

Fraud Barometer

December 2009 readings

Fraud continues to impose significant costs on the Australian economy.

This is the main finding from KPMG's Australian *Fraud Barometer* covering the December half year of 2009. The *Fraud Barometer* tracks the incidence of large frauds (those exceeding \$100,000 each) coming before the Australian criminal courts. Given the relative scarcity of hard data on fraud in Australia, KPMG believes its barometer offers useful insights into fraud trends across the economy.

In releasing our initial *Fraud Barometer* last August for the June half year, we wrote that fraud in Australia appeared to be an unacknowledged epidemic. Data from our latest *Fraud Barometer* suggests there is little sign of the epidemic subsiding. Indeed while the number of frauds reaching the courts in the December half year was only modestly higher than in the previous June half year, the aggregate value of these frauds more than doubled from just over \$100 million to more than \$217 million (Figure 1).

The increased value of individual frauds may be linked to the 2008 financial crisis and its immediate economic aftermath in Australia. While we can acknowledge the link between the economic downturn and large frauds coming to light, we can only speculate about the causal link – i.e. whether the financial crisis caused an increase in the number and size of frauds, or whether the downturn accelerated the detection of some large frauds as a result of closer scrutiny of financial performance – in reality, probably a bit of both.

This document explores the nature and possible causes of these frauds.

Latest findings – December half

Figures 1 and 2 summarise fraud matters being tried in Australian courts over the past four consecutive half-year periods.

Figure 1: Frauds tried in Australian courts – 2008-2009

Period	Value (\$)	Number
Jun-08	119,563,000	72
Dec-08	101,862,000	88
Jun-09	100,122,000	69
Dec-09	217,924,000	81
Total	539,471,000	310

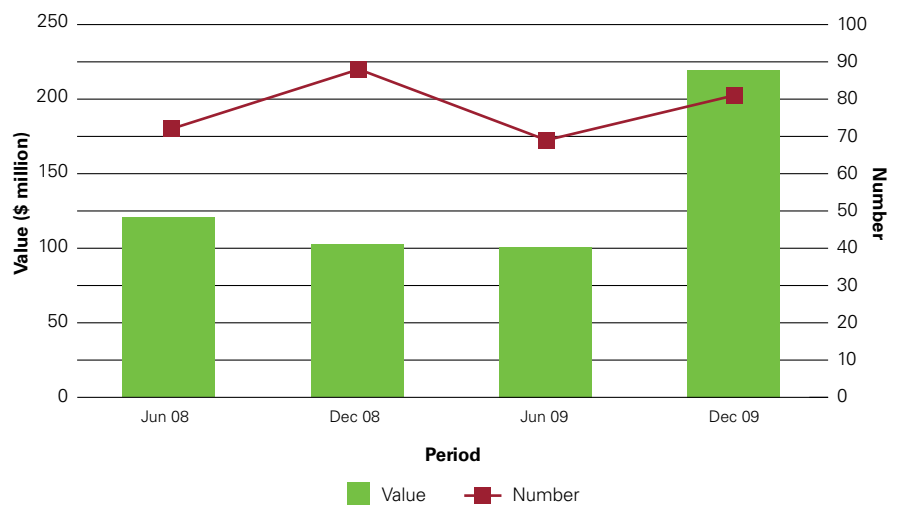
Source: KPMG Research

As previously noted, the aggregate value of frauds in the most recent six-month period was substantially higher than experienced in the previous halves covered by our *Fraud Barometer*. For the 2009 calendar year the value of frauds tried in Australian courts exceeded \$318 million, which was nearly 50 percent higher than the \$221 million for the 2008 calendar year. The latest figure included several major fraud cases.

- Major investment scams in Victoria and Queensland.
- Multi-million dollar accounting frauds at financial institutions and major retailers.
- A \$15 million vehicle consignment scam and a \$13 million duty evasion case involving imported tobacco.

These matters helped lift the average amount per individual fraud to more than \$2.6 million for the December half year, almost double the average for the three prior periods.

