

State of Global Financial Crime

In-depth Analysis on GCC Countries

دراسة حالة الجرائم المالية عالميا

دراسة مفصلة لدول مجلس التعاون الخليجي

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Abstract

Financial crime has been present ever since business and trade have started; however, the issue of financial crime was only dealt with ex post facto. In the last few years, particularly after the 2007 global economic crisis, finding the connection between white-collar crime and economic crises became the primary focus of many corporations and legal entities. This research paper shows how financial crime contributed to the global financial crisis, consolidates the global state of financial crime in the last 5 years (2007-2011), presents an analysis on corruption and explains the laws created and/or modified by governments to mitigate the risk of financial crime. Research has shown that financial delinquency is more common in developing countries than developed ones; therefore, this research paper delves into the state of financial crime in the GCC markets by presenting the largest incidents of fraud that occurred and governments' actions to combat it. The research method used was qualitative case study research; the data used was qualitative secondary data and was analyzed using content analysis. The paper finds that financial crime was one of the factors that caused the 2007 global economic crisis, financial crime incidents were aggravated in some sectors and countries after the crisis but decreased in others, and most importantly, it is the discovery of crime that increased the most during economic turmoil. The paper also concludes that corruption and bribery are increasing in many countries, regulators are paying attention to the issue of corruption but corporations are not. Lastly, GCC countries are still on their early stages in combating financial crime, however, they are employing effective tools and measures, which put them on the right direction.

الملخص:

تعتبر الجرائم المالية قديمة قدم التجارة والأعمال. ولكن هذا النوع من الجرائم لم يعطى أي إهتمام إلا بعد وقوعه. من خلال السنين الماضية، وبعد الأزمة الاقتصادية عام 2007 تحديداً، أصبحت مسألة الجرائم المالية من أكثر وأهم المواضيع المتداولة بين الحكومات والشركات عالمياً، محاولين جاهداً إيجاد الرابط المشترك ما بين الجرائم المالية والأزمة الاقتصادية. يظهر هذا التقرير كيفية إسهام الجرائم المالية بإحداث الأزمة الاقتصادية العالمية وذلك بدمج حالة الجرائم المالية عالمياً، بتقديم تحليل عن الفساد، بشرح القوانين التي سنت من أجل التخفيف والحد من خطر وقوع هذه الجرائم. أثبتت الدراسات أن الجرائم المالية شائعة بالدول النامية أكثر منها بالدول المتقدمة، لذلك، تعمدت في هذا التقرير التحدث عن وضع الجرائم المالية بمجلس التعاون الخليجي وذلك بواسطة تقديم أكبر الجرائم التي وقعت وكيفية التعامل مع هذه القضايا بالتحديد. استخدم في هذا البحث أسلوب "دراسة حالة " كما استخدمت بيانات نوعية ثانوية و حللت باستخدام طريقة تحليل المحتوى. كما استنتج البحث، أن الجرائم المالية كانت عاملاً فعالاً لحدوث الأزمة الاقتصادية الأخيرة. في الآونة الأخيرة وخاصة بعد وقوع الأزمة، إزدادت نسبة الجرائم المالية في بعض القطاعات و الدول وقلت في قطاعات ودول أخرى. والأهم من ذلك كله، أن إكتشاف الجرائم المالية يزداد في الأزمات الاقتصادية بشكل عام. يستنتج من هذا البحث، أن مسألة الفساد تزداد إنتشاراً في عديد من الدول وإن المنظمين يولون إهتماماً ملحوظاً لهذا موضوع ولكن الشركات ما زالوا يستخفون بها. أخيراً، إن دول مجلس التعاون الخليجي ما زالت في مرحلتها الأولى بمحاربة الجرائم المالية وذلك باستخدامها الطرق المبتكرة مما يدل على إتباعهم النهج الصحيح.

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I. Research Objective

The objective of this research paper was to identify the role financial crime played in causing the 2007 global financial crisis, focusing on organizations/individuals that caused massive losses to investors, such as Goldman Sachs, credit rating agencies and Bernard Madoff. Moreover, it aimed to analyze the state of global financial crime collectively, regionally and by industry in the last five years (2007-2011), and then presented an overview of the Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act, followed by a study on corruption and bribery, and briefly explained the profile of the typical fraudster and inside jobs. It also thoroughly examined the state of white-collar crime in the Gulf Cooperation Council (GCC) countries; pointed out the biggest and latest crimes, identified the most prevalent type of crimes that ensued and the actions taken by the authorities against them mainly by analyzing surveys published by auditing firms in 2004, 2007 and 2011. Finally, the research paper presented a set of recommendations suggested by fraud professionals from leading companies such as Kroll, Deloitte, KPMG and published authors.

II. Research Rationale

For many years the subject of financial crime received little or no attention and was often overlooked, companies considered compliance a hurdle to doing business and gaining profits, and regulators turned a blind eye to companies' suspicious transactions as long as they were profitable and contributed to countries' economic growth. However, this has changed following the financial crisis, as governments and companies acknowledged the importance of fighting financial crime in order to save businesses and in some cases, economies. In pursuance of combating financial crime, individuals should first understand the different types of white-collar crime, what constitutes a crime in their home country and internationally and methods for tackling and preventing it. This research paper covers these areas by describing the different categories of crime, presenting the Foreign Corrupt Practices Act & the UK Bribery Act, and thoroughly examining the state of financial crime globally and by sector from 2007 until 2011. I have chosen "financial crime" as my research topic for several reasons: firstly, to examine the extent to which financial crime contributed to the onset and/or precipitation of the recent economic crisis as when it started, investors, fund managers, bankers and regulators started pointing fingers accusing one another of ignoring red flags and failing to impose stricter rules to mitigate all kinds of risk. Secondly, to prove how damaging financial crime can be to the fraudster and the victim, causing monetary and/or reputational losses, and how implementing effective anti-fraud measures lead to high profits in the long haul. Therefore, this research paper highlights the importance of embedding anti-fraud tools into daily operations and long-term strategy and considering them means to increase profits and ensure long-term survival rather than obstacles to achieving short and long-term goals. Thirdly, I have chosen this topic to track the prevalence of financial crime incidents before and after the recent economic crisis in developing countries, namely the GCC. As many countries in the GCC were and still are

rapidly growing, financial crime cases were often discarded and unannounced, nevertheless, as my research paper shows through the presentation of the biggest scandals that occurred and surveys conducted, countries in the GCC are striving to fight financial crime by enhancing transparency, imposing stricter rules and adopting anti-fraud measures. White-collar crime is one of the most imperative and common matters being analyzed and examined today due to its damaging consequences, heightened prevalence and perceived vulnerability to it.

III. Research Methodology

Research Method

The research methodology used was the qualitative case study research, as the topic of financial crime was exhaustively examined from different aspects, that is, being an inseparable part of conducting business, the effect of the financial crisis on it and vice versa, a five year analysis of the prevalence of financial crime by region and by industry, and an in-depth analysis of financial crime in the GCC countries. The research paper presents case studies of financial crime incidents that were caused by organizations and individuals such as Goldman Sachs and Bernard Madoff. Moreover, it also presents case studies in the GCC countries of the biggest scandals of financial crime.

Data Collection

The research paper heavily relied on the use of secondary data, primary data could not be obtained as financial crime is a topic avoided by many firms, that is why I relied on surveys published by leading multinational companies, such as, Kroll, Deloitte, KPMG and PWC. The surveys published by those companies include respondents globally and from varying sectors, as in the case of Kroll and Deloitte's surveys, and regionally as in the case of Deloitte, KPMG and PWC. Additionally, published reports were used for the case studies.

Data Analysis

Content analysis was used to create patterns and draw conclusions from data compiled from surveys, published reports and news articles about the prevalence of fraud, effect of financial crime on the financial crisis and anti-fraud measures adopted. An example of such explanation is giving reasons behind the increased or decreased prevalence of fraud in some sectors at the onset of the financial crisis. Another example is analyzing the reasons behind the fluctuation of different types of fraud in different regions over the years. Content

analysis was used for analyzing the data because the research paper's primary focus was on financial crime that relied less on quantitative methods and more on actual case studies and surveys.

IV. Introduction

The act of financial crime is as old as business and trade. Companies cannot completely eliminate it, but they can minimize its risk of occurring by hiring the right people and adopting effective measures. As Andres Antonius -President of Kroll's Consulting Group- says, "The risk of fraud is a part of doing business. It can even be considered a consequence" (Antonius 2007, p.2). Similarly, Crawford & Weirich (2011) point out that financial statements fraud of public companies has existed ever since the public securities market was established. They also found that perpetrators are opportunists; therefore, they commit white-collar crimes when greed coincides with an opportunity for deception. Also, Antonius (2007) explained that the occurrence of fraud was not caused by negligence; it was a consequence for doing business in different industries, currencies, regions and cultures. Managers used to view compliance and anti-fraud measures as a nuisance. Nonetheless, following the global financial crisis of 2007, complacency was no longer an option; financial crime has been gaining attention from most of the companies worldwide, where they are investing money and assigning the necessary resources to mitigate the risks of financial crime. Several industries, countries and even religions have defined financial crime. The Federal Bureau of Investigation (FBI) defines financial crime as "crimes characterized by deceit, concealment, or violation of trust and are not dependent upon the application or threat of physical force or violence" (FBI 2009, p.1). The International Monetary Fund (IMF) defines it as "any non-violent crime resulting in a financial loss" (IMF 2001, p.5). Moreover, there are many verses in the Quran that condemn and prohibit financial crime, "Oh ye who believe! Eat not each other's property by unfair and dishonest means" (*Holy Quran*, 4.29)¹. The terms financial crime and white-collar crime will be used interchangeably in this report

¹ Er, M. (2008). Corruption from the Islamic perspective: Some recommendations for the MENA region. *International Journal of Islamic and Middle Eastern Finance and Management*, vol. 1 (1), pp. 31.51.

and both are defined as “crime against property, involving the unlawful conversion of property belonging to another, to one’s own personal use and benefit” (Gottschalk 2010, p.442). According to Gottschalk (2010), anyone can fall victim to financial crime, be it an individual, organization, government and/or economy. It is therefore imperative to understand the different types of white collar/financial crime and their categories and sub categories: *corruption*, which involves kickbacks, bribery, extortion and embezzlement; *fraud*, which involves corporate, identity, mortgage and occupational fraud; *theft*, which involves physical and intellectual property theft; *manipulation*, which involves laundering, cyber-crime, bid rigging and insider trading (Gottschalk, 2010).

This research paper is structured as follows: section V explores how the effects of the financial crisis were magnified by the financial crimes revealed; section VI presents the state of financial crime globally with emphasis on some regions, section VII provides an in-depth analysis of the state of financial crime in GCC countries, and finally, sections VIII & IX end the research paper with a set of recommendations and conclusions, respectively.

V. Financial Crime & the Global Financial Crisis

In the aftermath of the 2007 global financial crisis, many questions were raised on the laxity of regulators, the quality of capital reserved by banks, the contribution of financial crime to triggering the financial crisis, and whether these crimes could have been detected earlier if regulators, banks and investors were more cautious. Kroll (2007, p.3) states, “Recent months have shown that turbulence in financial markets reveals rocks at the bottom of the stream. They have always been there, but only when the water level drops do the sharp edges become exposed.”

Tomasic (2011) argues that the global financial crisis exposed financial crime cases that resulted in colossal monetary losses, and that some of those crimes could have been detected earlier if some investors and traders’ activities had been scrutinized. “You only find out who is swimming naked when the tide goes out” (The New York Times, 2007). Financial crime has always been an inseparable part of doing business, and controlling it has and still is a challenge faced by the legal system, more so, when the perpetrators are powerful individuals or when the amounts involved are massive (Tomasic, 2011). To make matters worse, as Tomasic (2011) argues, perpetrators’ imperviousness to regulations is amplified when influential political figures encourage excessive risk taking. This is achieved by restraining enforcement agencies’ activities and limiting required and sufficient resources or by claiming that the market needs to be “self-regulated”, thus limiting the interference of regulators in order to promote a “business friendly” environment to attract investors.

