

Investigations & Forensic Services

# Economic Crime in a Downturn

The 2009 Global Economic Crime Survey:  
The Canadian Perspective

## Introduction

Over the past 12 months, in the midst of a global economic downturn, several significant economic crimes have come to light. Canada has not been exempt from such criminal activity, with large-scale Ponzi schemes under investigation in Quebec, Ontario and Alberta and alleged financial fraud in the government sector. In response, the government has signaled their intention to crack down on crime by developing anti-fraud regimes and introducing legislation to impose harsher prison sentences for white collar criminals. There has also been an increased interest in foreign corruption with Canada's corporate expansion into developing countries, given the surge in demand for commodities such as precious metals, oil and gas.

From an economic crime perspective, the worst may be on the horizon. During difficult economic times, the incentive to commit fraud increases while the focus on fraud detection, prevention and investigation generally diminishes. Since companies are more vulnerable with weakened or non-existent controls due to cost-cutting and downsizing, fraudsters see increased opportunity to commit economic crime. As a result, financial fraud occurs both from within and outside organizations.

To address this risk, organizations will need to increase their vigil over economic crime. They will need to develop robust anti-fraud regimes and task fraud as a top priority.

### Economic crime is pervasive, persistent and pernicious

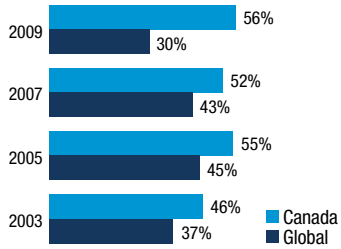
The results of the **PricewaterhouseCoopers' (PwC) Global Economic Crime Survey 2009** suggest that economic crime in Canada has risen to its highest level in the past six years. Our survey shows that 56% of Canadian companies surveyed reported being victims of economic crime during the previous 12 months. This is an increase of 10% from the 2003 survey results. Figure 1 illustrates the percentage of companies reporting fraud in 2003, 2005, 2007 and 2009. More than 24% of Canadian companies (27% globally) that were victims of fraud within the past year estimated their direct fraud-related losses to be greater than US\$500,000.

Although Canada has historically reported higher instances of economic crime than our global counterparts, the 2009 results show a widening disparity. This year, 30% of global respondents experienced economic crime, a decrease of 13% from the 43% reported in 2007 (Figure 1). This decrease in reported economic crime globally may be due to the lack of awareness of incidences taking place, caused by an overall breakdown in anti-fraud regime controls which would usually assist in the detection of economic crime.



Economic crime in Canada has risen to its highest level in six years with 56% of Canadian companies surveyed reporting they were victims in the last 12 months.

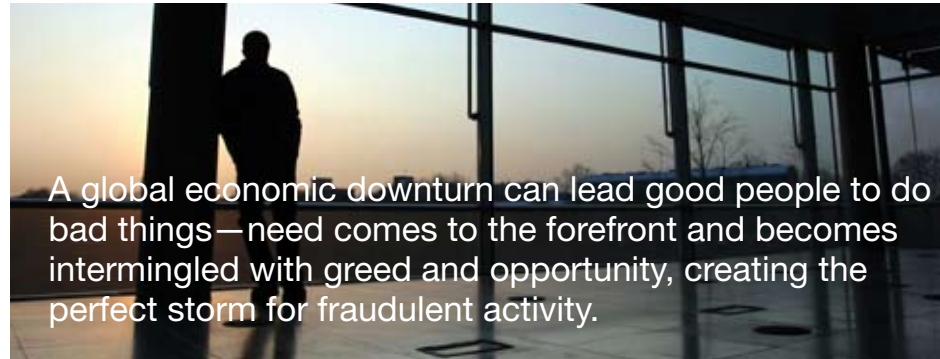
Figure 1: Companies reporting fraud (2003-2009)



% respondents who experienced economic crime in the past 12 months for 2009 and in the past two years for 2003, 2005 and 2007

PwC’s Global Economic Crime Survey 2009 continues to provide insight into the state of economic crime worldwide. It is clear from the results of this year’s survey that all stakeholders must remain diligent about fraud risk management as we struggle through an economic downturn.