Figure 2: Frauds tried in Australian courts 2008-2009



Source: KPMG Research

As Figures 3 and 4 demonstrate, large frauds were prosecuted right across the country in the latest period. As would be expected, most frauds (including most of the high value cases) were uncovered along the eastern seaboard, reflecting the geographic concentrations of population and economic activity. Queensland, New South Wales and Victoria accounted for more than 90 percent of frauds by value.

New South Wales recorded the highest value of fraud in the most recent 6 months, accounting for 26 separate cases totalling \$110 million in aggregate. Interestingly, the New South Wales figures for the December 2009 half year exceeded the value of all the frauds reported in the Australian *Fraud Barometer* for the first half of the same year.

Figure 3: Frauds in Australia by region – 2008-2009

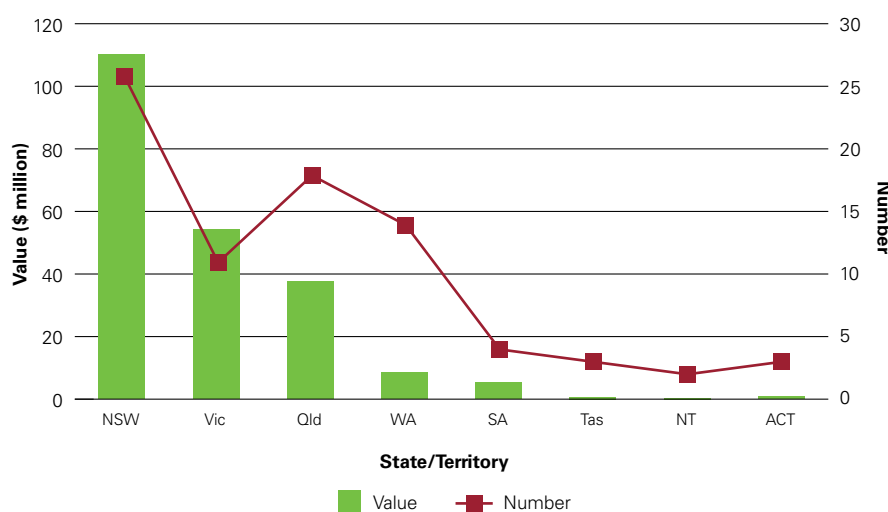
Region	Jun-08		Dec-08		Jun-09		Dec-09		Total	
	Number	Value (\$)	Number	Value (\$)	Number	Value (\$)	Number	Value (\$)	Number	Value (\$)
NSW	21	64,644,000	18	24,463,000	22	53,042,000	26	110,243,000	87	252,392,000
Vic	22	31,253,000	24	30,348,000	11	8,924,000	11	54,307,000	68	124,832,000
Qld	14	12,781,000	34	36,050,000	26	32,411,000	18	37,676,000	92	118,918,000
WA	7	4,343,000	6	8,510,000	6	4,077,000	14	8,572,000	33	25,502,000
SA	6	5,812,000	2	1,471,000	2	1,251,000	4	5,286,000	14	13,820,000
Tas	2	730,000	3	790,000	–	–	3	704,000	8	2,224,000
NT	–	–	–	–	2	417,000	2	345,000	4	762,000
ACT	–	–	1	230,000	–	–	3	791,000	4	1,021,000
Total	72	119,563,000	88	101,862,000	69	100,122,000	81	217,924,000	310	539,471,000

Source: KPMG Research

Western Australia experienced a jump in fraud cases in the December half with twice as many large fraud cases compared to the prior periods in 2009 and 2008.

Queensland continues to record a high number of fraud cases, trying more large fraud cases than Victoria for the third straight period. Victoria and New South Wales continued to experience higher value frauds on average than Queensland.

Figure 4: Frauds by region – Dec-09



Source: KPMG Research

When we analysed fraud cases by the type of victim, we found that business enterprises of various kinds predominate by both the number of frauds suffered and their average value (Figure 5).

