types of economic crime suffered in the last 12 months**



*% respondents who experienced economic crime in the last 12 months*

## Are organisations detecting fraud effectively?

Despite the high incidence of fraud reported (62%), we cannot discount the possibility that there are still further incidences that remain undetected. This statement is further supported in that we have seen a reduction in the number of staff members deployed on internal controls as a consequence of current economic circumstances.

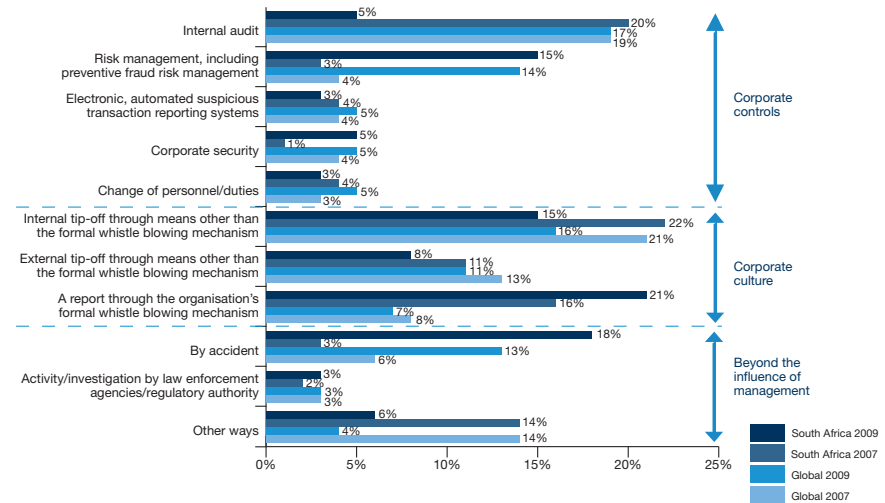
Furthermore, we have seen a drastic reduction in the success rate of the internal audit function in detecting economic crime. In 2007, 20% of respondents in South Africa and 19% globally reported that internal audit was the means by which economic crime was detected. In 2009 in South

Africa, only 5% of respondents referred to internal audit in comparison with the 17% reported globally.

It is likely that the reduction in staff numbers has adversely affected the detection ability of the internal controls team.

A formal whistle-blowing mechanism has been reported as our most effective means of detecting economic crime over the past 12 months (21% of respondents). This result is markedly different from what has been reported globally, with only 7% of respondents citing whistle-blowing as an effective means of detection.

**Figure 8: Detection methods**



*% respondents who experienced economic crime in the last 12 months (for 2009) and in the last 2 years (for 2007)*

Fraud risk assessments are an essential tool, which can be employed by organisations to identify potential threats and take effective action to remediate control system weaknesses that contribute to an environment in which there is an opportunity to commit fraud.

Of reported frauds, 15% were detected through risk management measures, including preventive fraud risk assessments. It is therefore cause for concern that in the last 12 months 27% of South African respondents did not perform a fraud risk assessment at all and another 33% made use of this tool on only one occasion.

Furthermore, while 54% of respondents believe that there has been an increase in the incidence of economic crime over the past 12 months, only 22% increased the frequency of fraud risk assessments while 68% made no change to the frequency of these procedures.

It is disturbing that 41% of incidences were detected by accident and through informal tip-offs and not by means of a formal mechanism.

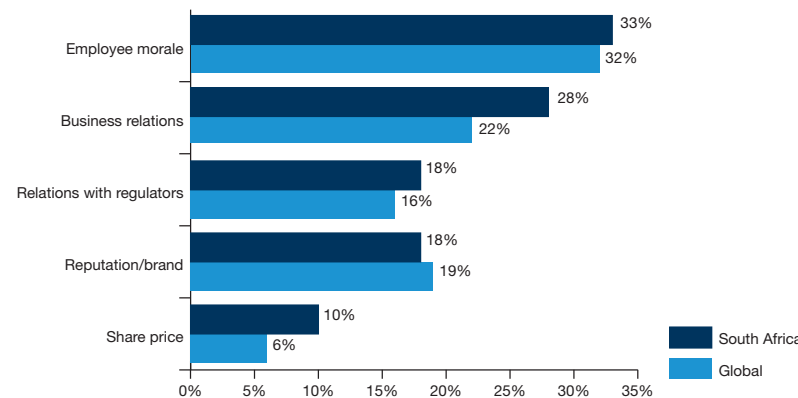
### Financial and non-financial damage

Of respondents who reported fraud, 59% indicated that the direct impact or cost in the last 12 months was in excess of US\$100 000. These are clearly avoidable costs, and costs which in the current environment cannot easily be absorbed.

It goes without saying that the cost of economic crime should not only be measured in financial terms. Collateral damage can be just as harmful, if not more so, than what is experienced in monetary terms.

Our survey investigated the impact of economic crime as this relates to reputation/brand, share price, employee morale, business relations and relations with regulators.

Figure 9: Organisations reporting significant collateral damage



% respondents who experienced economic crime in the last 12 months

Both globally and locally, the impact on employee morale was considered to be the most significant. The fact that it is impossible to quantify the cost of this collateral damage is by no means a reason to discount the negative impact it can have.