Cregan et al (2011) and Tomasic (2011) agree that the recent financial crisis has proven how challenging it is to criminalize “catastrophic failures”, since three years after the crisis, not a single financial executive has been prosecuted, and the rogue traders who were

prosecuted faced criminal charges after causing immense losses, that is, when the damage was already done. One example of a rogue trader is Nick Leeson, who was responsible for bankrupting Barings Bank in 1995, one of the oldest banks in England at the time. A more recent rogue trader is Kweku Adoboli, a former UBS trader who is accused of unapproved trading and caused the bank a loss of \$2.25 billion in late 2011, which accounts for the greatest illegal trading loss in British history (Croft, 2012). However, it is interesting to note that fraud cases causing billions in losses are not common. Regulators should also be wary of perpetrators who manage to fraud companies and investors for years. Kroll (2010) mentions that if fraud were to be a virus, then at one time or another, everyone would be faintly ill, to quote, “the most successful pathogens do not kill the host, but live off them. Of course, huge, company - destroying losses do occur, but they are very rare, more typical are smaller losses over months or years” (Kroll 2010, p. 5). Perpetrators live off limited company resources until the perfect opportunity arises, causing enormous financial and reputational damage, and similar to a virus, if fraud is left unchecked and untreated, it will “mutate” and become “life-threatening” (Kroll, 2010). Looking at it from a different perspective, according to Wright² (2006), there are many reasons behind the failure of fraud prosecutions; firstly, the length of the trial³, which risks the mental health of defendants as in many instances defendants accused of major fraud cases are declared ill fit to trial, deeming it to end, unlike non-fraud related cases. Moreover, the exceptional length of trials imposes pressure on some key witnesses and victims and in some cases, the judges. Secondly, the mass documented evidence presented clouds the subject of honesty. Thirdly, the trial process occasionally lacks successful management. Lastly, the constant attempts to

² Rosalind Wright is the Director of the Serious Fraud Office (SFO) and Chairman of the Fraud Advisory Panel.

³ According to Wright (2006), the average length of an SFO fraud dispute trial is six months, which is twice the length of non-fraud related trial.

split up the case in order to make it shorter cause ambiguity to fundamental issues of the case.

According to Cregan et al (2011), many corporations' reckless conduct has contributed to the global financial crisis. Tomasic (2011) suggests that senior managers of large corporations do not consider themselves at risk of being prosecuted even if they do not comply with the rules. Additionally, rules and regulations were too lenient and could have easily been circumvented, which was the case with several large corporations such as Goldman Sachs, credit rating agencies, and hedge fund managers such as Bernard Madoff (Cregan et al, 2011).

Goldman Sachs

In 2006, Goldman Sachs was not only one of the biggest underwriters of collateralized debt obligations (CDO), but also took interest in mezzanine tranches, where the company went short for its own interest once the value of residential mortgage backed securities (RMBS) started deteriorating (Cregan et al, 2011). According to Cregan et al (2011) and Greenberger (2010), Johnson Paulson, the hedge fund manager of Paulson & Co, Inc., approached Goldman Sachs (charged a fee of \$15 million) to create a synthetic CDO⁴ called ABACUS 2007 - AC, which consists of a portfolio of assets chosen by Paulson and marketed by Goldman Sachs, where the investors would be taking an opposite position to Paulson's and would be funding any "expected failure" of the portfolio. The Securities and Exchange Commission (SEC) believes that both Paulson and Goldman Sachs were aware of the failure of the CDO market as early as January 2007, that is, when Paulson first contacted Goldman Sachs (Cregan et al, 2011). However, Goldman Sachs, specifically, Fabrice Tourre (Vice

⁴ "Synthetic CDOs are composed of a series of naked credit default swaps" (Greenberger 2010, p. 16)

President) deliberately hid the identity of Paulson to investors and alleged that an “experienced and independent third – party collateral manager” selected the underlying assets of the security (Cregan et al, 2011). One of Paulson’s counterparties, IKB, a German bank, lost \$150 million, and most of the money lost was paid to Paulson and Goldman Sachs (Cregan et al, 2011). The SEC filed a complaint against Goldman Sachs for defrauding investors by neglecting to disclose conflict of interest and hiding key information about the CDO product; promoting a product that it knew was going to lose and betting against the failure of the U.S mortgage market, which it helped create to begin with (Barr, 2010). Therefore, Goldman Sachs ended up paying \$300 million in fines and \$250 million in compensation for investors (SEC, 2010). One might think that \$550 million is a considerable fine to be paid; however, it barely scratched the surface of Goldman Sach’s fortune, as it made \$13.39 billion in profit in 2009 only. Moreover, after the settlement was announced, share prices increased by 5%, adding to the corporation’s market value much more than it paid in penalties (Chan & Story, 2010).

Credit Rating Agencies

As it has already been established, RMBSs and CDOs were some of the triggers of the 2007 financial crisis. According to Cregan et al (2011), these securities are considered to be speculative junk investments, therefore, their credit rating should be BBB- and below, but instead, credit rating agencies rated them AAA, rendering them risk-free. Consequently, these products attracted many investors given their high return/risk-free profile.

Credit rating agencies overrated the grade of these investment products, as it solely relied on “hard information”, that is, statistical models that base ratings on historical data only, and neglected “soft information”, which requires using human judgment when rating

investment products (Cregan et al, 2011 & Murphy 2008). Credit rating agencies eventually downgraded the ratings of RMBSs by \$1.9 trillion, shocking the global financial system and initiating the crisis (Cregan et al 2011; Kirchgaessner & Sieff 2010). Moreover, since the investment products were downgraded, corporations had to increase collateral as per the BASEL II Accord; however, many corporations did not have sufficient liquidity, leading to government bailouts (Cregan et al, 2011). More importantly, investors were paying for credit rating agencies until 1970, after that the SEC implemented Rule 15C31-1, instructing investment banks to pay for ratings and to self-regulate. This decision has presented credit rating agencies with conflict of interest as they were rating the same companies that pay them (Cregan et al 2011; Kirchgaessner & Sieff 2010).

Bernard Madoff

One of the many frauds that arose during the financial crisis is Bernard Madoff's Ponzi scheme. Henriques (2008, p.1) describes the severity of the Ponzi scheme as "the first worldwide Ponzi scheme – a fraud that lasted longer, reached wider and cut deeper than any similar scheme in history." Madoff's scheme began in the late 1980s and continued until December 2008, when his sons passed on to regulators their father's confession that this was all "a big lie" (Tomasic, 2011). The strategy Madoff claimed to adopt is a "split-strike conversion strategy" that generated exceptionally high returns through "thick and thin". The "split-strike conversion strategy involved a "hedge fund shop" where he was handling investors' money through brokerage accounts within his company, and hedge funds operated as feeder funds channeling money to Madoff. In reality, his fraud strategy was to construct a pyramid scheme where existing investors' returns were provided from new investors' money, causing investors a loss of \$65 billion (The Economist, 2008). Many large

banks lent massively to funds of funds that wanted to invest with Madoff. The nationalized Dutch arm of Belgian bank Fortis declared losses of \$1.3 billion, Royal Bank of Scotland declared losses of almost \$630 million, Fairfield Greenwich (a hedge fund) admitted to exposure of more than \$7 billion, among many others such as HSBC, Santander of Spain, Union Bancaire Privée of Switzerland, London-listed Man Group, Arki Busson's EIM Group, and Tremont of the US have all admitted holdings in funds linked to Madoff (Financial Times, 2008). According to Tomasic (2011), Madoff's scheme was revealed when investors asked for their funds because of the liquidity crisis only to discover that they have been conned all along. Bernard Madoff was a "wolf in sheep's clothing"; on the forefront he was a respectable hedge fund manager and market maker, ex-chairman of NASDAQ, vice-chairman of National Association of Securities Dealers (his industry's self-regulatory body), occasional SEC advisor, and philanthropist. But the truth is, he did not fool everyone, his "too good to be true" investment that generated an annual return of 10% through "thick and thin" led many analysts to raise questions and even complaints about his internal control, business strategy and consistency of high returns (Financial Times 2008; The Economist 2008; Tomasic 2011). Namely, Aksia, an advisory firm, reported that the S&P 100 options market was too small to manage Madoff's portfolio and advised against investing. MPI, a quantitative research company, was unable to find a valid strategy for Madoff's high returns, what it did find though, was that Madoff's returns matched that of Bayou, a fraudulent hedge fund that ceased to exist (The Economist, 2008). Yet more red flags were raised when Madoff's clients and feeder fund managers were prohibited from accessing accounts online, and he hired an auditing firm consisting of three employees that include a secretary and an 80 year old residing in Florida (The Economist, 2008). It is obvious that investors turned a blind eye on Madoff's investment strategy as they failed to perform due diligence, despite the fact that they "were kept in the dark" and were not allowed to ask

“awkward questions”, deeming it justifiable due to the remarkably high returns he was generating (Alloway 2008; The Economist 2008). One issue that came to light in 2010 was JP Morgan’s deliberate negligence while managing Madoff’s investments. As reported by Alloway (2008), Madoff’s trustees sued JP Morgan for \$6.4 billion. The reason behind the lawsuit is that JP Morgan, Madoff’s primary investment bank, “willfully turned a blind eye” to the fraud and continued to profit from his investments, while questioning his abnormal and consistent high returns (Cregan et al, 2011). Additionally, what made JP Morgan look more suspicious was that the “Suspicious Activity Report” was only submitted to regulators once it acknowledged that its profits were at risk, and then withdrew its investments prior to Madoff’s arrest (Alloway 2008; Cregan et al 2011).

Will the stricter rules enforced by the SEC, FCPA and the application of the UK Bribery Act inhibit the reoccurrences of similar incidents? Well, history shows that it is highly unlikely. According to Tomasic (2011), once the markets recover from the financial crisis, the risk of going back to their “old ways” will be high. Evidence shows that history keeps repeating itself when it comes to corporate fraud; this is showed through the massive corporate frauds arising in the early 2000s by companies like Enron, where it overstated profits by \$586 million for 4 years and created limited partnerships to cover its \$3.1 billion debt; WorldCom, overstated earnings by \$3.8 billion, and many more, such as Global Crossing, Tyco International, AOL Time Warner, Bristol – Meyers Squibb, and Quest Communications International (Kroll, 2011a). Following those frauds, firmer legislations have been formed, rules have been amended, and Sarbanes-Oxley Act of 2002 was created as well as the Patriot Act and US anti-money laundering statutes, yet, in 2005, the financial world witnessed a 140% increase in financial misrepresentation cases, 133% increase in money laundering cases and a 71% increase in corruption and bribery (Kroll 2011a;

PricewaterhouseCooper's, 2005). The reason for this pattern is that people do not want to ask difficult questions and perform due diligence when an investment seems like "it is too good to be true"; they just search for investments with abnormally high returns and the cycle continues (Kroll, 2011b). Whipple (2009) argues that the incidences of fraud do not automatically increase during financial crises, what does increase he adds is the detection of fraud as perpetrators, especially fraudsters, are affected by economic downturns just like legitimate businesses. However, this does not mean that attempts to commit financial crime decreases during economic downturn; research has shown that fraud intent increases during difficult times but the opportunity declines. To add, the level of financial crime varies according to the sector during tough times, depending on how close the sector is to the "original crisis". For example, the financial services sector witnessed fraud, whereas sectors that experienced a drop in sales such as construction and natural resources have seen a decrease in the incidences of crime (Kroll, 2008).

What has been shown from the cases of Goldman Sachs, credit-rating agencies and Bernard Madoff is the negligence and irresponsibility of large corporations and individual investors as well as the laxity of regulators. Corporations such as Goldman Sachs and JP Morgan have proved to be only concerned with their profits, turning a blind eye to alarming investment behavior and putting their interest ahead of their clients and the overall financial system. Moreover, this was facilitated by the lenient policies set by regulators and the encouragement of the so -called "self-regulation" of credit-rating agencies (Cregan et al 2011; Tomasic 2011). Ironically, Madoff criticized the SEC in an interview conducted by the Financial Times:

My complaint about regulators and the SEC, which dates back as long as I've been involved, is I feel they spend too much time going after minor infractions and no time going after the major firms and investment banks, very

little, if anything, has been done with this new regulatory reform that is going to correct this (Gelles & Tett, 2010).