Commercial enterprises accounted for 28 percent of the cases coming to court in the most recent half year. The majority of these frauds involved employees, managers or directors manipulating accounting records in order to misappropriate funds. These misappropriations typically involve false invoicing. This finding is consistent with KPMG Forensic’s experience of investigating commercial fraud.

Figure 5: Frauds by type of victim – Dec-09

Source: KPMG Research

Financial institutions remained a target for fraudsters in the December half, accounting for 20 percent of cases by number. Perhaps not surprisingly, banks and other financial institutions are particularly vulnerable to high-value frauds. Thus in the December half they accounted for one third by value of the frauds prosecuted. This overall result was influenced by a single \$45 million 'superfraud' perpetrated by an employee of a financial institution. However, when this case is excluded, we find that most of the frauds against financial institutions over the past 6 months were committed by external parties such as customers or criminal syndicates.

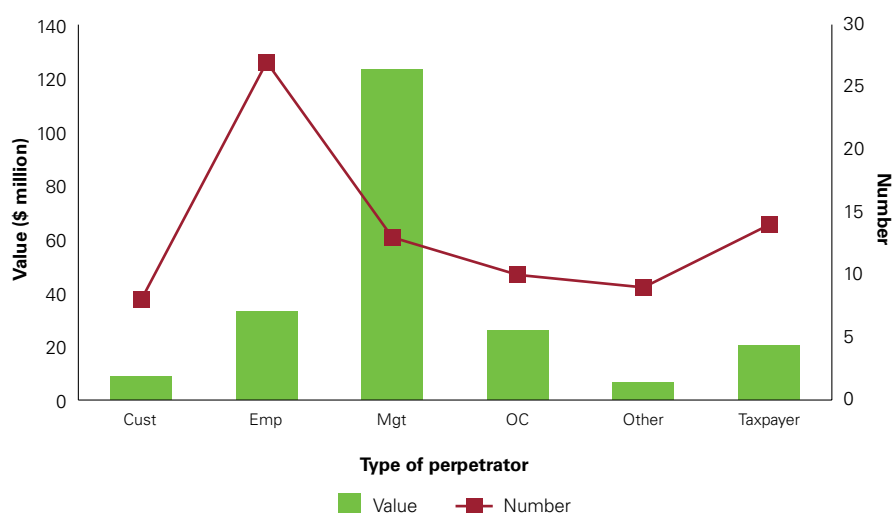
Public sector entities continued to be prominent victims of fraud in the latest December half. Two thirds of these cases involved tax or benefit frauds. The victim of the \$13 million tobacco duty supercase noted above was the government, or, more accurately, the taxpayer.

Frauds against investors are uncommon. When they do occur, however, they tend to be significant. Three separate investment scams that came to trial in the latest period involved a total \$44 million of misappropriated investor funds. Two of these were alleged Ponzi-type schemes.

When it comes to the perpetrators of fraud (Figure 6), victim organisations are likely to be defrauded by those they most trust. Thus in the latest December half year, rank-and-file employees were responsible for the largest number of individual frauds while management were responsible for the lion's share (57 percent) of losses from fraud. This is a familiar pattern – when managers perpetrate frauds they invariably steal significantly higher amounts than lower level staff.

Taxpayer frauds are common, although the amounts involved tend to be smaller than for the frauds committed by other groups. Frauds committed by groups of conspirators and organised crime syndicates are significant. In the latest period an EFTPOS card skimming fraud in Western Australia netted the perpetrators around \$4 million. It is thought to have been the largest fraud of its kind so far prosecuted in Australia.

Figure 6: Frauds by perpetrator – Dec-09



Source: KPMG Research

We have broken down the frauds tried in the December half of 2009 into categories. Figure 7 summarises the top five categories of fraud for the period by both number and value.

