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FORENSIC

Fraud and Misconduct Survey 2010

Australia and New Zealand

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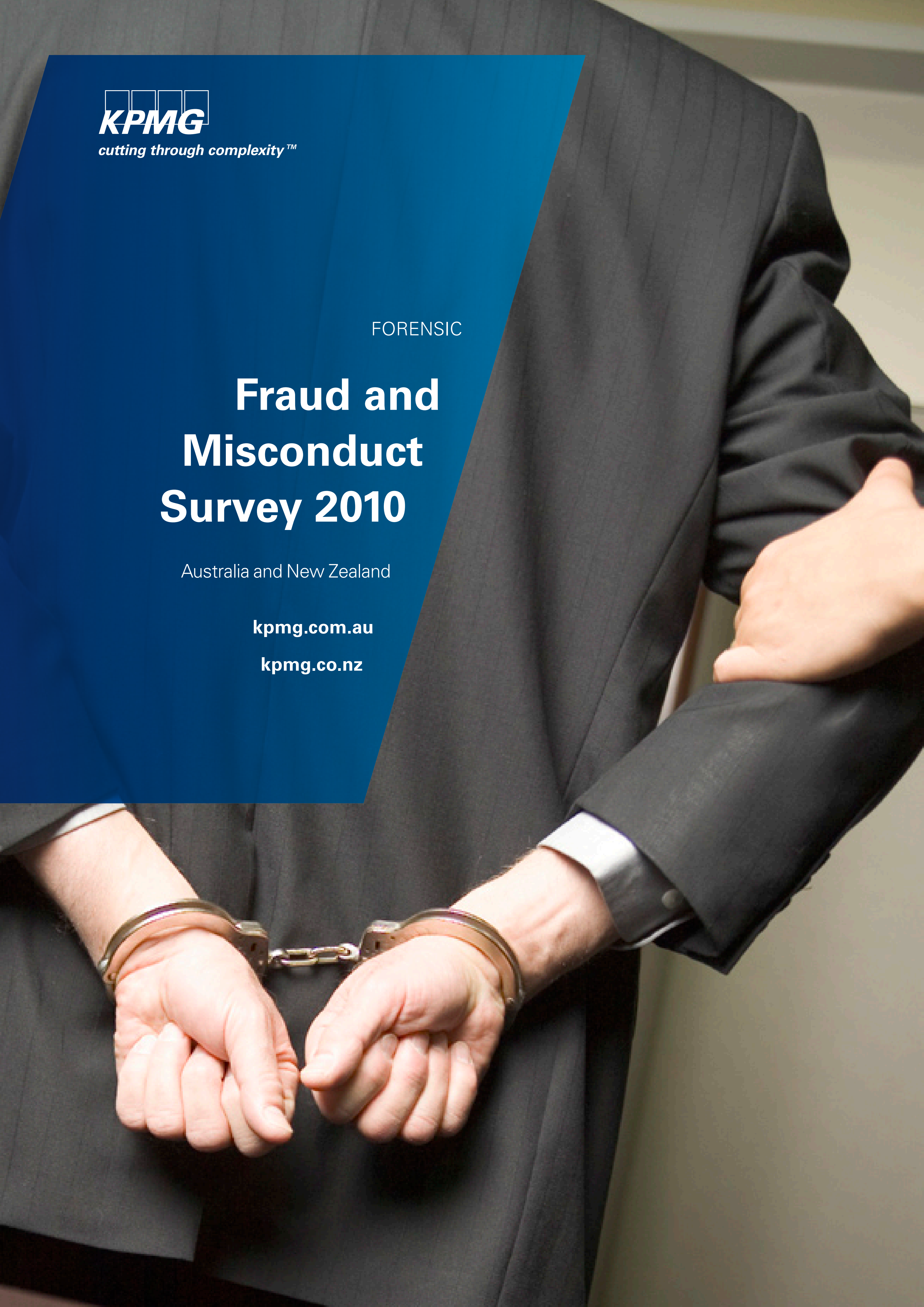

Unless otherwise stated, the amounts in this document are in Australian Dollars.

Due to rounding graph totals may not add up to 100 percent.

Contents

1. Preface

Welcome to KPMG Forensic's 2010 survey of fraud and misconduct in Australia and New Zealand.

For over 17 years the biennial KPMG Fraud Survey has become the most credible and widely quoted survey of fraud for Australian and New Zealand businesses.

This survey was undertaken with the support of the University of Melbourne. We would like to thank Professor Colin Ferguson, Dr Jennifer Grafton and Michelle Louise Hoggan from the University for their ongoing input and advice to this research.

This survey provides a detailed insight into contemporary fraud issues in Australia and New Zealand, including:

- the types of fraud affecting both public and private sectors
- the financial consequences of fraud
- the perpetrators of fraud
- how organisations respond to the discovery of fraud
- the strategies employed by entities to mitigate the risks of fraud
- unethical behaviours common in business and the factors that encourage these behaviours.

Our report is based on a detailed study of fraud across a broad cross-section of Australian and New Zealand organisations.

We would like to thank those people and organisations that took the time to respond to this year's survey. Without their support this report would not have been possible. We believe this document is essential reading for business leaders. We trust you will find it a useful tool in helping you and your organisation better manage the risk of fraud.

Gary Gill
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2. Executive summary

The total amount reported as having been lost to fraud increased from $301.1 million to $345.4 million.

Respondents believed that only a third of the total losses are being detected.

KPMG's 2010 biennial Fraud and Misconduct Survey for Australia and New Zealand reveals that the total amount reported as having been lost to fraud has increased significantly.

How big is the problem?

- The total amount reported as having been lost to fraud increased from $301.1 million to $345.4 million.
- The average loss from fraud by each organisation experiencing at least one incident of fraud rose from $1.5 million in 2008 to $3 million in 2010, and the average number of frauds increased from 530 in 2008 to 813 in 2010.
- Fifty-three percent of respondents experienced at least one incident of fraud. Among organisations with more than 500 employees, nearly three quarters experienced at least one fraud over the survey period (1 February 2008 to 31 January 2010).
- Eleven respondents experienced fraud losses exceeding $1 million each for the survey period. Nine of these organisations were from the finance and insurance sector.
- Respondents believed that only a third of the total losses are being detected.
- Just over half of the respondents agreed that fraud was an issue for both private and public sector organisations generally. However, in line with previous surveys, only a relatively small minority (20 percent) thought fraud was a serious problem for their own organisation.

Which sectors are vulnerable?

- The finance and insurance sector remains particularly vulnerable to frauds committed by external parties. Finance sector frauds typically involved credit cards, lending fraud and bogus insurance claims.
- For the first time, non-finance sector respondents in general suffered more frauds (by both number and value) at the hands of outsiders than they did from their employees. Nevertheless, the largest frauds were 'inside jobs'.
- Internally, theft of cash, diversion of sales and cheque tampering were the main employee frauds by value.

Of the largest frauds 65 percent by number and 98 percent by value were 'inside jobs'.

Who did it and why?

- Sixty-five percent of major frauds are committed by people already working in the victim organisation, who usually act alone. These frauds account for 98 percent of the losses.
- The main motivator for fraud was greed and lifestyle, with an average value of over $1.5 million.
- Eighty-three percent of the internal perpetrators of major fraud were earning less than $100,000.

How was it discovered?

- Most frauds were detected through the operation of internal controls and by reports from external and internal sources.
- Fraud 'red flags' or warning signs were overlooked or ignored in 38 percent of major frauds.
- The average period of time taken to detect a major fraud increased from 342 to 372 days.

What do we know about bribery and corruption?

- Fifty percent of our survey respondents said they were aware of the relevant Australian and New Zealand anti-bribery legislation. Twenty percent of respondents who stated they were not aware of this legislation, operated in jurisdictions outside of Australia and New Zealand.
- Most respondents (84 percent) stated that they had not taken advice to determine whether foreign anti-bribery and corruption legislation applied, even though 20 percent of these organisations operated outside of Australia and New Zealand.

Organisations experiencing unethical behaviour

- Fifty-one percent of respondents experienced unethical behaviour.
- Unauthorised use of the internet was the most common form of unethical behaviour experienced by respondents.

Conclusion

Fraud and misconduct remains a serious issue for Australian and New Zealand businesses. All sectors are vulnerable to fraud and organisations need to focus particular attention on fraud prevention and timely detection.

3. They stole how much?

Losses from fraud are far from trivial. They impose substantial costs on the entire community. Victims of fraud include individuals, businesses and governments. Most indicators (including this survey) suggest the problem is continuing to escalate.

3.1 The size of the problem

Respondents reported 174,914 separate incidents of fraud for the survey period. The total value of the frauds reported in the latest period amounted to $345.4 million, which was up on the $301.1 million identified in the 2008 survey. The average loss from fraud by each organisation experiencing at least one incident of fraud rose from $1.5 million in 2008 to $3 million in 2010, and the average number of frauds increased from 530 in 2008 to 813 in 2010.

3.2 Respondents experiencing fraud

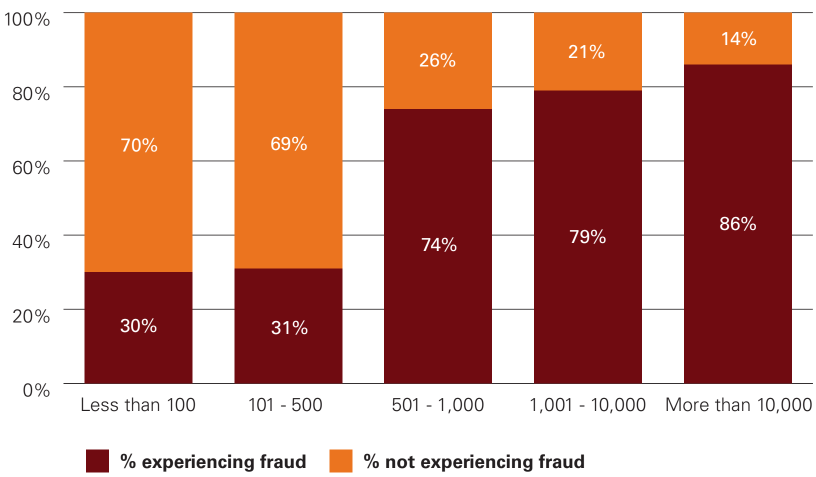
Fifty-three percent of our respondents reported experiencing at least one case of fraud over the survey period, which is an increase on the 2008 survey in which 45 percent of respondents suffered at least one fraud. Among private entities responding to the survey, 50 percent reported at least one fraud; among public sector respondents, 61 percent had experienced fraud.

Eleven separate respondents had suffered total fraud losses of more than $1 million each during the survey period. Nine were engaged in finance and/or insurance, one came from the entertainment/hospitality sector and one was a retailer. This result confirms that the largest overall fraud losses are concentrated in the finance and insurance sector.

More typical fraud losses were in the range of $10,000 to $100,000.

Large organisations are more likely to experience fraud than their smaller counterparts (Figure 1). Among organisations with more than 500 employees, nearly three quarters experienced at least one fraud over the survey period. Less than a third of the respondents with fewer than 500 employees experienced a fraud.

Figure 1 – Respondents experiencing fraud by size (number of employees)



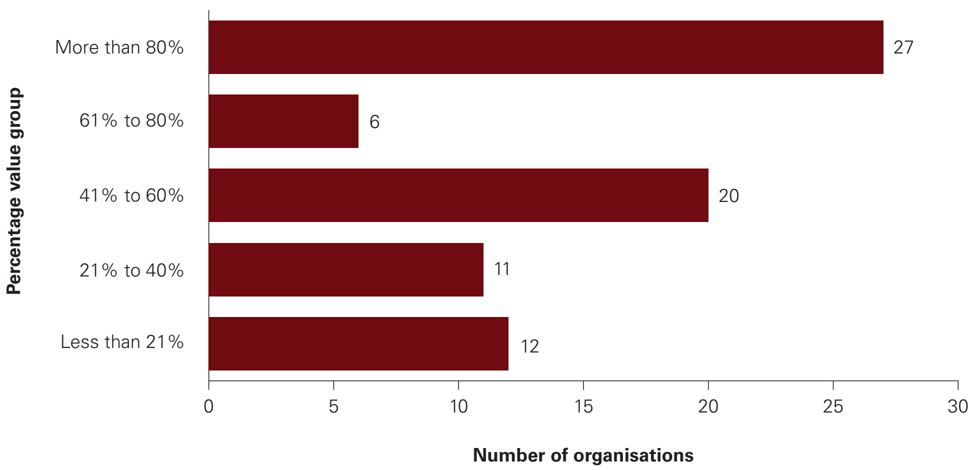
Source: KPMG Australia 2010

3.3 How much did they take?

For the first time, we asked respondents to tell us what proportion of all estimated fraud in their organisations was detected. Seventy-six organisations responded to this question. They reported combined known fraud losses for the survey period of $281.7 million. The same organisations estimated that they had suffered total fraud losses of $817 million over the same period, meaning that total estimated fraud losses were 2.9 times greater than detected losses. In other words, almost two thirds of total fraud goes undetected.

