



FORENSIC

Fraud Survey 2006

ADVISORY

Contents

| | |
|---|----|
| Preface | 2 |
| Executive Summary | 4 |
| 1. Fraud in Australia and New Zealand | 7 |
| 1.1 How big is the problem? | 7 |
| 1.2 Who are the perpetrators? | 9 |
| 1.3 Fraud by managers (including directors and senior executives) | 11 |
| 1.4 Fraud by non-management employees | 12 |
| 1.5 Fraud by external parties | 14 |
| 2. Analysis of individual fraud incidents | 15 |
| 2.1 Overview | 15 |
| 2.2 Who are the perpetrators of major fraud? | 17 |
| 2.3 Motivation | 18 |
| 2.4 Collusion | 19 |
| 2.5 How is fraud detected? | 20 |
| 2.6 The delay in detecting fraud | 21 |
| 2.7 The cost of ignoring red flags | 21 |
| 2.8 How much of the proceeds of fraud are recovered? | 22 |
| 2.9 What allowed the fraud to occur? | 24 |
| 2.10 How do organisations respond to fraud incidents? | 24 |
| 2.11 How much does it cost to investigate the fraud? | 26 |
| 2.12 Was there a history of fraud? | 26 |
| 2.13 Misuse of computers and organised crime | 27 |
| 2.14 The typical fraudster – a ‘word picture’ | 27 |
| 3. Identity fraud | 28 |
| 4. Controlling fraud risk | 30 |
| 4.1 What are organisations doing to control fraud risk? | 30 |
| 4.2 Fraud reporting channels | 31 |
| 5. Business ethics | 32 |
| 6. Operations in Asia | 34 |
| 6.1 Current experience | 34 |
| About this survey | 36 |
| Contact us | 38 |
| Contributors | 39 |

Preface

Welcome to KPMG Forensic's 2006 survey of fraud in Australia and New Zealand.

Since 1993 the biennial KPMG *Fraud Survey* has become a credible and widely quoted survey of fraud in Australian business. In 2002 we expanded it to become the only comprehensive survey dealing with fraud in New Zealand. In 2006 we included questions about the fraud experience of Australian and New Zealand organisations operating in Asia.



Since 2003 KPMG Forensic, the University of Queensland and the University of Melbourne have joined forces to investigate the instances, motivations and prevalence of fraud in Australia and New Zealand. We thank, in particular, Dr Larelle Chapple of the University of Queensland, Professor Colin Ferguson of the University of Melbourne and the joint research team for their invaluable support and guidance over many months.

The 2006 survey provides a comprehensive 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
- the conditions that increase the risk of fraud
- how organisations respond to the discovery of fraud
- identity fraud and how organisations respond to it
- the strategies employed by entities to combat fraud
- unethical behaviours common in business and the factors that encourage these behaviours.



For this survey we also enquired into the prevalence of fraud in the Asian operations of Australian and New Zealand organisations. We believe this is one of the first attempts to describe and quantify the incidence of fraud in offshore branches and subsidiaries. The results, whilst not unexpected, provide a benchmark for subsequent surveys.



The KPMG *Fraud Survey 2006* is based on a comprehensive study of fraud across a broad cross-section of the Australian and New Zealand economies. However, our research does not end with this report. We are further analysing the results by industry and by location. Supplementary reports containing the results of these analyses will be released progressively over the next 12 months in our *Forensic Insight* publication.

Moreover, the data captured in the 2006 survey will be used by Professor Ferguson's research team to understand more about how fraud is affecting organisations in Australia and New Zealand.

We express our gratitude to the people and organisations that took the time to respond to the 2006 survey. Without their support this survey 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.



David Van Homrigh
National Managing Partner
KPMG Forensic
Australia



Mark Leishman
Director
KPMG Forensic
New Zealand

Executive Summary

Fraud continues to hit the headlines and the bottom line of organisations in Australia and New Zealand.

Respondents reported over 65,000 separate frauds.

This and other findings set out in KPMG's *Fraud Survey 2006* were derived from the responses to a questionnaire sent in February 2006 to 2,146 of Australia's and New Zealand's largest organisations across the public and private sectors. The questionnaire contained 48 questions. It sought information about fraud incidents within the respondents' business operations during the period April 2004 to January 2006.¹ Usable responses were received from 465 organisations, representing just over 21 percent of the surveys distributed.

Our major findings include the following:

- Forty-seven percent of all respondents experienced at least one fraud during the survey period, which was up marginally from 45 percent reported in 2004.
- Total value of fraud reported was \$154.9 million with an average value for each organisation of \$714,000.
- Respondents reported over 65,000 separate frauds.
- Ninety percent of respondents agreed or strongly agreed that fraud is a governance issue.
- Non-management employees were found to be the group most likely to commit fraud.
- Greed and lifestyle considerations, together with gambling, were the most common motivators of fraud.
- The use of internal controls was the most effective means of detecting fraud. Conversely, poor internal controls were the most important factor contributing to major fraud.
- Seventy-five percent of respondents have a system for anonymous reporting of fraud.
- In 42 percent of major frauds none of the money or goods stolen was recovered.
- Fourteen percent of employees involved in fraudulent conduct had a history of dishonesty with previous employers, up from seven percent in 2004.

In 42 percent of major frauds none of the money or goods stolen was recovered.

¹ Referred to in this report as the 'survey period'.

- Seventeen percent of major frauds involved the use or misuse of computers, computer networks or on-line banking facilities.
- Sixty-one percent of respondents believed identity fraud is a major problem for business.
- Sixty-one percent of respondents who had operations in Asia suffered at least one incident of fraud during the survey period.
- Kickbacks and bribery accounted for 34 percent of reported fraud within Asian operations; within Australia and New Zealand kickbacks and bribery represented less than five percent of the reported frauds.

The total number of fraud incidents reported has increased by over 50% compared to our 2004 survey*, although the monetary value of this fraud was lower. This monetary value decrease was primarily due to the variation in respondents and, in some cases, the way in which they responded.

There have been some interesting changes since our 2004 survey, which indicate that fraud risk management is certainly moving up the strategic agenda, particularly as major frauds have the capacity to damage an organisation's public image, reputation and financial stability.

Consistent with this, organisations are investing more time and resources into the management of fraud with a focus mostly on detection (fraud reporting channels and increased focus by senior management on fraud), rather than prevention and response. This increased focus on detection has seen the average time to detect fraud decrease significantly. Whilst this is a positive development, KPMG considers there is substantial room for improvement. Increased focus on prevention of and response to fraud should also be a priority for organisations, as a holistic approach to fraud risk management can substantially reduce fraud losses.

While there have been improvements in the recovery of the proceeds of fraud, overall the value recovered remains low. This reinforces our belief that increased efforts to strengthen response strategies are required.

A number of worrying trends continue:

- False invoicing and theft of cash and inventory remain the most common frauds for organisations, suggesting that controls over these 'age old' fraud risks are poor.
- The significant increase in the number of frauds committed by persons with a history of dishonesty indicates that organisations are either not performing employee due diligence at all or not performing it adequately.

Sixty-one percent of respondents believed identity fraud is a major problem for business.

Kickbacks and bribery accounted for 34 percent of reported fraud within Asian operations...

...fraud risk management is certainly moving up the strategic agenda...

*After normalising of responses for variations in the manner in which survey participants responded.

Organisations need to continually assess their fraud risk management programs to ensure...the right balance is struck between prevention, detection and response strategies.

- The increase in the manipulation of computer data is indicative of the increased use of IT systems. However, controls over access and changes to computer data appear inadequate.

The survey findings on fraud in Asia confirm that organisations operating in countries where fraud is known to be prevalent need to be aware of issues, such as bribery and kick-backs, and have appropriate policies in place for the ethical conduct of business.

The survey results suggest that organisations need to remain vigilant about fraud. Given that 73 percent of the largest frauds were detected by means under the control of the organisation, the benefits of an integrated approach to fraud detection is apparent. Organisations also need to continually assess their fraud risk management programs to ensure they are appropriately targeted and the right balance is struck between prevention, detection and response strategies.

1. Fraud in Australia and New Zealand

1.1 How big is the problem?

Survey respondents reported 65,074 incidents of fraud during the survey period. The total value of fraud reported (before taking into account associated costs and recoveries) was \$154.9 million. Forty-seven percent of all respondents experienced at least one fraud during the survey period (see Figure 1), up slightly from 2004's 45 percent.

The average value of fraud for each organisation experiencing at least one fraud was over \$700,000. Thirty-four respondents reported single frauds with a value greater than \$200,000 each and there were eight organisations where the value of fraud in the two year period exceeded \$4 million.

Consistent with previous surveys, reported fraud increased proportionately with the size of the organisation. Sixty-five percent of organisations with between 1,000 and 10,000 employees experienced at least one fraud, while 82 percent of respondents employing more than 10,000 people reported at least one incident (see Figure 2). Lower rates of fraud were reported in smaller organisations.

Figure 1 – Respondents experiencing fraud

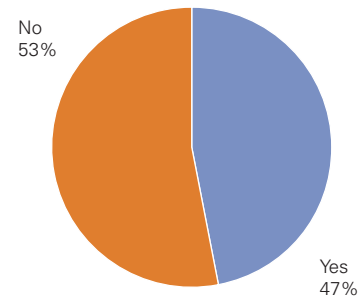
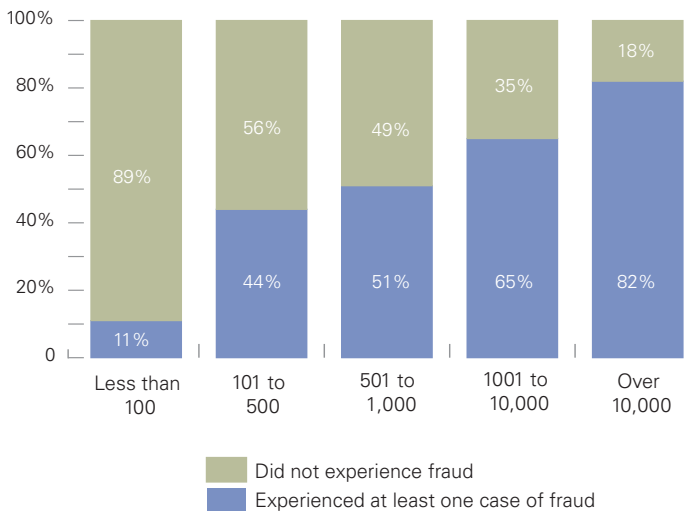


Figure 2 – Respondents experiencing fraud by size (no of employee)



...reported fraud increased proportionately with the size of organisation.