Regulators have to enforce supervisory approaches that focus on the stability of the financial system as a whole, rather than the current approach (Turner 2009 in Tomasic 2011), which focuses on individual institutions. In other words, regulators should adopt a macroprudential approach rather than the current microprudential one (Pandey, 2011).

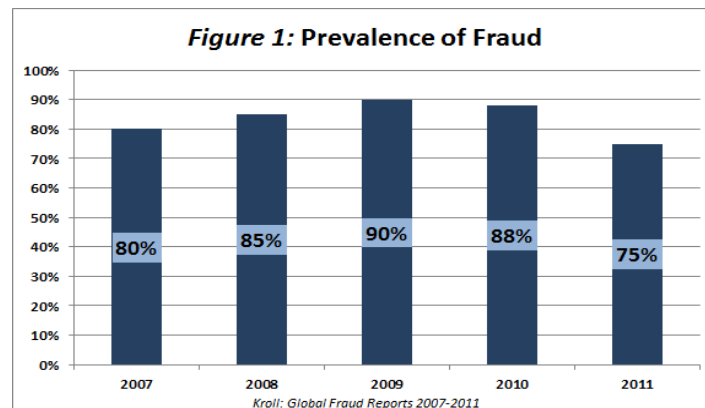
Summary, comments and criticisms

As can be seen from the section above, authors and economists are still trying to make sense of the 2007 global financial crisis by finding the fundamental reasons behind it. Tomasic (2011) and Fisher et al (2011) mainly blame the unethical trading behavior and investment activities of large institutions combined with the lack of strict regulations governing the financial markets. I agree with both of them that one of the reasons was the unaccountable behavior of Goldman Sachs, JP Morgan, credit rating agencies and the like. However, what Tomasic (2011) and Fisher et al (2011) fail to mention is that everyone in the financial sector share the blame of causing or magnifying the effects of the financial crisis in one way or another. It is not the Ponzi Scheme of Bernard Madoff that caused it, nor the inadequate rating of investment products by credit rating agencies per se, it is all of these large and trivial financial crimes put together resulting in tremendous losses. To elaborate, clients and investors did not raise red flags or question large corporations and hedge fund managers when they were offered large returns, even if the returns were exceptionally and continuously high. They only started asking questions once the economic downturn hit the financial markets and they started losing money. Therefore, clients and investors are accused of negligence and greed. Companies thus not expecting to be scrutinized by their clients, invested and structured highly speculative products that were simultaneously,

inadequately rated by credit rating agencies (that are paid by the same companies they rate, which leads to conflict of interest to begin with). Next, companies generated extremely high revenues, exceeding their targets and attracting investors globally, therefore, boosting the financial markets. When that is the case, regulators do not ask questions and are highly influenced by powerful individuals until large corporations' investment activities get out of hand, causing vast losses to investors and shocking the financial system, hence, a financial crisis. The crux of the matter in my opinion revolves around greed; which caused and will still cause economic crises that destroy countries. Therefore, there is not one party accused of causing the financial crisis as everyone contributed to it somehow. The only party who was fairly prosecuted is Bernard Madoff who caused investors losses totaling to \$65 billion dollars, however, intentions and strategies aside, Madoff, Goldman Sachs and credit rating agencies have one thing in common, their crimes contributed to the initiation of the financial crisis, Goldman Sachs even bet on it. This raises the question, if Madoff caused a loss of \$65 billion, Goldman Sachs bet on the failure of the US market and credit rating agencies caused losses of \$1.9 trillion, then how come Madoff is the only one fairly prosecuted by being sentenced to 150 years in jail? Nevertheless, going back to Tomasic (2011) and Fisher et al (2011), the answer for this predicament are three words regulation, regulation and regulation.

VI. Global State of Financial Crime

The global financial crisis of 2007 did not only expose poor market and credit risk management approaches imposed by regulators and applied by institutions, it also revealed the inadequacy of the operational risk management approaches. Until this day, the world has not recovered from the crisis, as large corporations' reckless behavior, intentional and unintentional negligence by regulators and governments, and the discovery of Ponzi schemes all played a major role in triggering, and to some extent, causing the global financial crisis.



Kroll, a professional services company, commissions the Economist Intelligence Unit (EIU) to conduct an annual global fraud survey⁵ covering a wide range of industries and regions. As can be seen in *figure 1*, fraud was on the rise in 2007 through 2009, where 9 out of 10 companies had been hit by fraud in 2009. The incidences of fraud started decreasing in 2010 and reached 75% in 2011, the lowest in 5 years. As mentioned above, some financial crime types do not necessarily increase during financial crises; it is the discovery of those crimes that increases. This can be shown in *figure 1*, as 8 out of 10 companies experienced fraud in 2007, keeping in mind that the bubble burst at the end of that year. Moreover,

⁵ Fraud types listed by Kroll Global Fraud Survey Reports 2007-2011 are available in the Appendix.

according to Kroll's⁶ Global Fraud Survey 2007, the average amount lost to fraud is \$6.7 million per company. Kroll (2007) believes that the reasons fraud was widespread in 2007, were rapid growth of emerging markets, where the rewards are based on profits rather than ethical behavior, and the substantial increase in liquidity. Furthermore, perpetrators constantly find loopholes in systems and regulations, and as a result, many fraud types persist and new ones are created, such as ID theft and cybercrimes. As Kroll (2007, p.3) puts it, "Technology can be the tool which is used to commit the act or unearth the crime." The survey conveys that the most prevalent types of fraud were theft of physical assets (35%), information theft (22%), management conflict of interest (21%) and vendor, supplier or procurement fraud (19%). In 2008, fraud reached 85%, a 6% increase from the year before and the average amount lost per company was \$8.2 million (Kroll, 2008). This increase, as Kroll (2008) reports, can be explained by failing internal controls and high staff turnover. It is interesting to note that weaker internal controls increased the probability of fraud in companies by one and a half times, causing management conflict of interest (41%), financial mismanagement (40%), theft of physical assets (50%), information theft (36%), and was even behind 6% of the money laundering cases discovered. As to high staff turnover, it was responsible for theft of physical assets (49%), information theft (36%), management conflict of interest (33%), regulatory and compliance breach (31%), and money laundering (6%). Other reasons for the increase in the incidences of financial crime were IT complexity, investing in risky markets and joint ventures (Kroll, 2008). Lastly, the most prevalent type of fraud in 2008 was theft of physical assets, which reached 38%, followed by information theft (25%), and management conflict of interest (23%). Moving on to 2009, 90% of respondents experienced fraud (the highest in the period between 2007 and 2011) where the average amount lost to crime was \$8.8 million per company. As has been said, financial

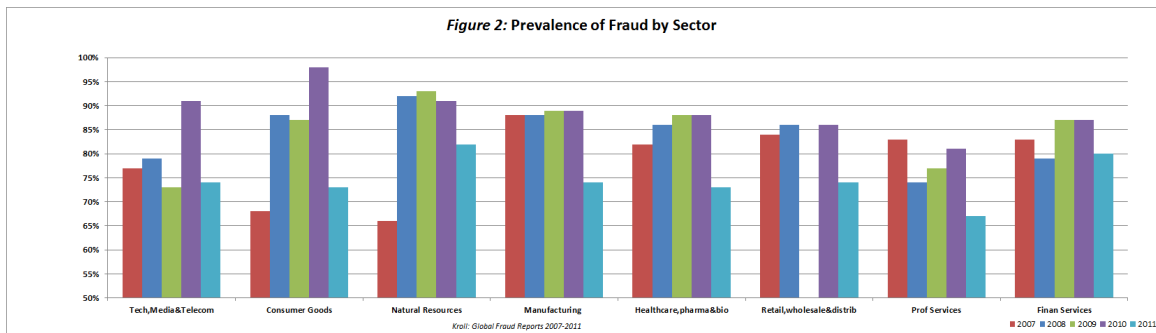
crises affect legitimate businesses as well as illegitimate ones due to decreased liquidity. One of the reasons for the 6% increase in fraud, as reported by Whipple (2009), is the discovery of fraudulent activities, whether committed by insiders or outsiders, which have been going on for years. Another reason is companies tightening their costs, especially in the compliance and internal control departments. However, Whipple (2009) explains that by doing so, companies will only decrease costs in the short run and drastically increase costs in the long run, as investing in compliance can mitigate the risk of financial crime. Contrary to the 2008 results, incidences of financial crime were not caused by high staff turnover as employees retained their current jobs due to the limited job opportunities offered during that turbulent period. According to the Kroll Global Fraud Survey 2008, respondents believe that “complexity of IT infrastructure”, “increased collaboration between firms”, and “entry into new and riskier markets” as the main reasons for their increased exposure to fraud (Kroll, 2009). Notably, the fraud types committed in 2009 did not vary from those committed in 2008, as the findings of the survey convey the following: in 2009, the most prevalent type of fraud was theft of physical assets (38%), followed by information theft, loss or attack (25%) and management conflict of interest (23%). In 2010, 88% of respondents suffered from fraud, a 2% decrease from 2009, where 2.1% of average income per company was lost (Kroll, 2010). In 2010, 27.3% of respondents were exposed to information theft, followed by theft of physical assets (27.2%) and management conflict of interest (19%). This change in fraudulent activities can be traced to the increased reliance on information technology (IT). It is interesting to note that the Kroll Global Fraud Survey 2010 reveals that fraud has discouraged 48% of companies from entering into new markets and expanding their businesses despite the opportunities for growth (Harloff and Price, 2010). Lastly, based on Kroll Global Fraud Survey 2011, fraud significantly decreased to 75%. According to Hartley (2011), the sharp decrease can be partially explained by the

attentiveness to fraud by managers. The survey demonstrates that companies affected by theft of physical assets and information have decreased to 25% and 23% respectively, a decline of 7.4% and 15% from the previous year. Nevertheless, there was an increase in the number of companies affected by other fraud types, such as management conflict of interest (21%), vendor, supplier or procurement fraud (20%), internal financial fraud (19%) and bribery & corruption (19%). The results suggest that perpetrators are not “giving up” on fraud, but are resorting to other methods, hence the decrease in theft of physical assets and information, and the increase in corruption and bribery. 62% of respondents cite corruption as the main reason for not operating in new markets (Kroll, 2011c). Although the actual incidences of fraud decreased to 75% in 2011, concern for almost all types of fraud has reportedly increased. Contrary to respondents’ concerns, it has been reported that only 72% have the necessary controls in place to detect and/or prevent fraud; only 60% of companies that lost 10% of revenue to fraud invest in financial anti-fraud measures⁷, 42% percent of that same group (10% of revenue lost to fraud) invests in information anti-fraud measures (66% average), and 38% invests in management control anti-fraud measures (52% average) (Kroll, 2011c). This validates that companies highly vulnerable to fraud are the ones that invest the least in anti-fraud measures (Kroll, 2011c). It is important to note that although information theft decreased in its occurrence, companies still consider themselves vulnerable to it; in fact, their susceptibility has increased from 38% in 2010 to 50% in 2011 due to the fact that information theft tends to cost more than other types of fraud. Evidently, victims of physical theft tend to lose 1.5% of income to fraud whereas victims of information theft tend to lose 1.9% of their income (Kroll, 2011c).

⁷ Anti-fraud measures suggested by Kroll Global Fraud Survey Reports 2007-2011 are available in the Appendix.

Fraud by Sector

As has been said, fraud tends to be the highest in the financial sector during economic crises while other sectors, such as consumer goods, lose sales (decreased income) and consequently impede fraud.