In Canada and around the world, respondents to the survey have indicated that the extreme economic conditions of the past year have contributed to an increase in both the motivation and the opportunity to commit fraud. The survey results illustrate that in this period of heightened risk of fraud, cost reductions have paradoxically led to diminished performance of fraud risk assessments and a reduction in resources deployed to focus upon internal controls. It is important, now more than ever, for companies to task fraud as a priority and to implement



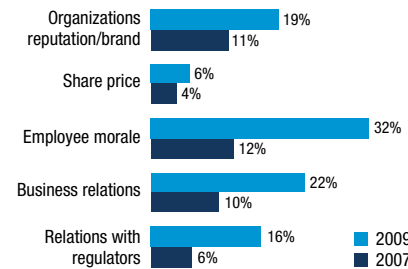
robust anti-fraud regimes. Companies need to be aware that a global economic downturn can lead good people to do bad things—need comes to the forefront and becomes intermingled with greed and opportunity, creating the perfect storm for fraudulent activity.

### The cost of fraud

According to the 2009 survey results, 41% of Canadian companies that were victims of economic crime in the past year (42% globally) believe the cost of fraud is higher now than it was 12 months ago with respect to direct financial losses. The cost of fraud, however, can affect an organization in more ways than immediate financial loss. Economic crime can harm the organization’s brand name or reputation and it can negatively affect its relationships with suppliers, customers, regulatory bodies and other key stakeholders. Figure 2

provides detail on companies reporting significant collateral damage of fraud at the global level.

Figure 2: Companies reporting significant collateral damage (Global 2007-2009)



% respondents who experienced economic crime in the past 12 months for 2009 and in the past two years for 2007

In this year’s survey, results show that 24% of Canadian companies (27% globally) that were victims of fraud within the past year estimated their direct fraud-related losses to be greater than US\$500,000. However, when

asked to rate the impact of cases of fraud, other than direct financial losses, fewer than 24% of Canadian companies perceived a “significant” or “very significant” impact on the organization in terms of the following elements:

- Employee morale – 24%
- Business relations – 21%
- Brand or reputation – 7%
- Share price – 3%
- Relations with regulatory bodies – 3%

Although it may be relatively simple to assess the losses incurred directly from fraud, many of these additional indirect factors can prove more difficult to quantify. One example is employee morale. Although only 24% of Canadian respondents (32% globally) believed that fraud would impact employee morale, the impact should not be underestimated. Experience has shown that negative employee morale can result in additional losses for a company because it can lead to reduced performance and future detrimental behaviour such as committing economic crime.

### Types of economic crime reported

The most common type of fraud encountered by companies surveyed globally was asset misappropriation, or the theft of tangible assets that have a defined value. Asset misappropriation was reported by 83% of Canadian companies surveyed that were victims of economic crime in the past 12 months. This is notably higher than the global survey result of 67%. These results are consistent with the 2007 survey results where both Canadian and global respondents reported that asset misappropriation was the most prevalent type of reported fraud. One factor that makes asset misappropriation common is that often the main focus of this type of fraud is for the perpetrator to obtain assets of the company for their personal benefit. Many of the other types of fraud shown in Figure 3 also have an asset misappropriation component. For this reason, having strong controls over the physical access to assets is essential.

Another primary form of fraud being perpetrated over the last 12 months was accounting fraud. Thirty-one percent of Canadian companies surveyed that were victims of economic crime reported the occurrence of at least one form of accounting fraud, as compared to 38% globally.

Accounting fraud includes accounting manipulations, fraudulent borrowing/raising of finance, fraudulent applications for credit and unauthorized transactions/rogue trading.

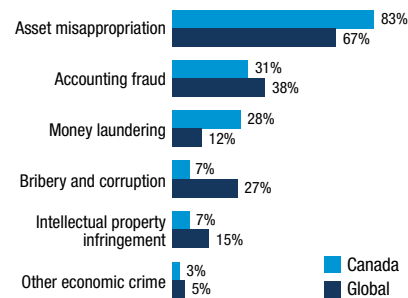
The 2009 survey results also identify money laundering as a type of fraud experienced by 28% of Canadian companies surveyed that were victims of economic crime in the past 12 months. This number is significantly higher than the global results, where only 12% of companies identified money laundering as an economic crime encountered during the past year. This result suggests that Canada's anti-money laundering regulation may be making money laundering activities more susceptible to detection than in countries where such regulation does not exist.

The survey results show that bribery and corruption are more common globally, as 27% of global respondents reported being a victim of this type of economic crime compared to only 7% of Canadian respondents (Figure 3). Bribery and corruption is a form of economic crime which has consistently increased in our previous surveys. However, our current survey shows that there has been a slight decline in the reported cases of bribery and corruption in the past 12 months. Organizations may be

reluctant to report this form of economic crime because of increased media attention to high profile bribery cases in recent years.