Figure 3 – Number of frauds detected

| Number of frauds detected | Percentage of organisations |
|----------------------------------|------------------------------------|
| 1 | 21% |
| 2 to 10 | 55% |
| 11 to 50 | 14% |
| 51 to 1000 | 7% |
| over 1000 | 3% |
| | 100% |

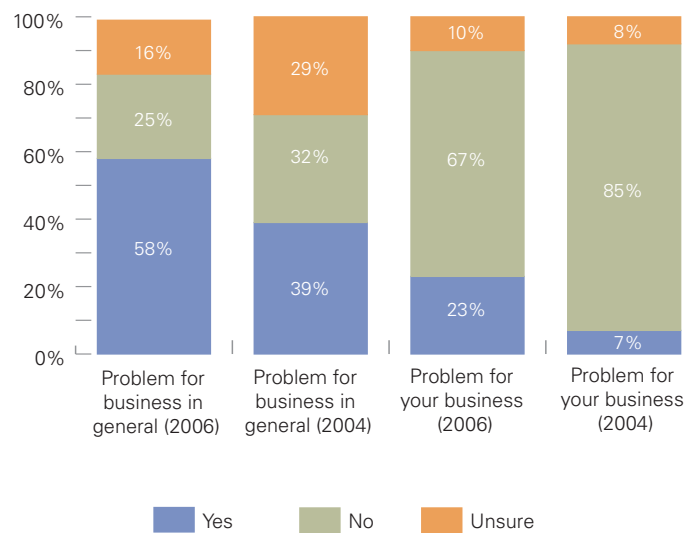
Of the respondents that experienced fraud, 79 percent suffered more than one incident of fraud (see Figure 3). Three percent reported more than 1,000 incidents each!

In 2006 respondents appeared more aware of the fraud problem. Fifty-eight percent of them believed that fraud was a major problem for business generally (see Figure 4), a significant increase on the 39 percent that said this in 2004.

Twenty-three percent of respondents believe that fraud was a major problem for their own organisations, which was more than triple the seven percent that said this in 2004.

Fifty-eight percent of respondents believed that fraud was a major problem for business generally...

Figure 4 – Perceptions of whether fraud is a major problem



1.2 Who are the perpetrators?

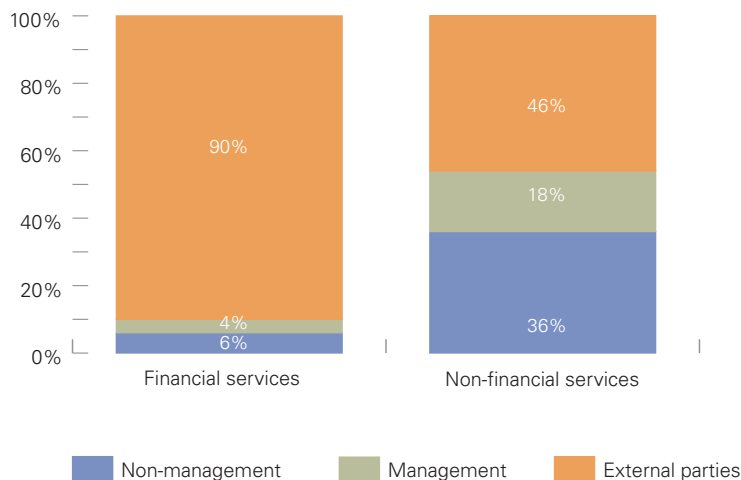
Consistent with the findings of our previous surveys, the latest survey confirms that internal fraud occurs more frequently than external fraud. The financial services sector is an exception to this finding, reporting a far higher incidence of externally instigated fraud.

The survey considered the extent and financial impact of frauds committed by three categories of perpetrator:

- managers (including senior executives and directors)
- non-management employees
- external parties.

The overall result of this analysis is set out at Figure 5. It shows the value of reported fraud across the three perpetrator categories, both for the financial services and the non-financial services sectors. We have separated financial services to avoid distorting the overall results, given the prevalence of external fraud.

Figure 5 – Breakdown of fraud by perpetrators by value



...externally instigated fraud accounted for a majority of frauds in the financial services sector...

As expected, externally instigated fraud accounted for a majority of frauds in the financial services sector – in 2006 externally instigated fraud accounted for 90 percent of the value of reported fraud in the financial services sector.

External frauds represented a higher average value per organisation than internal frauds.

For respondents generally, excluding those in the financial services sector, 54 percent of the fraud was perpetrated internally. Fraud instigated by management level personnel (including senior executives and directors) accounted for 18 percent of the total reported fraud value, while non-management level personnel accounted for 36 percent. Forty-six percent of the total reported fraud resulted from frauds committed by outsiders.

Figure 6 shows the average value associated with frauds committed by the three perpetrator types for the financial services and non-financial services sectors. External frauds represented a higher average value per organisation than internal frauds. It is noteworthy, however that management fraud represents the highest average value per incident.

Figure 6 – Average value associated with fraud by perpetrator type

| Perpetrator | Financial services | | Non-financial services | |
|-------------------------|-------------------------------------|--|-------------------------------------|--|
| | Average value per fraud (\$) | Average value per organisation (\$) | Average value per fraud (\$) | Average value per organisation (\$) |
| External | 5,647 | 1,825,975 | 779 | 188,308 |
| Manager | 109,853 | 83,835 | 16,025 | 75,859 |
| Non-management employee | 3,928 | 118,761 | 4,072 | 146,647 |

The following three sections contain a more detailed analysis of the types of fraud reported for each of the three perpetrator categories across the financial services and non-financial services sectors.

1.3 Fraud by managers (including directors and senior executives)

Within the financial services sector, the most costly fraud committed by management level personnel was lending fraud, representing 43 percent of the total (see Figure 7). This was followed by theft of cash at 35 percent and fraudulent expense claims at 13 percent.

Within the non-financial services sector, the most costly fraud associated with managers was false invoicing, representing 31 percent of the fraud value (see Figure 8). Theft of inventory followed, representing 21 percent of the total value.

Within the financial services sector, the most costly fraud committed by management level personnel was lending fraud...

Within the non-financial services sector, the most costly fraud associated with managers was false invoicing...

Figure 7 – Value of fraud by management in financial services sector

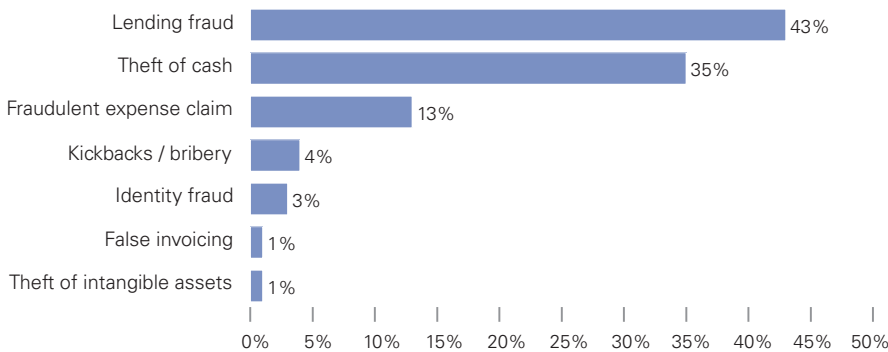
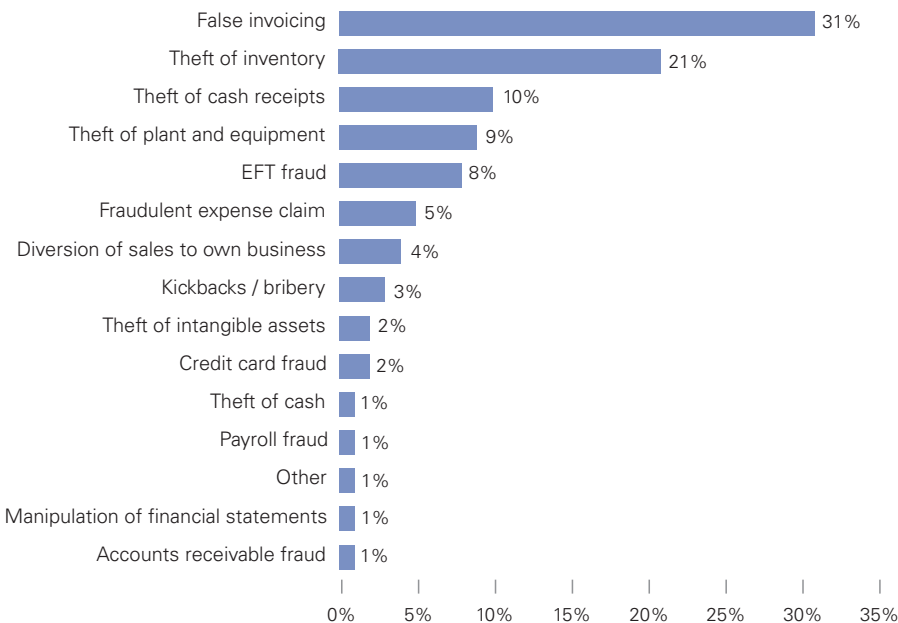


Figure 8 – Value of fraud by management in non-financial services sector



Within the financial services sector, false invoicing accounted for 22 percent of the total value of non-management fraud...

1.4 Fraud by non-management employees

Within the financial services sector, false invoicing accounted for 22 percent of the total value of non-management fraud (see Figure 9). This was followed by theft of intangible assets (20 percent) and theft of cash (18 percent).

Within the non-financial services sector, the most significant type of fraud committed by non-management employees was the theft of cash at 29 percent (see Figure 10). This was followed by theft of inventory at 20 percent and unauthorised manipulation of computer data at 17 percent, highlighting the need for effective controls over physical assets and electronic information systems.