Figure 7: Types of fraud – Dec-09

Number		Value (\$)	
Accounting fraud	23	Accounting fraud	53,338,000
Tax fraud	8	Internal bank fraud	49,255,000
Internal bank fraud	5	Investment scam	44,661,000
Fraudulent loans	5	Consignment scam	15,000,000
Investment scam	4	Duty evasion	13,000,000

Source: KPMG Research

By far the most common form of fraud can be described as accounting fraud. It typically involves employees overriding or manipulating accounting procedures and controls to divert funds for their own benefit. Manipulation of the accounts payable function by the creation of fictitious suppliers and payments is the classic accounting fraud.

Accounting fraud also involved the largest aggregate loss. Internal bank frauds, which typically share some of the characteristics of accounting frauds, were responsible for large losses (although the value was influenced by a single \$45 million fraud perpetrated against a financial institution), as were investment scams.

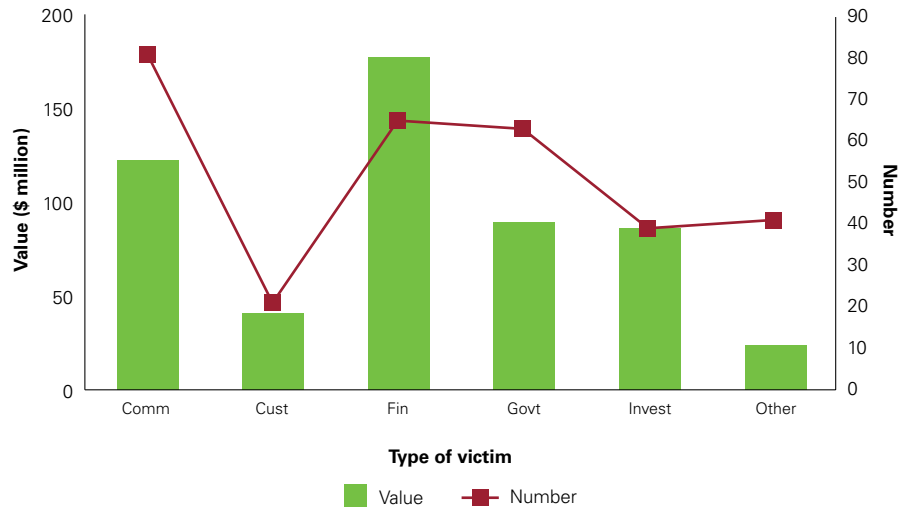
Long-term findings

KPMG’s *Fraud Barometer* is being compiled and published every 6 months in order to provide users with up-to-date information on fraud patterns in Australia. Of course, results for specific 6-month periods can be distorted by very large individual cases — longer data runs are likely to provide a more accurate depiction of underlying fraud patterns and trends.

When our initial *Fraud Barometer* was compiled last year, its figures for the June half of 2009 were supplemented with the corresponding results for the June and December halves of 2008, effectively providing an 18-month run of data. With the compilation of the latest December half year’s data on fraud cases before Australian courts, we can now observe a full 2 years of fraud data. Some interesting trends emerge.

Figure 8 depicts the number and value of frauds classified by principal victim type.

Figure 8: Frauds by victim – 2008-2009



Source: KPMG Research

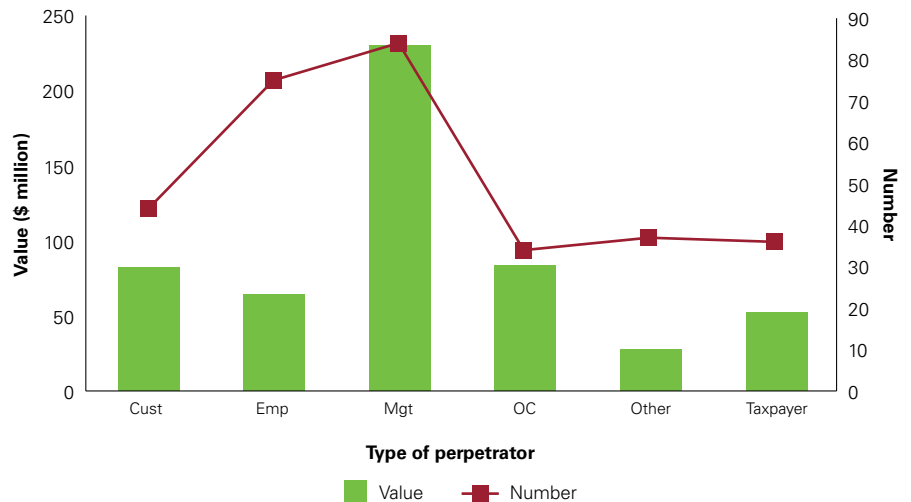
Unsurprisingly, commercial business organisations are the most common target of large frauds. As we have already indicated, these frauds typically involve internal accounting manipulations, usually involving managers or other trusted employees. Where the perpetrators are managers, the average fraud value exceeds \$1.5 million; where only lower-level employees are involved, the average loss falls to about \$0.5 million. The prevalence of these kinds of fraud suggests many organisations are paying insufficient attention to their internal financial controls and fraud risk management strategies.