More than a third of the organisations responding to this question thought they were detecting more than 80 percent of their fraud losses (Figure 2).

Figure 2 – Estimate of total fraud detected



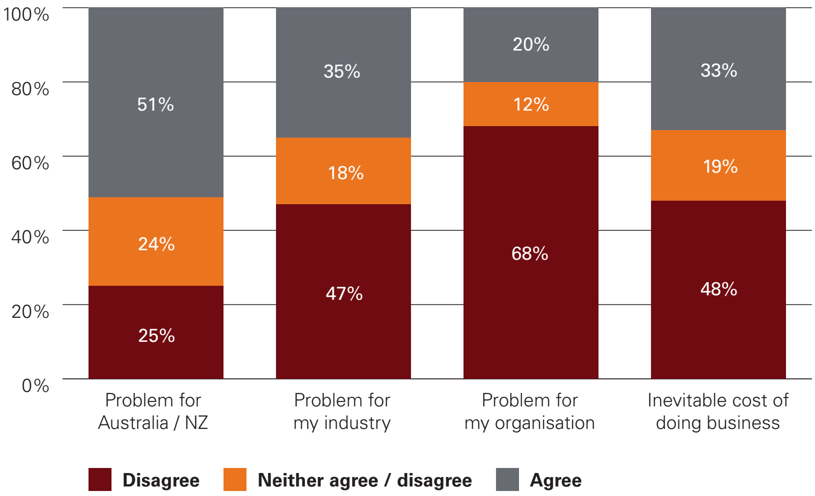
Source: KPMG Australia 2010

3.4 How organisations perceive fraud

Just over half (51 percent) of our respondents agreed that fraud is a problem in Australia and New Zealand, which is a slight decline from the 55 percent that answered this question in the affirmative in 2008.

However, only 20 percent believed fraud is a significant problem for their own organisations, which is a change from the 18 percent that thought this way in 2008 (Figure 3). We are concerned that this prevailing attitude, particularly after many well publicised large frauds during the global financial crisis, will result in lower investment in fraud risk management and inevitably an increase in the level of fraud.

Figure 3 – Perception of whether fraud is a major problem



Source: KPMG Australia 2010

3.5 So who were the perpetrators?

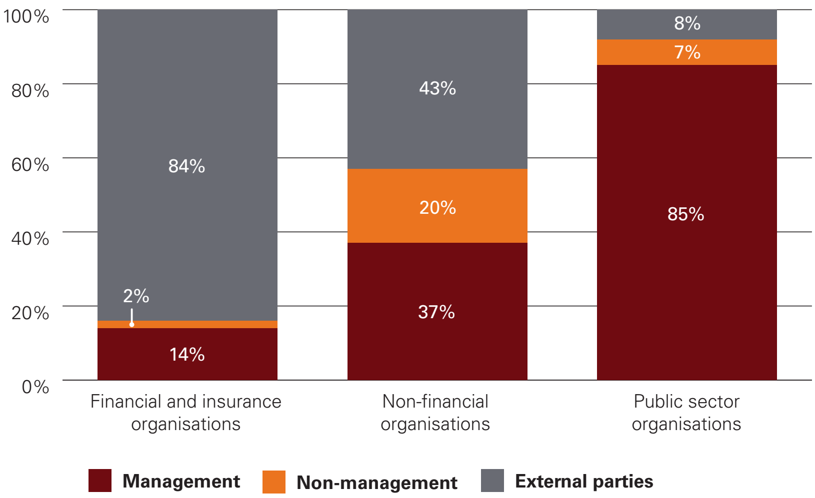
Our survey divided the perpetrators of fraud into three general categories: managers (including senior executives and directors), non-management employees and external parties.

For finance and insurance organisations, external perpetrators were responsible for most fraud losses as well as for the majority of fraud incidents (Figures 4 and 5).

In public sector organisations, managers were responsible for most of the losses.

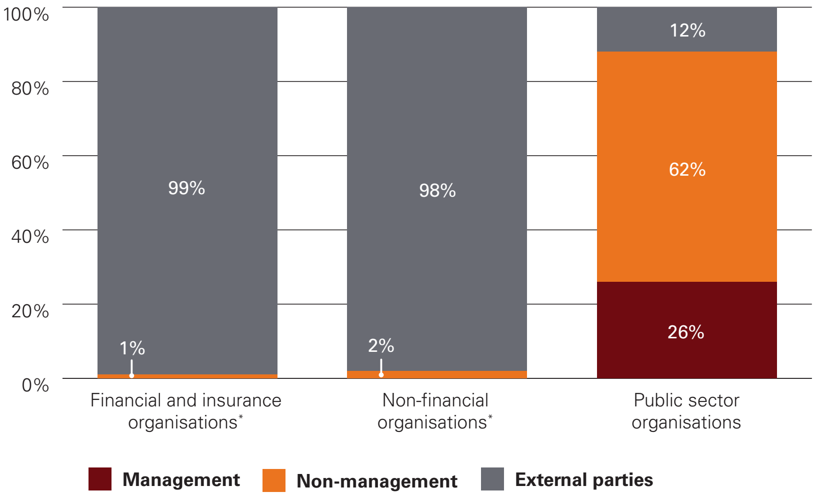
For non-financial organisations, external perpetrators were responsible for most fraud losses as well as the majority of fraud incidents. These external frauds were attributable to a high number of relatively lower value incidents. With the removal of outlier results, non-management were responsible for the majority of fraud incidents.

Figure 4 – Breakdown of fraud by perpetrators by value



Source: KPMG Australia 2010

Figure 5 – Breakdown of fraud by perpetrators by incidents



** Fraud incidents by management totalled less than 1 percent.*

Source: KPMG Australia 2010

3.6 What kinds of fraud are being committed?

By value, theft of cash was the main category of fraud perpetrated by management; cheque tampering was the main category of fraud perpetrated by non-management; and false claims for insurance were the main category of fraud perpetrated by external parties (see Appendix A)[1].

Consistent with prior surveys, theft of cash was the main category of fraud perpetrated by employees. With the increased reliance on using electronic funds transfer (EFT), it is imperative that organisations continually review and improve their fraud risk management strategies regarding their EFT facility. These strategies should include:

- a review of payroll processes (including the ability to amend electronic payroll records)
- a review of accounts payable processes (including ability to amend the master vendor file)
- a review of segregation of duties (particularly after an organisational restructure)
- maintaining EFT transaction logs and an analysis of these logs for indicators of fraud.

Incidents of fraud within financial and insurance service organisations

Appendix B summarises responses received from entities operating in the finance and insurance sector. It shows that the main fraud categories (by value) for employees were theft of cash and cheque tampering. The main frauds (by value) committed by external parties were lending fraud, credit card fraud, fraudulent general insurance claims and fraudulent motor vehicle-related claims.

Responses under the 'other' category included theft of IT assets and superannuation benefit fraud.

Incidents of fraud within non-finance private sector organisations

For the purposes of this analysis we have divided non-finance sector respondents into private and public sector entities. Appendix C summarises the responses of private non-finance sector organisations.

Appendix C shows that the main fraud categories (by value) for employees were theft of cash, false invoicing and diversion of sales. External parties were mainly responsible for the theft of inventory and false invoicing.

1 The total number of incidents recorded in Appendix A (incidents total 164,065) differs from the reported 174,914 incidents of fraud due to the non-completion of some parts of the survey by respondents.

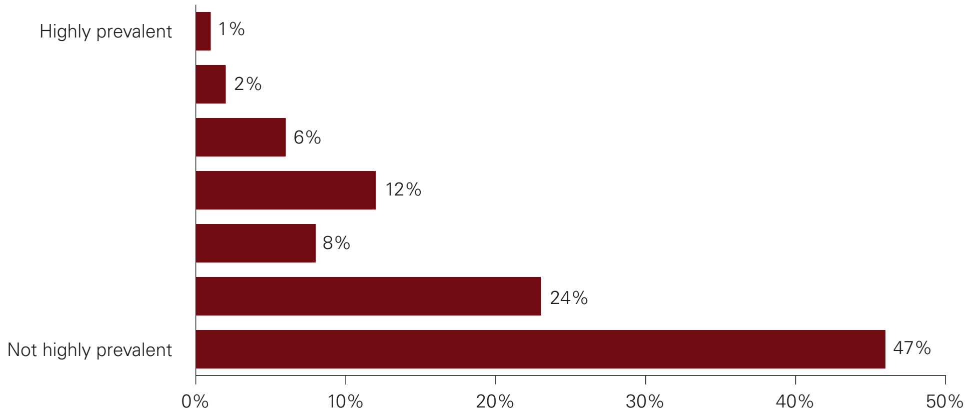
Among the frauds classified under the 'other' category, the main losses resulted from false claims and fraudulent invoicing.

Incidents of fraud within public sector organisations
Appendix D summarises the survey responses of public-sector organisations. It shows that the main fraud categories (by value) for employees were the diversion of sales, false invoicing, theft of plant and equipment, fraudulent expense claims and the receipt of secret commissions. The principal fraud committed by external parties was the theft of cash. The 'other' category includes identity fraud to obtain information and betting on credit.

3.7 Internal reporting fraud

For the first time, we asked about fraud associated with internal reporting processes[2]. Only 9 percent of respondents thought internal reporting fraud was prevalent in their organisation (Figure 6).

Figure 6 – Extent of internal reporting fraud



Source: KPMG Australia 2010

2 For the purposes of our survey, internal reports are defined as 'Financial or non-financial reports prepared for management use and generally not provided to external stakeholders. Such reports may include production statements, cost/revenue reports, balanced scorecards, KPIs and quality reports. They may include disaggregated financials for parts of the organisation.'

4. They did what?

To better understand the consequences of fraud, the factors that contribute to it and the ways in which it is detected and dealt with, we asked respondents to tell us more about the largest individual fraud (by value) that they had detected during the survey period.

We received 102 useable responses to this request.

4.1 Major frauds by type

The types of major fraud reported (the single largest fraud experienced by each organisation) are listed in Appendix E.

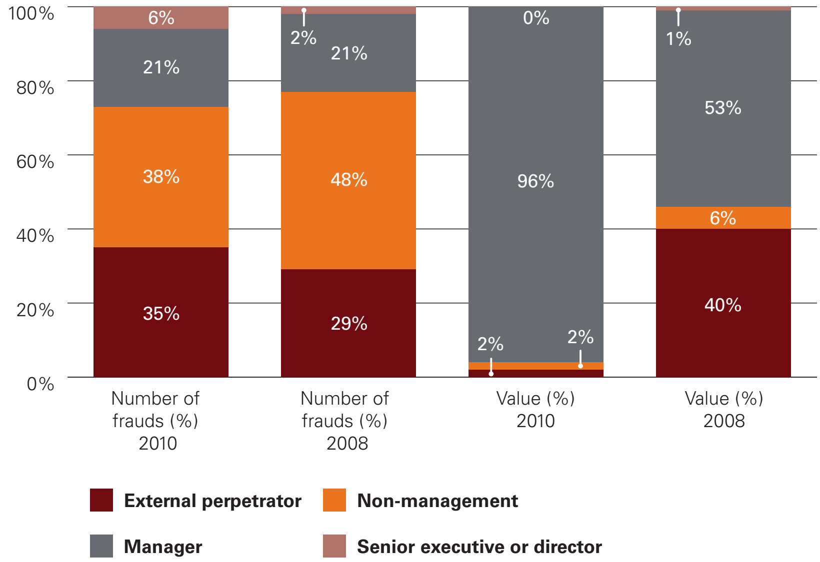
Overall, theft of cash was the most common form of major fraud reported, both in terms of its frequency and the scale of the losses incurred. Significantly, the average loss from these thefts was over $1.8 million; compared to $465,000 reported in our 2008 survey.