Figure 9 – Value of fraud by non-management in financial services sector

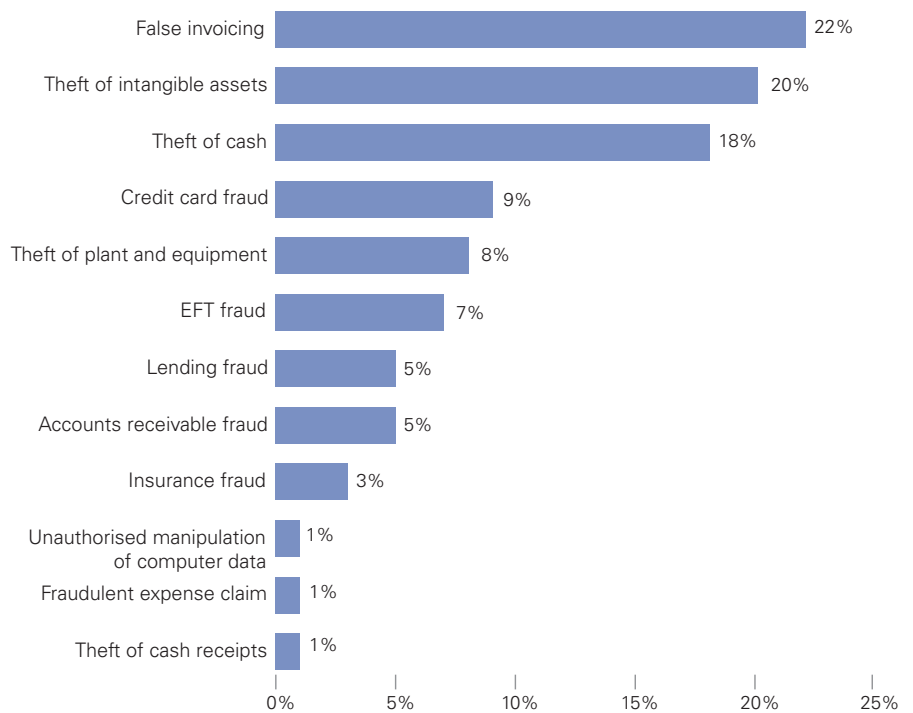
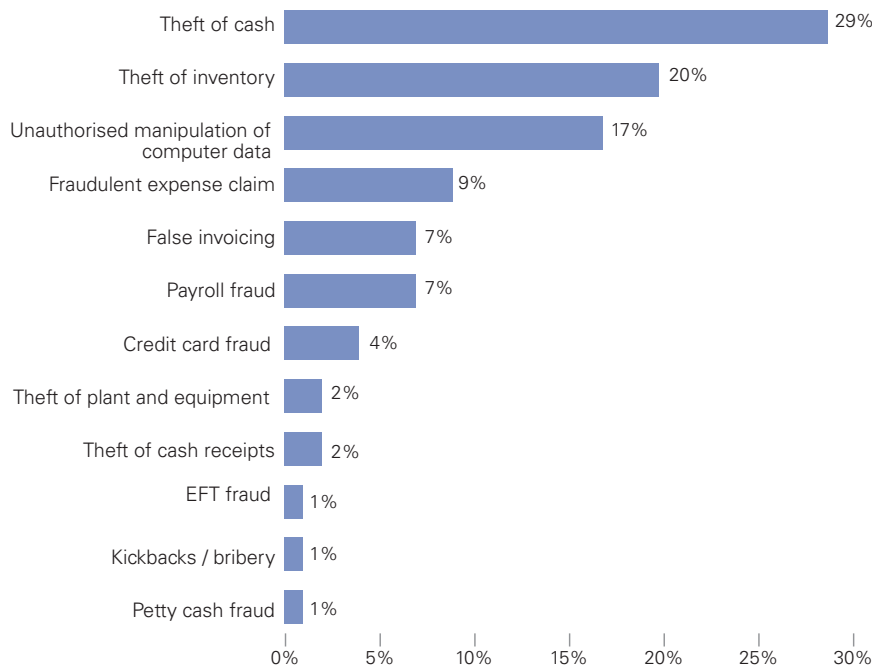


Figure 10 – Value of fraud by non-management in non-financial services sector



Within the non-financial services sector, the most significant type of fraud committed by non-management employees was the theft of cash...

Within the financial services sector, insurance fraud accounted for 52 percent of the value of fraud attributable to external parties.

1.5 Fraud by external parties

Within the financial services sector, insurance fraud accounted for 52 percent of the value of fraud attributable to external parties. Benefit fraud (e.g. fraudulent application for the release of a superannuation benefit) accounted for 16 percent of the total value attributable to external parties (see Figure 11).

Within the non-financial services sector, theft of inventory was the most costly form of fraud, accounting for 47 percent (see Figure 12).

Within the non-financial services sector, theft of inventory was the most costly form of fraud...

Figure 11 – Value of fraud by external parties in financial services sector

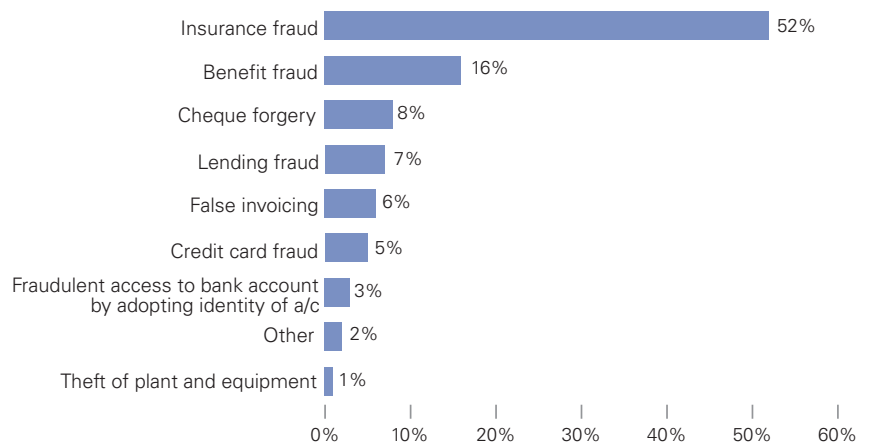
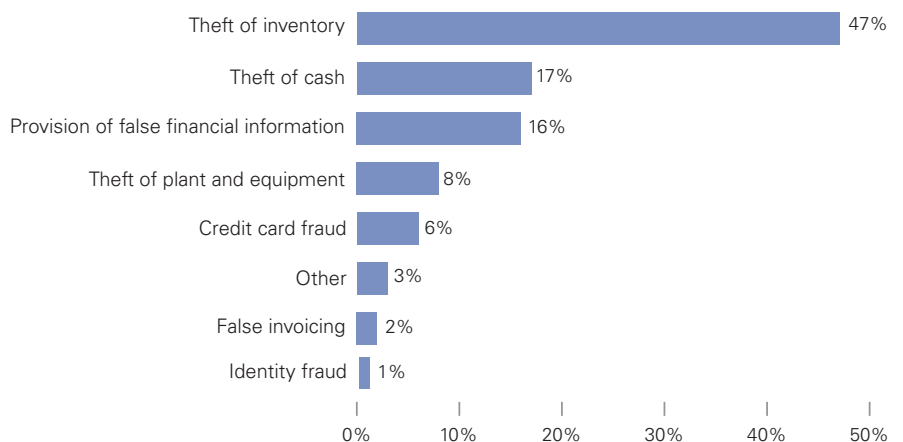


Figure 12 – Value of fraud by external parties in non-financial services sector



2. Analysis of individual fraud incidents

2.1 Overview

To better understand the effects of fraud, the factors that contribute to it and the ways in which it is detected and dealt with, we asked organisations to tell us more about the largest single fraud they detected during the survey period.

Respondents nominated the type, value and perpetrator(s) of their largest fraud. They answered a number of questions about the circumstances of this fraud, including:

- the type of fraud
- the loss incurred
- the perpetrators
- factors contributing to the fraud
- how the fraud was detected
- whether there was any recovery of the funds
- whether the matter was reported to the police.

In cases where frauds involved internal parties, respondents were asked to provide additional details about the perpetrators including:

- gender
- age
- employment position
- length of service within the organisation prior to the fraud occurring
- duration of service in current position at the time of committing the fraud
- motivation for the fraud
- the period of time that elapsed before the fraud was discovered
- whether the internal perpetrators had a known history of dishonest conduct.

We also captured information about whether or not the fraud involved collusion with other persons (internal or external to the organisation).

We received 196 usable questionnaires providing details of an individual fraud. They are summarised by type in Figure 13, showing also the average value attributable to each fraud type.

Figure 13 – Summary of major fraud incidents

| <i>Fraud types</i> | <i>Number of frauds</i> | <i>Number of frauds (%)</i> | <i>Total value of fraud (\$)</i> | <i>Total value of fraud (%)</i> | <i>Average value of fraud (\$)</i> |
|---|-------------------------|-----------------------------|----------------------------------|---------------------------------|------------------------------------|
| False invoicing | 26 | 13% | 9,921,127 | 26% | 381,582 |
| Theft of cash | 24 | 12% | 6,400,553 | 17% | 266,690 |
| Theft of inventory (held for resale) | 21 | 11% | 2,124,663 | 6% | 101,174 |
| Payroll fraud | 19 | 10% | 1,996,444 | 5% | 105,076 |
| Theft of plant and equipment | 14 | 7% | 197,918 | 1% | 14,137 |
| Fraudulent use of corporate issued credit card | 13 | 7% | 2,147,913 | 6% | 165,224 |
| Fraudulent expense claim | 9 | 5% | 1,868,500 | 5% | 207,611 |
| Theft of cash receipts | 8 | 4% | 681,487 | 2% | 85,186 |
| Electronic Funds Transfer fraud | 7 | 4% | 729,144 | 2% | 104,163 |
| Other | 7 | 4% | 191,307 | 0% | 27,330 |
| Credit card fraud (cardholder fraud) | 6 | 3% | 2,215,792 | 6% | 369,299 |
| Accounts receivable fraud | 6 | 3% | 330,000 | 1% | 55,000 |
| Theft of inventory (not held for resale) | 6 | 3% | 198,036 | 1% | 33,006 |
| Kickbacks / bribery (receiving) | 5 | 3% | 277,300 | 1% | 55,460 |
| Cheque fraud | 5 | 3% | 123,500 | 0% | 24,700 |
| Lending fraud | 4 | 2% | 1,063,599 | 3% | 265,900 |
| Diversion of sales to own business | 3 | 2% | 1,450,000 | 4% | 483,333 |
| Petty cash fraud | 3 | 2% | 30,800 | 0% | 10,267 |
| Fraudulent access to a bank account by adopting the identity of the account holder (does not involve use of the internet) | 2 | 1% | 765,500 | 2% | 382,750 |
| Benefit fraud | 2 | 1% | 652,721 | 2% | 326,361 |
| Insurance fraud (claims) | 2 | 1% | 31,000 | 0% | 15,500 |
| Provision of fraudulent financial information | 1 | 1% | 5,000,000 | 13% | 5,000,000 |
| Manipulation of financial information | 1 | 1% | 137,680 | 0% | 137,680 |
| Fraudulent access to a bank account by adopting the identity of the account holder via 'phishing' attacks over the internet | 1 | 1% | 17,000 | 0% | 17,000 |
| Credit card fraud (merchant fraud) | 1 | 1% | 9,500 | 0% | 9,500 |
| Total/Average | 196 | 100% | 38,561,485 | 100% | 196,742 |

The most common type of fraud by number of events was false invoicing.

The most common type of fraud by number of events was false invoicing. It involved 26 frauds, or 13 percent of cases. This was closely followed by theft of cash, which figured in 24 instances, or 12 percent of all the reported major frauds. False invoicing also accounted for the highest total value of fraud at \$9.9 million, equivalent to 26 percent of value, followed by theft of cash at 17 percent.

