



KPMG FORENSIC

Fraud Survey 2003

ADVISORY

Organizations are reporting a rise in fraud, responding with expanded fraud measures both reactive and preemptive, and planning further actions for the future.

That's the conclusion of KPMG's Fraud Survey 2003.

As in 1994 and 1998, we looked at the state of fraud and anti-fraud measures in government and industry in the United States. We interviewed more than 450 executives in medium-sized and large organizations across industries and in state and federal government agencies. Where possible, we benchmarked the findings against our 1994 and 1998 survey data.

The following report provides detailed findings about fraudulent activities, anti-fraud responses, and the way respondents picture fraud in the future.

We hope you will gain insights from this report as you evaluate your organization's fraud risk management programs.

A handwritten signature in cursive script that reads "Richard".

Richard H. Girgenti
National Partner in Charge
KPMG Forensic

Executive Summary

According to the results of KPMG's Fraud Survey 2003, organizations are reporting more experiences of fraud than in prior years and are taking concerted actions to deal with it. We also found they will continue to take anti-fraud actions in the future.

Reports of Fraud Are on the Rise

Seventy-five percent of companies surveyed report they experienced an instance of fraud—13 percentage points more than in 1998. While employee fraud is the most prevalent type of fraud experienced by organizations, financial reporting fraud and medical/insurance fraud are the most costly. In fact, financial reporting fraud more than doubled its rate of occurrence since the last survey. The greatest percentage point increases since 1998 are in theft of assets and expense account abuse.

Organizations Are Responding with Anti-fraud Measures

The survey indicates that organizations are taking both reactive and preemptive measures. This responsiveness may be driven by Sarbanes-Oxley legislation or the business environment that inspired that legislation, or a combination of both.

Organizations are responding to fraud occurrences with investigations, employee dismissals, and legal action. In addition, the survey indicates that internal controls, internal audit, and notification by an employee are the three leading ways of uncovering fraud, with internal controls being the fastest-growing method.

Among newly instituted programs, respondents cite "reviewing or strengthening internal controls" more frequently than any other type of program. These findings reflect a growing institutionalization of anti-fraud efforts.

Organizations Will Take Further Anti-fraud Measures

Collectively, organizations are working hard to combat fraud and believe they have turned the corner on the problem. Three out of four organizations evaluated their compliance programs within the last 12 months. An equally large number plans to implement new programs or procedures to help combat fraud and misconduct in direct response to Sarbanes-Oxley.

As a result of these efforts, more than one third of organizations believes that fraud will decline in the future, and a slightly larger group of organizations believes fraud levels will stay the same.

Organizations identify collusion between employees and third parties as the most significant factor contributing to fraud. This combined internal and external threat offers ample opportunity for improvement, and should be a focus of new anti-fraud programs.

Methodology

In the spring of 2003, KPMG ForensicSM commissioned telephone interviews with executives from 459 public companies (annual revenue of \$250 million or more) and state and federal government agencies.

As shown below, respondents represented a cross-section of industries and management classes.

Industry Representation

Financial Services	104 (23%)
Industrial	103 (22%)
Consumer	101 (22%)
Information, Communications & Entertainment	81 (18%)
Healthcare & Public Services	70 (15%)

Management Class

Internal Audit Directors/VP Controls	187 (41%)
CFOs/Financial Executives/CEOs	99 (22%)
General/Corporate Counsel	78 (17%)
Security Executives/Risk Officers	76 (16%)
Compliance Officers	19 (4%)

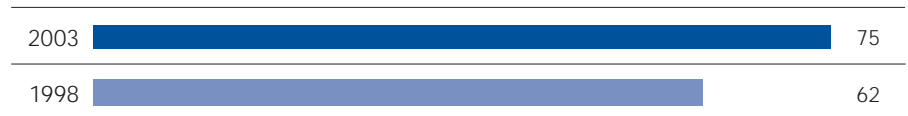
Results were benchmarked against KPMG studies conducted in 1994 and 1998.

Detailed Findings

Reports of Fraud Are on the Rise

We asked organizations if they had experienced any of a number of broad categories of fraud during the prior 12 months. Three out of four organizations in 2003 reported they had—an increase of 13 percentage points since 1998.