Canadian figures may also illustrate Canada's commitment under the Corruption of Foreign Public Officials Act (CFPOA) to reduce the incidences of bribery of foreign public officials by representatives of Canadian companies. As Canadian companies expand into developing countries, especially in the mining, oil and gas industries, it is important for them to understand the CFPOA and how it governs their interactions with foreign public officials.

Figure 3: Types of economic crime reported (2009)<sup>†</sup>



<sup>†</sup> Note: multiple types of economic crime were experienced by many of the respondents.

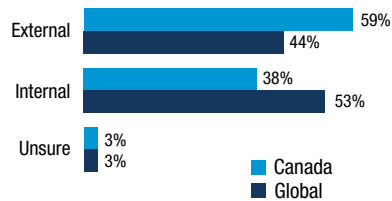
### The typical perpetrator

According to our 2009 survey results, 59% of Canadian companies that were victims of economic crime in the last 12 months said external fraudsters perpetrated the fraud and 38% identified the main perpetrator as an employee (Figure 4). In contrast, 44% of global respondents that experienced economic crime identified the main perpetrator as an external individual versus 53% internally.

The Canadian statistics vary significantly from prior surveys where companies indicated employees as being the main perpetrators in both our 2007 and 2005 surveys (67% and 61% respectively).

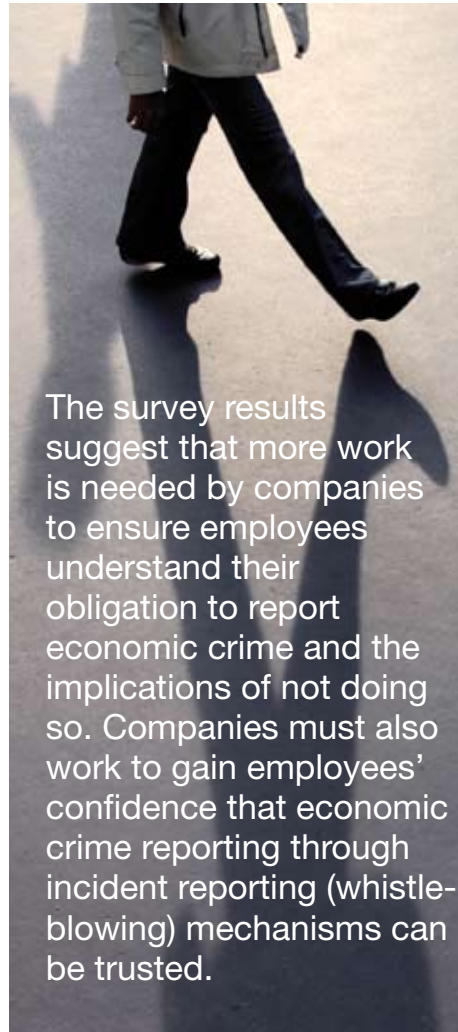
The 2009 figures for Canadian companies may be swayed heavily by the results noted previously where 28% of the Canadian companies that were victims of economic crime were victims of money laundering activities, a crime often perpetrated externally. Another possibility may be that external perpetrators are being reported as having committed the crime but have been aided through collusion with employees of the companies. Regardless of the true cause, the high percentage of fraud perpetrated by external persons illustrates the importance of having a strong enterprise-wide anti-fraud regime for protection from all perpetrators of fraud, both internal and external.

Figure 4: Fraudsters' relation to the company (2009)



For the Canadian companies that experienced economic crime primarily by external parties, 41% identified customers as the most common perpetrators, 12% indicated agents or intermediaries as the perpetrators, and 6% indicated vendors.

For those Canadian companies that experienced economic crime as the result of employee actions, 55% of the perpetrators were classified as middle management and 45% were classified as junior staff. It is important to note that senior management was not identified as one of the key perpetrators of fraud by any of the Canadian respondents. In previous surveys, senior management was identified as a key internal perpetrator—12% in 2007 and 24% in 2005. The 2009 survey result may indicate that tighter controls with respect to the oversight of senior management have been put in place and are effective. Alternatively, this result may be due to the fact that senior management is more likely to commit complex economic crimes which are



more difficult to detect and may be on the rise as companies report financial results in the coming months.

### Means of detecting fraud

In 2009, 38% of Canadian companies that were victims of economic crime over the past 12 months detected the fraud by chance or by internal or external tip-off. This is consistent with the 39% reported in 2007. An additional 14% of frauds were detected by internal audit, while preventative fraud risk management activities contributed to 17% of frauds detected. Canadian organizations were almost twice as likely as their global counterparts to detect fraud through electronic means, such as automated suspicious transaction reporting systems, which accounted for more than 10% of frauds detected.