### Do organisations have the right tone at the top?

It is often said that having the right “tone at the top” is an important tool for fighting fraud. A corporate governance structure with vigorous escalation procedures, creating an environment in which employees can assertively report their concerns confidentially, and in which perpetrators are dealt with seriously by top management, is a powerful deterrent tool.

Heed must be paid to an organisation’s culture. The fact that 71% of respondents in South Africa reported that increased pressures and incentives were the most likely causes for the greater risk of fraud, should raise alarm amongst organisations’ top management structures. It is vital that the right message be conveyed by top management and that this message is reinforced by appropriate actions and behaviours.

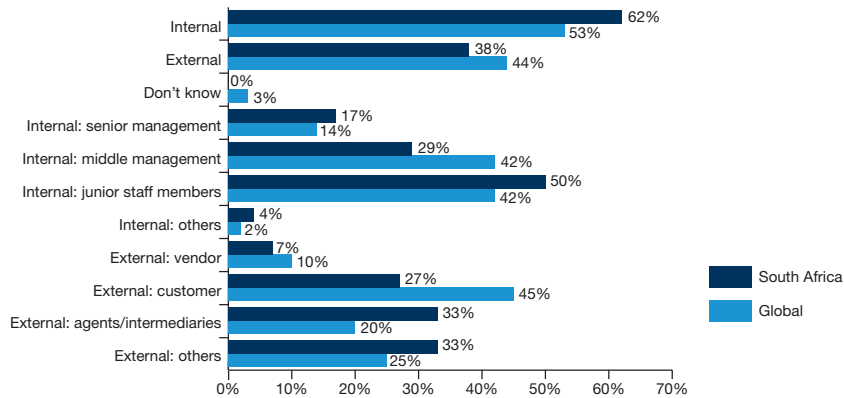
Only once a workforce has been equipped with the right skills and is empowered and motivated to “do the right thing”, can a positive change be implemented.

### Perpetrators of fraud and action taken

Once again, organisations will be alarmed to find that the majority of economic crimes were perpetrated from within. While this finding may be disheartening, it should not shock the reader. Employees have a greater understanding of the business and also of the internal controls that are in place and which have been designed to prevent fraud.

Internally, perpetrators tended to be at a junior to middle management level, while external perpetrators were found to be spread fairly evenly amongst customers and agents/intermediaries.

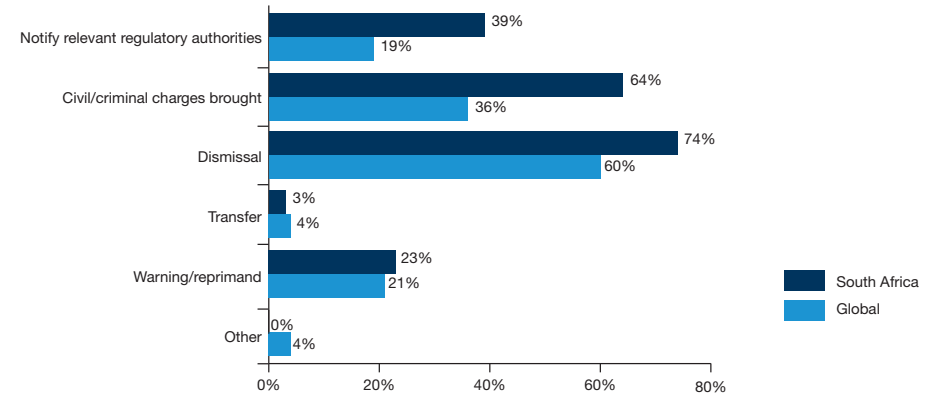
Figure 10: Perpetrators of economic crime



% respondents who experienced economic crime in the last 12 months

It is comforting to note that there has been an increase in the number of respondents that have taken action against perpetrators. A total of 23% of respondents indicated that they had employed warning/reprimand as a response to an internal perpetrator (compared with 21% globally). Even more positive is the fact that 74% of organisations chose to dismiss internal perpetrators and 64% went to the lengths of bringing civil and/or criminal charges.

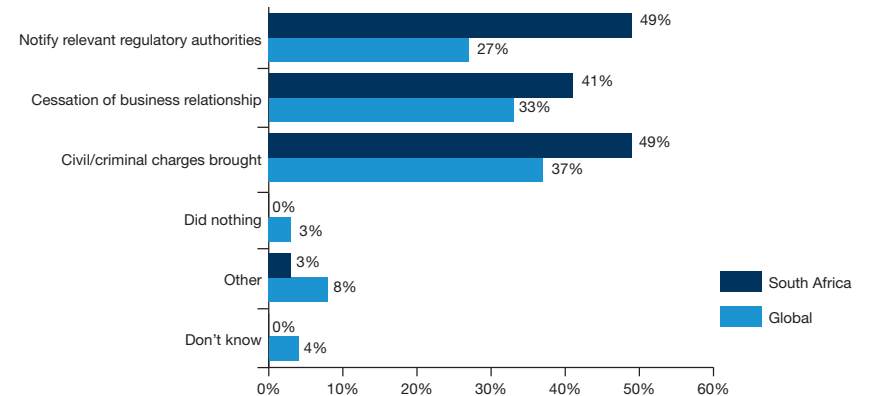
Figure 11: Companies taking action against internal perpetrators



% respondents who experienced economic crime in the last 12 months

For external perpetrators, 49% of respondents opted to bring civil and/or criminal charges, and to report transgressions to relevant regulatory authorities.