Organizations Experiencing Fraud During the Prior 12 Months (Percentages)

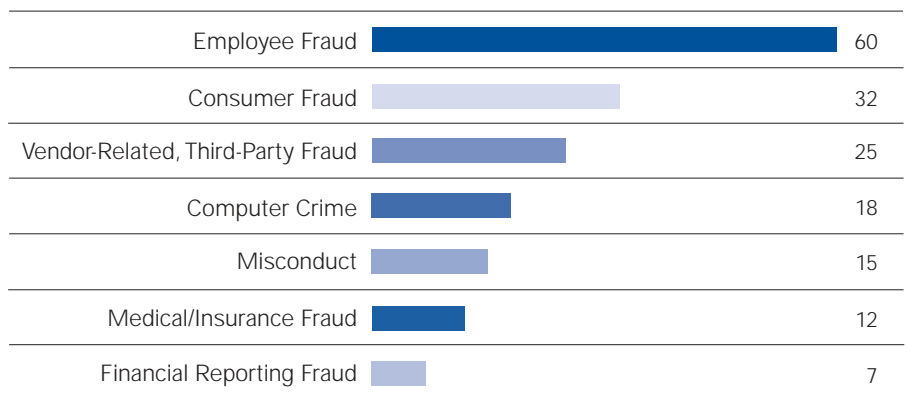


Note: Comparable data unavailable from 1994 survey.

Major Types of Fraud

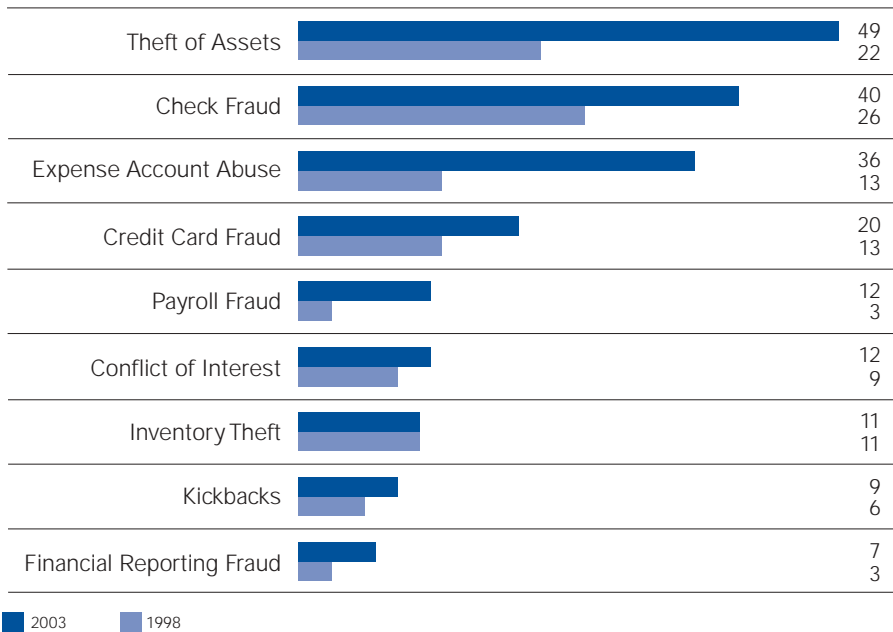
We asked organizations about their experiences with seven broad categories of fraud. Of these categories, employee fraud was almost twice as prevalent as the number-two category, consumer fraud.

Type of Fraud Experienced During the Prior 12 Months (Percentages)



Among the types of fraud we benchmarked against 1998 data, reported occurrences in several categories showed dramatic increases. Theft of assets and expense account abuse, already high in 1998, more than doubled in 2003. Financial reporting fraud in 2003 also more than doubled its 1998 rate of occurrence.

Certain Types of Fraud Have Increased
(Percentages)



Note: Comparable data unavailable from 1994 survey.

Cost of Fraud

When we asked organizations for the estimated dollar losses from each type of fraud they experienced, they said the most costly form was financial reporting fraud. For organizations that experienced this type of fraud, the average cost was more than \$250 million. The cost of medical/insurance fraud was also significant, averaging \$33.7 million for those companies that experienced it.