Interestingly, reports made through organizations' formal whistle-blowing mechanisms, often viewed by management as a principle fraud detection mechanism, played a role in only 3% of frauds detected in Canada and 7% globally. This may be an indication that:

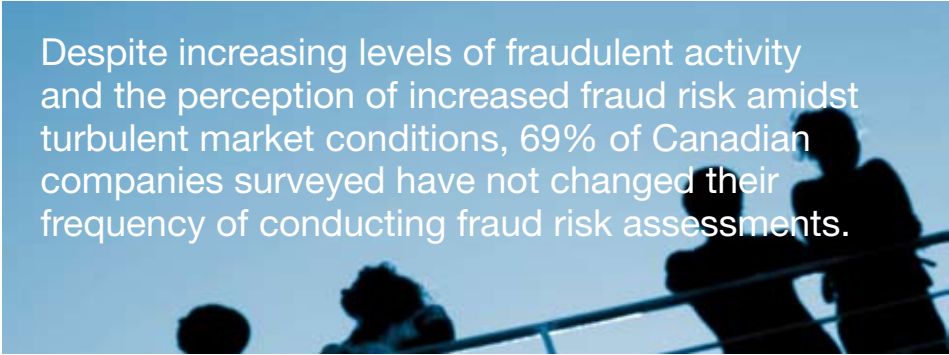
- more work is needed by companies to ensure employees understand their obligation to report economic crime and the implications of not doing so;
- the importance of incident reporting (whistle-blowing) is not being supported culturally within organizations or being appropriately communicated;

- leadership is not seen to take whistle-blowing seriously; or
- companies need to work on gaining employee confidence that economic crime reporting through both internal and external whistle-blowing mechanisms can be trusted.

The current year's results illustrate that proactive, preventative fraud risk management measures taken by management can have a significant impact on fraud detection. Companies with a cross-organizational approach to fraud detection which encompasses a culture of ethics, strong controls and transparent communication have a greater likelihood of detecting fraudulent behaviour—in other words, if you look for fraud you will find it.

### Adopting timely fraud prevention measures

Our research suggests that Canadian fraud instances have increased during the past year, consistent with historical trends of increased fraudulent activity during an economic downturn. Despite the growing levels of fraudulent activity and the perception of increased fraud risk amidst turbulent market conditions, 69% of Canadian companies surveyed have not changed their frequency of conducting fraud risk assessments. Moreover, 29% (40% globally) of respondents stated that their respective



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organizations had not performed a fraud risk assessment, or had no knowledge if one had been performed in the last 12 months. It appears that in times of economic uncertainty, fraud risk management is seen as a luxury rather than a necessity. Since fraud is not a static threat, organizations should strive to continually assess their fraud risks.

From an external prevention perspective, 50% of Canadian companies surveyed are of the opinion that the measures adopted by regulatory and/or law enforcement authorities to prevent crime in the face of increasingly prevalent fraud occurrences have been either entirely ineffective or only marginally effective.

Our global survey results show that although there has been an increase in the perception levels, there is a significant gap between the perceived likelihood that fraud will occur in the future compared with the reality of the

incidence of fraud historically reported. Organizations generally appear to believe that they are somehow immune to fraud when looking forward, but history shows this to be a misplaced confidence.

The 2009 survey results demonstrate that an organization's ethical "tone at the top" and a strong internal control environment combine to provide the strongest deterrent to fraudulent behaviour, and increases the likelihood of detecting fraudulent activities. A corporate culture that clearly stresses the importance of integrity, and where senior management are seen as "walking the talk" to operationalize a well-communicated, comprehensive anti-fraud regime, is significantly less likely to be victimized by economic crime. Global survey results also show that chief officers and board members report less fraud than other employees, suggesting that they may not be sufficiently aware of the full extent of

economic crime in their organizations. These results could indicate that knowledge of fraud occurring within an organization lies with junior or middle management and is not reaching directors. When directors take an active interest in fraud within their organization, and take robust disciplinary action towards the perpetrators of fraud, the right "tone at the top" is established.

The Canadian responses for disciplinary action taken against internal perpetrators for the most significant form of economic crime experienced by an organization showed that in the majority of cases (55%) the perpetrators were dismissed. 48% percent of Canadian respondents also noted that civil action or criminal charges were brought against these internal perpetrators. Civil action or criminal charges were brought in 55% of the cases against external perpetrators and the business relationship ceased in 35% of the cases.