Sections 2.2 to 2.14 below outline the findings of our research into the largest single cases of fraud reported.

2.2 Who are the perpetrators of major fraud?

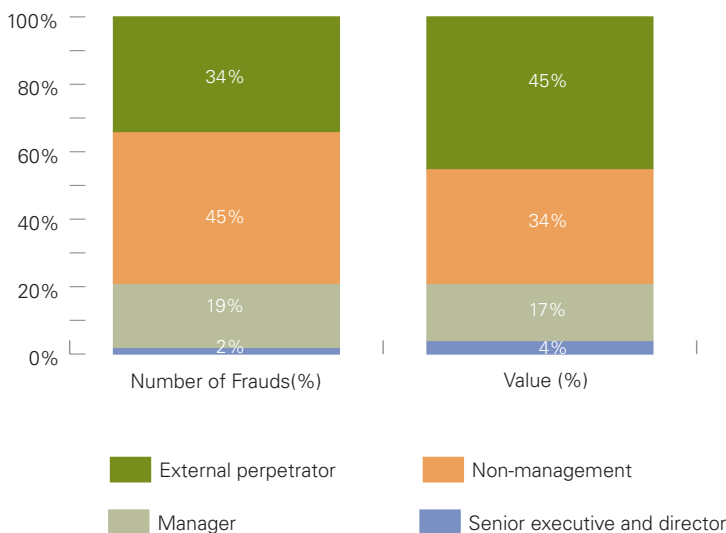
The survey shows that Australian and New Zealand business is vulnerable to fraudulent attack at the hands of people within their organisations as well as from outsiders, including organised crime and opportunistic criminals acting alone.

The most likely perpetrators of major fraud were people working within the organisation.

The survey categorised the frequency and proportionate value of fraud committed against the respondent organisations into four perpetrator categories: directors and senior executives, management, non-management employees and external parties.

Figure 14 summarises the impact of fraud categorised by perpetrator type.

Figure 14 – Major fraud committed by known perpetrator



The most likely perpetrators identified in the 2006 survey were people working within the organisation. The frauds they were responsible for accounted for 66 percent by number and 55 percent by value.

Figure 15 shows the average value of the major frauds categorised by perpetrator type. (Note that where more than one perpetrator type was associated with a single fraud, the total value has been allocated evenly over all known perpetrators.)

Figure 15 – Major fraud committed by known perpetrator

| <i>Perpetrator</i> | <i>Number of frauds</i> | <i>Number of frauds (%)</i> | <i>Total value (\$)</i> | <i>Total value (%)</i> | <i>Average value of each fraud (\$)</i> |
|-------------------------------|-------------------------|-----------------------------|-------------------------|------------------------|---|
| Senior executive and director | 3 | 2% | 1,347,680 | 4% | 449,227 |
| Manager | 31 | 19% | 6,496,767 | 17% | 209,573 |
| Non-management | 72 | 45% | 12,896,191 | 34% | 179,114 |
| External perpetrator | 54 | 34% | 16,843,678 | 45% | 311,920 |
| Total (\$) | 160 | 100% | 37,584,317 | 100% | 234,902 |

Whilst external perpetrators were responsible for the highest total value of fraud (nearly \$17 million), senior executives and directors were responsible for the highest average value of fraud (\$449,227).

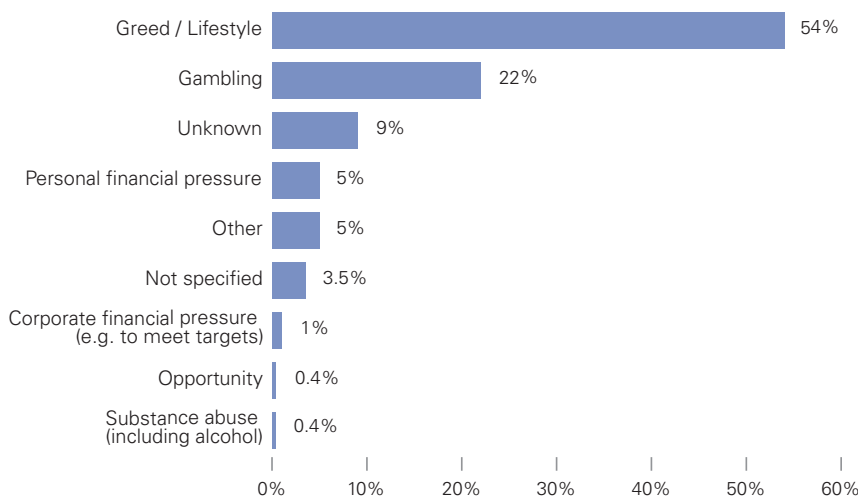
...senior executives and directors were responsible for the highest average value of fraud.

2.3 Motivation

Three factors are present when fraud occurs: motivation, rationalisation (justification by the individual of the fraudulent activity) and opportunity (which is often a function of poor internal controls). It is not clear from the survey whether motivation precedes the recognition of the opportunity, however our experience suggests that motivation is certainly the reason for the continuation of fraudulent activity.

Figure 16 shows the value of fraud associated with the various motives for fraud.

Figure 16 – Value of major fraud by internal perpetrator motivation



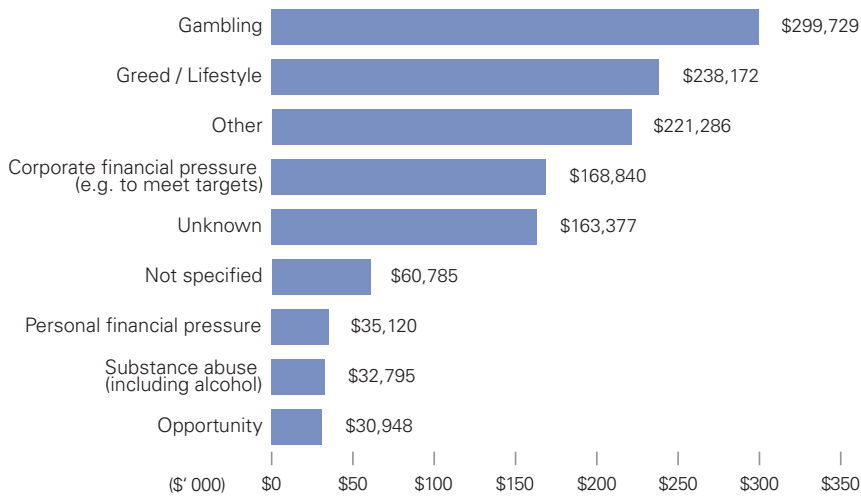
The most common motive for fraud... was greed and lifestyle.

The most common motive for fraud, measured by the value of the fraud committed, was greed and lifestyle. Fifty-four percent of the total value of fraud was attributed to this motive without any apparent more specific motive. The second most prevalent motive observed was gambling, which accounted for 22 percent.

It is revealing to consider the average value of fraud associated with the various fraud motivators. Figure 17 shows the average value associated with all frauds where a motive was determined. Gambling as a motive resulted in an average value per incident of \$299,729, followed by greed, which resulted in a value per incident of \$238,172.

The highest average, value of major fraud by motive was gambling.

Figure 17 – Average value of major fraud by motivation



Of the frauds motivated by gambling, electronic gaming machines had the highest average value of \$1.4 million. This is in contrast with 2004, when casino gambling had the highest average value (\$1.1 million). In 2006, fraud originating from casino gambling motivations had an average value of \$17,836; whilst racing had an average value of \$55,950.

2.4 Collusion

The survey found that employees who committed fraud usually acted alone (73 percent of cases), but occasionally they would collude with parties internal and / or external to the organisation (see Figure 18).

Figure 18 – Internal fraud involving collusion

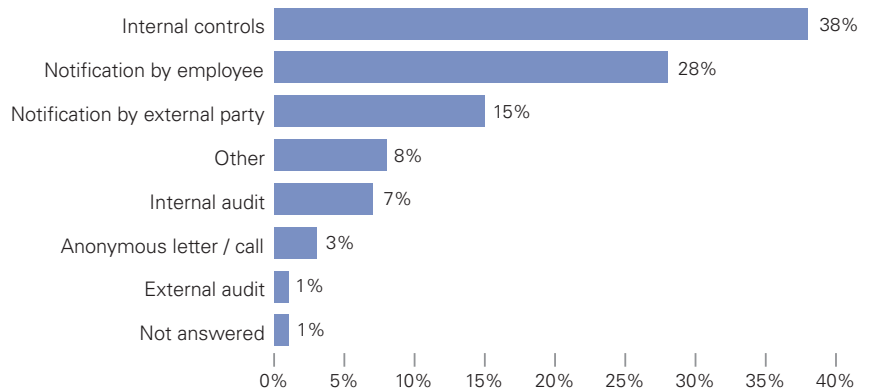
| | |
|---|-----|
| Acted alone | 73% |
| Colluded with internal party | 11% |
| Colluded with external party | 14% |
| Colluded with external and internal party | 2% |

Internal control was the most common method by which respondents detected their largest fraud.

2.5 How is fraud detected?

Internal control was the most common method by which respondents detected their largest fraud (38 percent of cases – see Figure 19). This was followed by notification by employees (28 percent of cases). It was significant that in 15 percent of cases, the largest single fraud was detected as a result of notification by an external party. This suggests that a comprehensive fraud control program should include appropriate avenues allowing internal and external parties to report allegations or suspicions of fraud.

Figure 19 – Detection of largest fraud



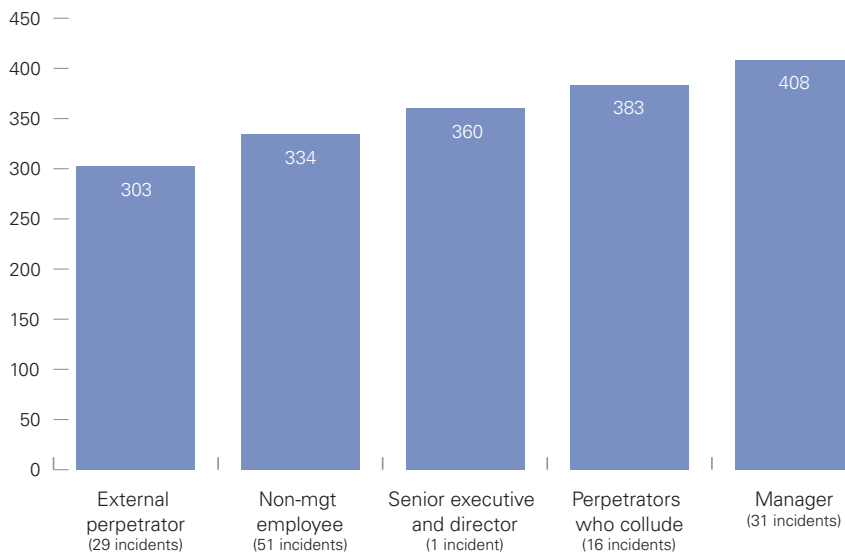
Seventy three percent of the largest frauds were detected by means under the control of the organisation (internal controls, notification by employee and internal audit).