While financial reporting fraud cost the most per incident, it occurred least often. Medical/insurance fraud, also costly, occurred relatively infrequently. Employee fraud was among the least costly, but a full 60 percent of organizations experienced it.

Average Annual Cost of Fraud by Major Categories (In Thousands of Dollars)

Financial Reporting Fraud*	257,923
Medical/Insurance Fraud	33,709
Consumer Fraud	2,705
Vendor-Related, Third-Party Fraud	759
Employee Fraud	464
Misconduct	432
Computer Crime	67

* One company reported costs of financial reporting fraud of \$4 billion.

FRAUD CATEGORIES ASSESSED IN SURVEY

Computer Crime

- Hacking and other cybertheft

Consumer Fraud

- ATM theft
- Check fraud
- Credit card fraud
- Fraudulent classification of merchandise for customers
- Fraudulent merchandise returns
- Identity theft

Employee Fraud

- Check fraud
- Expense account abuse
- Payroll fraud
- Pension theft
- Theft or misappropriation of assets

Financial Reporting Fraud

- Asset revenue misstatement
- Concealed liabilities and expenses
- Improper revenue recognition
- Inadequate omissions or inappropriate disclosures

Medical/Insurance Fraud

- Medical/insurance claims fraud
- Policy churning
- Workers' compensation fraud

Misconduct

- Conflicts of interest
- Insider trading

Vendor-Related and Other Third-Party Fraud

- Bid rigging and price fixing
- Bribery
- Diversion of sales
- Duplicate billings
- Extortion
- False invoices and phantom vendors
- Inventory theft
- Kickbacks and conflicts of interest
- Loan fraud
- Theft of intellectual property

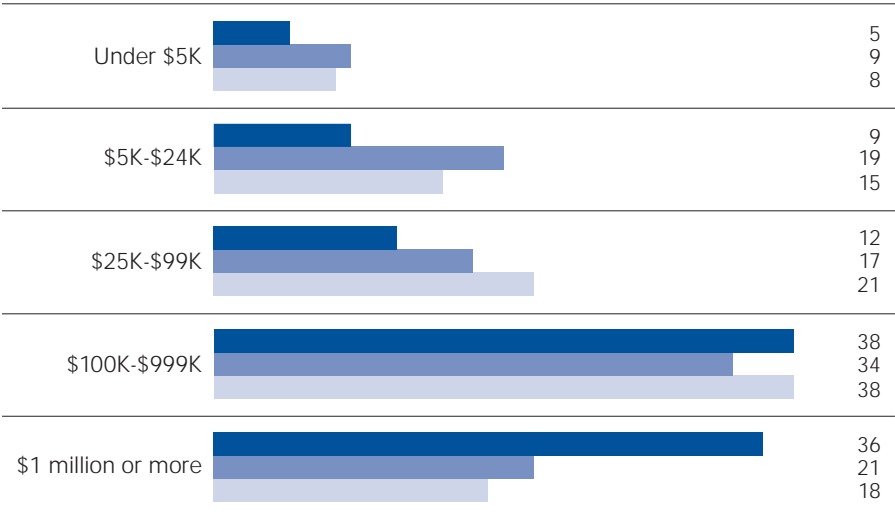
When we further explored the subcategories of fraud—specifically those benchmarked against previous survey data—we found that almost all increased in cost since 1994.

Average Cost of Fraud by Subcategories
(In Thousands of Dollars)

	2003	1998	1994
Medical/Insurance Claims Fraud	42,267	3,177	622
Credit Card Fraud	3,241	1,126	367
Bid Rigging and Price Fixing	644	342	110
Conflicts of Interest	444	38	162
Diversion of Sales	406	180	206
Inventory Theft	234	346	305
Kickbacks	99	35	231
Payroll Fraud	91	26	35
ATM Theft	78	300	132
Expense Account Abuse	43	141	21

We also looked at the cost of fraud overall and discovered that in 2003, 36 percent of companies incurred \$1 million or more in costs due to fraud, a significant jump from 21 percent in 1998.