4.2 Who are the fraudsters?

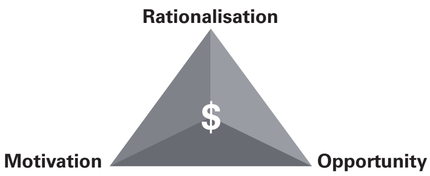
Businesses in Australia and New Zealand are vulnerable to internal fraud as well as frauds perpetrated by outsiders, including organised crime (an increasing problem) and individuals acting alone. It is clear from Figure 7 that the perpetrators of major fraud are most likely to come from within the organisation. Indeed, 65 percent of major frauds by number and 98 percent by value were 'inside jobs'.

Businesses in Australia and New Zealand are vulnerable to internal fraud as well as from frauds perpetrated by outsiders, including organised crime (an increasing problem) and individuals acting alone.

Figure 7 – Major fraud by perpetrator type



Source: KPMG Australia 2010



4.3 The motives for fraud

Three traditional factors are usually present when fraud occurs:

- motivation
- rationalisation (a justification for the activity)
- opportunity (often a function of poor controls).

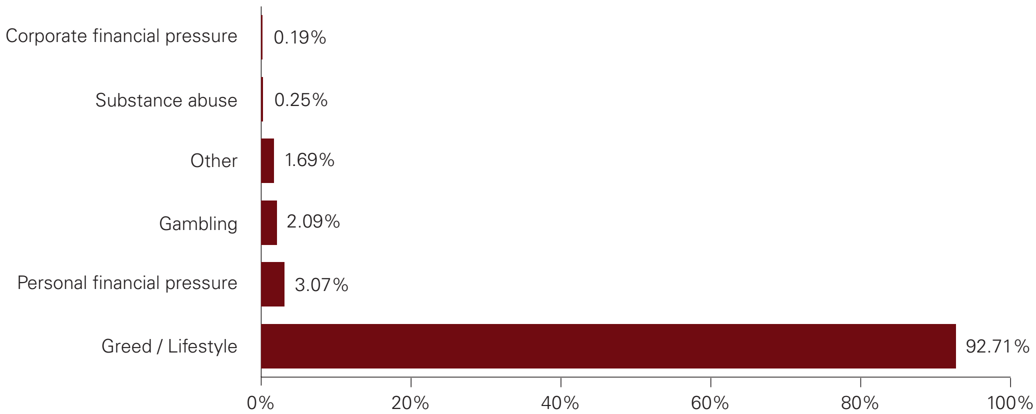
Current research also indicates the following factors contribute to fraud occurring:

- leadership
- role of significant others (family, friends)
- organisational culture.

It remains unclear whether motivation precedes or follows the recognition of opportunity. Figure 8 depicts the losses associated with selected fraud motivators.

The most common motive for fraud, at least as measured by the value of the major frauds detected, is greed and the desire to enhance lifestyle. Interestingly, the most prevalent motivator in the 2008 survey, gambling, was cited as the primary motivator in just 2 percent of detected frauds.

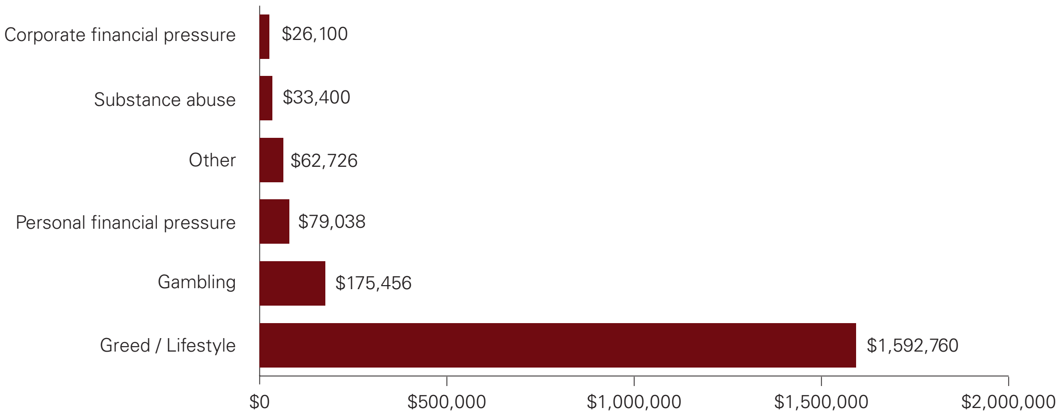
Figure 8 – Major fraud motivation



Source: KPMG Australia 2010

The average value of major fraud has shown substantial changes, greed and lifestyle has increased by a factor of six and personal financial pressure has increased by over 60 percent. The average loss associated with gambling has reduced substantially from a hefty $1.1 million in 2008 to $175,456 in 2010.

Figure 9 – Average value of major fraud by motivation

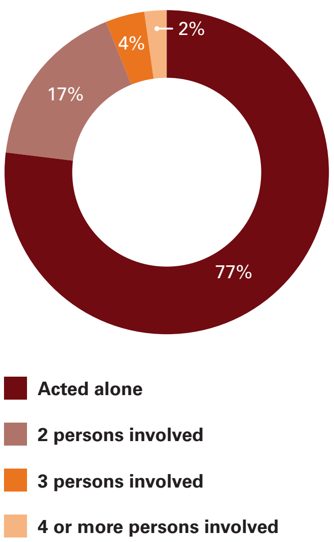


Source: KPMG Australia 2010

4.4 Collusion

Consistent with the results of our previous surveys, the latest survey found that employees who committed fraud appear to have acted alone in more than three quarters of the cases reported. This suggests controls, particularly segregation of duties require attention. Collusion between two or more individual employees occurs in 23 percent of internal frauds, a slight increase on our 2008 result of 20 percent.

Figure 10 – Internal fraud involving collusion



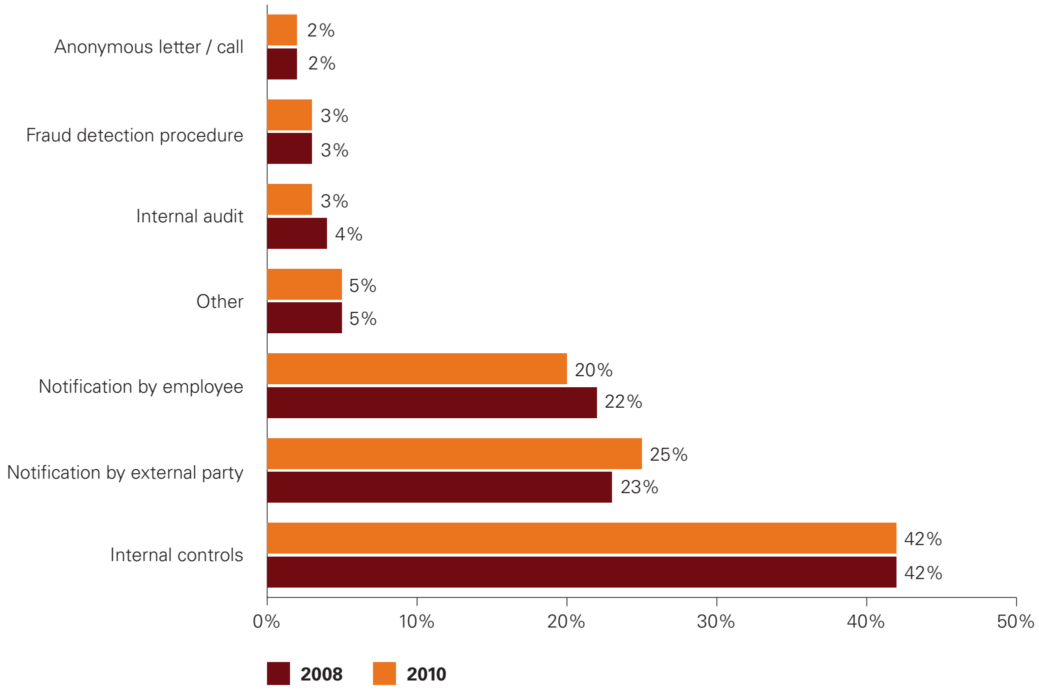
Source: KPMG Australia 2010

Of concern however is the continued decline in the rate of detection by employees. This may be linked to the low level of organisations offering anonymous reporting channels.

4.5 How was the major fraud detected?

Major fraud was predominantly detected by the application of internal controls. Indeed as Figure 11 shows, there has been remarkably little change in the ways frauds are detected when the survey results for 2008 and 2010 are compared. Of concern however is the continued decline in the rate of detection by employees. This may be linked to the low level of organisations offering anonymous reporting channels (see section 6.3).

Figure 11 – Detection of largest fraud



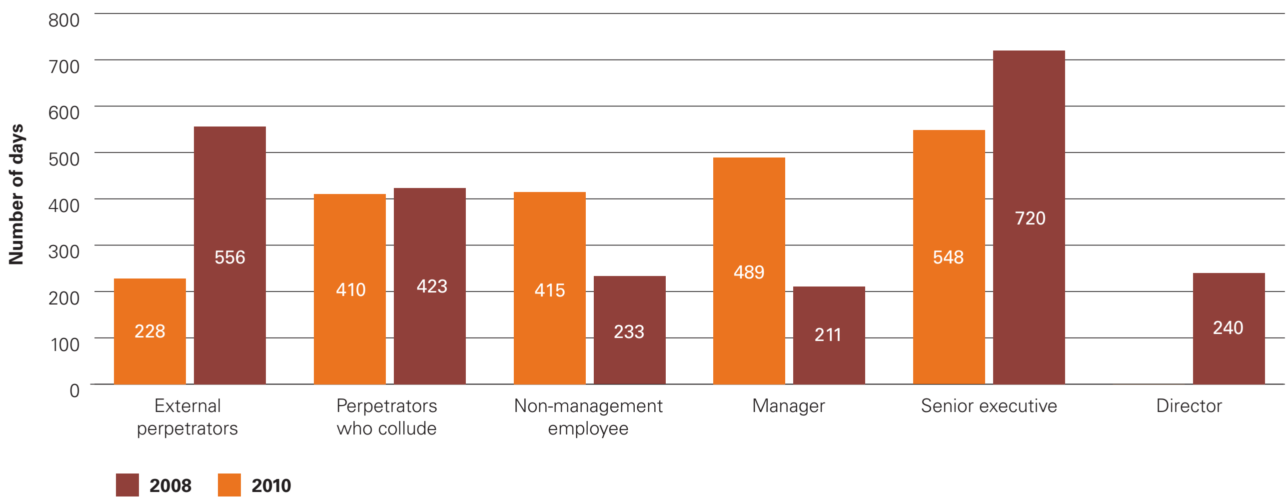
Source: KPMG Australia 2010

The delay in detection indicates that fraud risk management strategies require updating to ensure they are linked to current fraud risks applicable to the organisation's business.

4.6 Finding them takes time

The average time taken to detect a major fraud increased from 342 days in 2008 to 372 days. The time taken to uncover manager frauds increased by 132 percent and by 78 percent for frauds committed by other employees. These trends are disturbing. Experience shows that the longer a fraud goes undetected, the larger the losses are likely to become, while recoveries are proportionately smaller. The delay in detection indicates that fraud risk management detection strategies require updating to ensure they are linked to current fraud risks applicable to the organisation's business.

Figure 12 – Average time to discovery of largest fraud (days)



Source: KPMG Australia 2010

4.7 Ignore red flags at your peril

Early warnings or indicators of fraud can be thought of as 'red flags'. In 38 percent of major frauds, respondents admitted that relevant red flags were overlooked or ignored. This was a significant increase on the 22 percent figure reported in our 2008 survey. This result together with the decreasing number of frauds detected by employees suggests that organisations should review fraud awareness training delivered to employees, so they can recognise red flags.