Figure 12: Companies taking action against external perpetrators



% respondents who experienced economic crime in the last 12 months

## Fraud in the future

We have considered organisations' attitudes to and perceptions of, fraud in the future. Previous surveys have reflected that in the main, organisations are optimistic about the future, taking a view that the incidence of economic crime is likely to decrease. In spite of this positive outlook, we consistently find that organisations fall prey to economic crime.

With the exception of accounting manipulation, fraudulent borrowing, illegal insider trading and tax fraud, South African respondents have a darker view of the future than their global counterparts.

Asset misappropriation and bribery and corruption are the two forms of economic crime that respondents believe their organisations will most likely experience in the next 12 months. This perception appears to be consistent with actual incidence in the past 12 months, given that these two categories were most prevalent.

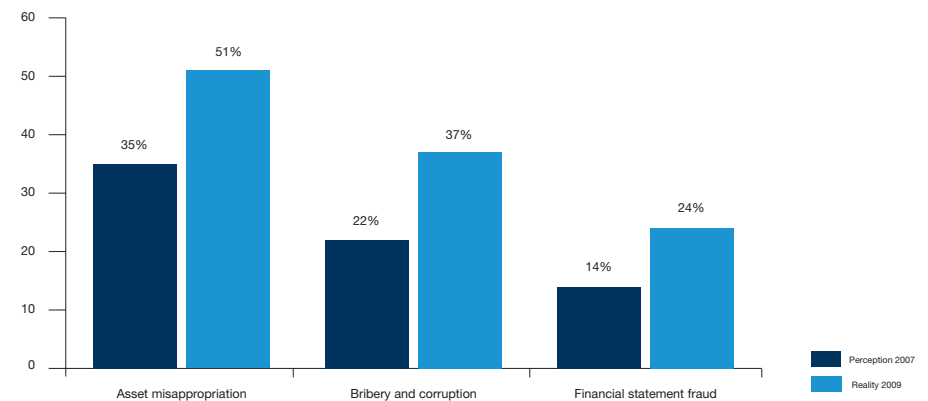
Figure 13: Perception of economic crime in the future



% all respondents' perception over the next 12 months

When we compare the perception of economic crime in the future to actual incidence over the past 12 months, there is a clear disparity between perception and reality. Without exception, across the three main categories, the expectation of the likelihood of future occurrence was significantly less than actual incidence.

Figure 14: Perception in 2007 vs reality in 2009



% all respondents' perception over the next 2 years in 2007; and the actual incidents in the last 12 months in the 2009 survey

Organisations must be mindful that complacency and a rosy view of the future are indicators of a misguided confidence and would be advised to ensure that they are appropriately prepared for future threats.

In our survey, the respondents were asked who they thought is most likely to perpetrate a fraud – external or internal fraudster – in the next year. Fascinatingly, for eight of the 12 frauds listed, respondents in South Africa expect external individuals to be the main perpetrators in the year ahead. The reality of course is that while some organisations will continue to face threats from external fraudsters, a significant threat lies within the organisation. This rose-tinted view needs to be promptly addressed – otherwise organisations will struggle to implement adequate detective and preventive internal procedures.

## Contacts

### National Leader: Louis Strydom

Gauteng  
Telephone: +27 11 797 5465  
E-mail: louis.strydom@za.pwc.com

### Investigations: Jabu Mahlangu

Gauteng  
Telephone: +27 11 797 4413  
E-mail: jabu.mahlangu@za.pwc.com

### Fraud Risk Consulting: Peter Goss

Gauteng  
Telephone: +27 12 429 0331  
E-mail: peter.goss@za.pwc.com

### Disputes and Expert Accounting: Colm Tonge

Gauteng  
Telephone: +27 11 797 4007  
E-mail: colm.tonge@za.pwc.com

### Central Region: Connie Hertzog

Bloemfontein  
Telephone: +27 51 503 4350  
E-mail: connie.hertzog@za.pwc.com

### Eastern Cape: Jacques Eybers

Port Elizabeth  
Telephone: +27 43 707 9802  
E-mail: jacques.eybers@za.pwc.com

### KwaZulu-Natal: Trevor White

Durban  
Telephone: +27 31 271 2020  
E-mail: trevor.white@za.pwc.com

### Western Cape: Horton Griffiths

Cape Town  
Telephone: +27 21 529 2067  
E-mail: horton.griffiths@za.pwc.com

### Namibia: Schalk Walters

Windhoek  
Telephone: +264 61 2841038  
E-mail: schalk.walters@na.pwc.com

<http://www.pwc.com/za/gecs>

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