

# FraudTrack 5

## Fraud: A Global Challenge



Dear Reader,

I am delighted to enclose the fifth edition of FraudTrack, our annual report based upon extensive research conducted throughout 2007 by BDO Stoy Hayward compared with the experiences of my own fraud investigation team.

What is particularly striking this year is the widening gap between what we are seeing in the market place and what is being prosecuted in the criminal courts. We are seeing an explosion in the number of new fraud investigations, our fraud team took on up to three investigations per week in 2007, yet the number of cases prosecuted in British criminal courts is falling.

There is no criticism of the police implied here: in the face of rising demands and limited resources, attention is still quite rightly focused on terrorism, murder and other threats to life and safety.

However as fraud, fraudsters and the proceeds of fraud increasingly cross international boundaries we need to take a global perspective. FraudTrack 5 therefore presents recent case studies from BDO International's offices around the world. I believe that our UK team dedicated to white collar fraud investigation is the largest in the country. In addition to many UK clients, 2007 has seen us operating in the Channel Islands, the United States, South Africa, Germany, Canada and Switzerland.

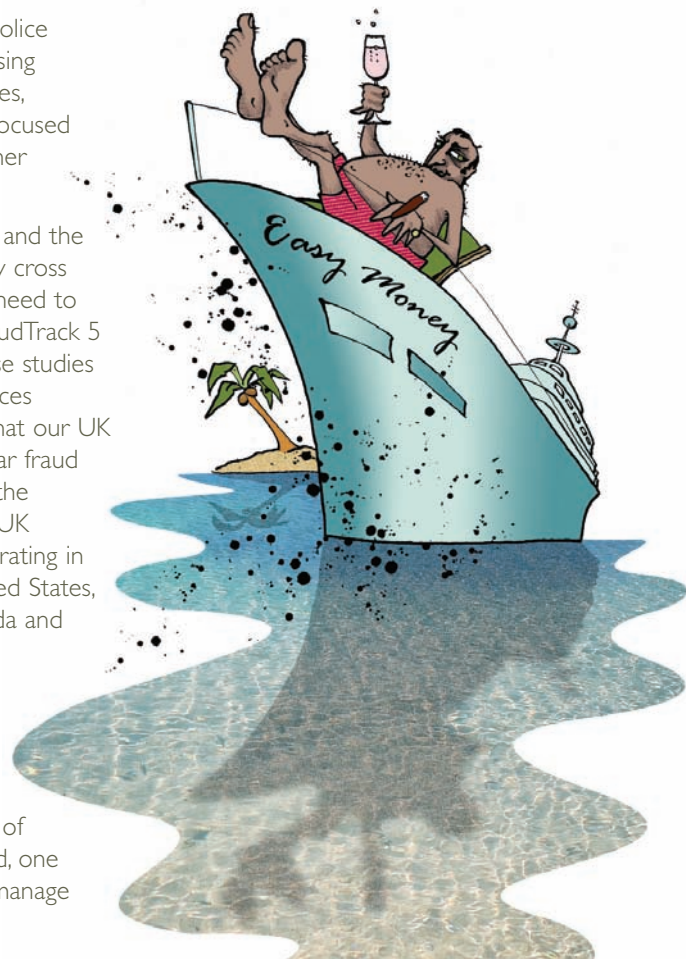
There is nothing mystical or mysterious about fraud. It is just another business risk that must be mitigated. However, without awareness of the risks and practice of fraud, one cannot anticipate, detect or manage

the problem. We hope that FraudTrack 5 will help you to protect your people, your business and your profits.