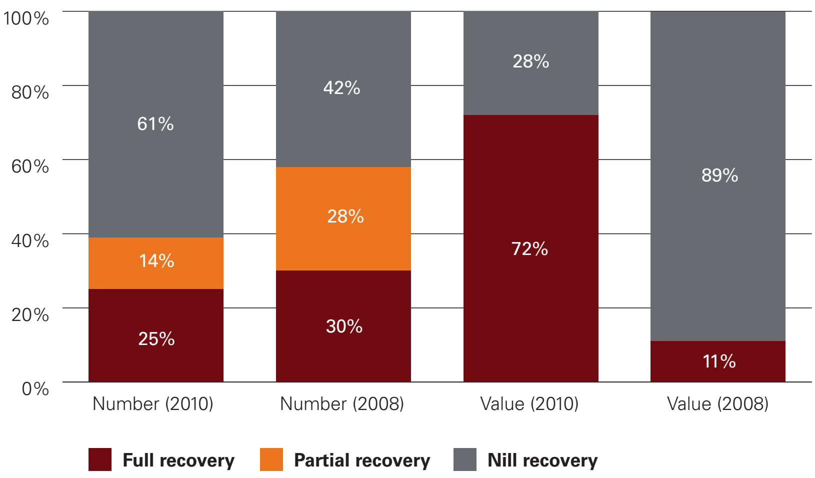
In 38 percent of major frauds, respondents admitted that relevant red flags were overlooked or ignored.

4.8 What about getting the money back?

The prospects of recovering monies lost to fraud are poor. Our survey finds that in 61 percent of major frauds there was zero recovery of funds (Figure 13). This represented a deterioration from 2008 when 42 percent of frauds resulted in a total loss. In this survey, full or partial recovery was achieved for 72 percent of the value. However, with the removal of one exceptionally high partial recovery, the value of recovery reduced to only 9 percent – which is below the 2008 result of 11 percent.

In general, these results suggest that organisations might usefully review the adequacy of their insurance cover for fraud-related losses where there has been only a slight improvement from 15 percent in 2008, to 19 percent in 2010 (Figure 14).

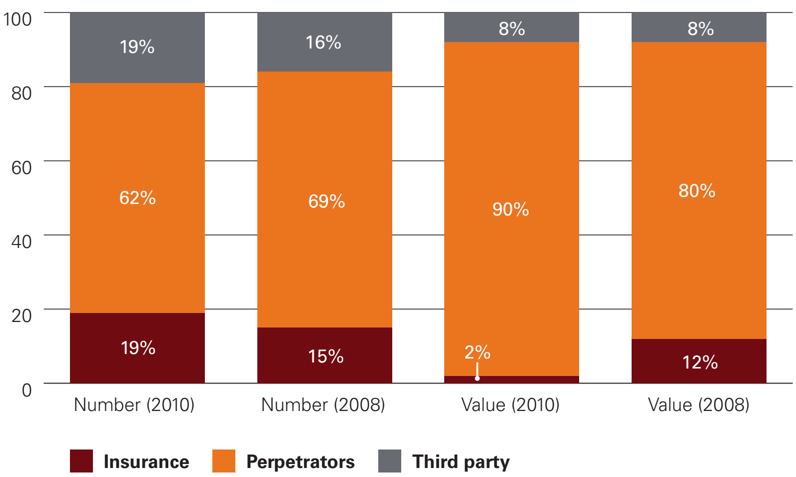
Figure 13 – Recovery of the proceeds of fraud



Source: KPMG Australia 2010

Perpetrators provided 62 percent of recoveries in the major frauds in which there were whole or partial recoveries (Figure 14).

Figure 14 – Source of funds where recovery is made



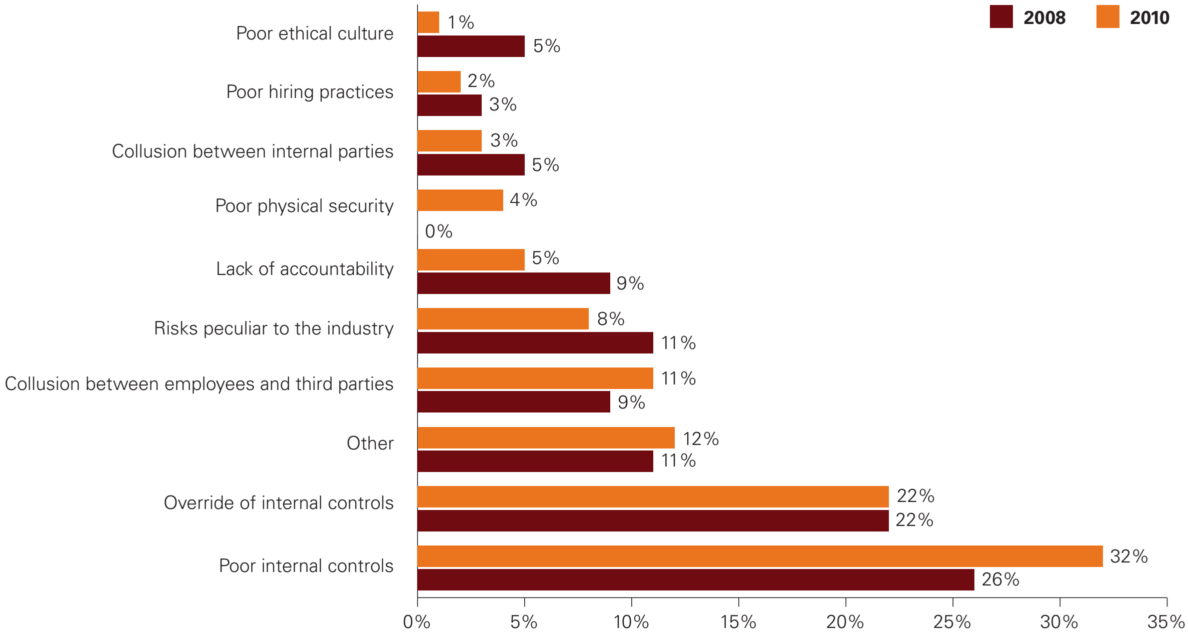
Source: KPMG Australia 2010

The nexus between fraud and control weaknesses is well established.

4.9 What allows fraud to occur?

Respondents stated that poor internal controls and the overriding of these controls were the main factors allowing major frauds to occur (Figure 15). Together these two factors were major contributors in over half the major frauds reported. This is a familiar finding — the nexus between fraud and control weaknesses is well established.

Figure 15 – Most important factor contributing to the largest fraud incident



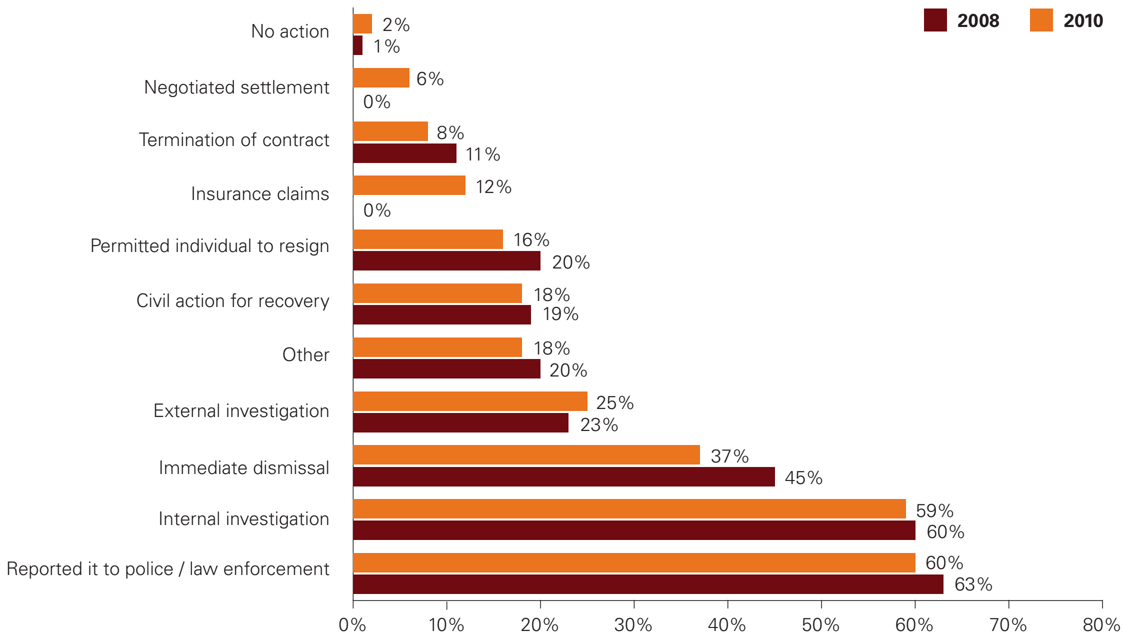
Source: KPMG Australia 2010

Of concern is the increase in poor internal controls as a contributing factor. This underscores the importance of fraud risk management strategies and the implementation of regular detailed fraud risk assessments in particular.

4.10 How do victims of fraud respond?

When a major fraud is uncovered, 60 percent of survey respondents said they report the matter to police and 59 percent launch an internal investigation, some organisations do both. More than a third claimed they immediately dismissed the individuals involved (Figure 16).

Figure 16 – Action taken concerning major fraud incidents

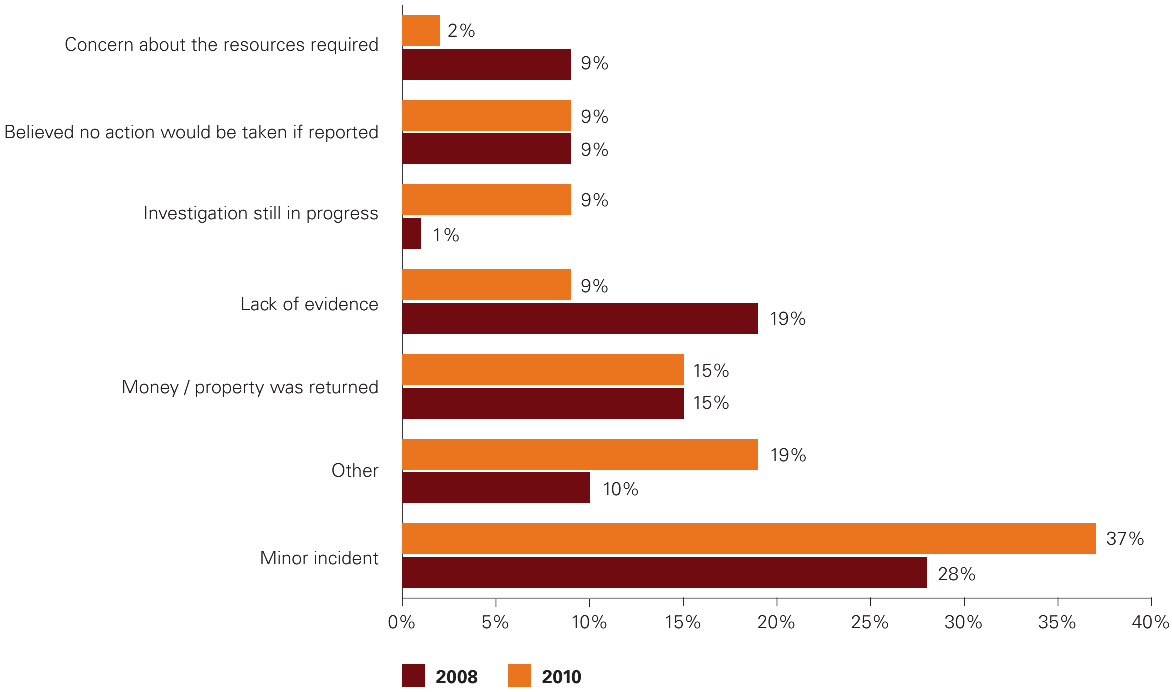


Source: KPMG Australia 2010

Our survey also asked why an organisation would not report a fraud to police (Figure 17). Here the most common response was that the incident was regarded as minor. On examination of responses, it appears that organisations have a different perspective of what constitutes 'minor'. For some organisations, those minor incidents resulted in dismissal.

Within the 'other' category, reasons given for not reporting fraud to police included the fact that no money was lost, the possibility that the individual concerned might defend the action, the fraud occurred overseas, or reporting was overruled by the board of directors or the board audit committee.

Figure 17 – Reasons for not reporting a major fraud incident to police



Source: KPMG Australia 2010

4.11 How much does it cost to investigate fraud?

Among the largest frauds reported, victim organisations spent an average of 8 percent of the amount lost in investigating these frauds (with the removal of a single large investigation, the average was 17 percent). On average, respondent organisations spent around 95 internal working hours investigating each major fraud.

The comparable figure from the 2008 survey was 10 percent, perhaps reflecting the increasing complexity of collecting evidence and developing a case for disciplinary, civil and criminal proceedings.

