Economic crime: people culture & controls

The 4th biennial Global Economic Crime Survey

New Zealand

Introduction

We are pleased to present the New Zealand results of the PricewaterhouseCoopers 4th biennial Global Economic Crime Survey 2007. The survey represents the largest international survey of economic crime worldwide with 5,428 organisations across 40 countries in industries as diverse as Automotive, Energy Utilities and Mining, Government, Financial Services, Industrial Manufacturing, Retail and Consumer Services and Transportation and Logistics.

Economic crime was defined to include asset misappropriation, accounting fraud, corruption & bribery, money laundering and IP (intellectual property) infringement.

The survey was previously conducted in 2001, 2003 and 2005 although this is the first time that focused New Zealand results have featured, with 78 organisations in New Zealand taking part (although in the 2005 survey some New Zealand organisations were included in the Australian results).

The survey provides insight into the nature and extent of economic crime in New Zealand relative to the Asia-Pacific region and globally. More than being merely a statistical report, this survey also provides valuable insight into how organisations can protect themselves and their property from the growing threat of fraud and other economic crime.

We appreciate the cooperation of those organisations in New Zealand that took the time to take part in the survey and speak about this sensitive topic.

John Fisk
Partner
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New Zealand Survey: Summary of Key Findings

Economic Crime in New Zealand

Two thirds of all respondents in New Zealand report that they have experienced an incident of economic crime within the last two years with an average loss of NZ$1,021,501. Of those who have suffered a loss, 20% have involved direct losses of between NZ$ 1.35 million and NZ$13.5 million (see figure 1).

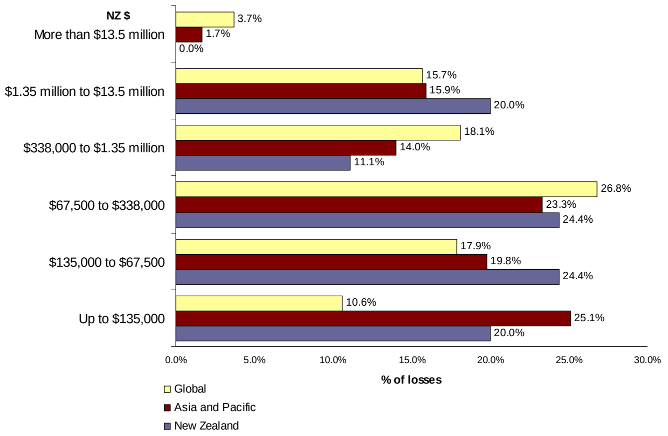
The percentage of organisations in New Zealand that reported an incident of economic crime was significantly higher than the comparable results in both the Asia-Pacific region and globally (see figure 2).

The survey results for 2007 highlight that asset misappropriation is the most prevalent risk to businesses in New Zealand, with 32% of organisations regarding this as the most dangerous threat. Of the reported economic crime incidents in New Zealand, 59% involves asset misappropriation.

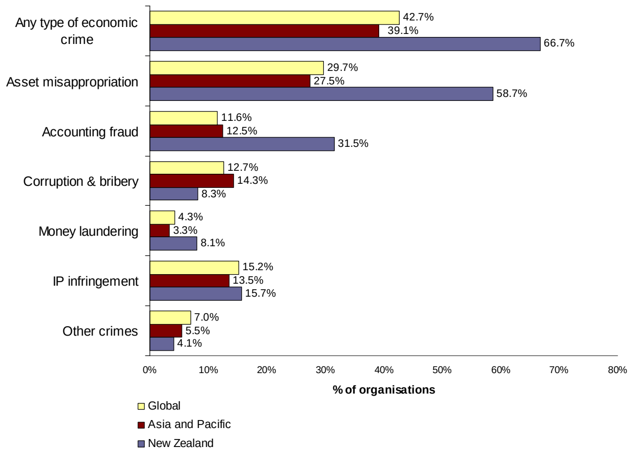
The Perception Gap

There is, in New Zealand, a distinct 'perception gap' about the effectiveness and appropriateness of controls to best deal with economic crime. It is clear from the survey that what is perceived to be effective and what is actually effective are markedly different. This has highlighted that an organisation's risk management frameworks for detecting economic crime need to incorporate what has been proven to work.