Seventy-three percent of the largest frauds were detected by means under the control of the organisation (internal controls, notification by employee and internal audit). This highlights the benefit of integrating comprehensive fraud detection measures into an organisation’s fraud risk management strategy.

2.6 The delay in detecting fraud

Figure 20 shows the average period that fraud continued before detection, ranked by perpetrator category.

Figure 20 – Average time to discovery of largest fraud (days)



The 2006 survey showed a reduction in the time taken to identify fraud within organisations. In 2006 the average time to detect was 362 days compared with 456 days in 2004. This significant reduction may be due to increased focus by senior management on fraud and in the number of respondents with anonymous fraud reporting hotlines (see Section 4).

Perpetrators with the longest ‘period to detect’ were management employees. Their average time to discovery was 408 days. Fraud perpetrated by internal perpetrators who colluded took an average 383 days to detect. Figure 22 shows an analysis of the value of fraud associated with failing to recognise or act on ‘red flags’.

2.7 The cost of ignoring red flags

‘Red flags’ are early warning signs or indicators of possible fraud. In 31 percent of cases, respondents indicated that relevant warning signs were ignored by the organisation (see Figure 21).

The information set out at Figure 22 describes the nature of early warning signs, symptoms or red flags that were overlooked or ignored, as described by respondents. The value associated with each incident is given together with the time-to-detect for each incident. Significantly, it took more than a year to detect many of these frauds.

The 2006 survey showed a reduction in the time taken to identify fraud within organisations.

Figure 21 – Respondents indicating early warning signs were ignored

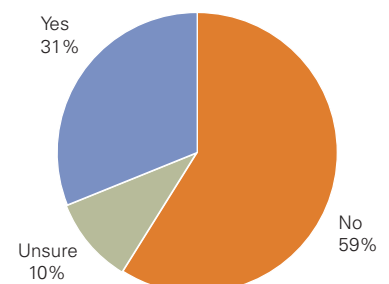


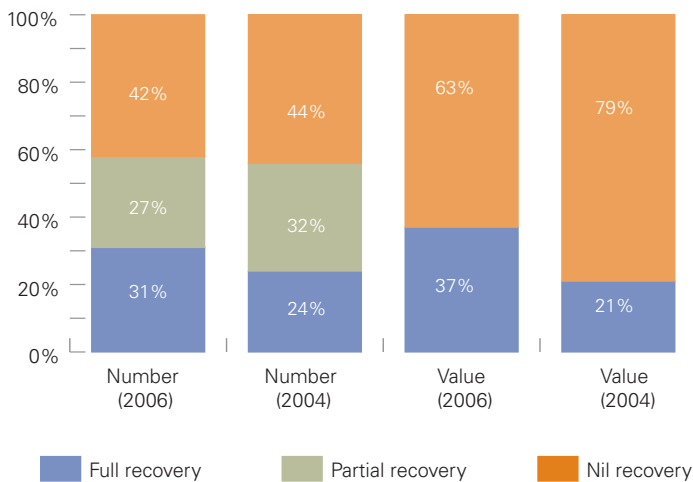
Figure 22 – Value of fraud and delay where early warning signs were ignored

| Red flags | Value (\$) | Time to detect (days) |
|---|-------------------|------------------------------|
| Refusing to take annual leave and known to be gambling | 5,200,000 | 1,459 |
| Previous criminal record but not declared | 5,000,000 | 91 |
| Alteration of customer details | 2,100,000 | 30 |
| Funds paid into foreign bank accounts | 700,000 | 23 |
| Complaint of potential misconduct | 500,000 | 304 |
| Level of activity devoted to developing this account but no reward to the company | 500,000 | 182 |
| Lack of adequate procedures for type of business | 350,000 | 1,094 |
| Exception reports which highlighted the fraudulent transactions were ignored | 275,361 | 304 |
| Accounts not reconciling | 250,000 | 1,824 |
| Reject rates in production area too high when benchmarked internally | 250,000 | 1,459 |
| Living beyond means | 250,000 | 30 |
| Revenue down on budget | 230,000 | 608 |
| Breaches of banking policy which were identified but explained away | 200,340 | 547 |
| Rejection of previous claims | 137,680 | 122 |
| Large overspends | 110,000 | 365 |
| Reports of suspicious behaviour by employees | 92,000 | 365 |
| Gambling problem | 91,000 | 91 |
| Working unusually long hours | 70,000 | 61 |
| Cash deficiencies | 70,000 | 1,459 |
| Marriage problems | 60,000 | 274 |
| Working unsupervised after hours | 50,000 | 182 |
| Accounting discrepancies | 50,000 | 365 |
| Expense claim abnormalities and missing receipts, affluent lifestyle, travel insurance claims | 45,893 | 91 |
| Lack of supporting documentation | 45,000 | 730 |
| Large number of unallocated transactions | 40,000 | 365 |
| Theft of receipt data and non-submission of reports | 40,000 | 365 |
| Remote site, costings not followed up promptly to investigate variances | 40,000 | 547 |
| Items not reconciling against bank account | 33,000 | 30 |
| Previous break-ins | 30,000 | 1 |
| The perpetrator was middle aged but had no credit history | 27,536 | 61 |
| Allegations by an external whistleblower | 25,000 | 1 |
| Reported to senior management | 25,000 | 547 |

2.8 How much of the proceeds of fraud are recovered?

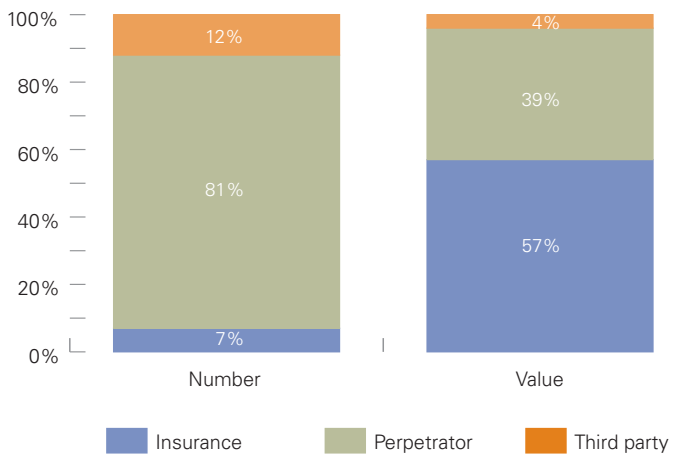
Figure 23 shows that in 42 percent of the number of fraud cases there was no recovery. In terms of value of fraud reported, only 37 percent was recovered or considered likely to be recovered. Figure 24 shows that of these recovered funds, 39 percent was recovered from the perpetrator, four percent from third parties and 57 percent from insurance claims.

Figure 23 – Number of cases where full or partial recovery is made and proportion of value recovered



...in 42 percent of the number of fraud cases there was no recovery.

Figure 24 – Source of funds where recovery is made



Compared with our 2004 results, there was an increase in the number and value of recoveries and a significant increase in recovery from insurance. The recovery rates, however, remained low suggesting that fraud response strategies, including fidelity guarantee insurance, still requires attention.

In the 2006 survey, for the first time, we asked what costs were incurred in recovering or attempting to recover losses. According to our respondents, on average 10 percent of value of the fraud was incurred to recover funds and/or property lost.

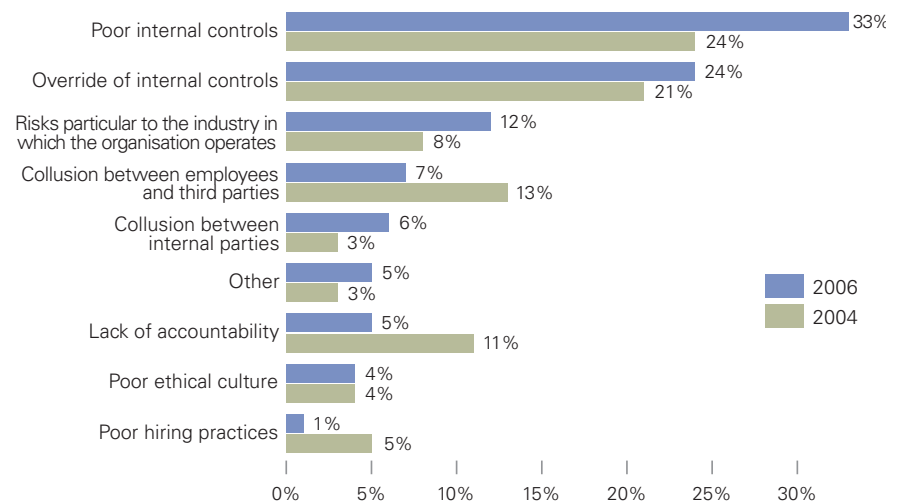
...the major factors allowing fraud to occur were the overriding of internal controls or poor internal controls.

2.9 What allowed the fraud to occur?

Effective internal control is crucial to preventing and detecting fraud.

The responses to our latest survey indicated that the major factors allowing fraud to occur were the overriding of internal controls or poor internal controls. These two factors combined represented 57 percent of frauds reported (see Figure 25). This finding is consistent with all KPMG fraud surveys since 1993. It is clear that there is a very strong nexus between fraud and internal control weakness or failure.

Figure 25 – Factors contributing to largest fraud incident

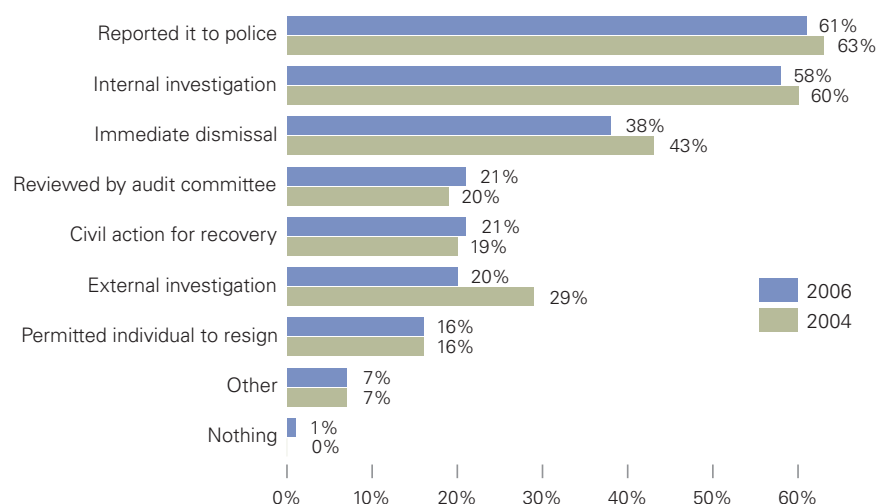


2.10 How do organisations respond to fraud incidents?

When fraud is detected, the response varies according to how well prepared the organisation is for the event, i.e. appropriate fraud response strategies have been designed and implemented.