4.12 Damage to reputations

Reputational damage is an often-overlooked consequence of fraud. Certain major frauds have left long term scars on the reputations of the organisations involved. Reputational damage can be caused not only by the size of the fraud but also by the ease with which the fraud is perpetrated, the period over which it occurred and the response of the organisation once the fraud is detected.

In our latest survey, 17 percent of respondents thought their reputations had sustained major damage as a result of major fraud.

17 percent of respondents thought their reputations had sustained major damage as a result of major fraud.

4.13 Watch out for repeat offenders

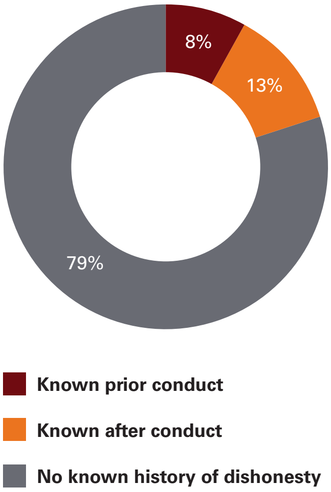
Many fraudsters are repeat offenders. Respondents reported that 8 percent of employees involved in fraudulent conduct had a known history of dishonesty with a previous organisation. The comparable figure for the 2008 survey was only 3 percent.

A further 13 percent of employees involved in frauds were subsequently found to have a history of dishonesty. The average size of the frauds perpetrated by employees with a history of dishonesty was $84,657.

The fact that many perpetrators of fraud have a prior record of dishonesty reinforces the case for pre-employment screening (a relatively inexpensive procedure that should be a standard component of the hiring process) and careful consideration of the position for those with a known history of dishonesty.

The fact that many perpetrators of fraud have a prior record of dishonesty reinforces the case for pre-employment screening

Figure 18 – Percentage of perpetrators with a history of dishonesty

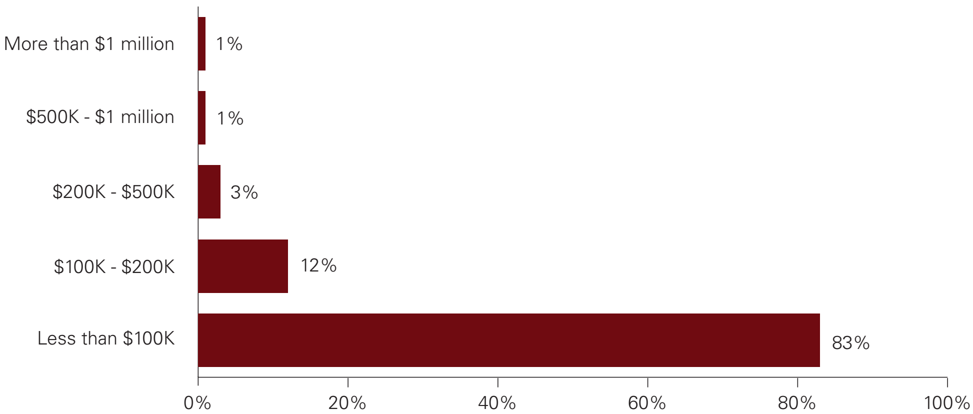


Source: KPMG Australia 2010

4.14 Does a person's income matter when committing a fraud?

Eighty-three percent of major fraudsters (employees) were earning less than $100,000 per year. The average fraud for persons earning less than $100,000 was $307,000, for persons earning more than $100,000 but less than $200,000 it was $131,000 and for persons earning more than $1 million it was $160,000. For persons earning more than $200,000 but less than $1 million, the fraud involved internal reporting fraud.

Figure 19 – Income of major fraudsters (employees only)



Source: KPMG Australia 2010

4.15 What does a fraudster look like?

By analysing the most common, or 'average', responses to survey questions dealing with major frauds, we have developed a profile of the typical fraudster. Such an individual will be:

- a male non-management employee of the victim organisation, acting alone and with no known history of dishonesty
- aged 38 years and earning $113,000 p.a.
- employed by the organisation for a period of 5 years and held his current position for 3 years at the time of detection
- motivated by greed and stole on average $229,000
- detected by the organisation's internal controls 12 months after the commencement of the fraud.

When compared with our 2008 survey, our typical fraudster is the same age, will have been in his current position for 1 year less time and will be detected 1 month later. On a more positive note, he will have misappropriated less money.

5. What about the neighbours? Fraud and corruption in Asia

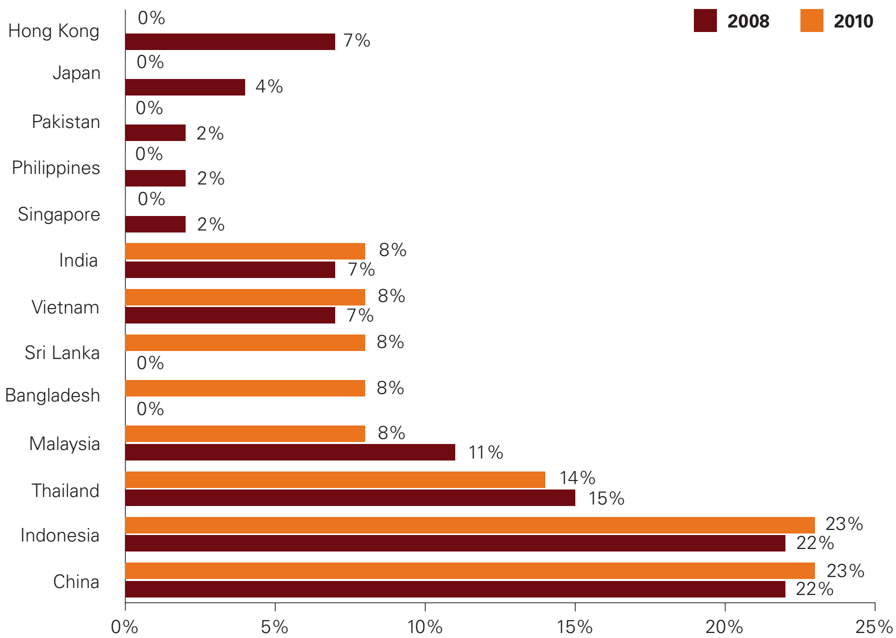
Corruption is endemic in many parts of the world. As increasing numbers of Australian and New Zealand businesses expand into Asia, they need to be conscious of potential problems associated with corruption.

5.1 Where in Asia is fraud and corruption occurring?

Six percent of respondents in our latest survey reported experiencing fraud or corruption problems in their Asian operations. The Asian countries in which frauds occurred were similar to those revealed in our 2008 survey (Figure 21).

Fraudulent expense claims were the most prevalent form of fraud reported, followed by bribes and kickbacks paid by the organisations concerned (Appendix F).

Figure 21 – Fraud incidents in Asia by location



Source: KPMG Australia 2010

5.2 Anti-bribery legislation

Both Australia and New Zealand possess legislation designed to deter bribing foreign public officials. This legislation includes the Criminal Code Act 1995 in Australia and the Crimes Act 1961 in New Zealand. In certain circumstances, Australian and New Zealand residents and corporate entities can also be subject to another country's anti-corruption legislation, such as the US Foreign Corrupt Practices Act and the UK Bribery Act. What this means is that an Australian or New Zealand company and/or individual making a corrupt payment to a public official in another country could be prosecuted under Australian/New Zealand law, under the law of the country in which the offence took place, and in some circumstances, under the law of another country (by virtue of the type and mode of payment).

Most respondents stated that they had not taken advice to determine whether foreign anti-bribery and corruption legislation applied.

Fifty percent of our survey respondents said they were aware of the relevant Australian and New Zealand anti-bribery legislation. Twenty percent of respondents who stated they were not aware of relevant Australian and New Zealand bribery legislation, operated in jurisdictions outside of Australia and New Zealand.

Two percent of respondents admitted making 'facilitation payments' to government officials overseas. The countries in which these payments have been made include South Africa, Indonesia and China. The 'facilitation payments' in question may or may not be illegal under the relevant Australian or New Zealand laws, although a majority of the organisations concerned did not have policies or procedures for checking the legality of such payments.

Figure 20 summarises measures taken by respondent organisations to ensure their compliance with anti-bribery legislation. Other strategies include the communication of responsibilities, conflict of interest training, awareness training for employees located offshore and code of conduct and pre-departure briefings.

Figure 20 — Measures taken by organisations to ensure compliance with anti-bribery legislation

	Implemented within the last 2 years	Implemented for over 2 years	Planned	Not applicable
Perform due diligence on suppliers	22%	51%	11%	16%
Perform due diligence on business partners	19%	68%	12%	1%
Perform due diligence on management and employees	18%	72%	9%	1%
Perform active monitoring of bribery/ corrupt payments	11%	51%	17%	21%
Include audit rights to your agency agreement	10%	63%	6%	21%
Exercise audit rights included in agency agreements	10%	55%	14%	21%
Require information from foreign agents that they have compiled with the terms of their agency agreement	6%	41%	24%	29%

Source: KPMG Australia 2010

Most respondents (84 percent) stated that they had not taken advice to determine whether foreign anti-bribery and corruption legislation applied, even though 20 percent of these organisations operated outside of Australia and New Zealand. Bribery and corruption has gained the attention of regulators globally and has thus become a fast moving area of the law. We encourage organisations to consider the risk of bribery and corruption when developing fraud risk strategies.

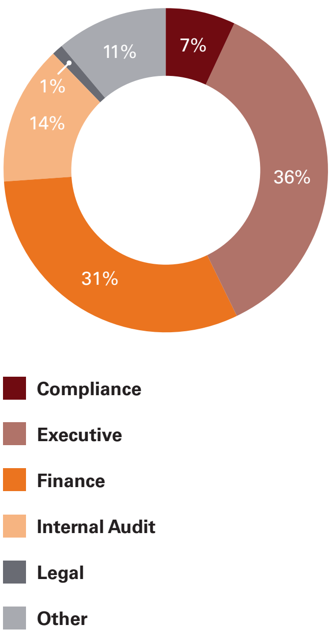
6. Managing the risk of fraud

Awareness of potential fraud is only the starting point. Leading organisations will implement suitable policies and processes to prevent, detect and respond to fraud. In this context, we asked organisations surveyed about how they managed the risk of fraud and responded to actual and suspected frauds.

6.1 Who is responsible for managing fraud risk?

Figure 22 shows the business units/functions that our survey respondents nominated as being primarily responsible for managing the risk of fraud and responding to it within their respective organisations. Overwhelmingly these responsibilities are with executive and finance units.

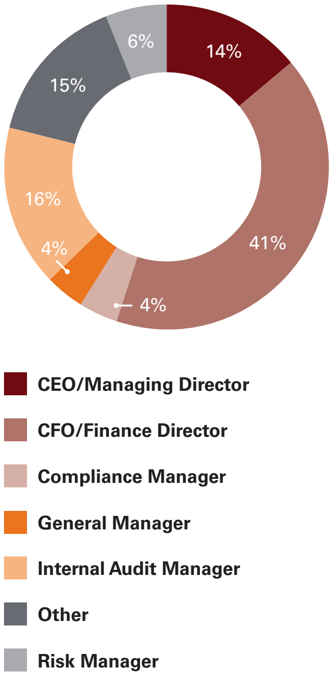
Figure 22 – Business units responsible for fraud



Source: KPMG Australia 2010

Figure 23 depicts fraud risk responsibilities for individuals/positions within respondent organisations. As with our 2008 survey, this responsibility resides mostly with the CFO/Finance Director.

Figure 23 – Responsibility for fraud management by position



Source: KPMG Australia 2010

6.2 What are organisations doing to mitigate fraud risk?

In KPMG's view, an effective approach to fraud risk management should focus on controls with three key objectives:

- Prevention – controls designed to reduce the risk of fraud.
- Detection – controls designed to uncover fraud when it occurs.
- Response – controls designed to facilitate corrective action and harm minimisation.