1. Direct New Zealand losses



2. Actual incidence of economic crime



Emerging risks

New Zealand's increasing exposure to global markets, changes to the legislative environment and more sophisticated economic crime risks have resulted in the emergence of a number of new risk threats particularly intellectual property infringement, money laundering and corruption & bribery. The results of the survey suggest that organisations should incorporate these new threats into their risk frameworks.

Mitigating the Risk

It is important that organisations seek to mitigate their risk exposure by ensuring the controls they have in place are integrated into business as usual practice and adequately address present risks wherever an organisation operates. Senior management needs to address future risk, create the right environment for tip-offs and reporting and facilitate a swift response to incidents of fraud and other economic crime being reported.

Economic Crime: A Major Issue in New Zealand

The number of organisations having experienced an economic crime incident in the last two years (67% of respondents) is significantly higher in New Zealand than in the Asia-Pacific region (39%) and globally (43%).

The possible reasons for this include a high degree of willingness and transparency in reporting these issues as they are discovered. We would also hope that robust internal controls within New Zealand organisations are capturing incidents of economic crime. However, as noted later in our comments on the 'Perception Gap', there is still room for improvement in this area.

Clearly these results indicate that New Zealand organisations are far from immune to the significant risks posed by fraud and other economic crime which remains a fact of business life.

For those New Zealand respondents that suffered an economic crime, the total loss was NZ$69,540,574 with an average loss of NZ$1,021,501 over a two year period. Alarmingly, 20% of New Zealand organisations that reported an incident of economic crime suffered losses of between NZ$ 1.35 million and NZ$13.5 million.

The survey results for 2007 highlight that asset misappropriation remains the most prevalent risk to businesses in New Zealand. This was regarded as the most dangerous threat by 32% of organisations (see figure 3) and 59% of economic crime incidents in New Zealand involves asset misappropriation.

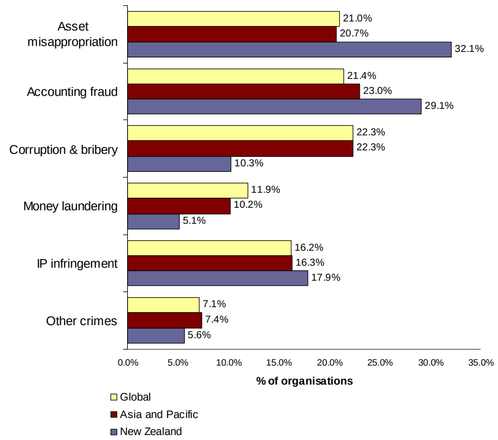
The average loss to New Zealand companies through asset misappropriation over the last two years was NZ$544,922.

Cost of New Zealand's Economic Crime

Of the reported losses to economic crime in New Zealand, 48% has never been recovered.

When it comes to insurance against these issues, 68% of respondents say that they

3. Most prevalent risk to business



two thirds of New Zealand respondents report that they have experienced an economic crime event within the last two years and 20% of these events have involved direct losses in excess of $US 1 million have relevant insurance policies. However, those who report having suffered from economic crime have only recovered an average of 6% of the lost funds from these insurance policies.

In our experience, organisations within New Zealand are concerned about the impact of collateral damage that can be caused by economic crime. This includes damage to brand, staff morale and share price. However, the survey results show that only 5.6% report significant collateral damage against 7.0% for the Asia-Pacific region and 9.5% globally. No collateral damage was reported by 56% of New Zealand respondents.

In our experience in conducting forensic investigations into corporate malfeasance, economic crime can absorb considerable resources, people, time and cost.

Perpetrators

In New Zealand, 65% of economic crime involves an internal party with a quarter being at middle management level or higher. A 'typical' perpetrator in New Zealand is male (70%), has been in his position and with the organisation for less than 2 years, has a high school education or less and is aged between 31 and 40 (see figure 4).

However, in the past two years we have investigated a number of significant incidents of fraud where the perpetrator did not fit this profile, particularly in relation to gender.

The survey indicates that the most common reason for economic crime being committed is, unsurprisingly, financial gain.