If you have any questions about BDO Stoy Hayward's Fraud Services Unit or have any concerns that you would like to discuss confidentially, please contact me on 0113 204 1286 or email me at [simon.p.bevan@bdo.co.uk](mailto:simon.p.bevan@bdo.co.uk)

Yours sincerely,

**Simon P Bevan**  
Partner & Head of Fraud Services Unit



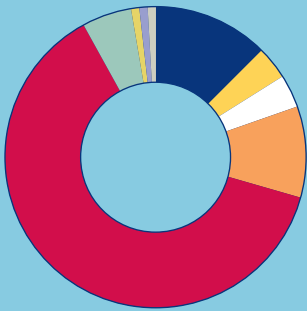
# FraudTrack 5

## Fraud: A Global Challenge



# Analysis

## Motive



■ Debt ■ Divorce/marital problems ■ Drugs/alcohol  
 ■ Gambling ■ Greed/lavish lifestyle  
 ■ Health/depression ■ Need/unforeseen circumstances  
 ■ Other ■ Terrorism

Contrary to common public perception, fraud is not a victimless crime. Highly sophisticated and organised fraud drains resources and affects public services.

## Fraud: to fall or not to fall?

Last year we warned that a downward turn in the economic cycle is often accompanied by a dramatic rise in fraud: when the tide goes out, it's easy to spot those swimming without their trunks on!

The economic tide is indeed starting to turn. However, our figures show that reported fraud has fallen from £1.37bn last year to £1.037bn this year, a substantial reduction of 24 per cent. This is massively at odds with our own experience of spiralling case loads that have kept us busier than ever before. Many organisations call us suspecting that they are victims of fraud. The reduction in reported fraud is reflected in the widening gap between the numbers of fraud investigations that we are undertaking and the numbers of prosecutions in the criminal courts. It seems that both criminal and civil frauds are on the rise but that criminal frauds often go unreported. In essence, fraudsters are still getting away with it, and we don't want to carry on funding their greedy and lavish lifestyles!!

We are not placing any criticism with the police, as we are fully aware of the increasing obstacles faced by them like rising demands and limited resources and quite rightly they are focussing on terrorism, murder and other threats to life and safety.

Contrary to common public perception, fraud is not a victimless crime. Highly sophisticated and organised fraud drains resources and affects public services. For example, carousel fraud cost the UK £541m this year which equates to £10 for every man, woman and child in the UK. This severely hits public services and means we all have to work that bit harder to replace the tax lost. In addition of course, this kind of crime may fund other criminal and terrorist activity.

Throughout 2007, BDO Stoy Hayward's Fraud Services Unit investigated frauds in:

- Financial Services
- Leisure and Hospitality
- Manufacturing
- Not-for-profit Organisations
- Professional Services
- Real Estate and Construction
- Retail
- Technology, Media and Telecoms
- Support Services and Transportation.

Our FraudTrack report last year reported that the major fraud risk areas lay in procurement, commercial lending and housing association developments. These risky areas remain and we would warn those in these areas to stay vigilant.

# Case studies

## Australia: a matter of trust



A member of a small family business committed a \$2m fraud, costing profits, jobs and a great deal of trust.

The family business owners became suspicious when they realised that their son-in-law used the company diesel card to buy petrol for his car. On closer scrutiny, they soon uncovered a company cheque for \$80,000 made payable to the son-in-law's personal account.

Our Brisbane office discovered that the cheque and fuel were just the tip of a vast iceberg.

The company's complex accounts system allowed the perpetrator to disguise cheques payable to himself as creditor payments.

He then became a signatory and took ever larger cheques. He claimed that the poor cash flow was due to losses in one particular division which the family therefore closed, creating redundancies and losing what was in truth a successful business.

The costs of inefficient accounting systems and undue trust can be massive. Every business should protect itself with thorough controls and vigilance.

## Canada: too good to be true?



We recently conducted an investigation into a large joint venture company trading in online advertising and payment systems.

The joint venture comprised around 50 corporations with more than 250 bank accounts world-wide. Although technologically skilled, the business partners failed to establish proper financial systems and controls. Without any clearly assigned responsibilities or shareholder agreements in place, those responsible for banking arrangements easily disguised misappropriated funds. They maintained an illusion of healthy profit margins... until the cash ran out!

There were three key phases to the ensuing fraud investigation:

- determining the total value of global assets
- obtaining documentation for all banking transactions for over four years prior to the investigation
- monitoring ongoing transactions.

A Mareva injunction (an order to freeze world-wide assets) was granted against the company. Our offices world-wide continue to liaise, establishing an accurate forensic history that will assist future court proceedings.