In 2007, fraud was most prevalent in the manufacturing sector, where 47% of respondents reported theft of physical assets and 28% reported corruption and bribery, the highest in the survey. This sector was prone to fraud due to global competition, which required entering into new markets, adopting highly sophisticated IT programs and the increasing collaboration across countries and businesses (Kroll, 2007). The lowest level of fraud was in the natural resources sector, where only 66% suffered from fraud in 2007, however, as reported in the Kroll Global Fraud Survey 2007, this sector is highly susceptible to corruption and bribery, and fraud incidents occurring in this sector are extremely costly. In 2008, there was a shift in fraud levels across sectors; natural resources moved from being the least hit by fraud in 2007 to the most affected in 2008 and 2009, where fraud levels reached 92% and 93% respectively (Kroll, 2008, 2009). Management conflict of interest affected 39% of companies in 2008 as opposed to 31% in 2007; financial mismanagement

grew from 14% in 2007 to 29% in 2008, and information theft increased from 15% to 17% in those two years, while theft of physical assets increased to 52% in 2009, the highest in the survey (Kroll 2008, 2009). The natural resources sector is highly exposed to fraud because it needs to attain raw materials regardless of where it is found, also because of entry into new and riskier markets. As Kroll (2008, 2009) shows, other sectors where fraud was prevalent in 2008 and 2009 are manufacturing (88% and 89%), consumer goods (88% and 87%), financial services (79% and 87%) and professional services (74% and 77%). The 10% increase in fraud in financial services can be traced to the financial crisis as 51% of respondents claim. Moving on to 2010, the highest level of fraud was in the consumer goods sector (98%), an increase of almost 13% since 2008 (Kroll, 2010). This sector was the most affected by theft of physical assets (43%) in the survey and also suffered from information theft (25%), management conflict of interest and financial mismanagement (21%) to name a few, however, vendor, supplier or procurement fraud decreased by nearly 49% compared to 2009 (Kroll, 2010). As can be seen in *figure 2* above, fraud rates hiked in almost all sectors, especially technology, media and telecom, where the fraud rate increased from 73% to 91% (Kroll, 2011c). Finally, based on Kroll Global Fraud Survey 2011, fraud levels declined in almost all sectors surveyed; the lowest fraud experienced was in professional services (67%), followed by consumer goods and healthcare & pharmaceuticals (73%). The highest fraud level was in the natural resources sector, the second most affected by theft of physical assets (33%) after manufacturing (34%).

Fraud by Region

Research suggests that fraud is more prevalent in emerging and developing countries than in developed ones, a fact proven by several global fraud surveys over the years.

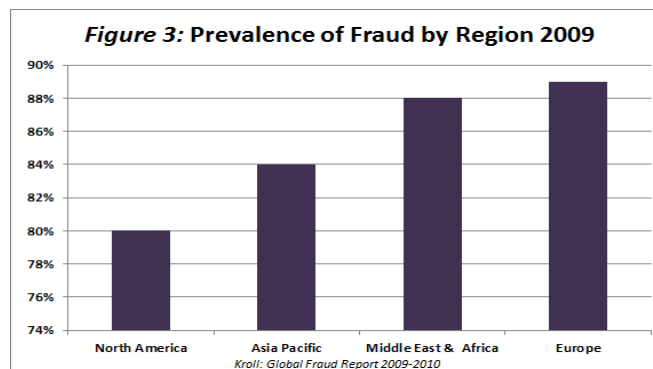
Nevertheless, Antonius (2007) points out that although it is the norm that people believe

fraud is more rampant in emerging and developing markets, the largest frauds in history occurred in developed markets with highly progressed legal and financial systems, and where such acts are considered punishable by law. Kroll Global Fraud Report of 2007 demonstrates that out of the surveyed companies from different countries, the Middle East and Africa witnessed the highest level of corruption and bribery (39%), followed by Latin America (29%), Eastern Europe (29%), Asia Pacific (24%), Western Europe (14%) and the lowest being North America (9%). Furthermore, internal financial fraud follows the same pattern, as it affected 46% of companies in the Middle East and Africa, 28% of Eastern European companies, 18% of Western European companies and 14% of North American ones. Conversely, referring to Kroll Global Fraud Report of 2008, these figures have drastically changed in some regions; corruption and bribery have declined by almost 13% in the Middle East and Africa, reaching 34%, and it has also declined by 33% in North America, reaching 6%. Internal financial fraud has substantially declined in the Middle East and Africa, reaching 27% (a 41% decrease) and has also declined in North America, affecting 10% of companies only. Despite the decline in these two fraud types, 43% of respondents from the Middle East and Africa were affected by management conflict of interest, while 18% of North American companies were affected compared to the 26% total average. According to Kroll (2008), the countries with the highest exposure to theft of physical assets were the Middle East and Africa (46%), China (43%), and North America (28%) compared to the total average of 37%. Middle East and Africa respondents have scored higher than average in all fraud types except IP theft and piracy, while North American respondents have scored lower than average in all fraud types except IP theft and piracy, where it reached 18% compared to the 15% average (Kroll, 2008).

The survey results of 2009 have been somewhat similar to those of 2008; *figure 3* presents

the frequency of fraud by region in 2009 as shown below. North America displays the lowest fraud rate compared to other regions, where 8 out of 10 of respondents have suffered from at least one fraud incident (Kroll, 2009). According to the Kroll Global Fraud Report 2009, the financial crisis was the main reason behind financial crime in North America more than any region surveyed; theft of physical assets increased from 28% in 2008 to 33% in 2009, also information theft increased from 22% in 2008 to 23% in 2009, internal financial fraud increased by 50% where 15% of companies were affected, and lastly, financial mismanagement reached 23% in 2009, up from 16% in 2008.

Although the occurrence of fraud is low in the region, 84% of companies in North America consider themselves highly susceptible to it, having the highest figure among other regions, with the most vulnerability being in regulatory breach (17%), management conflict of interest (16%), and money laundering (6%).



Asia Pacific is one of the two regions that witnessed a decline in fraud rate (88% in 2008 to 84% in 2009). Furthermore, the average loss per company decreased to \$6.2 million from \$9.1 million. This decrease is explained by the economic crisis that hindered fraudulent activity, as with less money flowing in a business comes less fraudulent acts. Information theft decreased from 31% in 2008 to 26% in 2009, regulatory or compliance breach decreased from 28% to 21%, and corruption and bribery fell from 21% to 17%. However,

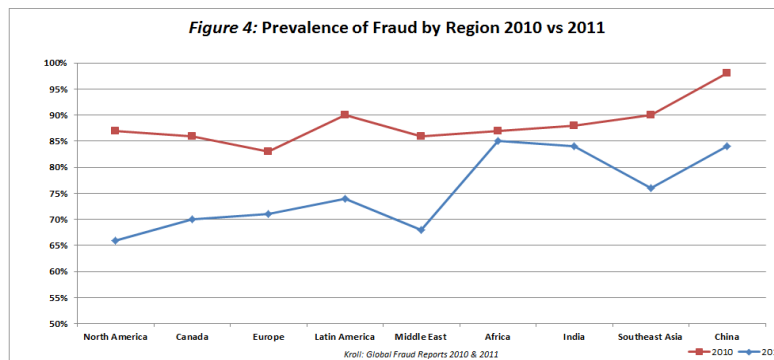
theft of physical assets saw a slight increase from 41% in 2008 to 43% in 2009 (Kroll, 2009). The most common factor for fraud in Asia Pacific in 2009, according to Kroll (2009) was the high staff turnover, where it was the reason behind fraud for 35% of companies; this is well above the average of 26%. Also, although corruption and bribery increased, the threat increased from 10% to 15% due to employee relationships. Finally, the survey suggests that this decline in fraud incidences is short lived, as when the downturn is over, fraud will soar (Kroll, 2009). One country in Asia Pacific that continued to witness fraud despite the downturn is China, where its exposure to fraud reached 96% in 2009. Vendor and procurement fraud reached 42% in China and 21% in Asia Pacific as a whole, internal financial fraud (31% versus 18%), regulatory breaches (31% versus 21%), corruption and bribery (27% versus 17%) and IP theft (23% versus 13%) (Kroll, 2009).

Middle East & Africa is another region that witnessed a drop in fraud rate; 88% of respondents suffered from fraud in 2009 as opposed to 91% in 2008, nevertheless, the average loss per company increased from \$5.6 million in 2008 to \$11.5 million in 2009 (Kroll, 2009). According to Kroll Global Fraud Report 2009, Middle East & Africa was the most affected region by fraud. Although relatively high in this region, most fraud types have reduced in their occurrences; theft of physical assets decreased from 46% in 2008 to 38% in 2009, management conflict of interest from 43% to 31%, financial mismanagement from 38% to 31%, and information theft from 29% to 26% (Kroll 2009). The reasons behind increased vulnerability, as Kroll (2009) states, are high staff turnover (36%), weaker internal controls as a result of cutting costs (27%), limiting payments as a result of reduced income (21%) and drop in sales (16%). In order to fight fraud in this region, companies are investing in several anti-fraud strategies, such as IT security (58% compared to the 51% average) and physical asset security (56% to 37%).

It comes as a surprise that fraud was most prevalent in Europe in 2009 and that its exposure has increased from 84% in 2008 to 89% in 2009; conversely, its average loss per company decreased from \$8.3 million in 2008 to \$7.7 million in 2009. According to Kroll Global Fraud Survey 2009, the increase in fraud prevalence in Europe was cited to entry into new markets (28%) and drop in revenues (16%). Despite the high prevalence of fraud, respondents from Europe were the least likely to further invest in anti-fraud strategies and considered themselves the least vulnerable. To illustrate, only 16% and 6% considered they were vulnerable to information theft and management conflict of interest respectively; these figures are the lowest amongst the regions. Additionally, although the figures prove otherwise, 30% of respondents from Europe believe that their exposure to fraud has remained the same. This is so because many European companies surveyed have effective anti-strategies in place; 83% invest in IT security, 78% in physical asset security, 72% in management controls, 48% in reputation protection, 47% in risk management systems and 47% in IP monitoring (Kroll, 2009). Although respondents from Europe invested in these measures more than any other region surveyed, theft of physical assets increased from 34% in 2008 to 38% in 2009, management conflict of interest from 24% to 25% and financial mismanagement from 20% to 22%. Also, although 25% of respondents were affected by management conflict of interest, only 6% considered themselves highly vulnerable to it, and 25% invested in management control.

Kroll global Fraud Reports of 2010 & 2011 indicate that the prevalence of fraud has seen drastic changes across regions between the two years. The levels of fraud dropped in all the regions surveyed in 2011 compared to 2010. As can be seen in *figure 3* below, North America's incidences of fraud decreased by 24% (from 2010 to 2011), Canada by almost 19%, Europe by 14.5%, Latin America by nearly 18%, Middle East by almost 21%, Africa by

2.3%, India by 4.5%, Southeast Asia by 15.5% and China by 14.3%.



Fraud levels in North America fluctuated in between 2009 and 2011, increasing from 80% in 2009 to 87% in 2010 and then significantly dropping to 66% in 2011. Loss rate in 2011 was 1.7% of revenue. To illustrate, theft of physical assets increased by approximately 23% in 2010, reaching 27%, yet dropped to 23% in 2011; information theft significantly increased from 19% in 2009 to 32% in 2010 and again declined to 26% in 2011 (Kroll, 2010, 2011c). Lastly, management conflict of interest decreased from 17% in 2009 to 14% in 2010 but then increased to 15% in 2011. Respondents from North America stated IT security as the biggest driver for fraud in 2009, 2010 and 2011 (32%, 26% and 35% respectively). The reason behind information theft increase in 2010 is the decrease in investment in IT security (44% in 2009 to 42% in 2010), yet companies in this region re-invested in IT security in 2011, hence the decline. To add, more than half of the companies surveyed in North America in 2011 believe that they are highly vulnerable to fraud as opposed to 34% in 2010. Although the region witnessed the lowest level of fraud in 2011, it needs to remain cautious especially from information and IP theft (Kroll, 2009, 2010, 2011c).

