Is fraud the silent partner in your business?

Fraud Barometer Edition 6: Four year anniversary special edition

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Fraud losses top the billion dollar mark

A new analysis of KPMG’s Fraud Barometer suggests many organisations remain vulnerable to fraud, with losses recorded by the Barometer exceeding $1 billion over the past four years, a large sum of money in anyone’s language.

Fraud is always lurking in the shadows. Organisations that ignore it are asking to lose money. Many of them will not be disappointed. This is the key message to emerge from a review of KPMG’s Fraud Barometer.

The Barometer collates data about large frauds coming before the criminal courts in Australia. To be included in the Barometer, a fraud must involve a loss of at least $100,000 and the alleged perpetrator(s) must have at least been charged with a fraud related offence. The Fraud Barometer began in 2008, which means it has collected a considerable body of data about serious frauds in this country.

Of course, fraud is difficult to measure. By its nature it is a clandestine activity. Many frauds go unreported or undetected. Others are misclassified or downgraded by organisations to avoid publicity or embarrassment.

Given the difficulties in gathering meaningful fraud data, we believe KPMG’s Fraud Barometer offers unique insights into general fraud trends, the kinds of frauds being committed and details about both perpetrators and victims.

So what does the Barometer tell us about fraud in Australia over the past four years?

The figures tell the story

Since KPMG Forensic started collecting data in the first half of 2008, the Fraud Barometer has recorded just over $1 billion in fraud associated losses over the four years from 2008 to 2011 (inclusive). This figure covers 546 separate large frauds.

The data is summarised in Figure 1. Interestingly, the chart highlights a recent increase in the value and number of large frauds coming before the courts, countering the downward trend since the December half of 2009 when a number of frauds that emerged during the GFC hit the courts. Allowing for the inevitable time delays, part of this could be attributed to the economic downturn in some sectors of the Australian economy during 2011. This observation is consistent with historical data suggesting a positive correlation between levels of fraud and economic recessions and/or episodes of financial instability.
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The actual levels of fraud are no doubt considerably greater than indicated by the above figures. Non-detection, non-reporting and failure to substantiate charges depress the level of reported fraud, while many other frauds fall below the Barometer’s $100,000 cut-off.

Where are the frauds occurring?

Broken down by state, the Barometer’s fraud figures generally correlate to population levels (Table 1), although Tasmania and Queensland are over represented in the Barometer on a population basis. On a per capita basis Queensland has experienced more large frauds than the other mainland states and territories with 30 percent more large frauds than Victoria and almost the same number as New South Wales despite almost three million fewer people.

New South Wales has the dubious honour of experiencing the greatest number of frauds, the highest aggregate losses from fraud and the highest average losses.

Table 1: Large frauds by state and territory 2008-2011

<table>
<thead>
<tr>
<th>State</th>
<th>Population</th>
<th>Population %</th>
<th>Number of Cases</th>
<th>Number of Cases %</th>
<th>Value ($)</th>
<th>Average ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>7,303,700</td>
<td>32.3%</td>
<td>153</td>
<td>28.0%</td>
<td>$407,639,000</td>
<td>$2,664,307</td>
</tr>
<tr>
<td>Victoria</td>
<td>5,624,100</td>
<td>24.9%</td>
<td>117</td>
<td>21.4%</td>
<td>$211,045,000</td>
<td>$1,803,803</td>
</tr>
<tr>
<td>Queensland</td>
<td>4,580,700</td>
<td>20.3%</td>
<td>151</td>
<td>27.7%</td>
<td>$208,135,000</td>
<td>$1,378,376</td>
</tr>
<tr>
<td>Western Australia</td>
<td>2,346,400</td>
<td>10.4%</td>
<td>62</td>
<td>11.4%</td>
<td>$103,276,000</td>
<td>$1,665,742</td>
</tr>
<tr>
<td>South Australia</td>
<td>1,857,000</td>
<td>7.3%</td>
<td>27</td>
<td>4.9%</td>
<td>$64,094,000</td>
<td>$2,373,852</td>
</tr>
<tr>
<td>Tasmania</td>
<td>510,600</td>
<td>2.3%</td>
<td>23</td>
<td>4.2%</td>
<td>$7,781,000</td>
<td>$338,304</td>
</tr>
<tr>
<td>Australian Capital Territory</td>
<td>365,400</td>
<td>1.6%</td>
<td>9</td>
<td>1.6%</td>
<td>$6,709,000</td>
<td>$745,444</td>
</tr>
<tr>
<td>Northern Territory</td>
<td>230,200</td>
<td>1.0%</td>
<td>4</td>
<td>0.7%</td>
<td>$762,000</td>
<td>$190,500</td>
</tr>
</tbody>
</table>

Source: KPMG Australia 2012
Who are the victims?

Examining the Barometer’s four-year figures, we find that commercial businesses and financial institutions are just about level pegging when it comes to the value of the frauds they have sustained, although financial institutions experience a much higher average loss per individual fraud (Figure 2). There are only a relatively few financial institutions compared with the number of commercial businesses generally, so banks and other intermediaries experience a disproportionate share of fraud pain.