When assessing and reshaping their anti-fraud regimes, management should consider obtaining professional advice on effective compliance and detection programs, ensuring that anti-fraud guidelines and practices remain current in the face of a changing economic climate, and that measures taken consider the laws and cultures of relevant operating jurisdictions within the global marketplace.

We continue to believe that key anti-fraud controls should include the following:

1. Governance—oversight by the audit committee and board of directors;
2. Fraud risk assessments;
3. Code of business conduct and ethics;
4. Incident reporting mechanisms;
5. Investigative protocol;
6. Remediation protocol;
7. Hiring and promotion policies and procedures; and
8. Management evaluation and testing.

### Economic crime reported by industry sectors

Globally, the industries that reported having suffered the most economic crime were communication, insurance, financial services, hospitality and leisure. These industries tend to be targeted by fraudsters because of their product or service. Additionally, organizations in these industry sectors tend to have more robust and proactive anti-fraud measures. In effect, they both suffer and detect more fraud than other sectors.

Over the coming months, we will likely see significant growth in the resource (mining, oil and gas) and government sectors. As Canadian companies grow

into emerging markets with the expansion of work in these sectors, new risks of economic crime may come to light. Because of these new risks, it is important that companies perform adequate risk assessments prior to expansion and implement robust anti-fraud regimes.

### Economic downturn and the heightened risks of fraud

In the last 12 months, 62% (62% globally) of Canadian companies surveyed say they experienced a decline in financial performance. Our current economic environment helps to further explain the 2009 survey results.

Half (50%) of Canadian respondents (40% globally) believe the economic downturn presents a heightened risk of fraud in general, while 48% think this risk has not changed. Of the Canadian respondents who believe the economic downturn presents a heightened risk of fraud, 65% felt that the economic conditions imposed increased pressures and presented individuals with greater incentives to commit fraud. Most of these companies felt the main contributing factors were concern about job loss, bonuses not being awarded, and business targets becoming more difficult to achieve (Figure 5).

Consequently, the temptation to inflate results, and/or omit expenses may likely overrule ethical values. These situations can lead otherwise good people to commit economic crime, when under other circumstances, that person would likely not have done so. For example, as employees discover they will not be receiving bonuses or pay increases, or watch co-workers lose their jobs, it becomes easier for them to rationalize fraud as something that is justified.

Figure 5: Contribution towards increased incentives/pressures for risk of fraud (Canada 2009)



Of Canadian respondents who believe the economic downturn presents a heightened risk of fraud, 19% felt the most likely reason for the greater risk of fraud in the current economic environment was due to more opportunities to commit fraud as costs were being cut and gaps in control



systems were appearing. Most of these companies believe that employee reductions resulted in fewer resources being deployed to focus on internal controls, and management was preoccupied with the survival of the business rather than “keeping their eye out for fraud.”

The harsh economic reality has caused significant pressure for companies and their management across the globe. In general, there are three key motivations to commit fraud—need, greed and opportunity. In an economic

downturn, need comes to the forefront and becomes intermingled with greed and opportunity.

It is critical that those charged with governance within companies continue to task fraud as a priority during these difficult economic times and seek forensic assistance to evaluate and reinforce the key components of an anti-fraud regime. Given the global nature of this crisis, fraud issues can have significant and far-reaching implications on the international stage.

## How PwC can help

### Dealing with fraud and financial investigations with speed, sensitivity and discretion

Economic crime poses a real and substantial threat to the stability of any business. Dealing with fraud and financial investigations requires more than simple know-how: it requires speed, sensitivity and discretion. We appreciate the need to stop illegal activity while safeguarding your company's assets and reputation, preventing recurrences and arriving at a resolution with as little disruption as possible to the regular flow of business. Our services include:

- Fraud investigation;
- Forensic accounting;
- Fraud risk management;
- Computer forensics;
- Electronic discovery;
- Intelligence screening;
- Money laundering investigations; and
- Asset recovery services.

PwC's international network of Investigations & Forensic Services professionals includes investigative forensic accountants, certified fraud examiners, former financial regulators, law enforcement officers, computer forensic technicians and asset recovery specialists. We have the technical skills, knowledge and hands-on experience necessary to investigate white collar crime and advise on managing and mitigating risk—including ways to identify and analyze vulnerabilities.

PwC provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 155,000 people in 153 countries work collaboratively using Connected Thinking to develop fresh perspectives and practical advice. In Canada, PricewaterhouseCoopers LLP and its related entities have more than 5,200 partners and staff in offices across the country.

Our diverse background and skill-sets will benefit you in your investigations and forensic undertakings, regardless of how big or small the project.

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