Dealing with the Issue

It is interesting that 36% of organisations did not report the incident of economic crime to the appropriate law enforcement agency. Whilst this is slightly better than the Asia-Pacific region and global figures, it indicates an inconsistent approach to dealing with these issues. In only approximately 70% of New Zealand cases was the incident reported to the Board or Audit Committee, or Executive Management.

When asked "what action did you take against the main perpetrator", a disappointing 16% of New Zealand organisations say that they did nothing and only 53% say that they dismissed the perpetrator. In just 46% of cases were criminal charges instigated against the perpetrator (see figure 5).

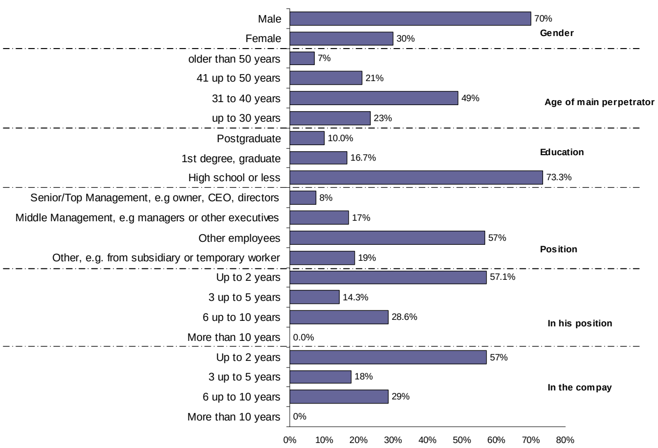
These figures indicate that organisations in New Zealand could significantly improve the way that they deal with issues of economic crime. Particularly, organisations need to have an enforced policy on how these incidents will be dealt with. This includes internal reporting of the matter to the Executive Management and the Board as well as reporting to the appropriate law enforcement agency. This will help ensure that a consistent approach is taken to incidents of fraud and other economic crime.

At the very least, perpetrators of economic crime (which is almost always a criminal offence) should not be allowed to remain within the organisation.

The Perception Gap

Results from the 2007 survey indicate that in New Zealand 50% of economic crime incidents are detected through some form of tip-off (including a formal 'whistle-

4. 'Typical' New Zealand perpetrator



despite fears of negative publicity, the organisations that did suffer from fraud and other economic crime suffered no significant collateral damage blowing' system) or by accident. Nearly 20% of detected cases come from internal audit and the remaining 30% from other means.

Despite the evidence noted above, internal audit, was rated between effective and very effective by 84% of respondents whilst the audit committee was rated the same by over 73%. However, having a whistle-blower system was rated as very effective by only 5% and rated as less than effective by 24% of organisations.

These figures show a perception gap between what New Zealand organisations think is effective in stopping economic crime and what actually works.

Collectively, internal controls that generally fall outside of the audit function, which include whistle-blowers, other forms of tip-offs, fraud risk management and automated transaction monitoring system, detect 50% of cases of economic crime. In order to mitigate the risks of economic crime, organisations in New Zealand should consider employing a number of these detection systems in addition to their existing audit functions.

The survey respondents also see the value of staff selection tests with 82% saying they have them in place. However, our experience in New Zealand shows that there are wide differences in standards adopted for pre-employment screening processes. Many organisations that we have reviewed do not have robust or appropriate pre-employment screening tests.

Bridging the Gap

For those charged with detecting and managing economic crime, it is not sufficient to simply rely on the auditors.

The insights provided in the survey demonstrate that there is a need in New Zealand to institute a fully integrated risk management framework that provides a company the best chance of both preventing and managing economic crime.