Respondent Distribution by Total Fraud Cost
(Percentages)



■ 2003 ■ 1998 ■ 1994

Organizations Are Responding with Anti-fraud Measures

Our research revealed a strong upsurge in anti-fraud measures since 1994—both reactive and preemptive—as well as an intense focus on fraud prevention within the last 12 months.

Compared with 1994 and 1998 more companies reacted to fraud occurrences through all the types of actions we benchmarked. Those with the largest increases included seeking legal action and notifying a regulatory or law enforcement agency.

The “Other Actions” category also rose sharply. This category included actions such as reevaluating and improving controls and policies.

More Companies Taking Action in Response to Fraud
(Percentages)



More than three out of four organizations uncovered fraud through internal controls. This method for uncovering fraud showed the greatest increase—26 percentage points—over 1998 results.

Almost two thirds reported discovery by internal audit. Notification by employee was the third most important method, falling from the top method in 1998.

Methods for Uncovering Fraud (Percentages)

	2003	1998	1994
Internal Controls	77	51	52
Internal Audit	65	43	47
Notification by Employee	63	58	51
Accident	54	37	28
Anonymous Tip	41	35	26
Notification by Customer	34	41	34
Notification by Regulatory or Law Enforcement Agency	19	16	8
Notification by Vendor	16	11	15
External Audit	12	4	5

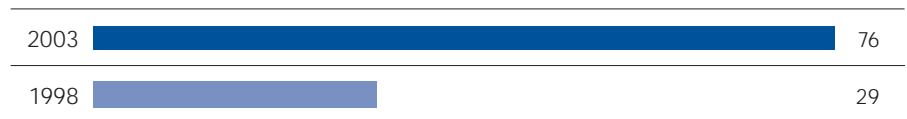
We also queried executives about anti-fraud policies instituted within the prior 12 months. We discovered that three quarters of organizations instituted review or strengthening of internal controls, significantly more than any other type of policy or program. Many also instituted periodic compliance audits or established employee hotlines.

Fraud Mitigation Policies Instituted During the Prior 12 Months (Percentages)

Reviewed or Strengthened Internal Controls	75
Instituted Periodic Compliance Audits	44
Created an Employee Hotline	42
Appointed Compliance Personnel	41
Established a Code of Conduct for All Employees	40
Conducted Background Checks for Hires with Budgetary Responsibility	38
Instituted Fraud Awareness Training	28
Tied Employee Evaluations to Ethics or Compliance Objectives	24
Other Policies	19

Similarly, when we asked organizations if they had reviewed the effectiveness of their compliance programs, more than three out of four said they had, an increase of 47 percentage points over the 1998 response.

Compliance Program Evaluation (Percentages)



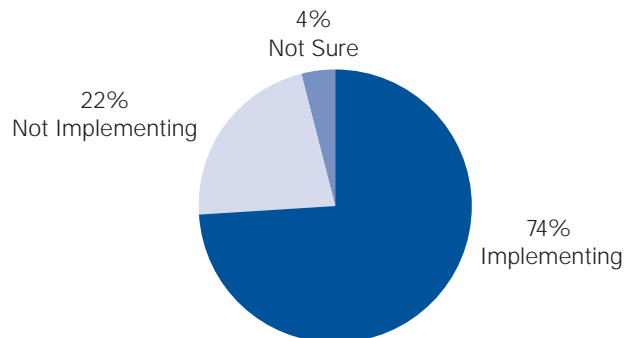
Note: Comparable data unavailable from 1994 survey.

Organizations Will Take Further Anti-fraud Measures

Collectively, organizations indicated they have been working hard to combat fraud. What's more, they believe they have turned the corner on the problem.

We surveyed organizations regarding potential influence of the Sarbanes-Oxley Act of 2002 on future implementation of anti-fraud measures. Sarbanes-Oxley appeared to be a priority: three out of four organizations will implement new programs as a result of this legislation.

Implementation of Anti-fraud Programs as a Result of the Sarbanes-Oxley Act



Many more organizations than in previous surveys felt that fraud will decline in the future. Consistent with 1994 and 1998, a similarly large group in 2003 believed the incidence of fraud within their organizations will stay stable, at least in the near term.