Figure 26 shows how organisations responded to a major fraud incident. The 2006 responses are shown compared with the equivalent responses from the 2004 survey. The results were remarkably consistent across the two surveys e.g., 61 percent of cases in the 2006 survey were reported to the police compared with 63 percent in 2004.

Figure 26 – Action taken concerning major fraud incident



Organisations quoted ‘lack of evidence’ as their main reasons for not reporting matters to the police (see Figure 27), suggesting that more attention should be paid to investigating fraud incidents. It also seems significant that 17 percent of the respondents did not report the matter as it was considered of a ‘minor’ nature. Thirteen percent of the respondents also indicated that they did not report the matter as they were concerned about the resources required to prepare the complaint.

Figure 27 – Reasons for failing to report major fraud incident to police

Reasons for not reporting to the police

| | |
|---|-----|
| Lack of evidence | 30% |
| Minor incident | 17% |
| Concern about the resources required to prepare the organisations complaint | 13% |
| Concern about adverse publicity | 6% |
| Money was refunded | 5% |
| Believed no progress will be made if reported | 5% |
| Matter still in progress | 2% |
| Other | 23% |

2.11 How much does it cost to investigate the fraud?

In the 2006 survey, for the first time, we asked what costs were incurred in investigating the largest fraud incident. We found that, on average, 25 percent of the value of fraud was incurred in investigating the largest fraud.

2.12 Was there a history of fraud?

Our research showed that 14 percent of employees who were involved in fraudulent conduct during the survey period had a history of dishonesty with a previous employer. This is an increase from 2004 when seven percent of employees were reported as having a prior history of dishonesty.

The chart at Figure 28 shows a breakdown of persons with a history of dishonesty committing internal fraud split between managers and non-managers. Seventy one percent of these prior offenders were non-management-level employees.

The fraud most commonly associated with a history of dishonesty in previous employment was theft of inventory and false invoicing. Each of these fraud types accounted for 22 percent of cases (see Figure 29).

Figure 28 – Positions held by prior offenders in largest fraud incident

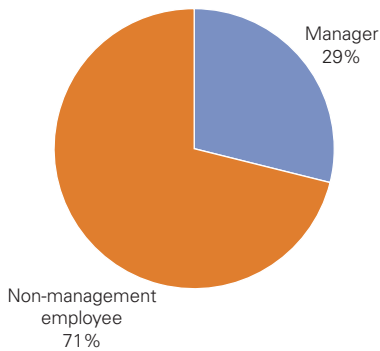


Figure 29 – Fraud by prior offenders by fraud type

| Fraud type | Prior offenders (%) | Total value (\$) | Average value (\$) |
|--|----------------------------|-------------------------|---------------------------|
| Provision of fraudulent financial information | 6% | 5,000,000 | 5,000,000 |
| Theft of inventory (held for resale) | 22% | 820,893 | 205,223 |
| False invoicing | 22% | 478,934 | 119,734 |
| Theft of cash | 6% | 100,000 | 100,000 |
| Electronic funds transfer fraud | 11% | 182,000 | 91,000 |
| Kickbacks / bribery (receiving) | 6% | 70,000 | 70,000 |
| Cheque fraud | 6% | 35,000 | 35,000 |
| Payroll fraud | 11% | 34,500 | 17,250 |
| Fraudulent use of corporate issued credit card | 6% | 2,763 | 2,763 |
| Other | 6% | 578 | 578 |
| Total / Average | 100% | \$6,724,669 | \$373,593 |

The average value of frauds perpetrated by re-offenders was \$373,593, significantly higher than the average value of fraud overall (see Figure 15). This experience reinforces the value of making pre-employment screening a standard part of the hiring process.

2.13 Misuse of computers and organised crime

For the first time, we asked respondents to indicate whether their major fraud incident involved use or misuse of computers, or involved organised criminal groups. Interestingly, 17 percent of the major frauds involved misuse of computers, computer networks or online banking and six percent involved organised crime.

These findings demonstrate the importance of IT-related controls and the fact that organisations in Australia and New Zealand are susceptible to organised crime.

2.14 The typical fraudster – a ‘word picture’

Using the most common response, or in appropriate cases, the ‘average’ response, to the questions dealing with major fraud, we have developed a profile of the ‘typical fraudster’.

The typical fraudster in the survey period exhibited the following characteristics.

- The offender was a non-management employee of the victim organisation with no known history of dishonesty.
- A male aged 38 years acting alone.
- Employed by the organisation for a period of five years and had held his current position for three years at the time of detection.
- Motivated by greed, misappropriating funds to an average value of \$219,707.
- Detected by the organisation's internal controls 12 months after the commencement of the fraud, leading to the organisation recovering 36 per cent of the proceeds of the fraud.

This profile is largely consistent with our 2004 survey.

3. Identity fraud

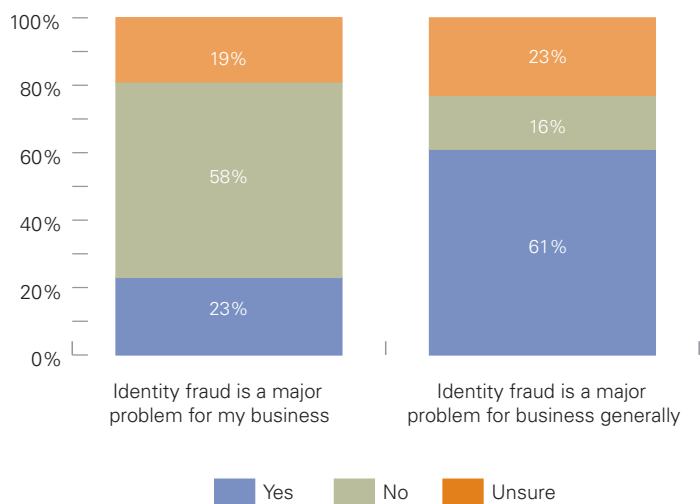
The most common form of identity fraud...was obtaining loans by means of a falsified identity.

Identity fraud has been a pervasive development over recent years.

The most common form of identity fraud reported by respondents in 2006 was obtaining loans by means of a falsified identity. Respondents reported 546 cases of this kind of fraud with total value of over \$2.8 million.

We asked respondents about their perception of identity fraud and whether it is considered a major problem. Their responses are summarised in Figure 30.

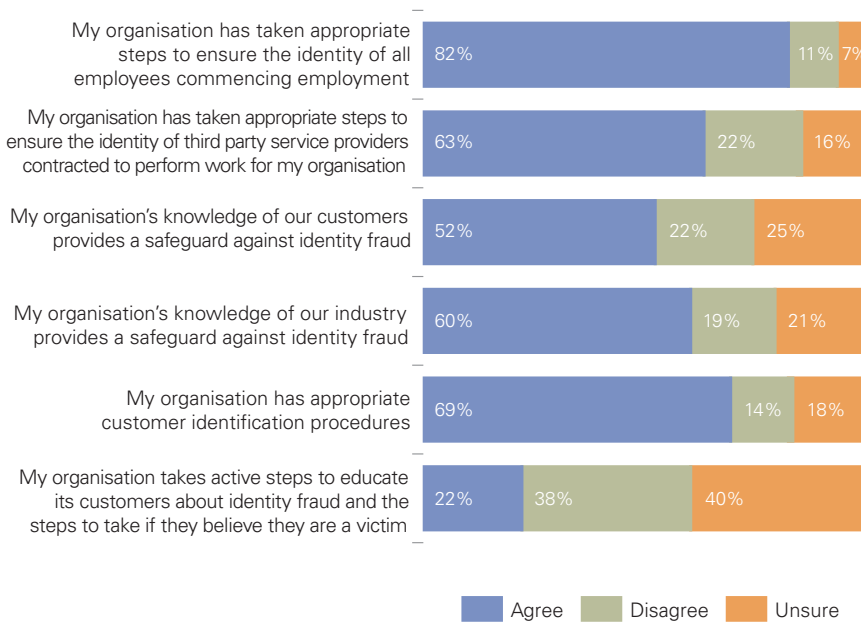
Figure 30 – Perceptions of identity fraud as a problem



Twenty-three percent of this year’s respondents believed that identity fraud was a major problem for their business. Sixty-one percent believed that identity fraud was a major problem for business generally. This response conforms to a pattern noted in earlier surveys whereby respondents recognise risks as they apply to other people’s organisations, but rate them less seriously when it comes to their own organisations.

In response to the emerging risk of identity fraud, organisations have generally implemented strategies to mitigate the problem. It is apparent that more needs to be done by organisations in educating their customers about identity fraud. Figure 31 summarises the steps respondents have taken to deal with identity fraud.

Figure 31 – Mitigating identity fraud



4. Controlling fraud risk

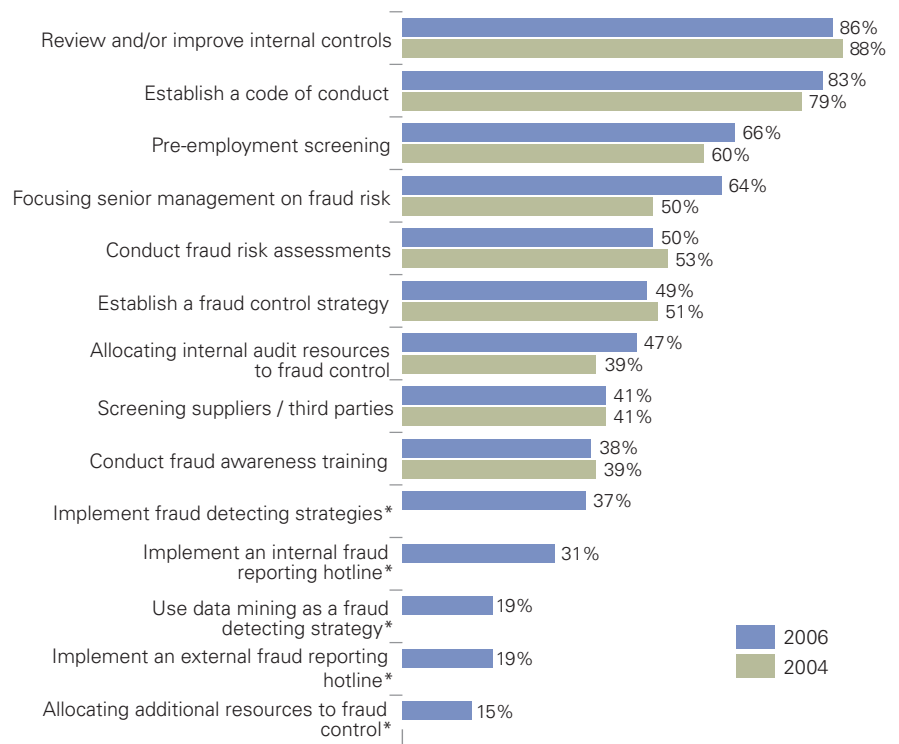
...91 percent of respondents agreed or strongly agreed with the proposition that fraud control was a governance issue.