# Analysis

If you're a female don't commit fraud with a loss of between £250,000 and £1m: find a man to do it instead! He will land a shorter prison sentence so you can spend your ill-gotten gains all the sooner after the man finishes his porridge.

## The fraudster under the microscope

The typical fraudster profile is a male aged between 20 and 39, although the 40-59 age group is also strongly represented; these groups account for 64 per cent of all reported fraud.

### Learning from the law?

There remains a puzzling contradiction between jail sentences and the value of fraud. For example, losses between £50m and £100m attract the toughest sentences with an average jail term of 6.79 years, yet frauds with losses above £100m see average sentences of 3.88 years. Strange – but true.

If you're a female don't commit fraud with a loss of between £250,000 and £1m: find a man to do it instead! He will land a shorter prison sentence so you can spend your ill-gotten gains all the sooner after the man finishes his porridge.

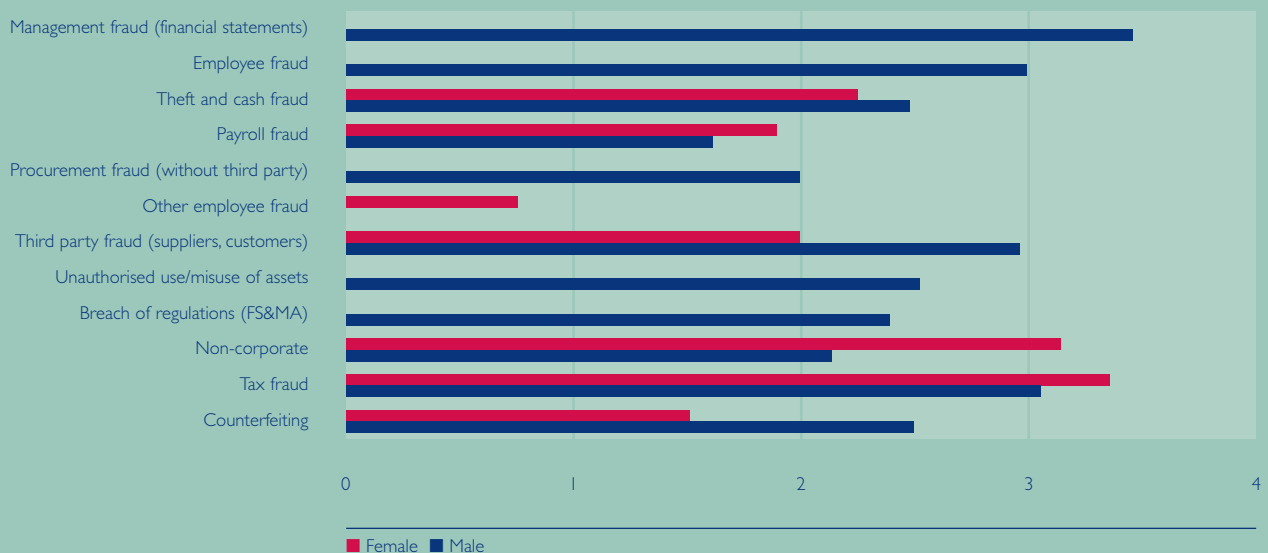
If our fraudster, Mr D Fraud, sticks to marital, debt or gambling motive, he may even get away with a lighter sentence, but there will be no sympathy for drug and alcohol problems which receive the toughest treatment.

If Mr D Fraud commits a fraud as an employee (such as a payroll fraud) his sentence is likely to be further reduced.

However, if you really want to drop Mr D Fraud in it, persuade him to go super-size and head for a fraud involving £50m to £100m. If he holds a position of trust such as a chief executive or director then you'll hit the jackpot and probably won't see him for five or six years.

It's almost as if fraud works like an insurance policy – tick the right boxes and you'll reduce your 'risk' or in this case, your jail time.

## Average Custodial Sentence by Fraud Type and Gender



# Case studies

## Germany: losing face or losing the plot?



A German-based world player in medical systems has suffered at the hands of its Korean affiliate.