Fraud levels in Canada look more optimistic than in other countries; companies affected by fraud declined from 86% in 2010 to 70% in 2011 and the average loss rate of revenue was

0.9%, the lowest amongst all regions surveyed (Kroll, 2011c). To elaborate further, information theft decreased from 28% in 2010 to 22% in 2011 and theft of physical assets markedly dropped from 44% to 16%. Moreover, 51% of Canadian companies abstained from doing business in countries that have a high level of fraud or lenient regulations, higher than the survey average of 37% (Kroll, 2011c). Similar to North America, the biggest driver of fraud is IT security, as believed by 33% and 35% of respondents in 2010 and 2011 respectively and yet only 17% of respondents in 2011 invested in IT security measures compared to 30% average. This puts the country at the risk of being complacent.

Europe experienced the lowest level of fraud in 2010 where it reached 83%, with 47% reporting that they have not lost any money to fraud, as opposed to 2009 where it had the highest fraud rate in the survey (89%). Also, fraud further decreased to 71% in 2011 but 23% reported that they have lost money to fraud, with the average percentage lost to fraud being 2% of income. Theft of physical assets remained at 23% in 2010 & 2011, information loss faintly decreased from 19% to 18%, management conflict of interest increased from 13% to 19%, corruption increased from 8% to 14%, and financial mismanagement increased from 12% to 19% (Kroll, 2009, 2010, 2011c). Similarly, the biggest driver of fraud was IT complexity in 2010 and 2011, scoring 33% and 29% respectively. Just like Canada, Europe is at the risk of being complacent, as respondents are less likely than average to invest in anti-fraud measures. For instance, only 34% of companies do employees background checks as opposed to the 47% average, although junior and senior managers were perpetrators in 25% and 23% of the cases respectively (Kroll, 2011c).

Fraud level in Latin America was 90% in 2010 and significantly dropped to 74% in 2011; with an average loss of revenue of 1.9%. In 2010, it had the second highest fraud level after Southeast Asia. Despite the decline in regulatory or compliance fraud from 28% in 2009 to

21% in 2010, it remained the region suffering the most from this type of fraud. Theft of physical asset slightly decreased from 26% in 2010 to 25% in 2011, information theft decreased from 35% to 24%, vendor, supplier or procurement fraud slightly increased from 22% to 23%, internal fraud increased from 13% to 18% and management conflict of interest decreased from 27% to 21%. Corruption and bribery were major problems in Latin American markets, affecting 23% in 2011 as opposed to 13% in 2010, a 77% increase. Additionally, the perception of vulnerability to this type of fraud is exceptionally high at 70% (Kroll, 2011c). Some respondents believe that it is not the incidences of corruption and bribery that have increased, rather the fact that Latin Americans started to believe that it should not be a part of operations (Kroll, 2011c). In 2010, companies planning to invest in anti-fraud measures were above average in areas of staff training (55%), IP monitoring (53%) and due diligence (46%). Lastly, IT complexity was reported to be one of the biggest contributors to fraud in 2010 and 2011, scoring 33% and 30% respectively.

The overall occurrence of fraud in the Middle East matched the global average of 86% in 2010 and declined to 68% in 2011, with a 2.6% average of revenue lost to fraud (Kroll, 2011c). These figures give the impression that the region is doing well tackling fraud, however, the reason for this positive image is that the respondents come from small companies (less than \$1 billion) and it is common knowledge that smaller companies experience less incidences of fraud (Kroll, 2011c). Information theft decreased to 26% in 2011 compared to 30% in 2010, internal financial fraud and theft slightly decreased from 21% to 19%, vendor, supplier or procurement fraud surged from 9% to 25%, corruption and bribery significantly increased from 9% to 21% and management conflict of interest increased from 12% to 23%. The biggest driver of fraud has been IT complexity in 2010 and 2011, scoring 35% and 33% respectively, and another driver of fraud was entry into new

markets, as reported by 35% of respondents in 2010. Additionally, weaker internal controls contributed to fraud as reported by 32% in 2011, up from 14% in 2010. Also, companies reported an increase in fraud exposure from 70% to 77%.

Although fraud level decreased in Africa from 2009 to 2011, it still remains exceptionally high. Fraud decreased from 89% in 2009 to 87% in 2010 and finally reached 85% in 2011, the highest among all regions, with a 3.1% average of revenue lost to fraud (Kroll, 2011c). Information theft reached 20% in 2009, drastically increased to 41% in 2010 and then declined to 22%. This decline is not a sign that the country is tackling fraud; on the contrary, perpetrators are just changing tactics. To prove, vendor, supplier or procurement fraud increased from 26% in 2010 to 31% in 2011, and corruption and bribery from 17% to 37%. Furthermore, 15% of global respondents from 2011 surveys were discouraged from expanding businesses in Africa; 69% of the 15% cited corruption and bribery as the dissuasion factor (Kroll, 2011c). Furthermore, market collusion remained unchanged, ranging between 14% and 15% over the three year period (2009-2011), so did regulatory or compliance breach, where it remained at 20%. Currently, companies in Africa are investing in anti-fraud measures and are planning to invest more in staff training, employee background screening, and third party due diligence. However, other than IT complexity being one of the fraud drivers (35% in 2010), 33% of respondents in 2011 believe that weaker internal controls is the main contributor to fraud, which is caused by cost cutting.

As India heads into considerable economic growth, many opportunities are arising, leading to fraud being overlooked. The country continues to face high fraud rates, with 88% in 2010 and 84% in 2011, and its average percentage of revenue lost to fraud reached 2.2% in 2011. Corruption and bribery hit 31% in 2011, information theft was 27%, internal financial fraud & theft of physical assets were 23%, vendor, supplier or procurement fraud was 22%,

financial mismanagement was 22% and management conflict of interest was 19%. The biggest driver of increased fraud exposure according to 41% of respondents is high staff turnover. Although 78% of respondents believe to be highly vulnerable to fraud, only 25% have the adequate anti-fraud measures and less than 50% are planning to invest in such measures.

The overall occurrence of fraud has decreased in Southeast Asia in 2011 compared to 2010 (90% down to 76%); however, the fraud problem is far from over. Despite what looks like an optimistic figure, fraud became worse in this region (average percentage of revenue lost to fraud was 2.5%). To demonstrate, respondents from this region witnessed one of the highest rates of theft of physical assets in 2010, where it reached 32%, and increased further, to 33% in 2011. Additionally, management conflict of interest increased from 26% to 31%, information theft from 25% to 28%, vendor, and supplier or procurement fraud jumped from 17% to 33%. The highest growth in fraud was in corruption and bribery, where it increased by almost 106% (from 13.6% to 28%), and internal financial fraud or theft as it increased from 9.9% to 24% (Kroll, 2011c). 70% of respondents believe that they are highly vulnerable to corruption and bribery, up from 40% in 2010, and 70% report that they are highly vulnerable to theft of physical assets, up from 46%. Lastly, 52% and 35% of respondents believe that weaker internal controls is the biggest driver to increased fraud in 2010 and 2011 respectively. In 2011, 38% and 33% of respondents suggest that “cost restraint over pay” and “reduced revenues” respectively also encourage fraud in the region.

In 2010, fraud levels in China were only 2% away from hitting 100%. The tremendous increase from 89% in 2009 to 98% in 2010 has been traced not only to an increase in actual incidences of fraud but also to the acknowledgment of it (Kroll, 2010). As of 2011, average revenue lost to fraud was 2.3%, and fraud level noticeably declined to 84% (Kroll, 2011c).

Looking at fraud types, theft of physical assets reached 31% in 2009, decreased to 22% in 2010 and further declined to 20% in 2011 (Kroll, 2009, 2010, 2011c). Furthermore, vendor, supplier or procurement fraud and information theft were the most prevalent amongst all regions in 2011, where they increased from 20% to 33% and 16% to 28% respectively. Corruption and bribery slightly decreased over two years from 20% to 19% in 2010 and 2011 respectively. It is important to note that money laundering decreased by 95% from 20% in 2009 to 1% in 2010. However, Kroll Global Fraud Survey 2011 suggests that the reason for this decrease can be that fraudsters adopted different tactics. 84% of the respondents in 2011 believe that their exposure to fraud has increased as opposed to the 72% figure in 2010. The biggest driver of fraud in 2010 and 2011 were high staff turnover (34%) and weaker internal controls (34%), the latter triggered by cost cutting after the economic downturn. This presents a problem in China because although companies are investing in anti-fraud measures, senior managers commit most of the financial crimes.

Summary, comments and criticisms

Fraud levels vary from one region and sector to the other; developing countries have higher number of incidences of fraud, while developed countries have a higher monetary value lost to fraud, that is because perpetrators in developing countries swindle small amounts of money over the years with low risk of getting caught, whereas in developed countries perpetrators embezzle large sums of money causing enormous losses to organizations and investors, hence high risk of getting caught within a shorter period of time. Moreover, research suggests that countries most affected by fraud are the least likely to invest or have invested in anti-fraud strategies (such as Asia Pacific), conversely, countries that have low level of fraud and invest in anti-fraud strategies perceive themselves as highly susceptible to it (such as North America). To clarify, in the case of companies that do not spend on anti-

fraud tools “ignorance is bliss”, in the sense that they do not fight it and simultaneously do not feel threatened by it, however they still suffer from high levels of fraud. Contrariwise, in the case of companies that devote time and energy on anti-fraud techniques “knowledge is power” as they comprehend the ever-changing threat of financial crime, hence the perceived vulnerability to it, which leads to investing in more advanced anti-fraud measures. As has been pointed out earlier, the financial crisis affected financial crime (and vice versa) in many ways, firstly, sectors that were closer to the original crisis, such as the financial sector, witnessed an increase in the prevalence of fraud, whereas, fraud decreased in sectors that relied solely on sales of tangible products. Secondly, developed countries blame the increase in fraud levels in 2008 and 2009 to the financial crisis, since this is where it originated. Whereas, since developing countries were not as affected by the financial crisis as developed ones due to lower investments in other countries and lower exposure, there was no correlation between the financial crisis and fraud levels. Thirdly, as has been mentioned above, the actual incidents of crime did increase during the financial crisis in some regions, but also the discovery of it. Lastly, the recent financial crisis led many companies to resort to cost cutting in all departments including compliance, which resulted in an increase in fraud. As can be determined from the countries’ figures, developed countries mostly suffered from high levels of IP and physical theft due to the increased IT threat that comes with technological advancement, which developing countries lack. On the other hand, developing countries mostly suffered from high corruption and bribery levels, due to the lack of governing bodies such as the FCPA and the UK Bribery Act, and because the power lies with few influential individuals. Looking at it from a different perspective, corruption and bribery soared in developing countries because what was considered a way of doing business before is now considered a crime, in an effort to fight financial crime, hence increase foreign investments.