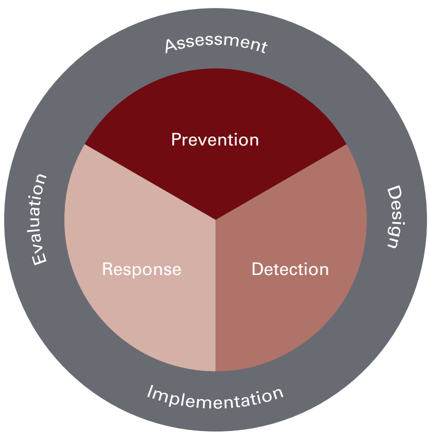
Organisations will generally require a range of strategies to meet these objectives and mitigate the risk of fraud. Leading organisations will have a dynamic approach to fraud risk management which will be built-in to their overall approach to governance, risk and compliance. Increasingly organisations are leveraging IT to analyse data collected in the ordinary course of business to identify indicators of fraud and have an appropriate response mechanism to analyse and confirm these suspicions. Fraud stress testing (a controlled attempt to perpetrate fraud) is an emerging strategy used to test the operating effectiveness of fraud controls, particularly for those organisations where manual controls are key to the prevention and detection of fraud.

These strategies, combined with traditional strategies, such as fraud awareness training and the implementation of anonymous reporting channels, can substantially assist with managing the risk of fraud.

Respondent organisations have adopted a range of strategies for preventing fraud (Appendix G). In only two of the identified strategies — screening of employees on promotion or transfer to high-risk positions and job rotation — was there a significant unwillingness to adopt the measures concerned.

Appendix H records the fraud detection strategies in common use. Of concern is the high number of organisations that have no plans to implement an external fraud reporting mechanism, which has long been considered necessary to provide employees with comfort regarding anonymous reporting (see our comments in section 6.3). A majority of respondents said they had no plans to introduce fraud stress testing.

Fraud risk management cycle



Source: KPMG Australia 2010

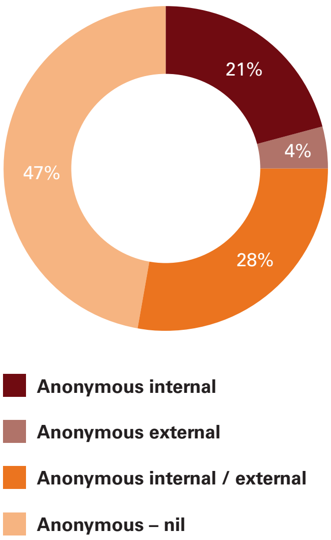
Appendix I summarises the main fraud response strategies adopted by respondent organisations. Most organisations have implemented or have plans to implement the generally accepted leading practice fraud response strategies.

6.3 Fraud reporting channels

In our latest survey, email remained the favoured channel for the reporting of fraud. Of note is the low number of organisations who offer anonymous reporting which can lead to a reluctance by employees to report observed fraud as highlighted in our detection results (section 4.5).

Email remained the favoured channel for the reporting of fraud.

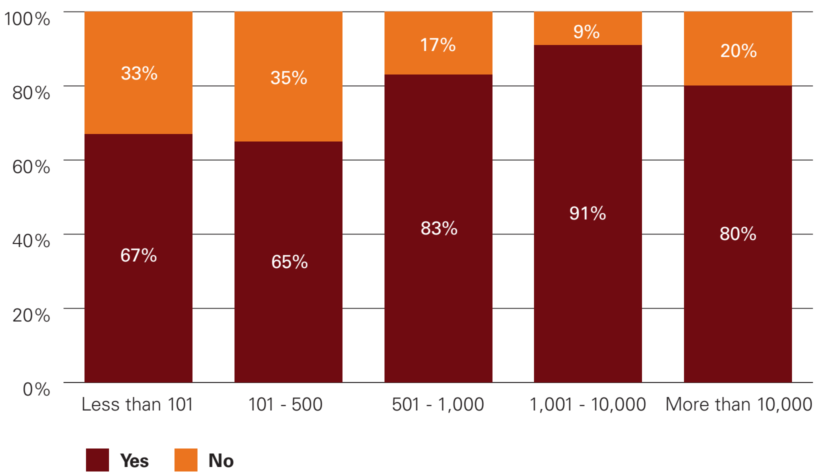
Figure 24 – Fraud reporting channels



Source: KPMG Australia 2010

Consistent with the findings of previous surveys, the existence of formal fraud reporting policies and procedures is positively correlated with the size of the workforce.

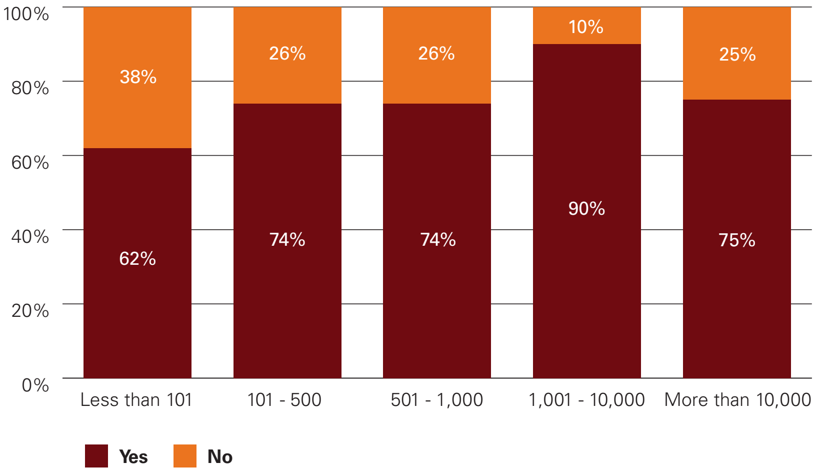
Figure 25 – Formal policy/procedure for reporting fraud



Source: KPMG Australia 2010

There has been an increase in the proportion of organisations with a formal policy/procedure for protection of whistleblowers across all organisations. Larger organisations also tend to have formal policies for protecting whistleblowers.

Figure 26 – Formal policy for protection of whistleblowers

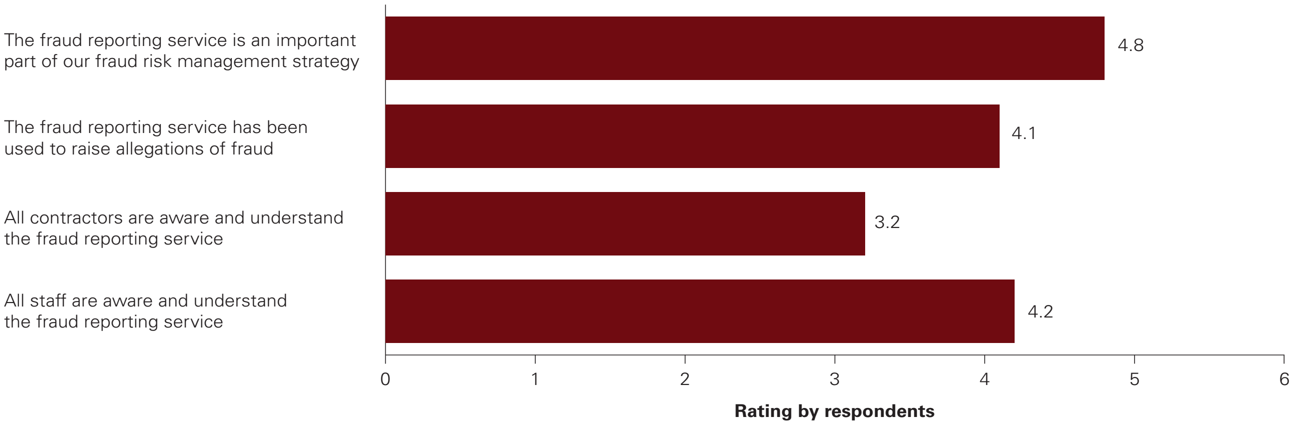


Source: KPMG Australia 2010

Larger organisations also tend to have formal policies for protecting whistleblowers.

We asked respondents to rate the awareness of fraud reporting programs in their organisations. Ratings ranged from 'strongly disagree' (rating 1) to 'strongly agree' (rating 7). The relatively low level of awareness may again be a reason for the decreasing level of fraud detection by employees.

Figure 27 – Awareness of fraud reporting services



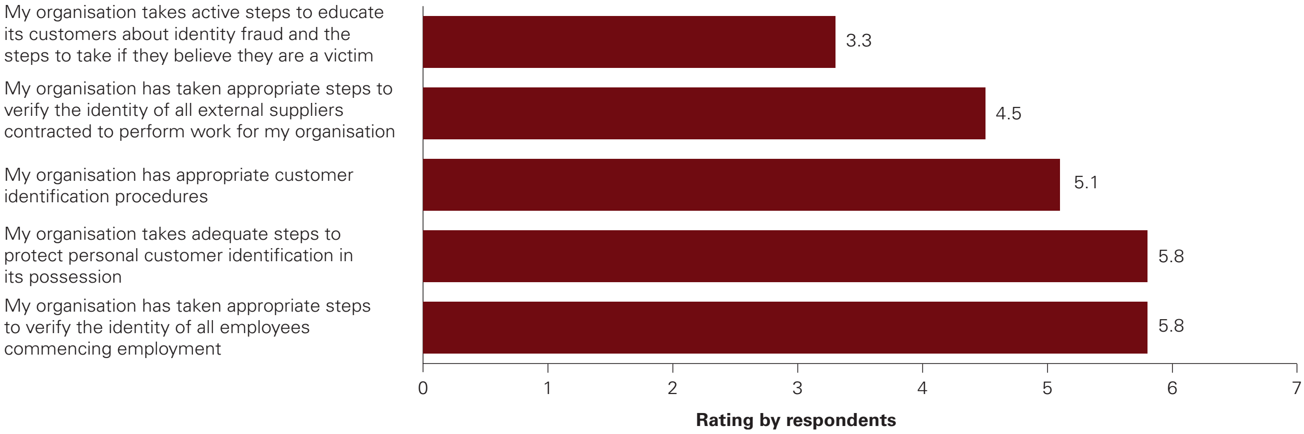
Source: KPMG Australia 2010

6.4 Mitigating the risks of identity fraud

Identity fraud is a continuing problem for all organisations. As Figure 28 demonstrates, respondent organisations are generally aware of identity fraud, however as with previous surveys, many organisations appear to be lagging when it comes to warning customers about the threat posed by identity fraud/theft. In Figure 28 respondents were asked to rate statements from 'strongly disagree' (rating 1) to 'strongly agree' (rating 7).

Many organisations appear to be lagging when it comes to warning customers about the threat posed by identity fraud/theft.

Figure 28 – Identity fraud



Source: KPMG Australia 2010

7. Misconduct in the workplace

We asked if organisations had experienced unethical conduct (other than fraud) during the survey period. Fifty one percent of respondents reported unethical behaviour compared with 37 percent for the 2008 survey.

Figure 29 depicts the types of unethical behaviour being experienced. Incidents in the 'other' category included providing false information on resumes, bullying, harassment and assault. It is unclear whether these results reflect an actual increase in unethical conduct, or simply greater organisational sensitivity to the problem.