Suspicious were aroused when the Korean business repeatedly failed to pay parent company invoices. Operating in partnership, BDO International offices in Germany and Korea conducted a forensic audit and investigation into the matter.

Analysis showed that despite a massive increase in reported sales between 2002-05, the flourishing revenues and client lists were faked. Instead, around \$6.5m worth of supplies ordered from the German parent company were stowed, unpaid for, in warehouses and staff had been bribed with 'customs consulting fees' to remain silent.

The perpetrators – the Korean Chief Executive and Chief Financial Officer – said they acted to prevent losing face when challenged by high sales targets.

Our client is hopeful that the perpetrators will support our final investigations and then resign, enabling the creation of a new, ethical and well-controlled Korean business.

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## Hong Kong: forensic solutions in Far Eastern fraud



When two property development subsidiaries defaulted on loan and contractor payments, the non-executive directors of the Main Board listed parent appointed our Hong Kong office to carry out forensic investigations.

Pre-sale proceeds of HK\$556m had been deposited by the two subsidiaries into a stakehold account. These monies were to be used solely for specific construction works. However,

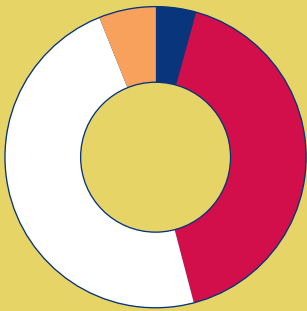
although construction was still in progress, BDO International discovered that only HK\$3m remained in the account.

Our enquiries uncovered systematic fraud by the Authorised Person, a director and architect who had presented false Architect Certificates and other documents to release stakehold monies for alleged costs. The fraudster was subsequently convicted and sentenced to five years in prison.



# Analysis

## Fraud by industry sector



■ Arts, Entertainment and Recreation  
■ Finance and Insurance  
■ Public Administration  
■ Other

From our experience, we see increasing numbers of people offering themselves for employment with the sole intention of committing a fraud further down the line.

## Impact on industry and commerce

The cost of all fraud in 2007 was £1.037bn. Half of this was carousel fraud (a simple but very effective VAT fraud). Of the remaining £496m, the finance and insurance sector was hit badly this year with reported losses of £432m (87 per cent of all non carousel fraud), of which 50 per cent was perpetrated by employees.

Frauds committed by corporate management escalated significantly, making a routine check of books and records a wise step for every business. Fraudulent financial statements were rife: false accounting, 'cooking the books', portraying businesses in unduly favourable terms (perhaps to obtain results-based bonuses or a loan or just to keep a job) and similar reported cases cost more than £358m.

If you're going into business and want to keep away from fraud, the safest sectors are agriculture, forestry, fishing and hunting, industries which combined lost just £120,000 in reported fraud last year. As for location, East Anglia seems to be a safer haven. London and the South East, the Midlands and the North West are no-go areas for those wanting to avoid the most dangerous fraudsters.

## Impact on financial institutions

Despite the worrying figures in this sector, it's encouraging that the financial institutions are willing to root out and prosecute fraudulent staff rather than sweep the matter under the corporate carpet. More than a quarter of all employee fraud prosecutions occur in our financial institutions. It's reassuring that they don't fear losing face because of a bad employee and they are keen to demonstrate a commitment to deal appropriately with wrongdoers.

## Recruitment – the first line of defence

No matter how poor your procedures, having the right people in place protects your business from internal fraud. On the contrary, weak, ineffective recruitment policies leave you open to attack even when your systems are sound.

From our experience, we see increasing numbers of people offering themselves for employment with the sole intention of committing a fraud further down the line. What's more, false references, qualifications and education histories are commonplace. The first class honours graduate may simply be a first class fraudster! HR filing cabinets across the country provide us with the evidence of widespread CV crime. Yet despite the clear risks, getting this message across can be frustrating and brings to mind an old Chinese proverb, 'Don't try to teach a pig to sing because (a) you will waste your time and (b) you will irritate the pig!'