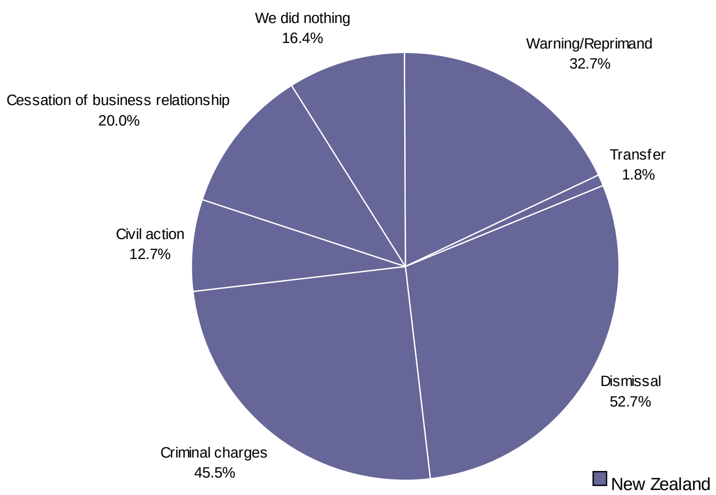
Over 39% of cases were discovered through some form of tip-off. A properly developed and integrated fraud risk framework should include an appropriately implemented and publicised whistle-blower mechanism, effective fraud risk management controls, policies, programs, controls and training for staff that fosters an environment in which the reporting of incidents of economic crime are encouraged and compliance is the norm.

In numerous investigations into economic crime conducted by PwC both in New Zealand and globally, it continues to emerge that an organisation's people are both its greatest weapon in the fight against economic crime, and its greatest liability.

The global results from the survey show that in virtually every region of the world whistle-blowing is playing a role in uncovering the activities of wrongdoers. More and more organisations around the world are now promoting whistle-blowing policies as an integral part of their risk management frameworks.

Only 58% of New Zealand organisations report that they have a hotline in place. This figure is actually higher than the global average (of 42%) possibly due to the New Zealand Protected Disclosures Act 2000 which requires every public

5. How was the perpetrator dealt with?



organisations in New Zealand need to take a consistent approach to incidents of economic crime when they occur sector organisation to have in place a protected disclosure policy. In our experience, however, many of these policies are either not well communicated or practical.

We believe that whistle-blowing systems that are well designed, well communicated and properly implemented can play a decisive role in uncovering criminal activity

Emerging Risks

IP Infringement

The 2007 survey reveals that the threat of IP infringement looms large for New Zealand organisations. Approximately 18% of organisations believe IP infringement is the most prevalent threat they face and 16% have actually experienced it. Broadly, these figures are matched in the Asia-Pacific region and globally.

In New Zealand the average loss for this type of incident was NZ$1,040,419.

Anecdotally, this supports our observations of the desire of organisations to protect their intellectual property and the increasing number of investigations that we have conducted into former employees taking intellectual property to competitors.

Money Laundering

The survey reveals that 5% of New Zealand organisations believe that money laundering is the most prevalent threat to their business that they face and 25% believe that it is ‘very likely’ that they will be subject to money laundering in the next two years. This figure is significantly higher than the same rating for respondents in both the Asia-Pacific region (3.2%) and globally (2.6%).

Approximately 8% of New Zealand organisations report being subject to some form of money laundering in the last two years. This is double the global results and more than double the results for the Asia-Pacific region.

New Zealand’s existing anti-money laundering legislation (the Financial Transactions Reporting Act 1996) will, by the end of 2008, go through some major amendments that will have significant effects on those organisations deemed to be financial institutions.

A significant finding from the 2007 Survey is that 63% of New Zealand organisations say they are not prepared for the impact of the new anti-money laundering legislative amendments (see figure 6). Of the respondents, 33% said they were not even aware that these legislative amendments were due to be implemented in New Zealand.

This is despite the fact that proposed legislative amendments will likely fundamentally change the scope of the Financial Transactions Reporting Act 1996 to cover many more organisations and place a heavy compliance burden on reporting entities.

The proposed amendments will likely introduce a risk-based rather than prescriptive approach. This will require organisations to, amongst other things, gain a good understanding of what is money laundering and how money launderers operate. Organisations will have to also define their product and customer risk profiles and have processes

in virtually every region of the world, whistle-blowing is playing a role in uncovering the activities of wrongdoers in place to ensure that their risk assessments are kept current.

It is important that organisations seek to determine the impact to themselves of the proposed changes to the regulatory environment and that an appropriate anti-money laundering programme is put in place.