FCPA and UK Bribery Act

The Department of Justice (DOJ) and the SEC enforce the US Foreign Corrupt Practices Act (FCPA) of 1977; “FCPA prohibits U.S companies and citizens, foreign companies listed on a U.S stock exchange, or any person acting while in the United States, from corruptly paying or offering to pay, directly or indirectly, money or anything of value to a foreign official to obtain or retain business” (FCPA, n.d.). It also applies to any person acting on behalf of such companies (Coppotelli, 2008). Furthermore, the FCPA compels all listed companies, whether local or foreign, to file periodic reports with the SEC, retain books and records that accurately mirror business transactions, and maintain effective internal controls (FCPA, n.d.). The FCPA does not only prohibit companies from bribery and corruption, it also places a set of compliance requirements that needs to be applied, such as, conducting due diligence on potential and existing business partners and third parties that act on their behalf, creating a written compliance policy that clearly states the right procedure to report fraud and respond to it, conducting the necessary training for employees and regularly auditing internal controls to warrant efficacy (Coppotelli 2008; Otero 2007). Implementing the FCPA by some companies in the US was a main contributor to the decrease of corruption and bribery. The US had and still has exposure to less developed foreign countries that overlook corruption and in some cases encourage it to keep business going, therefore, such laws will diminish fraudulent behavior as the risks would be too high, be it reputational or monetary. Although the DOJ and SEC have been passive in the past, they are currently applying the FCPA in full force, as between 2004 and 2009, DOJ investigated more cases than it did from 1977 till 2005 (Coppotelli, 2008). Regulators cannot stress enough on the importance of compliance with the FCPA, to prove their dedication to fighting corruption; DOJ investigated 60 cases between the years 2005 – 2009, where companies like Baker Hughes, Inc. paid \$44

million in fines, and Vetco International paid \$26 million in fines for three of its subsidiaries. To add, in 2010, the number of cases investigated grew by 100% totaling 120 (Kroll, 2011c). A more recent case, as reported by Nasiripour and Wiesmann (2011), was that of Deutsche Telecom and its Hungarian subsidiary Magyar Telekom, where they had to pay \$95.2 million to the US authorities in order to resolve a bribery case; it has been proven that executives working for the telecommunication company bribed government officials in Montenegro and Macedonia. FCPA gave Magyar a period of two years for it to develop a robust internal control and compliance program and not to commit any violations, until then, the FCPA will not prosecute the company in criminal courts (Nasiripour and Wiesmann, 2011). Albeit the US was recently criticized for the lack of ample and strict rules and regulations governing corporations, it is interesting to note that the country, namely New York City, was seen as an overly regulated market and frequently lost investors to the less regulated market of London (prior to the 2007 financial crisis). However, the US is overly regulated to strengthen compliance, which in return hinders fraud opportunities, and this eventually leads to more financially stable companies and a more resilient financial market (Coppotelli, 2008). On the other hand, the UK's regulations applied to big corporations had a laissez faire approach, enticing perpetrators to commit fraud. One of the cases that raised many questions on the "overprotectiveness" of large corporations in the UK is BAE Systems plc, the leading defense contractor in Europe (Hoyos, 2012). In 1985, the company has been involved in selling an aircraft to the Kingdom of Saudi Arabia (KSA) for \$68.4 billion and negotiating a contract worth approximately \$32 billion, the biggest weapons contract in Britain's history (Evans & Leigh 2007; Tomasic 2011). Evans & Leigh (2007) report that BAE paid Prince Bandar of Saudi, also KSA's ambassador in the US for 20 years, more than \$1.6 billion in bribes to secure the contract and facilitate the sales with KSA. The Serious Fraud Office (SFO) started an investigation but several measures were

taken by powerful individuals to terminate it, because the government alleged that investigating the corruption issue would cause tension between the UK and KSA. This decision raised many inquiries about the legitimacy of SFO and UK's seriousness in fighting corruption (Abbey 2009; BBC News 2008; Tomasic 2011). It is somewhat odd that a country as economically robust and developed as the UK only managed to create a law that officially prohibits corruption in 2011, this evokes many inquiries about the legitimacy of Britain's financial system as it suggests that there is a possibility that the market players never acted in a fairly manner until the law was enforced. Coppotelli (2008, p.21) describes the legal system in the UK prior to the UK Bribery Act in a nutshell:

"Its light – touch, risk – based approach has confronted severe challenges, and not always with success, as the UK's Financial Services Authority has recognized. Nor is the UK's record on corruption and its prosecution exactly spotless."

Nevertheless, after the role of financial crime in precipitating the 2007 global financial crisis was revealed, the UK is now following the lead of the US by introducing the UK Bribery Act 2010. Fine (2011) argues that the FCPA is more inclusive even though they both cover the rules and impose similar compliance challenges on companies. According to Kroll (2011c), on the other hand, the UK Bribery Act (also called "FCPA on steroids") covers more aspects of corruption than the FCPA, as the new act does not only prohibit bribery but also includes persons linked to the company that fails to prevent it.

The UK Bribery Act of 2010 was effective as of July 2011, and according to LRN⁸ (2011b) includes three key provisions; firstly, it prohibits giving, receiving, promising, requesting and/or agreeing to receive bribes; secondly, there is a separate violation for bribing or

⁸ LRN is a legal and regulatory consultancy firm.

attempting to bribe a foreign public official to attain a business advantage; thirdly, the law penalizes those who fail to prevent bribery by those associated to them.

To measure the extent companies apply the FCPA and UK Bribery Act in their daily operations, Kroll's 2010 annual global fraud report includes a global survey to see the extent of awareness of the FCPA and the UK Bribery Act. The research shows that both "acts" apply to 70% of respondents, yet surprisingly only 32.9% of senior managers are comprehensively familiar with the laws, and only 47.2% of respondents are sure they have clear and effective anti-bribery procedures in place in all levels of their operations while 17% are not sure (Kroll, 2010). The results of the survey convey that despite the high risk of being penalized by the FCPA and the UK Bribery Act, some of the companies' top management are not fully dedicated to implementing the law and avoiding being (even accidentally) victims or perpetrators of corruption. The reasons behind the lack of dedication can be due to the shortage of resources and the willingness to cut costs or lack of comprehension about the serious consequences following corruption.

Given that the DOJ and SEC are vigorously applying the FCPA, some have argued that the law has to be amended, as it has not changed for the last 10 years (Cramer, 2011). Jeffrey Cramer, a managing director and head of Kroll's Chicago office, mentions that at least five new areas need to be revised; firstly, DOJ needs to clarify what actions fall under "facilitating payments" because the definition DOJ uses can be confusing as to what is considered a crime versus what is considered a facilitating payment; secondly, DOJ needs to clearly state what constitutes a "foreign official"; thirdly, the FCPA should limit the successor's liability, that is, it should limit the penalty imposed on company A for a violation committed by company B before it was acquired by company A; fourthly, limitation of liability to willful violations, finally, and most importantly, the FCPA should add an

“affirmative defense⁹ for a compliance program”; if companies have the required procedures, code of conduct and adequate internal controls, this amendment would give them the constitutional right to help themselves before they get into potential trouble(Cramer, 2011). Conversely, Sklar (2011) debates that affirmative defense can weaken internal controls of companies and provide them with a “false sense of security”, in the sense that relying on allegedly a clear and effective internal control program will give companies the justification they need for nondisclosure.

Closer Look at Corruption & Bribery

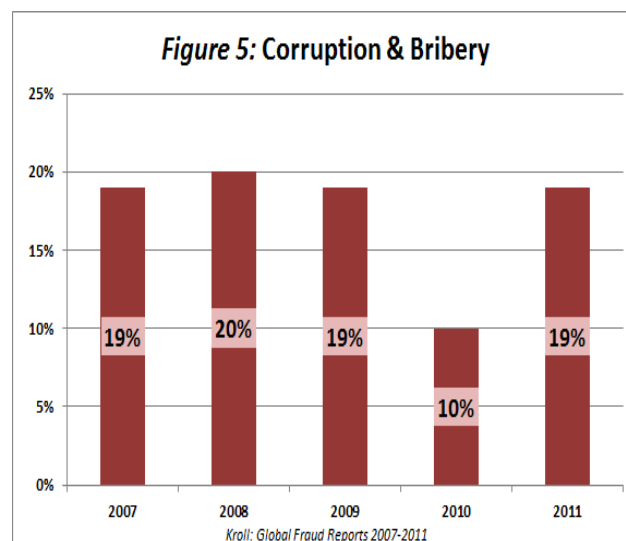
In the aftermath of the financial crisis, regulators started applying stricter rules, companies started developing codes of conduct to enforce ethical behavior across employees and operations, US DOJ forcefully imposed the FCPA on local and international banks and the UK developed and implemented the UK Bribery Act. As Scales (2008, p.22) remarks, “The ability to significantly increase profit margins is one compelling reason to systematically manage fraud and corruption risk. A thorough understanding of fraud and corruption risks across the organization is a prerequisite for effective prevention.” The reason behind the aggressive fight against corruption is that this type of financial crime significantly disrupts businesses worldwide by not giving fair chances to investors and companies (especially those entering new markets) and by using corruption in order to get business done. According to Transparency International (2009a), corruption surges the costs of business by 10%. 60% of respondents surveyed strongly believe that corruption is becoming uncontrollable, 40% are required to pay bribes to sustain business with the public sector,

⁹ Affirmative Defense is “one which requires the actual production of evidence, be it testimonial or physical...It does not directly attack an element of the crime but provide either justification for the conduct or some other legally recognized approach to undermining the charge”(Beneman n.d, p.1).

and 20% are confident that they lose contracts to competitors because of corruption and bribery:

The consequences are dramatic. In developing and transition countries alone, corrupt politicians and government officials receive bribes believed to total between US\$20 and 40 billion annually – the equivalent of some 20 to 40 per cent of official development assistance. The cost is measurable in more than money. When corruption allows reckless companies to disregard the law, the consequences range from water shortages in Spain, exploitative work conditions in China or illegal logging in Indonesia to unsafe medicines in Nigeria and poorly constructed buildings in Turkey that collapse with deadly consequences (Transparency International 2009, p.25).

Figure 5 shows the global average of corruption and bribery as reported in Kroll Global Fraud Surveys 2007-2011.



Corruption and Bribery level slightly fluctuated between 2007 and 2011; it dropped to 10% in 2010 but then increased to 19% in 2011. Surely, corruption and bribery differs from

one region to the other, and is usually higher in developing & emerging regions. This type of fraud increased in 2008 because companies were between survival and breakdown, so they needed government contracts the most, hence bribing government officials (Kroll, 2008). In 2010, 63% of respondents listed corruption as the main factor for not doing business in Africa, 59% in Central Asia and 21% in North America. The increase in corruption and bribery rate in 2011 can be explained by the implementation of strict regulations, such as FCPA, and is also explained by the fierce competition across countries, which leads to corruption in less regulated ones (Kroll, 2007, 2011c). To illustrate, in 2007 and 2008, corruption and bribery were the highest in the Middle East and Africa (39% & 34%) and lowest in North America (9% & 6%). Corruption is lower in developed countries due to the clarity of the rules as to what is considered a corrupt behavior, as opposed to developing countries where rules governing financial crime, especially corruption are vague. Additionally, developed countries invest in fighting corruption as opposed to developing countries. Also, corruption and bribery levels vary from one sector to another; in 2007, it was the highest in the manufacturing sector (28%) and the lowest in the natural resources one (20%), in 2008, it was the highest in the consumer goods and natural resources sectors (26%) and the lowest in the pharmaceuticals and healthcare one (20%), and finally, in 2011, it was the highest in the natural resources sector (29%) and the lowest in the healthcare and pharmaceuticals one (16%).

As stated in Kroll Global Fraud Survey 2010, corruption and fraud often go hand in hand; therefore, regions with high fraud rates are more likely to have high corruption levels than regions with low fraud rates. This was the case in 2010, as according to Corruption

Perception Index¹⁰ (CPI), China scored 3.5 (highly corrupt), and fraud levels were at 98%. However, scores of countries in the Middle East region vary, for instance, Qatar scored 7.7 in 2010, United Arab Emirates (UAE) 6.3, on the other hand, Saudi Arabia scored (4.7), Kuwait (4.5), Syria (2.5), Egypt (3.1) and Jordan (4.7), simultaneously fraud level was 86% in 2010 in the region. Europe had the lowest fraud rate (83%) therefore; some countries in the region were considered the least corrupt, such as, Denmark, Finland, Sweden and Norway, scoring 9.3, 9.2, 9.2 and 8.6 respectively (CPI, 2011). Also, in 2011, the region that experienced the lowest fraud levels was North America (66%) and scored between 8 and 8.9 in CPI 2011, whereas India and China had the second highest fraud levels where they scored 3.1 and 3.6, respectively (CPI, 2011). Finally, fraud was the highest in Africa, where it reached 85% and scored 2.2 in CPI 2011 survey.

A recent global survey conducted by Deloitte¹¹ (2011a) on anti-corruption practices, shows the extent of companies' dedication to fighting corruption and how strictly they follow FCPA and UK Bribery Act reforms. Deloitte (2011a) has proved that nearly 90% of companies surveyed have an anti-corruption policy, of which, 45% believe to have a "stand alone" anti-corruption policy and the remaining 43% state that it is part of the broader code of conduct. According to Deloitte (2011a), anti-corruption tends to gain more attention when it has a "stand alone" policy, so it is advisable that companies develop one. The survey suggests that large¹² companies are more likely than small ones to have a written anti-corruption policy that covers many areas. To illustrate, 9 out of 10 policies cover bribes in large companies, as opposed to 72% in small ones, also, 79% of large companies' policies cover facilitating payments as opposed to 63% in small ones, and travel/lodging expenses for government

¹⁰ Transparency International conducts an annual Corruption Perception Index survey in countries all over the world, and ranks countries depending on the prevalence of corruption, "0" as being highly clean and "10" as being highly corrupt.