# Case studies

## Malaysia: internal controls protect profits



A senior official at Company AB received an anonymous warning of irregular dealings between the firm's General Manager (GM) and a logistics company, XY Express. The note alleged that GM was receiving kickback payments on all invoices sent by Company AB to XY Express.

The subsequent investigation revealed that GM held sole control of all warehouse and logistics functions and contracts and used XY Express alone to fulfil Company AB's logistics requirements. In addition, XY Express charges to Company AB were 220 per cent higher than their normal rates.

Although no personal connection was discovered between GM and XY Express, enquiries uncovered extraordinary cash deposits of more than \$477,000 in a four-month period into GM's personal and family bank accounts.

Stronger internal controls could have protected Company AB from the effects of these highly suspicious activities. Procurement deals should always compare at least three quotes and high-value contracts require board approval.

## United Kingdom: credit and credulity



A UK bank suffered at the hands of an unsophisticated but greedy borrower.

The bank lent the individual £70m to buy a London hotel. He later presented a business case for an additional loan at reduced charges to enhance facilities and boost occupancy rates.

However the borrower soon defaulted on repayments and his company was dissolved. He claimed that his large house was his only asset and persuaded the bank to let him remain there. Actively deterring prospective buyers, he sold the property cheaply to a family member and continued to live there. The hotel was also sold at less than market value to an associate.

Investigations revealed that the bank's lending staff and the accountants responsible for the business plan had been manipulated, resulting in less than professional practice – and a £multi-million loss.

Naïve staff, rising property markets and sales-based (rather than repayment-based) bonuses all help fraudsters to hide their activities. Lenders beware!



# Analysis

## Sample

FraudTrack 5 is prepared by BDO Stoy Hayward and is based on all reported fraud cases of over £50,000 during 2007. The sources for the database are publicly available and include the UK's national, regional and local press. The data represents 267 cases of fraud with a total value of £1.037bn.

To view more of our fraud analysis in 2007 please visit:  
[www.bdo.co.uk/fraudtrack](http://www.bdo.co.uk/fraudtrack)

## The international picture

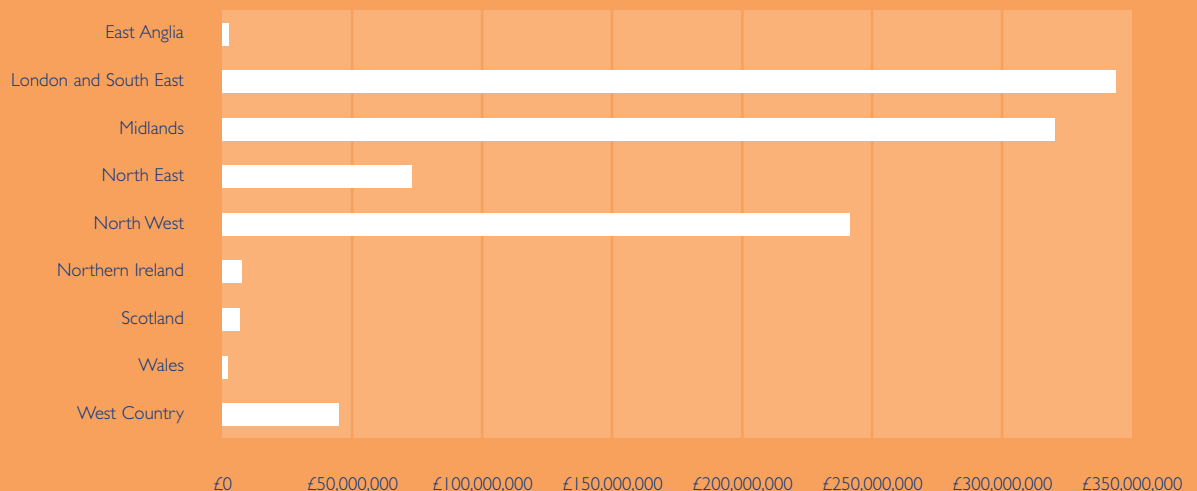
At the risk of repeating ourselves, we are keen to clarify that it is people, not computers, who commit fraud. Blaming technology is unwise and unhelpful. However, in a shrinking world it is possible to conduct a complex and sophisticated fraud from the comfort of your own living room. The fraudster's world is his oyster; so beware: it's no longer just your fellow countryman who will steal from you!