Figure 29 — Types of unethical behaviour

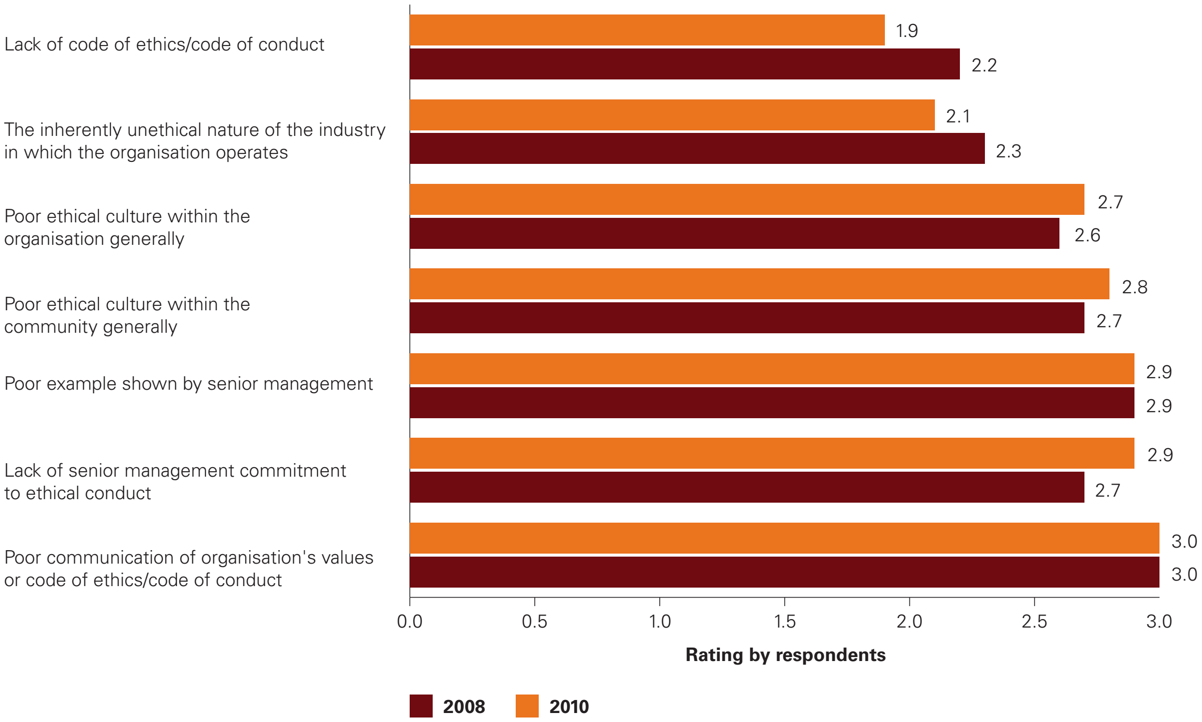
	2010	2008
Unauthorised use of the internet	29.3%	0.0%
Management/employees conflict of interest	12.5%	11.0%
Other	11.0%	20.0%
Falsely claiming sick leave or absenteeism	10.7%	14.0%
Conducting business transactions in a manner which derives an unwarranted personal advantage	9.2%	9.0%
Unauthorised disclosure of confidential or sensitive information	8.2%	13.0%
Lavish gifts or entertainment bought at the expense of your organisation, which are not brought to the attention of management	5.9%	8.0%
Gifts or entertainment bought at the expense of your organisation for parties external to your organisation	4.2%	0.0%
Unauthorised personal use of corporate assets	3.8%	17.0%
Running a private business during work hours	2.3%	4.0%
Favouritism to suppliers	1.5%	4.0%
Disclosure of information via internet	1.1%	0.0%
Reprisals against an employee for reporting suspicions of fraud or misconduct	0.3%	0.0%
Improperly gathering competitor information	0.2%	0.0%

Source: KPMG Australia 2010

We asked respondents to tell us what they thought had contributed to this misconduct and to rank the significance of these contributory factors from 'insignificant' (rating 1) to 'very significant' (rating 7). Figure 30 summarises these findings. The results are consistent with our 2008 survey which suggest organisations have not taken effective steps to address this type of behaviour.

Other cultural factors reported as contributing to unethical behaviour include financial pressures, lack of ethics and awareness and poor leadership by supervisors.

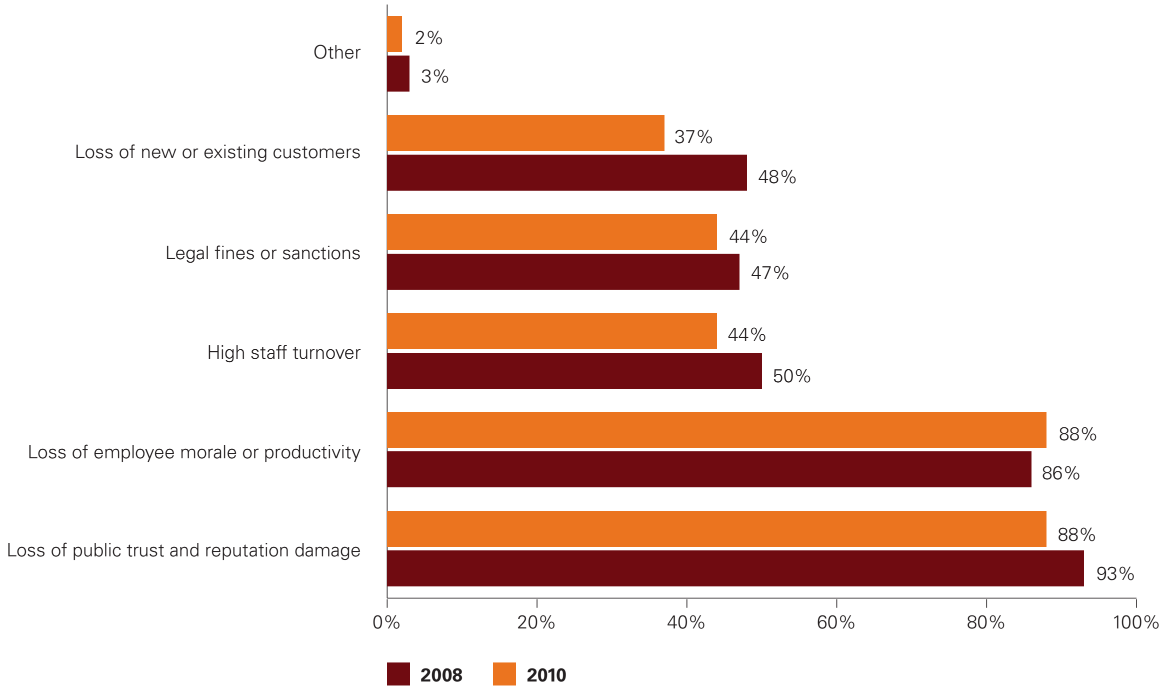
Figure 30 – Cultural factors contributing to unethical behaviour



Source: KPMG Australia 2010

Respondents were asked to consider how unethical behaviour could affect their organisation (Figure 31). As with fraudulent behaviour, we see reputational damage as a major impact upon the organisation.

Figure 31 – Implications for unethical behaviour



Source: KPMG Australia 2010

When we asked organisations how they had responded to unethical conduct, 31 respondents said they had provided training in ethics and 16 reported developing codes of conduct/ethics.

8. About the survey

In 2010 KPMG and the University of Melbourne invited a sample of Australian and New Zealand organisations in the private and public sectors to complete a questionnaire on their attitudes and responses to fraud. Respondents were asked to consider fraud occurring in their organisation during the period 1 February 2008 to 31 January 2010.

For the purposes of the survey, fraud was defined as 'any dishonest activity causing actual or potential financial loss to any person or entity including theft of monies or other property by employees or persons external to the entity and where deception is used at any time immediately before or immediately following the activity'. (AS8001 – 2008)

Usable replies were received from 214 organisations. This was a response rate of 10 percent.

Figure 32 sets out the percentage of respondents that indicated the nature of their business activities in accordance with the Australian and New Zealand Standard Industrial Classification.

Figure 32 — Industry breakdown of respondents

Industry	Percentage of respondents
Financial and insurance services	15
Electricity, gas, water and waste services	10
Other	10
Health care and social assistance	9
Education and training	9
Manufacturing	7
Public administration and safety	7
Construction	4
Retail trade	4
Mining	4
Agriculture, forestry and fishing	3
Wholesale trade	3
Arts and recreation services	3
Transport, postal and warehousing	3
Administrative and support services	3
Information, media and telecommunications	2
Professional, scientific and technical services	2
Accommodation and food services	1
Rental, hiring and real estate service	1

Source: KPMG Australia 2010

Appendix A: Summary of all fraud incidents

	Management		Non-management		External parties	
	Incidents	$	Incidents	$	Incidents	$
Asset misappropriation – cash						
Theft of cash (received)	18	45,893,186	399	2,338,630	1,428	758,124
Theft of cash (incoming)	3	105,000	27	106,340	2	750,000
Asset misappropriation – non cash						
Theft of plant and equipment	5	15,000	16	289,400	2	130,000
Theft of inventory	10	10,750	83	159,800	18,290	1,250,000
Theft of consumables	3	50,000	24	63,350	1	16,000
Theft of confidential information/business information	3	165,000	–	–	–	–
Theft of intellectual property	1	–	–	–	–	–
Other	2	160,000	4	139,800	2	2,907,000
Asset misappropriation – fraudulent disbursements						
Fraudulent expense claim	9	227,200	24	59,180	1	48,000
Fraudulent use of corporate credit card	11	122,932	22	97,204	1	20,000
False invoicing	8	2,035,240	12	218,520	10	377,998
Payroll fraud	9	117,400	24	329,540	1	3,000
Cheque tampering – change payee, change amount	–	–	1,202	4,008,000	35	132,697
False claim for workers compensation	–	–	2	7,600	–	–
Other	4	12,000	22	247,902	66	96,094
Asset misappropriation – insurance						
False claim for motor vehicle accident	–	–	–	–	365	45,136,037
False claim for personal insurance	–	–	–	–	6	32,735
False claim for general insurance	–	–	1	3,000	30,832	96,356,057
Other	–	–	–	–	160	1,000,000

	Management		Non-management		External parties	
	Incidents	$	Incidents	$	Incidents	$
Asset misappropriation – financial						
Lending fraud – false information	1	15,000	12	68,000	131	28,557,710
Lending fraud – identity fraud	–	–	–	–	16	2,662,000
Credit card fraud	2	2,000	2	1,000	73,645	49,888,754
Other	–	–	–	–	37,021	46,090,000
Asset misappropriation – government						
False claim for benefit	–	–	22	92,362	4	104,000
False claim to evade a liability	1	2,500	–	–	–	–
Other	–	–	–	–	2	–
Asset misappropriation – other						
Theft of telecommunications services	5	200	3	10,800	1	250,000
Theft of electricity/gas	–	–	1	6,000	–	–
Other	–	–	4	15,760	4	12,000
Corruption						
Secret commissions (kickbacks received by employees)	4	234,000	3	2,000	–	–
Bribery (kickbacks paid by the organisation)	–	–	–	–	3	10,000
Fraudulent tendering	2	45,000	5	40,000	–	–
Diversion of sales	2	10,800,000	5	280,200	–	–
Fraudulent statements – financial						
Asset/revenue overstatements	–	–	–	–	1	104,000
Asset/revenue understatements	1	60,000	–	–	–	–
Fraudulent statements – non-financial (received)						
Fraudulent employment history/education qualifications	–	–	12	1,800	–	–
	104	$60,072,408	1,931	$8,586,188	162,030	$276,692,206

Source: KPMG Australia 2010

Appendix B: Summary of all fraud incidents – finance and insurance sector

	Management		Non–management		External parties	
	Incidents	$	Incidents	$	Incidents	$
Asset misappropriation – cash						
Theft of cash (received)	4	45,271,976	269	2,161,350	1,416	521,024
Theft of cash (incoming)	–	–	4	4,200	–	–
Asset misappropriation – non cash						
Theft of plant and equipment	2	8,000	–	–	–	–
Theft of consumables	–	–	1	350	–	–
Other	–	–	1	50,000	1	2,900,000
Asset misappropriation – fraudulent disbursements						
Fraudulent expense claim	–	–	2	8,000	–	–
Fraudulent use of corporate credit card	–	–	3	2,700	–	–
False invoicing	–	–	–	–	4	64,000
Payroll fraud	–	–	1	1,000	–	–
Cheque tampering – change payee, change amount	–	–	1,200	4,000,000	34	88,697
Other	2	–	9	224,000	64	53,094
Asset misappropriation – insurance						
False claim for motor vehicle accident	–	–	–	–	365	45,136,037
False claim for personal insurance	–	–	–	–	6	32,735
False claim for general insurance	–	–	1	3,000	30,832	96,356,057
Other	–	–	–	–	160	1,000,000

	Management		Non–management		External parties	
	Incidents	$	Incidents	$	Incidents	$
Asset misappropriation – financial						
Lending fraud – false information	1	15,000	2	18,000	131	28,557,710
Lending fraud – identity fraud	–	–	–	–	16	2,662,000
Credit card fraud	–	–	–	–	73,644	49,884,000
Other	–	–	–	–	37,020	46,090,000
Fraudulent statements – non-financial (received)						
Fraudulent employment history/education qualifications	–	–	1	1,800	–	–
Total	9	$45,294,976	1,494	$6,474,400	143,693	$273,345,354