An overwhelming 91 percent of respondents agreed or strongly agreed with the proposition that fraud control was a governance issue. This result compared with the 84 percent of respondents that agreed with this proposition in the 2004 survey.

4.1 What are organisations doing to control fraud risk?

The survey asked recipients to identify the steps taken, or intended to be taken, by their organisations to reduce the risk of fraud. The results are set out in Figure 32.

Figure 32 – Steps taken to reduce risk of fraud in organisations



...respondents had increased the focus of their senior management on fraud risk...

* This option was not listed in 2004 survey.

The most significant initiative taken to reduce the risk of fraud was the review of internal controls (86 percent of respondents). Establishing a code of conduct was also seen to be an important fraud reduction initiative (83 percent).

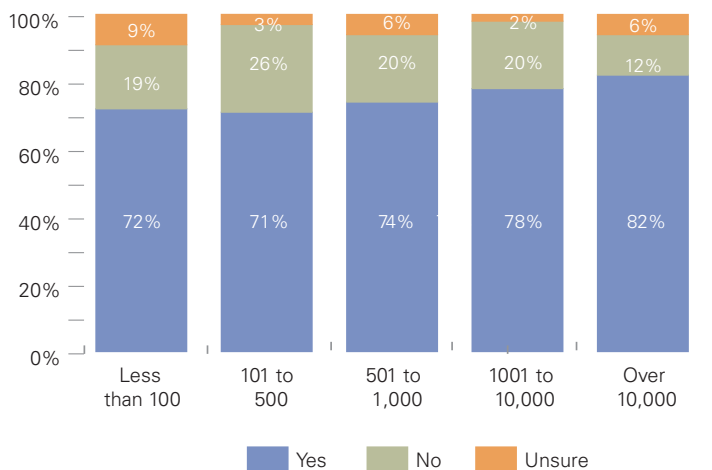
Interestingly, more respondents had increased the focus of their senior management on fraud risk – 64 percent in 2006 compared with 50 percent in 2004. However 62 percent of respondents do not conduct fraud awareness training, 51 percent do not have a fraud control strategy and 50 percent do not conduct fraud risks assessments. All three of these measures are well-established fraud risk management strategies.

4.2 Fraud reporting channels

Three-quarters of respondents (see Figure 33) said they had a system for the anonymous reporting of fraud and corruption. These systems were either operated by the organisation itself, or by an external agent acting on the organisation's behalf. This response represented an increase of 27 percent over the 2004 figure. It is encouraging that organisations are increasing their use of this means of reporting fraud.

Figure 34 depicts respondents with and without anonymous reporting lines by organisation size. This corresponds with the 50 percent increase in the detection of major fraud by employees.

Figure 34 – Availability of anonymous reporting channels by respondent size (employees)



Of the respondents with an anonymous reporting channel, a majority operated it internally (70 percent). Only 25 percent had both external and internal services (see Figure 35).

The survey revealed that respondents with anonymous reporting channels (either operated by the organisation itself, or by an external agency on the organisation's behalf) detected more incidents of fraud (see Figure 36) than those without such facilities.

Figure 36 – Respondents with anonymous reporting channels

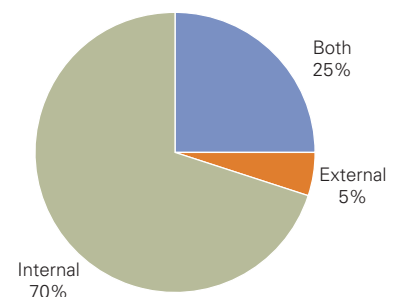
| | Yes | No |
|---|--------|-------|
| Does your organisation have channels in place for anonymous reporting of fraud? | 75% | 20% |
| Respondents that detected fraud | 51% | 38% |
| Total number of fraud incidents | 59,544 | 5,482 |
| Total value of fraud detected | \$140m | \$14m |

Figure 33 – Organisations with anonymous reporting systems

| | 2006 | 2004 |
|--------|------|------|
| Yes | 75% | 48% |
| No | 20% | 47% |
| Unsure | 5% | 5% |

...respondents with anonymous reporting channels...detected higher levels of fraud than those without such facilities.

Figure 35 – Method by which anonymous reporting channel is serviced

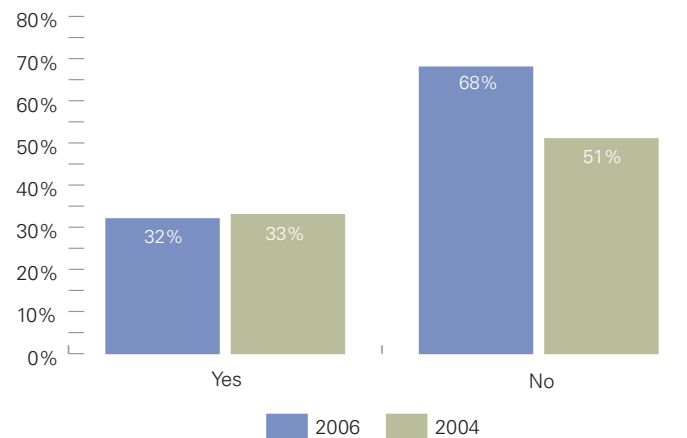


5. Business ethics

Survey recipients were asked if their organisations had been subject to unethical conduct (other than fraud) in the survey period. Thirty-two percent of respondents indicated that they had identified unethical conduct, almost exactly the same figure as in the 2004 survey (see Figure 37).

The table below (Figure 38) shows the types of unethical behaviour experienced compared with the results of the 2004 survey:

Figure 37 – Unethical behaviour experienced



Note: The 2004 survey allowed 'unsure' as a category of response.

Figure 38 – Types of unethical behaviour

| | 2006 | 2004 |
|--|--------|--------|
| Unauthorised personal use of corporate assets | 17.7% | 16.5% |
| Falsely claiming sick leave or absenteeism | 17.4% | 14.0% |
| Unauthorised disclosure of confidential or sensitive information | 16.7% | 11.8% |
| Conducting business transactions in a manner which derives an unwarranted personal advantage (e.g. using a personal credit card to pay major corporate expenses to generate frequent flyer points for the card holder) | 13.4% | 9.4% |
| Management employee's conflict of interest (eg awarding contract or diverting sales to a company in which the employee holds a personal interest) | 10.9% | 9.6% |
| Running a private business during working hours | 9.2% | 9.4% |
| Lavish gifts received by an employee of your organisation, which are not brought to the attention of management | 4.8% | 3.5% |
| Other | 3.1% | - |
| Breach of code of conduct | 2.9% | - |
| Intentionally falsifying the organisation's records (without personal gain) | 2.3% | 4.7% |
| Lavish gifts at the expense of your organisation to parties external to your organisation | n/a | 2.2% |
| Unjustified reprisals against an employee for reporting suspicions of unethical or inappropriate conduct | n/a | 2.0% |
| Sexual harassment or bullying | 1.0% | 12.0%* |
| Inappropriate use of internet/email | 0.6% | - |
| | 100.0% | 100.0% |

*These two categories were reported separately in the 2004 survey

Eighty-eight percent of respondents indicated that their CEO was responsible for developing an ethical culture in the organisation, whilst 67 percent indicated that the board was responsible. Interestingly, a high proportion of respondents believed that cultural issues generally, including lack of senior management commitment, were significant contributing factors to unethical behaviour (see Figure 39).

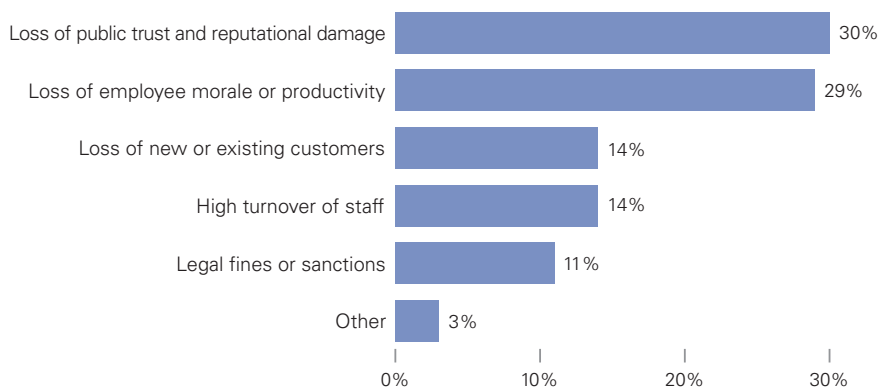
Figure 39 – Cultural factors contributing to unethical behaviour



* Option not included in 2004 survey

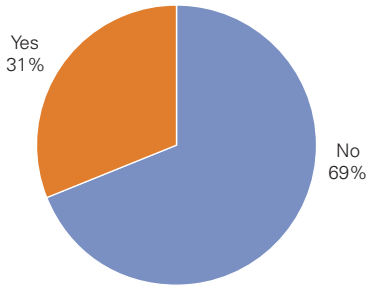
The 2006 survey introduced a new question to gauge how organisations perceived the implications of unethical behaviour. The results in Figure 40 (below) show that unethical behaviour affects both the internal and external environment of an organisation.

Figure 40 – Implications of unethical behaviour



6. Operations in Asia

Figure 41 – Percentage of respondents with operations in Asia



The 2006 survey saw the introduction of a new section, *Operations in Asia*. These questions reflect the increased presence of Australian and New Zealand companies in Asia and their experiences with fraud.

Thirty-one percent of respondents indicated they operated in Asia (see Figure 41).

Figure 42 – Summary of operation locations

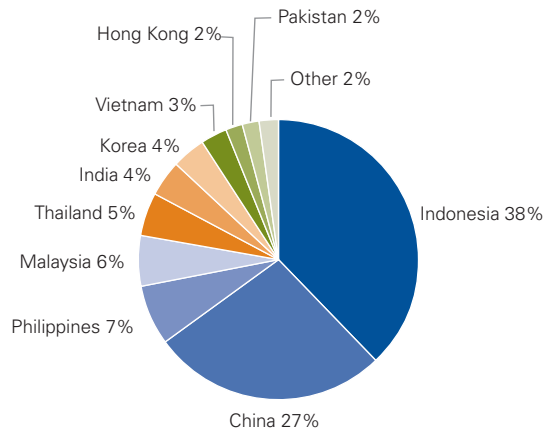
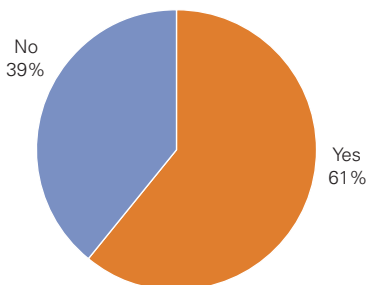


Figure 42 shows the breakdown of regional activity. China and Indonesia stand out as the two major areas for operations.