Looking at frauds by size of loss incurred, frauds against financial institutions account for a third of aggregate fraud losses, although they only amount to a fifth of all frauds going to trial by number. Frauds against financial institutions are perpetrated by employees, customers and organised crime groups.

Fraud against government is quite prolific, although the average value of individual cases is relatively small. Data matching and other statistical analysis by government agencies is helping identify cases of fraud that can be successfully prosecuted.

Figure 9 shows frauds classified by type of perpetrator for 2008 and 2009.

Figure 9: Frauds by perpetrator – 2008-2009



Source: KPMG Research

Again, we find that it is managers and other employees who are most likely to end up in court defending fraud charges. KPMG Forensic believes the large numbers of managers and employees involved in fraud prosecutions resulted from better fraud detection, following a tightening of internal controls as a result of the general deterioration in business conditions in 2008 and 2009. More effective controls should lead to better detection of fraud in the future, and perhaps act as a deterrent to this kind of criminal behaviour.

Figure 9 also makes it clear that their own managers are the critical point of vulnerability for many organisations — not only are managers likely to commit more frauds than any other group, but they also account for the largest average losses from fraud.

We expect the fraud threat from organised crime syndicates will continue to increase. In aggregate over the past 2 years these criminal groups have been responsible for more fraud losses than any perpetrator group other than management.

In Figure 10 we look at the top five types of fraud based on number and value.

Figure 10: Types of fraud – 2008-2009

Number		Value (\$)	
Accounting fraud	92	Accounting fraud	98,640,000
Fraudulent loans	24	Fraudulent loans	72,143,000
Investment scam	22	Internal bank fraud	71,162,000
Tax fraud	16	Investment scam	65,846,000
Identity fraud	15	Tax evasion	37,647,000

Source: KPMG Research

Accounting frauds top the list by both number and value. They are typically accounts payable frauds associated with the creation of bogus suppliers and transactions. Given the prevalence of this kind of fraud, it is disappointing that many organisations possess only rudimentary controls over this function.

For financial organisations, fraudulent borrowing tends to generate large losses per incident. Fraudulent borrowing sometimes involves external parties colluding with internal accomplices, emphasising the need for financial organisations to tailor prevention and detection procedures to recognise this possibility.

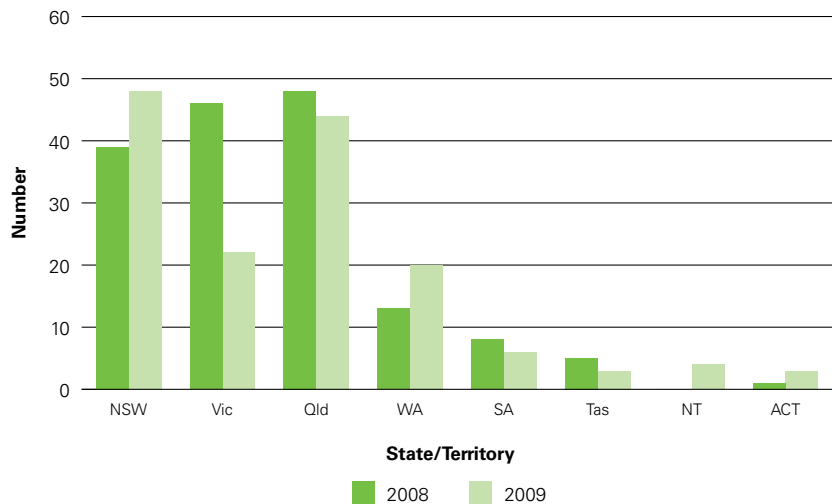
Figures 11 and 12 summarise the number and value of frauds prosecuted by region in Australia over the past 2 years.