Source: KPMG Australia 2010

Appendix C: Summary of all fraud incidents – non-financial and non-public sector

	Management		Non–management		External parties	
	Incidents	$	Incidents	$	Incidents	$
Asset misappropriation – cash						
Theft of cash (received)	7	581,500	115	125,100	5	5,000
Theft of cash (incoming)	2	103,000	16	98,140	–	–
Asset misappropriation – non cash						
Theft of plant and equipment	3	7,000	9	29,000	2	130,000
Theft of inventory	6	10,000	81	147,400	18,290	1,250,000
Theft of consumables	–	–	10	5,000	1	16,000
Theft of confidential information/business information	2	5,000	–	–	–	–
Other	2	160,000	1	80,000	1	7,000
Asset misappropriation – fraudulent disbursements						
Fraudulent expense claim	3	2,800	19	36,900	–	–
Fraudulent use of corporate credit card	3	14,900	7	20,672	–	–
False invoicing	3	753,640	2	27,000	4	304,000
Payroll fraud	6	81,000	15	77,240	–	–
Cheque tampering – change payee, change amount	–	–	–	–	1	44,000
False claim for workers compensation	–	–	1	2,000	–	–
Other	2	12,000	3	6,200	2	43,000
Asset misappropriation – financial						
Lending fraud – false information	–	–	10	50,000	–	–
Credit card fraud	2	2,000	1	1,000	–	–
Asset misappropriation – government						
False claim to evade a liability	1	2,500	–	–	–	–

	Management		Non–management		External parties	
	Incidents	$	Incidents	$	Incidents	$
Asset misappropriation – other						
Theft of telecommunications services	1	200	1	10,000	–	–
Other	–	–	4	15,760	4	12,000
Corruption						
Secret commissions (kickbacks received by employees)	1	2,000	2	1,000	–	–
Bribery (kickbacks paid by the organisation)	–	–	–	–	3	10,000
Diversion of sales	–	–	4	280,000	–	–
Fraudulent statements – non-financial (received)						
Fraudulent employment history/education qualifications	–	–	11	–	–	–
Total	44	$1,737,540	312	$1,012,412	18,313	$1,821,000

Source: KPMG Australia 2010

Appendix D: Summary of all fraud incidents – public sector

	Management		Non-management		External parties	
	Incidents	$	Incidents	$	Incidents	$
Asset misappropriation – cash						
Theft of cash (received)	7	39,710	15	52,180	7	232,100
Theft of cash (incoming)	1	2,000	7	4,000	2	750,000
Asset misappropriation – non cash						
Theft of plant and equipment	–	–	7	260,400	–	–
Theft of inventory	4	750	2	12,400	–	–
Theft of consumables	3	50,000	13	58,000	–	–
Theft of confidential information/business information	1	160,000	–	–	–	–
Theft of intellectual property	1	–	–	–	–	–
Other	–	–	2	9,800	–	–
Asset misappropriation – fraudulent disbursements						
Fraudulent expense claim	6	224,400	3	14,280	1	48,000
Fraudulent use of corporate credit card	8	108,032	12	73,832	1	20,000
False invoicing	5	1,281,600	10	191,520	2	9,998
Payroll fraud	3	36,400	8	251,300	1	3,000
Cheque tampering – change payee, change amount	–	–	2	8,000	–	–
False claim for workers compensation	–	–	1	5,600	–	–
Other	–	–	10	17,702	–	–
Asset misappropriation – financial						
Lending fraud – false information	–	–	–	–	–	–
Credit card fraud	–	–	1	–	1	4,754
Other	–	–	–	–	1	–

	Management		Non-management		External parties	
	Incidents	$	Incidents	$	Incidents	$
Asset misappropriation – government						
False claim for benefit	–	–	22	92,362	4	104,000
False claim to evade a liability	–	–	–	–	–	–
Other	–	–	–	–	2	–
Asset misappropriation – other						
Theft of telecommunications services	4	–	2	800	1	250,000
Theft of electricity/gas	–	–	1	6,000	–	–
Corruption						
Secret commissions (kickbacks received by employees)	3	232,000	1	1,000	–	–
Fraudulent tendering	2	45,000	5	40,000	–	–
Diversion of sales	2	10,800,000	1	200	–	–
Fraudulent statements – financial						
Asset/revenue overstatements	–	–	–	–	1	104,000
Asset/revenue understatements	1	60,000	–	–	–	–
Total	51	$13,039,892	125	$1,099,376	24	$1,525,852

Source: KPMG Australia 2010

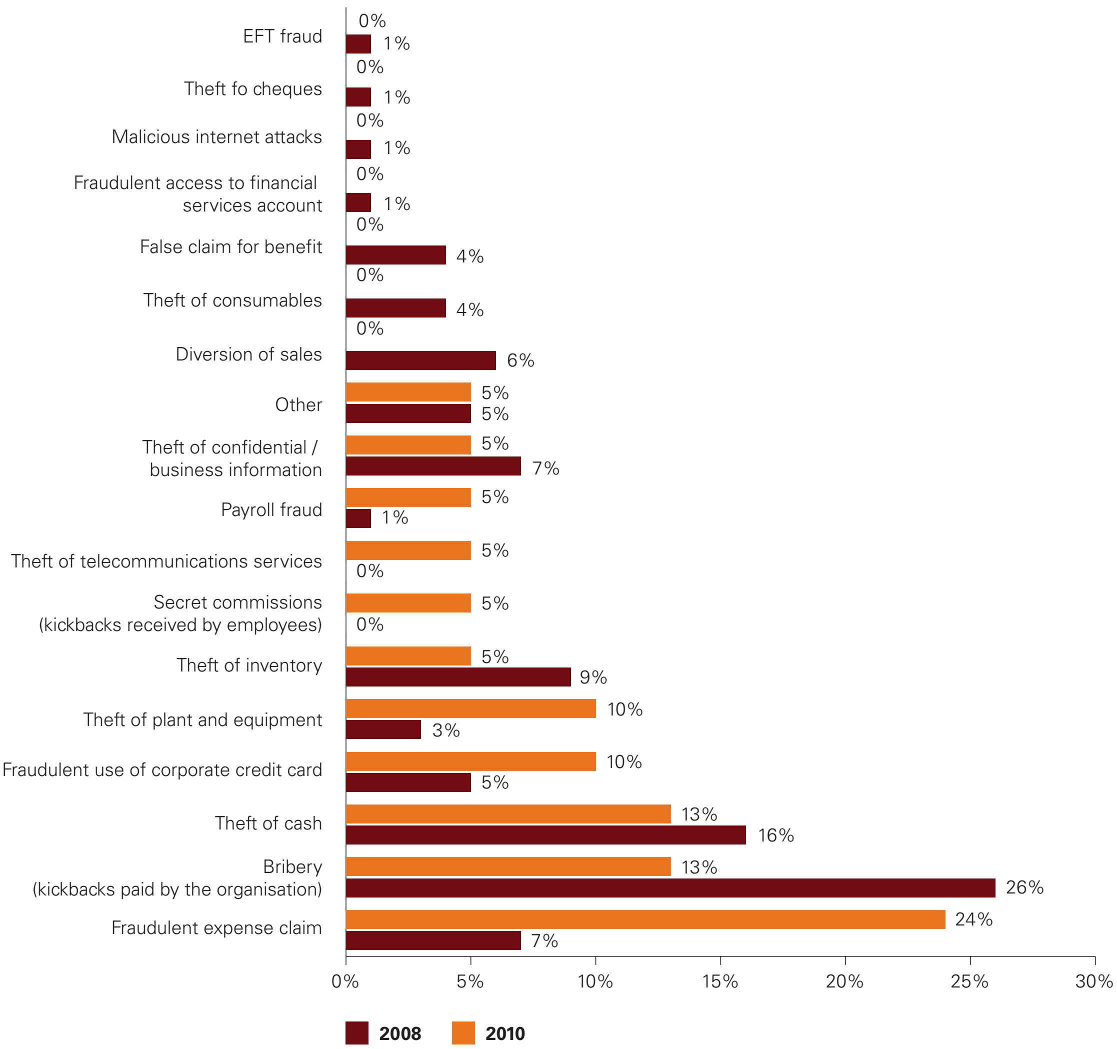
Appendix E: Major frauds by type of fraud

	Number of incidents	Number of incidents (%)	Value of fraud AUD$	Value of fraud (%)	Average Value of fraud ($)
Asset misappropriation – cash					
Theft of cash (received)	18	18	46,587,944	84	2,588,219
Theft of cash (incoming)	7	7	433,100	1	61,871
Asset misappropriation – non cash					
Theft of plant and equipment	8	8	456,000	1	57,000
Theft of inventory	3	3	106,400	0	35,467
Theft of consumables	3	3	43,000	0	14,333
Theft of confidential information/business information	1	1	160,000	0	160,000
Theft of intellectual property	–	–			
Other	3	3	3,303,800	6	1,101,267
Asset misappropriation – fraudulent disbursements					
Fraudulent expense claim	5	5	418,800	1	83,760
Fraudulent use of corporate credit card	3	3	24,672	0	8,224
False invoicing	11	11	2,404,600	4	218,600
Payroll fraud	8	8	298,640	1	37,330
Cheque tampering – change payee, change amount	2	2	60,000	0	30,000
False claim for workers compensation	–	–	–	–	–
Other	8	8	297,000	1	37,125
Asset misappropriation – insurance					
False claim for motor vehicle accident	–	–	–	–	–
False claim for personal insurance	–	–	–	–	–
False claim for general insurance	1	1	70,000	0	70,000
Other	–	–	–	–	–
Asset misappropriation – financial					
Lending fraud – false information	1	1	150,000	0	150,000
Lending fraud – identity fraud	2	2	190,000	0	95,000
Credit card fraud	–	–	–	–	–
Other	2	2	60,575	0	30,288
Asset misappropriation – government		–			
False claim for benefit	2	2	112,997	0	56,498
False claim to evade a liability	1	1	2,500	0	2,500
Other	–	–	–	–	–
Asset misappropriation – other					
Theft of telecommunications services	3	3	260,000	1	86,667
Theft of electricity/gas	–	–	–	–	–
Other	1	1	3,200	0	3,200

	Number of incidents	Number of incidents (%)	Value of fraud AUD$	Value of fraud (%)	Average Value of fraud ($)
Corruption					
Secret commissions (kickbacks received by employees)	3	3	3,000	0	1,000
Bribery (kickbacks paid by the organisation)	1	1	–	–	–
Fraudulent tendering	2	2	60,000	0	30,000
Diversion of sales	1	1	20,000	0	20,000
Fraudulent statements – financial					
Asset/revenue overstatements	1	1	104,000	0	104,000
Asset/revenue understatements	1	1	60,000	0	60,000
Total	102	100	$55,690,228	100	$545,983

Source: KPMG Australia 2010

Appendix F: Frauds occurring in Asia by fraud type



Source: KPMG Australia 2010

Appendix G: Fraud prevention strategies

Prevention	Put in place in the last 2 years	In place for over 2 years	Planned	Not applicable
Perform fraud risk assessments	28%	40%	18%	14%
Develop a fraud control strategy	20%	37%	24%	20%
Focus senior management on fraud risk	25%	43%	19%	13%
Develop a corporate code of conduct/ethics	19%	68%	4%	9%
Conduct fraud awareness training	17%	30%	27%	26%
Review and/or improve internal controls	21%	68%	8%	3%
Conduct pre-employment screening on staff	15%	71%	4%	10%
Perform screening of employees on promotion or transfer to high risk positions or geographic locations	9%	23%	15%	53%
Perform due diligence on suppliers/business partners	14%	45%	12%	29%
Enforce compulsory annual leave	18%	50%	15%	17%
Enforce job rotation	4%	8%	11%	76%
Provide employee support programs	13%	59%	4%	25%
Implement an independent audit committee	7%	70%	4%	18%

Source: KPMG Australia 2010

Appendix H: Fraud detection strategies

Detection	Put in place in the last 2 years	In place for over 2 years	Planned	Not applicable
Perform continuous monitoring/continuous auditing	19%	42%	13%	26%
Perform pro-active data analysis	20%	47%	18%	15%
Implement an internal fraud reporting mechanism	16%	51%	12%	21%
Implement an external fraud reporting mechanism	13%	37%	10%	40%
Allocate internal audit resources to fraud detection	16%	44%	9%	31%
Conduct unannounced audits	12%	43%	10%	36%
Perform fraud stress testing	6%	14%	15%	66%

Source: KPMG Australia 2010

Appendix I: Fraud response strategies

Response	Put in place in the last 2 years	In place for over 2 years	Planned	Not applicable
Implement an investigation policy to respond to fraud	16%	56%	9%	19%
Implement a disciplinary policy to respond to fraud	15%	62%	5%	18%
Establish an internal investigation unit	9%	33%	3%	55%
Implement a policy of reviewing internal controls and policies subsequent to an identified fraud	19%	55%	10%	17%
Implement a police referral policy	12%	57%	11%	20%

Source: KPMG Australia 2010

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ISBN 978-0-7340-4197-5

November 2010. VICN06580FO.