Corruption and Bribery

New Zealand continues to enjoy a reputation that is relatively free of the risks of bribery and corruption. This is supported by the survey results which show that only 8% of New Zealand organisations say that they have been subject to an incident of corruption and bribery in the last two years.

However 25% of New Zealand organisations believe that it is either likely or quite likely they will be subject to some form of bribery or corruption within the next two years. We believe this reflects an increasing exposure for New Zealand businesses trading with emerging economies.

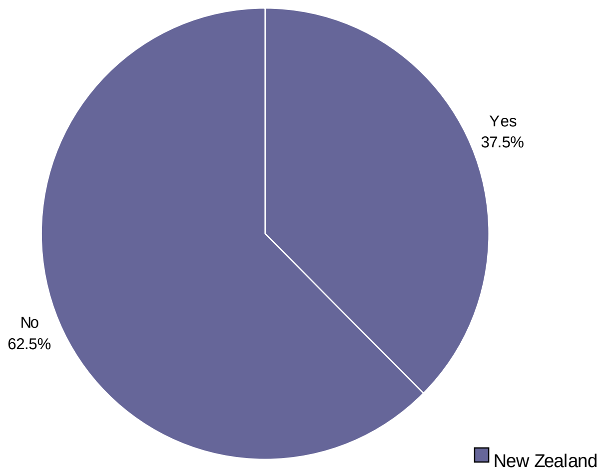
Conclusions

Economic crime is here to stay. It is a fact of life in doing business in New Zealand, in the Asia-Pacific region and globally. It can not be wholly prevented but the risks can be mitigated.

We recommend that organisations in New Zealand consider the following points as they move forward in developing fraud control programmes and strategies:

- Replace one-off risk mitigation programmes with comprehensive compliance programmes that are fully integrated into all components of business operations.
- Pro-actively monitor vulnerabilities to fraud. It is not so much a question of always expecting the worst, but being prepared for the unexpected; and, should it occur, being ready with an effective response plan.
- Developing a strong ethical culture that is clearly evident to all employees. This can be accomplished through setting the right 'tone at the top', encouraging company loyalty, providing processes whereby employees can report concerns (i.e. whistle-blowing systems), and by clearly showing that the penalties fraudsters incur – no matter what their position in the orgnaisation's hierachy – are serious.
- Be sensitive to issues that individual employees might be faced with, such as the wrongdoing of a colleague.
- It is impossible to eradicate economic crime; like the Hydra of myth, cutting off one head merely allows another to grow. This does not mean, however, that prevention is impossible and should therefore be abandoned. On the contrary, organisations large and small should take all precautionary steps they can to deter fraudsters – and those who merely contemplate the crime.
- Recovery of monies from fraud and other economic crime remains a difficult task. Engaging in legal action is a time-consuming and resource intensive activity that unnecessarily diverts resources from other activities. An

6. Are you prepared for the impact of proposed anti-money laundering legislation?



25% of organisations in New Zealand believe that they will be subject to an incidence of money laundering in the next two years.

appropriate fraud risk framework presents the best opportunity for organisations in New Zealand to minimise the risk and manage the process after an economic crime event has been detected.

- A comprehensive understanding of fraud risks sources and controls provides a foundation for making informed decisions about how and where the other risks – the right risks for building business – can be taken.

Demographics

The PricewaterhouseCoopers 4th biennial Global Economic Crime Survey 2007 interviewed 5,428 leading organisations globally, 894 in the Asia-Pacific region and 78 in New Zealand.

Interviews were conducted with representatives from various functions including finance, audit, legal, human resources, security, risk, compliance and at the CEO/Board level. Industries covered included aerospace & defence, energy, utilities & mining, engineering & construction, entertainment & media, financial services, government services/public services, healthcare, insurance, industrial manufacturing, pharmaceuticals, retail & consumer, technology and transportation & logistics

Results were compiled by independent experts and reported to PwC to protect the anonymity of those surveyed.

Further information pertaining to the survey demographics and definitions of 'economic crime' can be found in the Global Economic Crime Survey 2007. The Global Report can be downloaded from www.pwc.com/crimesurvey or from www.pwc.com/nz/forensics.

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economic crime is a fact of business life - it cannot be wholly prevented but the risks can be mitigated.

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