¹¹ A professional services company.

¹² According to Deloitte's anti-corruption survey (2011), companies that make more than \$1 billion in annual revenues are considered "large" and the ones that make less than \$1 billion are considered "small".

officials are covered by 70% of large companies and 55% of small ones. As has been mentioned before, facilitating payments is a grey area that confuses many companies, with the FCPA permitting some types of facilitating payments and the UK Bribery Act prohibiting it altogether. Therefore, as recounted in the Deloitte (2011a) survey, 47% of firms prohibit facilitating payments in all cases and only 5% allow them with no restrictions, of which, 53% have no limit on the amount of payments made. When respondents were asked about their confidence in their anti-corruption policies, only 29% confirmed that they are confident, 58% were somewhat confident and 13% were not at all confident. Deloitte (2011a) confirms that the reason behind the lack of confidence in some of the cases can be traced to the many factors that can lead to corruption, for example, third parties are considered to have significant corruption risk (52%), government business relations (30%), bribes (27%) and gifts to foreign officials (24%). Executives do not only believe that third parties have a major corruption risk, 43% also report that handling third party relationships is one of the significant challenges, other challenges include managing cultural differences (40%), testing and observing compliance (33%) and almost 20% list different challenges such as conducting risk assessments and obtaining and maintaining senior management commitment. Since many respondents believe that third parties are rendered extremely risky, top management should attempt to entrench an anti-corruption culture within all parts of the company whether the departments are directly exposed to third parties or not. As Deloitte (2011a) remarks, although smaller companies are less likely to have written anti-corruption policies than larger ones, they are also at lesser risk of corruption, this conclusion can be drawn from the fact that larger companies hire more third parties than smaller ones; 63% of respondents from large companies believe the use of third parties expose them to substantial risk as opposed to 33% of respondents from small firms. Also, 35% of large companies believe to be highly at risk by entertainment or

business development expenses related to government business, as opposed to 19% of small companies. Moreover, when executives were asked on the way they gauge their exposure, 58% of executives count on internal risk assessments, 51% rely on past experience in corruption matters, and 33% heavily depend on surveys and indices, such as CPI.

After the enactment of the FCPA and the UK Bribery Act, companies are held responsible for the actions of third parties, namely the ones with regular interaction with foreign governments, therefore, performing due diligence is critical to mitigating corruption risk. That being said, according to the survey conducted by Deloitte (2011b), only 34% of companies regularly conduct due diligence on foreign third parties with frequent interaction with government officials, 25% do not perform due diligence altogether and 34% sometimes do. Additionally, only 9% of executives closely monitor third party relationships, 47% loosely monitors them and 44% do not monitor them at all. Deloitte (2011b) asserts that conducting due diligence on all third parties prior to hiring is essential, however, scrutinizing the behavior of all third parties is tedious and unfeasible, therefore, companies should adopt a risk based approach by monitoring third parties who are considered risky or who operate in risky countries and/or industries.

Developing an anti-corruption policy, understanding legal requirements, performing due diligence on third parties and then selectively monitoring them are crucial for preventing corruption risk. However, companies should also train and educate employees on corruption and anti-corruption policies adopted. According to Deloitte (2011a), 73% of executives surveyed train their employees, of which, 64% selectively choose which ones to train depending on their tasks and exposure to corruption, 44% train all domestic employees, 50% train all international employees, and only 26% train third parties. Half of

the respondents conduct the trainings annually and a quarter conducts them more than once a year. When it comes to monitoring foreign operations, 87% of respondents monitor through audits, which are carried out annually by 19% of respondents and semiannually by 13%.

It is crucial for companies to develop and implement anti-corruption policies that thoroughly cover all risky operations and countries because corruption risk has significantly increased in the last few years, and because the FCPA and the UK Bribery Act are enforcing extremely strict rules that can cause companies substantial financial losses and reputational damage that have unquantifiable consequences.

Inside Jobs & Profile of the Typical Fraudster

Kenneth E. Yaroch, a previous loan officer in Signature Bank, was accused of fraud for forging loan documents between 2004 and 2005 (Feig, 2008). This example is only the tip of the iceberg when it comes to inside jobs. Abbey (2011) contends that outsiders have not committed the largest frauds in history; on the contrary, insiders who cause significant losses and sometimes collapse companies have committed them. History has shown that it is highly likely that senior managers are involved in the massive financial reporting cases revealed; as they create a culture that encourages gaining profits no matter what the costs are (Crawford and Weirich, 2011). This is especially true during economic turmoil when employees (including managers) are given an ultimatum to achieve the targets or get fired. Whipple (2010) reports that 55% of companies across all industries and regions believe that employees and third parties committed fraud. This figure, according to Plansky (2011) has increased as Kroll Global Fraud Report 2011 suggests that senior managers, junior employees and/or third party agents perpetrated 60% of the crimes revealed. The increase

in inside jobs from 2010 to 2011 can be interpreted in numerous ways, first that the crimes were not merely committed as a result of the financial crisis, second, that firms are not paying enough attention to fighting internal fraud as they are with external one, and third, perpetrators' changing tactics. As stated in PWC Global Economic Crime Survey¹³ 2012, inside jobs are significantly high in the Middle East region where internal employees compared to the 56% global average carried out 69% of the economic crimes perpetrated. One of the reasons for the increase in inside jobs, as Plansky (2011) proposes, is that the value of companies are no longer measured in solid property but by ideas (intellectual property), and access to those assets by employees are becoming easier every year with the invention of new technologies. Other reasons why fraudsters¹⁴ commit fraud, according to a recent survey conducted by KPMG¹⁵ (2011), are pressure to meet targets and budgets (which usually happens when companies set unrealistic goals), when employees' performances are continuously criticized and their jobs are threatened, and when a culture of ethics and intolerance to fraud are not implemented from the top down. As Wells (2001, p.1) notes, "it is either need or greed", therefore, job dissatisfaction and financial pressure can lead to internal financial crime (Wells, 2001). Companies cannot alter or control greed as it is a personality trait, therefore, they should manage to eliminate the other factor encouraging fraud, which is the need, by setting realistic goals and ensuring job security. There are three categories of internal financial fraud; "Isolated", which includes one or two senior managers that commit plain revenue manipulation; "Senior Management Clique", which consists of a few senior managers (usually CEOs and/or CFOs are involved) who conspire to manipulate financial statements; and "Boundary Crossing"; which involves senior managers encouraging mid-level managers and/or external senior managers to join

¹³ PricewaterhouseCooper (PWC) published a global economic crime survey (2012) that focuses on the Middle East region.

¹⁴ Financial crimes perpetrated by employees (including managers and board members) are referred to as fraudsters & perpetrators *in this section only*.

¹⁵ KPMG conducted a survey on the characteristics of the typical fraudster in Europe, the Middle East & Africa.

in order to deceive auditors, just like the previous category, this one includes CEOs and/or CFOs most of the time (Farrow and Hess, 2007). Evidently “Senior Management Clique” and “Boundary Crossing” are perturbing since they involve senior management and board members who are supposed to preach ethics and morality to lower level employees. Moreover, fraud committed by upper management might go undiscovered for years due to financial statements manipulation and employees’ hesitation to blow the whistle. The types of fraud insiders usually commit are misappropriation of assets, which reached 43% of inside jobs committed in 2011, and fraudulent financial reporting (KPMG, 2011). As stated in KPMG (2011) survey, 41% of fraudsters are between the ages of 36-45, as opposed to 39% in 2007 and 35% are between the ages 46-55 years old, as opposed to 31% in 2007. In KPMG 2011 survey, 87% of fraudsters were men in Europe, the Middle East and Africa (EMA) region; this figure grew from 85% in the KPMG 2007 survey. Women only presented 8% of fraudsters in EMA due to their low presence in senior positions in this specific region, whereas, they presented 22% in the Americas and 23% in Asia Pacific. Taking a closer look at the Middle East region, PWC (2012) finds that 92% of perpetrators are men, 54% are between 31 – 40 years old, and 63% hold a graduate degree and are working for the company for 3-5 years. In EMA (KPMG 2011), 29% of fraudsters hold management positions, as opposed to 26% in 2007, 35% are senior managers (same as 2007), and 18% are board members, as opposed to 11% in 2007. Also, 36% of perpetrators work in finance (32% in 2007), 26% are CEOs (11% in 2007), and 25% work in operations (32% in 2007). Furthermore, KPMG (2011) finds that 33% of fraudsters worked for their companies for more than 10 years (22% in 2007), 27% worked between 6 to 10 years (29% in 2007) and 29% worked between 3 to 5 years (36% in 2007). In EMA, 41% of perpetrators work alone and 59% collude with others, in the Americas, 34% work alone and 66% collude with others, and in Asia Pacific 42% work alone and 58% collude with others. Also, research

suggests that detecting a collusive activity is much harder than detecting a crime committed by one or two employees. The colluding parties are usually suppliers, customers, consultants and/or subcontractors. It is interesting to note that men are more likely (64%) to collude than women (33%). Moreover, companies tend to invest in anti-fraud procedures that mitigate the risk of external fraud taking place, ignoring the fact that fraud is more likely to occur from within the company (Feig, 2008). Manipulating weak internal controls to commit fraud has increased from 49% in 2007, to 74% in 2011 due to cost cutting when the economic crisis started (KPMG 2011). However, 36% of fraudsters commit fraud because they are dishonest and manipulative regardless of how strong the internal controls are, as opposed to 15% in 2007, finally, 15% collude to evade robust internal controls compared to 11% in 2007 (KPMG, 2011).

Companies surveyed reported that 10% of fraud was revealed through formal internal whistleblowing reports, 8% was discovered through customers or suppliers, 6% through third parties including regulators, banks and competitors, and 13% by accident, up from 8% in 2007 (KPMG, 2011). Companies are learning about fraud by accident because they usually rely on the good conscience of employees and third parties to report fraud if they learned about it or confess if they committed it, nonetheless, only 50% of fraud cases were discovered that way in 2011. Alarming, 17% of fraud was discovered by accident in the Middle East, as suggested by PWC Global Economic Fraud Survey 2012. Therefore, it is highly likely that many cases of fraud go undetected because employees do not blow the whistle. There are several reasons for that, such as, staff's reluctance to blow the whistle on colleagues, some believe that it is none of their business to raise such issues; others claim that they fear the consequences of reporting an insider, especially if the fraudster was a senior manager or a board member (KPMG, 2011). For all these reasons and for many

others, the United States developed the Dodd-Frank Act (2010) that rewards whistleblowers. Although companies fear reputational damage if they disclose cases of financial crime, it is necessary for “sending a clear message” to prospective culprits that the company has zero tolerance to it. KPMG (2011) survey shows that in 2011, 77% of the fraud cases were not revealed to the public domain, 13% made very minimal announcements and only 10% made detailed announcements. Surprisingly, companies also avoid to internally communicate the financial crime cases, as only 13% made detailed announcements, down from 35% in 2007, 33% made very limited announcements, up from 15% in 2007, and 54% did not disclose the crime altogether, up from 50% in 2007. When internal fraud goes unannounced, companies would be sending the wrong message to employees that perpetrators will be off the hook with minimal damages to the perpetrator.