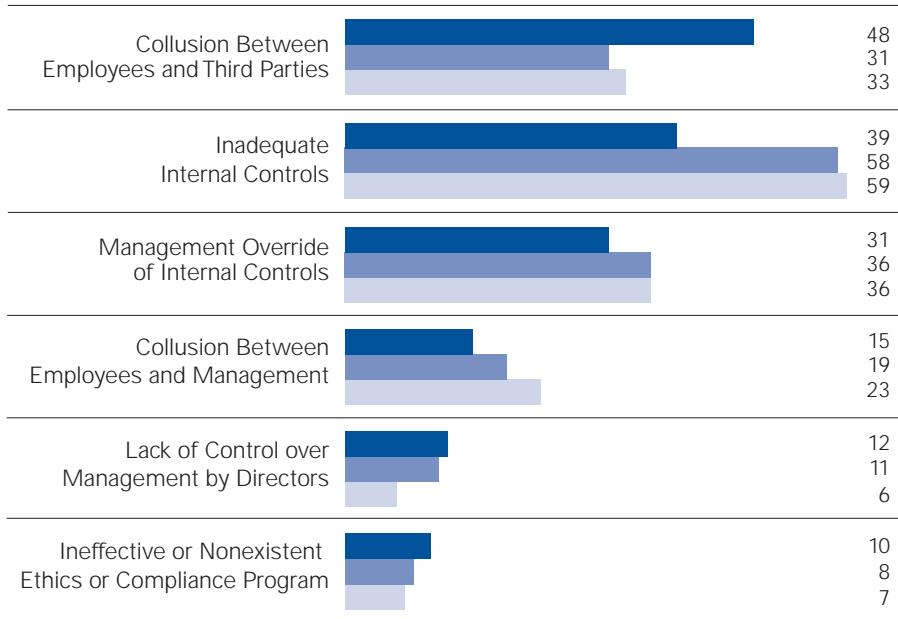
Anticipated Fraud Incidence over the Next 12 Months
(Percentages)

	2003	1998	1994
Decrease	43	6	7
Stay the Same	47	35	41
Increase	7	59	52
Not Sure	3	0	0

When we asked about factors contributing to fraud in the organization, respondents identified an area of concern that may become a point of focus in the future—collusion between employees and third parties.

Of the six factors offered, collusion was cited by almost half of respondents as contributing to fraud. Inadequate internal controls and management override of internal controls also scored high.

Factors Contributing to Fraud in the Organization
(Percentages)



■ 2003 ■ 1998 ■ 1994

About KPMG Forensic

KPMG Forensic is a global practice comprising multidisciplinary professionals from KPMG member firms who can assist clients in their efforts to achieve the highest levels of business integrity through the detection, prevention, and investigation of fraud and misconduct. This practice not only helps clients discover the facts underlying concerns about fraud and misconduct but also assists clients in assessing their vulnerabilities to such activities, and in developing controls and programs to address these risks.

KPMG Forensic uses computer forensic and data analysis techniques to help clients detect fraudulent activity and other forms of misconduct. In addition, KPMG LLP, the U.S. member firm, operates the Cypress Technology Center (CTEC), which offers sophisticated technology tools and skilled professionals to help clients reduce litigation costs and risks in the areas of evidence and discovery management and the acquisition, management, and analysis of large data sets.

Professionals in the KPMG Forensic practice draw on extensive experience in forensic accounting, law enforcement, fraud and misconduct risk assessment, anti-fraud risk controls, program design and implementation, asset tracing, computer forensics, and forensic data analysis.

With professionals from the Americas, Asia Pacific, and Europe to the Middle East and Africa, KPMG Forensic is well positioned to provide a high level of consistent service to global clients. It can readily assemble multinational teams comprising members who have shared methodologies, demonstrated technical skills, and deep industry knowledge.

Service offerings are subject to legal and regulatory restrictions. Some services may not be available to KPMG's financial statement audit or other attest service clients.

To Learn More

For more information about KPMG's Fraud Survey 2003, call the KPMG Forensic Hotline at 1-877-679-KPMG (1-877-679-5764) or visit our Web site at www.us.kpmg.com under Assurance Services.