This year we have seen a major increase in frauds committed by people who are either based outside the UK or who operate within an international network. Fraud has been committed in the UK this year by fraudsters from the US, Nigeria, Lithuania, Belgium and France, to name a few. We must reiterate however, that the majority of fraud in the UK is still perpetrated by your good old fashioned 'honest' Brit.

Our fraud investigation team has fulfilled more and more international assignments throughout 2007. BDO International has an outstanding global network of 600 offices in over 100 countries which put us at a great advantage in our fight against international fraud. Our forensic technology teams based in London, New York and Hamburg are adept in handling the capture, analysis, investigation and review of electronic evidence stored world-wide. A recent UK-based client asked if data could be captured within two days from a computer on a ship due to dock in Shanghai. Co-ordinated by our London office, a Mandarin speaker from our German team and a member of our New York team were in a position to meet the ship and assist the client within 24 hours.

We have shown in this publication a number of case studies from our international colleagues that give a clear indication of our capabilities around the globe.

## Total value by location



# Case studies

## United States: the wages of sin...



Our New York office was retained to enquire into a \$2.8m payroll fraud at the HQ of a major international manufacturer.

When the company's payroll manager was considered for promotion, a routine check on his credentials uncovered a false Social Security number and counterfeit educational and professional documents. Alarmed by their initial findings, the company alerted the authorities and BDO International was commissioned to investigate.

Our enquiries revealed that for three years the payroll manager had deliberately inflated the company's state unemployment tax rates, redirecting subsequent refund monies into his personal bank account.

Several red flags should have raised our client's suspicions:

- tight, personal control of payroll and tax systems
- the perpetrator's unduly extravagant lifestyle
- major increases in company tax expenditure.

Furthermore, better pre-employment checks, segregation of duties and corporate awareness could have prevented the fraud.

The perpetrator pleaded guilty and awaits a lengthy sentence.

## Conclusion

By its very nature, fraud is an international crime. The fraudsters themselves trade details about victims internationally. They move the proceeds of their crimes to international jurisdictions and when the fraud is discovered they hop from one jurisdiction to another in an attempt to escape either criminal or civil sanction.

To fight this, global organisations need truly global teams of fraud investigators who can jump on a plane at an hour's notice to assist a client anywhere in the world. Such teams can draw on local expertise, enabling clients to prosecute overseas or make civil recoveries, usually in UK or US civil courts. Ten years ago it was virtually impossible to investigate white collar fraud effectively without a Computer Forensics Division: electronic evidence forms the basis of any investigation and must be secured correctly and legally. As international fraud expands in this decade, the support of a dedicated international civil fraud team is vital in enabling successful prosecutions or recoveries.

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# Skills

## Our skills: defeating the fraudsters, defending your business

Discovering a fraud can be a particularly unnerving event for those who have not previously faced such a challenge. The receipt of a whistle-blowing letter, the discovery of an accounting 'black hole' or two sets of conflicting financial statements can cause anger, anxiety, frustration and a great deal of wasted time. Fortunately, expert help is at hand: a simple phone call is all it takes to discuss how our dedicated fraud team can help you resolve your problem.

### Complete confidentiality

We understand the need for the strictest confidentiality in fraud matters. Companies do not wish to see their name in the papers for the wrong reasons, nor will they want to allow suppliers and customers to take advantage of such a situation. With our extensive insight and experience, we will do all we can to protect your business reputation from potential damage following the discovery of a fraud.

In line with our policy of absolute confidentiality, all case studies in this publication have been anonymised.

### Rapid response

Fraud cases demand and deserve prompt action. Our national fraud team has bases in the North and South of the UK and we can also call in our BDO International colleagues from around the world. We can often have a team on-site in less than one day of the discovery of fraud – sometimes within just a few hours.

### Advanced technology

Our dedicated Computer Forensics team is trained in line with the Association of Chief Police Officers' guidelines in capturing data from computer hard drives, mobile phones and other electronic devices.