Figure 43 – Percentage of respondents with Asian operations who suffered at least one incident of fraud

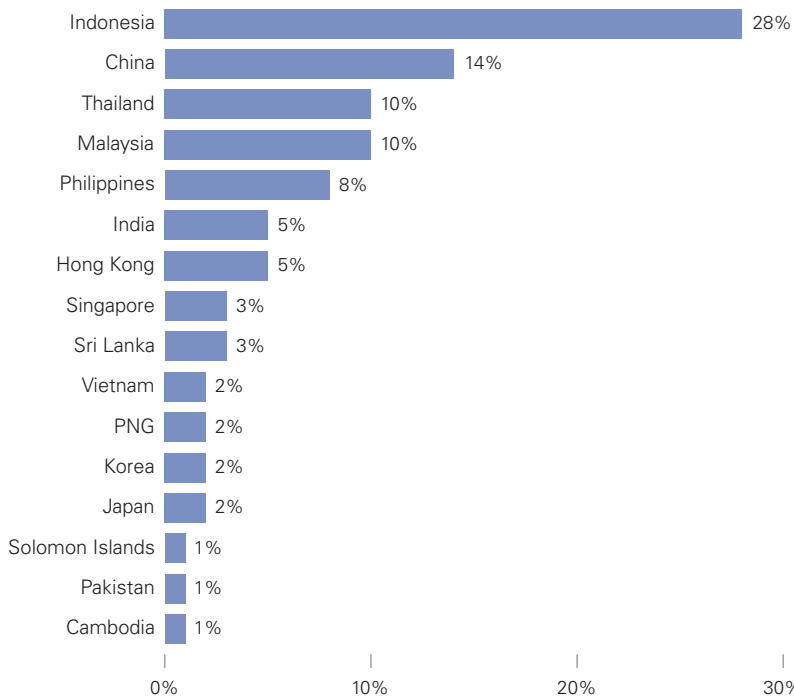


6.1 Current experience

Of those who operated in Asia, 61 percent had experienced at least one case of fraud in their Asian operations (see Figure 43).

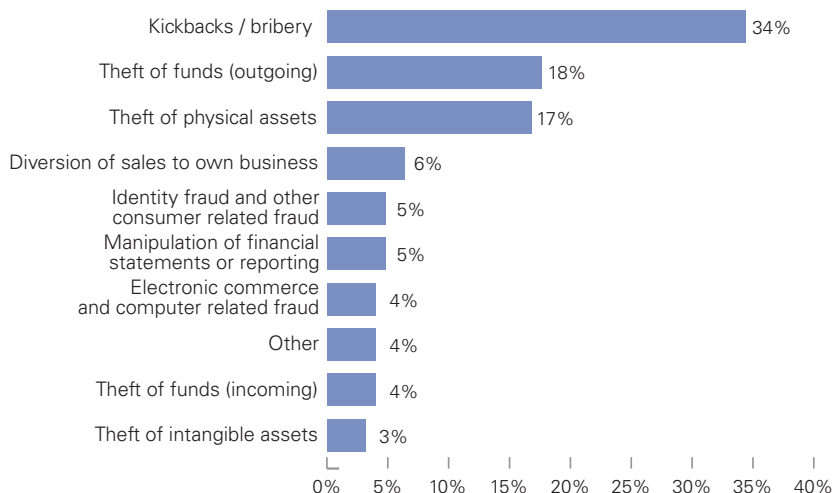
Figure 44 shows the regions within Asia where respondents experienced at least one case of fraud during the survey period.

Figure 44 – Experiences of fraud in Asia



There was a strong indication from the 2006 survey results that corruption was a major problem in Asia. Kickbacks and bribery, both giving and receiving, accounted for more than 34 percent of the fraud experienced in Asia, compared to less than five percent across Australia and New Zealand. This highlights the importance of understanding the risks of doing business in Asia, and taking steps to effectively mitigate those risks. Figure 45 highlights the prevalence of corruption and shows the breakdown of reported incidents of fraud perpetrated in Asia.

Figure 45 – Frauds occurring in Asia



About this survey

In February 2006 KPMG Forensic, in collaboration with the University of Melbourne and the University of Queensland, sent a fraud survey questionnaire to 2,146 of Australia and New Zealand's largest public and private sector organisations.

The survey was conducted on a confidential basis. We gave an undertaking that no information would be released on individual survey responses.

Those surveyed were asked questions relating to the following:

- Their opinion on the extent of fraud in business generally.
- The fraud experienced in their organisations during the survey period.
- The steps taken to prevent fraud.
- Business ethics.
- Identity fraud.

The definition of fraud for the purpose of this survey was 'any dishonest activity occasioning actual or potential financial loss to any person or entity or other property by employees or persons external to the entity, and whether or not deception is used at the time, immediately before or immediately following the activity'.

Usable replies were received from 465 organisations. This is a response rate of 21 percent. Figure 46 sets out the percentage of respondents by their primary line of business and Figure 47 sets out the industry in which respondents operate.

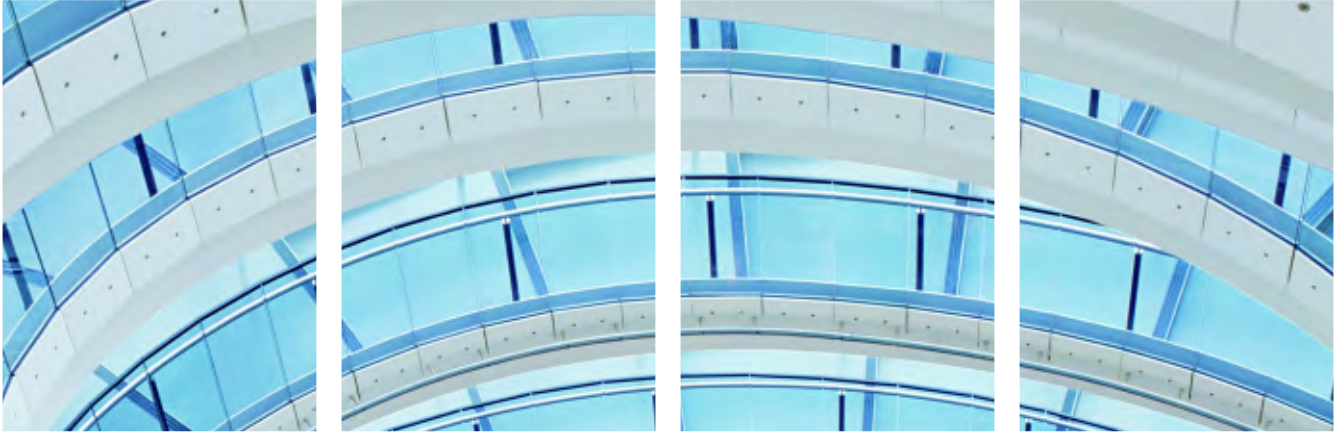
Figure 46 – Respondents by line of business

| Primary line of business | Percentage of respondents |
|--|----------------------------------|
| Consumer Markets | 15.5% |
| Energy and Resources | 12.9% |
| Financial Services | 18.5% |
| Government | 26.0% |
| Information, Communication and Entertainment | 6.7% |
| Industrial Markets | 18.7% |
| Other | 1.7% |
| Total | 100.0% |

Figure 47 – Industries in which respondents operate

| Industry | Percentage of respondents |
|---|----------------------------------|
| Power | 5.6% |
| Building and construction | 5.0% |
| Local government | 4.8% |
| Mining | 4.5% |
| Food and beverage | 4.4% |
| Automotive | 4.3% |
| State government | 4.3% |
| Transport | 4.0% |
| Insurance | 4.0% |
| Federal government | 4.0% |
| Consumer Products | 3.8% |
| Health Services | 3.8% |
| Other sectors | 3.8% |
| Oil | 3.5% |
| Banking | 3.5% |
| Superannuation | 3.5% |
| Retail | 3.2% |
| Managed investments and funds management | 2.9% |
| Tourism | 2.6% |
| Chemical | 2.5% |
| Industrial markets - other | 2.3% |
| Financial services - other | 2.3% |
| Software | 2.3% |
| Education | 1.9% |
| Consumer Markets - other | 1.9% |
| Government - other | 1.6% |
| Communication | 1.5% |
| Pharmaceutical | 1.3% |
| Real estate | 1.3% |
| Winery | 1.2% |
| Media | 1.0% |
| Biotechnology | 0.9% |
| Information, Communication, Entertainment - other | 0.7% |
| Forestry | 0.6% |
| Energy and Resources - other | 0.6% |
| IT Hardware | 0.4% |
| | 100.0% |

Contact us



For further information about the services offered by KPMG Forensic please contact us:

Auckland

Mark Leishman
+64 9 367 5939
markleishman@kpmg.co.nz

Alternatively, visit our website at
kpmg.com.au

Brisbane

David van Homrigh
+61 7 3233 3205
djvanhomrigh@kpmg.com.au

Melbourne

Peter Morris
+61 3 9288 5898
pmorris@kpmg.com.au

Perth

Matt Fehon
+61 8 9263 7539
mfehon@kpmg.com.au

Sydney

Gary Gill
+61 2 9335 7312
ggill@kpmg.com.au

Contributors



Peter Morris
KPMG Forensic

Kim Lee
KPMG Forensic

Ben Mahler
KPMG Forensic

Professor Colin Ferguson
The University of Melbourne

Katherine Geddes
The University of Melbourne

Dr Larelle Chapple
The University of Queensland

Related KPMG Publications

*Fraud Risk Management – Developing
a Strategy for Prevention, Detection
and Response* prepared by
KPMG Forensic

Notes:

ISBN 0 7340 3671 X

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

KPMG respects your privacy. We manage your personal information in accordance with the National Privacy Principles and use this information for business related purposes or to contact you about KPMG services in the future. For details on KPMG's Privacy policy, to enquire about any personal information we hold or to cease receiving information from us, please contact KPMG's National Privacy Officer at AUSTPrivacy@kpmg.com.au

© 2006 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. Printed in Australia.

KPMG and the KPMG logo are registered trademarks of KPMG International.

Liability limited by a scheme approved under Professional Standards Legislation.

October 2006. VIC10480FO.