Figure 2: Fraud cases by victim classification 2008-2011

Looking at frauds against financial institutions, several interesting trends emerge.

- Half of the large frauds against financial institutions took place in New South Wales.
- Forty nine percent of financial institution frauds were committed by customers, 25 percent by organised criminals, 13 percent by rank-and-file employees and 9 percent by managers.
- Within the finance sector, major banks were the most common victims of fraud, followed by insurance companies, credit unions/building societies and then other lenders.
- Insurance fraud was responsible for 85 percent of the fraud experienced by insurance underwriters, of which four fifths was perpetrated by policyholders.

Commercial businesses suffer the most frauds according to the Fraud Barometer. All industries and sectors are at risk, although the construction and resource sectors appear particularly susceptible. Among the ‘other’ category of victims, schools and universities, churches and charities regularly appear. Some of these organisations lack the formal governance and risk management processes that may be standard in similarly sized corporate entities. Perhaps an even bigger problem may be a culture of trusting attitude towards office bearers and staff that could be to their detriment.

Source: KPMG Australia 2012
Case study

A large consumer goods retailer

The largest fraud so far recorded in our Fraud Barometer against an Australian listed company was the theft committed by a senior accountant employed by a large consumer goods retailer. Following the fraud, the retailer entered into insolvency, although commercial factors also played a role in the firm’s demise. There were several significant features to this case.

- Over $19 million was misappropriated over a two year period, involving 125 illicit payments disguised as payroll-related transactions via the company’s online banking and payroll systems.
- In court it was revealed that the accountant had started to steal money because it was ‘so easy to do’. As the judge commented: ‘It was not just a case of one entry in the company’s books; rather you took steps before and after the misappropriations to hide your fraudulent activities from company officers and auditors.’
- The stolen funds were mainly used to buy and sell real estate (44 properties in all) as well as to buy shares in the victim company (a curious choice given the business’s recent poor performance).
- The large consumer goods retailer was able to recover more than $16 million of the stolen funds.
- Before being sentenced, the perpetrator managed to secure employment with another company, reinforcing the need for employers to conduct robust pre-employment screening.

Meet the perpetrators

According to the Fraud Barometer’s figures, 80 percent of the frauds against commercial businesses are inside jobs — they are committed by rank-and-file employees or managers. By way of contrast, nearly three quarters of the frauds against financial institutions are the responsibility of outsiders, mainly customers and organised crime groups. Sixty two percent of the frauds against government were committed by outsiders, including taxpayers (or perhaps by people who are not taxpayers, but should be).

Over the four years we have been compiling the Fraud Barometer, there has been little difference in the number of frauds perpetrated by managers as opposed to those involving other staff, but management frauds usually expose the victim organisation to substantially higher losses (about 2.7 times higher). Managers were also the culprits in nine of the 11 ‘superfrauds’ included in the Barometer (i.e. frauds over $10 million), and were implicated in two thirds of the frauds against investors.
So why do managers consistently misappropriate large sums?

- They may possess the authority to directly access or control funds.
- They may understand internal controls and control weaknesses/gaps.
- They may possess the authority and ability to override controls and/or conceal their actions.
- They may escape the level of scrutiny applied to other employees in sensitive positions.

Concerning rank-and-file employees, two thirds of the frauds committed by these people were accounting frauds.

Organised crime is the next most ‘successful’ perpetrator group based on average fraud size. Organised crime frauds can be quite sophisticated and often involve collusion with employees of victim organisations. This experience highlights the fact that some statistical distinctions can be misleading — frauds are often committed by insiders and outsiders working together.

Financial institutions were the target of three quarters of the frauds committed by customers, and 45 percent of those perpetrated by organised crime.

Gambling is often cited as an important motivator of fraud.

- Eighty percent of cases in which gambling was indicated as a motivator for fraud were located in Victoria and Queensland.
- Forty-three percent of gambling-related frauds took the form of accounting frauds against commercial businesses.
- Frauds committed against vulnerable individuals (e.g. frail aged, disabled) were often associated with gambling.
- Employee fraudsters are more likely to be motivated by gambling than their management counterparts.
What do the frauds look like?

Measured by both number and value, accounting frauds have dominated our Fraud Barometer over the past four years (Figure 4).

Accounting frauds as categorised in the Barometer relate to the manipulation of accounting systems or financial information, or the manipulation of processes within the finance function of an organisation. They include diversion of revenue, unauthorised funds transfers, falsification of cheques, manipulation of payrolls and the diversion of funds via internet/electronic banking systems. The manipulation of accounts payable information represents the most frequent form of accounting fraud.

Experienced fraud investigators will find little new here. The same patterns of fraud continue to reoccur, reflecting the continuing exploitation of known control weaknesses and shortcomings.

Other common types of frauds include fraudulent loans, internal bank frauds, tax evasion and investment scams. The average fraud size using these fraud techniques often exceeds the sums involved in accounting frauds.