### Exceptional experience

Our experienced forensic accountants are highly skilled specialists. We work exclusively in fraud investigation, so you can be assured of the best possible expertise, support and results.

# Our UK team



## Partner

- Head of BDO Stoy Hayward's Fraud Services team with over 23 years' experience of fraud investigation in excess of one hundred investigations in over 20 countries.



## Senior managers

- Over 20 years' investigation experience with Customs & Excise with eight years as a specialist Computer Forensic Practitioner.
- Over 10 years' experience of fraud investigations including high profile international fraud.
- Over 10 years' experience of financial investigations in both public and private sectors, including a secondment to the Serious Fraud Office (SFO).
- Eleven years' experience as a forensic accounting specialist, previously a partner in a specialist forensic accounting practice.



## Managers

- Five years' of fraud and anti-money laundering investigation experience in the US and UK.
- Over 15 years' experience as a Principal Investigator at the SFO working on large scale fraud investigations.
- Over 13 years' experience as an investigator with the SFO working on large and complex fraud cases.
- Over 15 years' investigative experience, specialising in computer forensics and e-discovery assignments.
- Nine years' forensic accounting experience having completed a secondment with the SFO.



## Supervisors

- Over six years' investigative experience having also completed a secondment to the Financial Services Authority investigating insider dealing.
- Over 11 years' experience with the DTI prior to specialising in fraud investigations.
- Four years' experience as a major incident analyst with two police forces and near completion of a criminology related PHD.
- Three years' investigation experience which includes investigating Government and EU funding in Ireland.



## Analysts

- Three years' experience as an investigator with the SFO.
- Eighteen months' experience as a research analyst in the Fraud Services Unit.
- Three years' experience as a research analyst in the Fraud Services Unit.



## Personal assistant

- Holding the team together, our PA has over 20 years' experience working within large multinational corporate firms.

## About BDO Stoy Hayward

BDO Stoy Hayward is the UK Member Firm of BDO International, the world's fifth largest accountancy network, with more than 600 offices in over 100 countries.

## How can we help you

If you would like more information about this publication or our wide range of fraud and forensic accounting services please contact your local BDO Stoy Hayward business centre:

### Belfast

stephen.moohan@bdo.co.uk  
028 9043 9009

### Birmingham

sat.plaha@bdo.co.uk  
0121 352 6210

### Bristol

sat.plaha@bdo.co.uk  
0121 352 6210

### Cambridge

richard.shave@bdo.co.uk  
01223 535055

### Chelmsford

gary.miller@bdo.co.uk  
01245 264 644

### Glasgow

judith.scott@bdo.co.uk  
0141 249 5263

### Hatfield

geoff.kinlan@bdo.co.uk  
01707 255880

### Leeds

simon.p.bevan@bdo.co.uk  
0113 204 1286

### London

simon.p.bevan@bdo.co.uk  
020 7893 2562

### Manchester

brent.wilkinson@bdo.co.uk  
0161 817 7506

### Reading

martha.thompson@bdo.co.uk  
0118 925 4439

### Southampton

kay.linnell@bdo.co.uk  
023 8088 1762

### Southern Region

Epsom, Gatwick & Guildford  
lesley.wills@bdo.co.uk  
01483 565666

We would like to thank our BDO Member Firms for contributing to this publication. For further information about our featured BDO Member Firms please contact the following:

### Australia

David Ferrier  
david.ferrier@bdo.com.au  
00 61 3 8320 2205

### Canada

Greg Hocking  
ghocking@bdo.ca  
001 905 946 1066

### Germany

Markus Brinkmann  
markus.brinkmann@bdo.de  
0049 40 3029 3355

### Hong Kong

Johnson Kong  
jkong@bdo.com.hk  
00 852 28531418

### Malaysia

Raymond Corray  
raymond.corray@bdo.com  
00 60 3 2616 2988

### USA

Timothy L. Mohr  
tmohr@bdo.com  
001 212 885 8042

[www.bdo.co.uk/fraudtrack](http://www.bdo.co.uk/fraudtrack)



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