Examination of the data reveals that Victoria saw a marked drop in large fraud cases in 2009 whereas New South Wales and Western Australia experienced an increase. Queensland continued to experience a large number of fraud cases relative to its population. New South Wales exhibited a substantial rise in the size of its fraud losses in 2009, dwarfing the other states and territories.

Abbreviations:

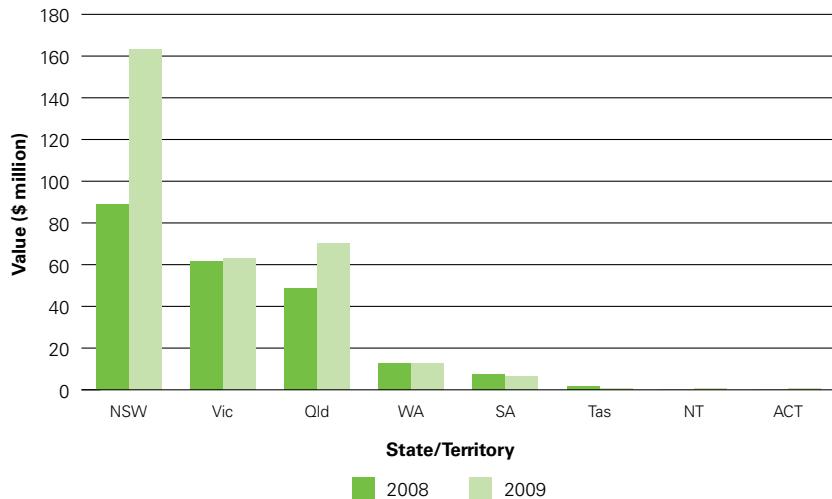
Comm	Commercial Businesses
Cust	Customers
Emp	Employees
Fin	Financial Institutions
Govt	Government
Invest	Investors
Mgt	Management
OC	Organised Crime

Figure 11: Number of frauds by region – 2008 and 2009



Source: KPMG Research

Figure 12: Value of frauds by region – 2008 and 2009



Source: KPMG Research

The overriding message from the latest *Fraud Barometer* is that organisations need to maintain vigilance in monitoring and reducing fraud risk. While external fraud threats are on the increase, most organisations remain at greatest risk from frauds instigated by their own managers and staff.

The Australian *Fraud Barometer* findings are also consistent with *Fraud Barometers* prepared by KPMG in other countries. In the UK, the 2009 *Fraud Barometer* reported record levels of fraud, with numerous substantial frauds perpetrated by organised criminals (over £700m). These sustained attacks by professional fraudsters against government and financial institutions should serve as a warning to Australia in light of the increased incidence of skimming and phishing scams in Australia in recent times. New Zealand also experienced a doubling in frauds in the December half of 2009, suggesting that fraud may have reached epidemic levels in many countries.

Contact us

For more information on KPMG Forensic services, please contact:

Gary Gill

Partner in Charge
KPMG Forensic
02 9335 7312
ggill@kpmg.com.au

Matt Fehon

Partner
KPMG Forensic
08 9263 7539
mfehon@kpmg.com.au

Peter Morris

Partner
KPMG Forensic
03 9288 5898
pmorris@kpmg.com.au

Mark Leishman

Partner
KPMG Forensic
07 3233 3226
mleishman@kpmg.com.au

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