Figure 4: Top 10 fraud types 2008-2011 (by number)

Some final observations

The average size of the frauds recorded by the Fraud Barometer over the period 2008 to 2011 was a sobering $1.8 million. Even if the statistical effect of the ‘superfrauds’ is removed, the average is still $1.3 million. These are serious numbers. In analysing the 2008-2011 Barometer figures, we have identified some other interesting patterns.

• The average size of frauds against government has been falling. That fall accelerated in 2011. This reduction could be attributable to (at least in part) the increasing practice among government departments and agencies to use data matching and data analysis to detect frauds earlier.
• The average size of frauds committed by employees and managers has been getting larger, suggesting these frauds could be taking longer to detect, or they are being more successful in stealing larger amounts more quickly.
• The average size of frauds involving identity theft continues to increase.
• Frauds affecting consumers and investors are significant. The fallout from the actions of a few rogue individuals can be widely felt.
• In Australia the incidences of fraud attributable to organised crime appears to be lower than in some comparable countries. However, it is conceivable that Australia will become a more attractive target for international crime syndicates in the future.
• As technology is an integral part of business, so it has become an integral part of committing fraud. Where appropriate controls do not exist or they are inadequate, there remains a potentially substantial risk to the viability of the organisation should a fraudster gain access to these systems.
• Cases are starting to come before the courts in relation to bribery and corruption offences. These are coupled with tighter regulation in some overseas jurisdictions and increased scrutiny in Australia making this topic an area of focus in boardrooms across Australia, particularly where those organisations operate in offshore jurisdictions.

Fraud in Australia continues to be a material financial issue for many organisations. Fraud is never an ‘unavoidable cost of doing business’. It can be prevented, deterred and detected. Losses can be avoided or minimised. While most fraud is an abuse of trust, it is often a failure of stewardship as well.

Successfully combating fraud

Given the losses which continue to be experienced by organisations as evidenced in the Barometer, there continues to be a need to have in place an effective approach to fraud prevention and detection.

This should include:

• Undertaking robust risk assessments that challenge existing internal controls with a focus on procurement, contracting, and accounting and payroll functions, including electronic banking and accounts payable vulnerabilities.
• Using data analytics to extract useful information from large volumes of data to help identify unusual trends, potential fraudulent activity, and relevant behavioural characteristics.
• Providing staff with fraud awareness training. Staff may be responsible for many frauds, but they are also an organisation’s best defence against it.
• Making sure there is a formal plan for combating and responding to fraud. Good intentions do not deter or detect many frauds; robust controls and thorough training do. An effective plan should set down clear roles and responsibilities and should allow for confidential reporting channels through which people can raise concerns and suspicions.
After three consecutive half-year declines, losses attributed to large frauds recorded in the Fraud Barometer for the period to December 2011 jumped by more than $40 million to $131 million (Table 2). Over the same period, the number of large frauds also increased, as did the size of the average loss sustained. It seems fraud is one sector of the economy that always bounces back.

Table 2: Large frauds 2008-2011

<table>
<thead>
<tr>
<th>Period</th>
<th>Number</th>
<th>Value</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jun-08</td>
<td>72</td>
<td>$119,563,000</td>
<td>$1,660,597</td>
</tr>
<tr>
<td>Dec-08</td>
<td>88</td>
<td>$101,862,000</td>
<td>$1,157,523</td>
</tr>
<tr>
<td>Jun-09</td>
<td>69</td>
<td>$155,922,000</td>
<td>$2,259,739</td>
</tr>
<tr>
<td>Dec-09</td>
<td>81</td>
<td>$217,924,000</td>
<td>$2,690,420</td>
</tr>
<tr>
<td>Jun-10</td>
<td>56</td>
<td>$132,176,000</td>
<td>$2,360,286</td>
</tr>
<tr>
<td>Dec-10</td>
<td>67</td>
<td>$115,771,000</td>
<td>$1,727,925</td>
</tr>
<tr>
<td>Jun-11</td>
<td>50</td>
<td>$90,750,000</td>
<td>$1,815,000</td>
</tr>
<tr>
<td>Dec-11</td>
<td>63</td>
<td>$131,279,000</td>
<td>$2,083,790</td>
</tr>
</tbody>
</table>

Source: KPMG Australia 2012

Figures for the latest half year were affected by three large ‘superfrauds’ (i.e. frauds involving losses of $10 million or more), including charges laid by the Australian Federal Police over the Securency corruption allegations and a large alleged fraud against Queensland Health that came to light in late 2011.

Commercial businesses were the most common target for large frauds during the latest December half year, suffering 20 major frauds, which was more than double the number experienced in the previous June half year. Commercial enterprises also incurred the highest financial losses for the period, being twice as much as the next category (government) and more than three times the figure for June 2011 half year. The most common frauds for the period included accounting fraud (22 cases with a value of $43.3 million), tax fraud (five cases, $7.6 million) and fraudulent loans (four cases, $12.2 million).
Consistent with previous Barometers, managers and other employees continued to be the main instigators of fraud (Figure 6). Managers also continued to misappropriate larger amounts per average fraud incident than other employees.