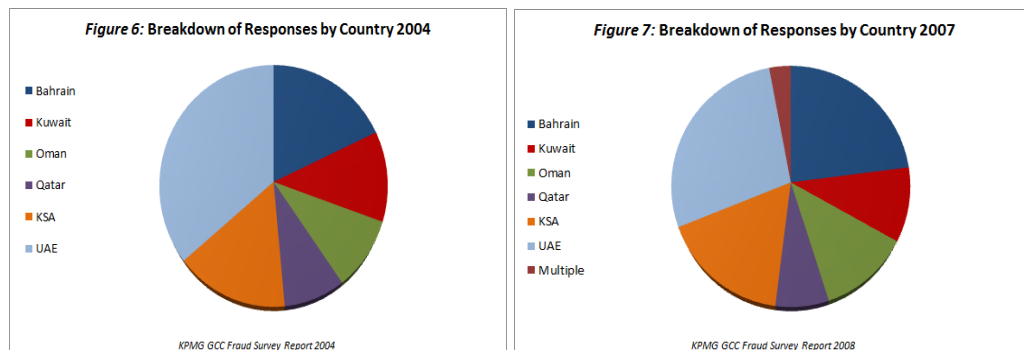
In many instances, executives are not proactive when it comes to compliance because they rely on their internal audit teams to detect fraud. Deloitte (2010) has conducted a survey to study the role of internal audit in detecting and preventing fraud. When executives were asked about their vulnerability to fraud risk, 63% believe that it has increased, 2% report that it has decreased and 35% state that it hasn't changed. However, it is interesting to note, that 80% of respondents claim that fraud committed by insiders has increased due to the economic slump. Furthermore, the survey results convey that 20% of respondents do not have a documented fraud policy, what makes matters worse is that 23% of companies surveyed state that the economic crisis has not pushed Board level managers to consider introducing or improving fraud risk procedures. The figures above denote complacency by upper management believing that internal fraud cannot happen to them; moreover, management prefers investing in tools that lead to an immediate payoff (profits). As has been mentioned earlier, companies rely on internal audit teams to detect and prevent fraud,

however, 51% of respondents indicate that the internal audit team in their company does not acquire the adequate resources and 55% believe that the internal audit team does not have the required skills and understanding in the area of data analysis. Also, almost 60% of respondents report that their internal audit teams were never trained on gathering and handling evidence and investigative interviews, 50% were never trained on regulatory investigations, nearly 40% were never trained on identifying and evaluating fraud schemes and almost 30% were never trained on bribery and corruption. Finally, 57% of respondents state that their internal audit teams do not perform fraud risk assessments. Crawford and Weirich (2011) affirm that firms that have weak internal controls and separate duties are more vulnerable to fraud. As Carrington (2010) puts it, companies believe that they if they ever fall victim to fraud, the perpetrators will be either outsiders or third parties, but they have to stay alert to the fact that, especially after the financial crisis, it is more likely that fraud is caused from within. Moreover, Searles (2010) adds that companies are putting false hope in internal audit teams, as they do not perform fraud risk assessments, do not undergo the necessary training and lack the adequate resources. Clearly, the survey results suggest that combating internal fraud is still in its early stages, as there is a clear lack of commitment and complacency by top management and without top management's devotion employees will not enforce an anti-fraud attitude to daily operations and long-term strategies. Furthermore, internal audit departments have insufficient resources and incompetent training. It is important to note that deficient internal audit departments can be an important motivator for prospective culprits to go ahead with their fraud. As companies can control what can and cannot be announced when an internal fraud has been revealed, and yet cannot do the same with external fraud, they spend more money and time on fighting external crime for fear of reputational damage.

VII. In-depth Analysis of Financial Crime in GCC Countries

The Gulf Cooperation Council (GCC) consists of the United Arab Emirates (UAE), Qatar, Kingdom of Saudi Arabia (KSA), Bahrain, Kuwait and Oman. GCC countries, especially the UAE and Qatar were and still are one of the fastest growing countries in the Middle East, and to some extent in the world, as Everett-Heath (2010) says, after the financial crisis; it has become a fact that the Gulf region is a part of the global economic markets. Therefore, as has been said earlier, when countries have massive growth potential and various investment opportunities, governments are keen to focus on expansion rather than apply strict rules and regulations that might inhibit growth and fail to attract foreign and local investments. This applied to GCC countries, as many corporations were not required to develop code of conduct policies and implement anti-fraud measures; therefore, most of the financial crimes perpetrated went unpunished. However, when the financial crisis hit the GCC markets, many financial crime cases came to light and what was considered “a way of doing business” prior to the crisis became an illegal act that is punishable by law. Everett-Heath (2010, p.40) talks about the Gulf region, “the quality of corporate governance has not grown as rapidly as the regional footprints of international corporations or the balance sheets of regional businesses; and the regional response to white-collar crime has shifted from denial to action.” The attitudes of regulators and powerful individuals have recently changed as discussing financial crime was a taboo and these issues were dealt with discreetly, conversely regulators and government officials started scrutinizing the activities of corporations locally and across borders, and to some extent disclosed the massive crimes discovered to the public (Everett-Heath 2010; Kawach 2010).

KPMG conducted fraud surveys in the GCC markets in 2004 and 2008¹⁶. In 2004, the company received responses from 297 companies across the GCC and in 2007 responses grew to 1,000. To add, Deloitte conducted a fraud survey in the GCC markets in 2010 and received replies from 1,100 companies. Fraud surveys conducted by KPMG and Deloitte were published and included organizations from the public and private sectors, and the questionnaires were distributed to many industries.



Figures 6 & 7 above show the breakdown of responses by country as provided by KPMG Fraud Survey Report of 2004 and 2008. As can be seen, the most forthcoming in both years was the UAE, where it contributed to 36% and 28% of the answers respectively. Conversely, Qatar was the least responsive in both years, where it only contributed to 8% and 7% of the total answers respectively. This does not come as a surprise because the Middle Eastern culture does not encourage transparency as it is associated with shame. Therefore, lack of transparency was magnified for both economical (attracting foreign investments and boosting investors confidence) and cultural reasons.

It is interesting to note that according to the surveys' results, greed was the most common factor for committing acts of fraud (35%), followed by lavish lifestyle and financial commitments (18%). However, greed is usually the universal reason behind committing

¹⁶ KPMG GCC Fraud Survey 2008 reflects responses from 2007.

fraud, not only in the GCC. The figure of respondents asserting that fraud is a major problem in business (in general) grew from 37% in GCC Fraud Survey 2004 to 43% in GCC Fraud Survey 2008. This increase could be caused by the tightened liquidity, which led to the economic turmoil, hence the major financial crimes were unraveled. A significant number of respondents refused to disclose fraud instances although they were aware of falling victims to fraud, however, for the ones disclosed, fraud cases grew by 33% since the 2004 fraud survey, totalling the number of cases to 2,179 in 2007. Moreover, 42% of respondents were aware of fraud being perpetrated at their organizations in 2007, a 31% increase since 2004. According to KPMG (2004, 2008), most of the perpetrators were insiders; 76% in 2007 (74% in 2004), of whom, 57% were non management employees and 17% were managers (in terms of number of incidents) compared to 29% and 47% in 2004 respectively. On the other hand, the largest frauds in terms of value, were committed by managers (38% in 2007 up from 25% in 2004), followed by external parties (35% in 2007, down from 52% in 2004) and finally, non management employees (27% in 2007, up from 23% in 2004). As has been mentioned above, many financial crimes that took place in the region prior to the financial crisis were not reported by employees despite them being aware of those crimes, especially that the largest frauds by value were committed by managers. The most prevalent fraud types in 2007 were cheque forgery, funds obtained through misrepresentation, kickbacks/bribery/procurement fraud and credit card fraud, moreover, the most common types of fraud in 2004 were misappropriation of funds, false invoicing, kickbacks/bribery/procurement fraud, and funds obtained through misrepresentation (KPMG 2004, 2008). It is worth mentioning that E-Commerce was not excruciatingly prevalent in the KPMG Global Fraud Report 2008, as it only constituted 9% of frauds reported by number and 4% by value, yet the Professional Services firm predicted that this type of fraud will be more common in the coming years due to companies' increased

reliance on technology when conducting business. KPMG was not mistaken, as according to Kumar (2010), fighting information theft/E-Commerce fraud has been a challenge in the GCC markets as this type of fraud threatens businesses as well as governments and destabilizes financial markets, consequently, research suggests that companies spent \$280 million on IT security, double what they spent in 2005. To validate these results, information theft was the second most prevalent type of fraud in Deloitte GCC Fraud Survey 2011, also 40% of Middle East respondents to PWC Global Economic Crime Survey 2012 have fallen victims to cybercrime. Economic growth and technological advancement go hand in hand, therefore, as the GCC countries are growing, so is their reliance on IT, which makes the countries prone to different sorts of fraud (IP theft, identity theft, phishing...etc). Next, according to KPMG Fraud Survey 2008, 29% of the fraudulent activities were detected by internal controls in 2007 (24% in 2004), 14% of the crimes were reported by customers (9.5% in 2004), 10% by employees (10.5% in 2004), 10% by internal audit review (14.3% in 2004), and 9% were accidentally revealed (3.6% in 2004). Alarming, 49% of respondents have signaled that fraud was being committed in their organizations but their warnings were dismissed, a 36% increase since 2004 (KPMG, 2008). The fact that the percentage of employees and internal audit departments reporting fraud decreased over the years shows that companies did not enforce a culture of transparency and morality, which explains ignoring red flags raised by employees. To prove, according to the surveys, the biggest drivers of fraud in both years were weak internal controls, collusion and lack of responsibility, and poor ethical culture.

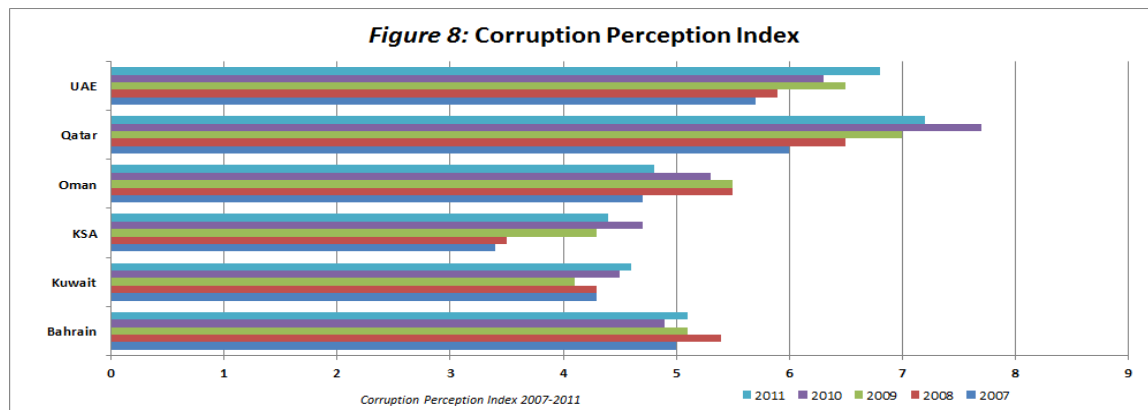
Looking at the more recent Deloitte GCC Fraud Survey 2011¹⁷, fraud levels reached 35% in the region in 2010, of which, 14% lost a value of more than \$1 million and 7% lost more

¹⁷ The survey was conducted in 2010 but published in 2011.

than \$10 million. Startlingly, although companies in the GCC lose millions on fraud, 40% of companies surveyed only spend \$50,000 on response plans. Unlike KPMG GCC Fraud Reports of 2004 and 2008, the most prevalent type of fraud was theft of physical assets in nearly 12% of the cases, followed by information theft in almost 9% of the cases, procurement fraud and corruption and bribery were to a lesser extent common at 6% and 5% respectively. It is encouraging to note that 87% and 83% of executives have ethics policy and code of conduct, which explains the decrease in corruption and procurement fraud. As has been proven globally, whistleblowing policy is the most effective anti-fraud measure, yet only 50% of companies in the GCC apply it as employees are highly concerned about confidentiality, regardless of how effective this policy is in deterring fraud. Although the figure of companies using the whistle blowing system is still low, it is increasing, therefore, this is a sign that transparency is being intertwined into the companies' culture. To add, 33% of the respondents claim that the probability of fraud has increased during the financial crisis (Deloitte, 2011b), this has been the case globally and Deloitte (2011b) explains it in two ways; firstly, the discovery of fraudulent activities that occurred before the financial crisis increased, secondly, when fraud is prevalent, employees tend to justify and rationalize it, hence, commit fraud.

GCC countries should beware of corruption and bribery; research suggests that this type of fraud is a growing problem in the Middle East. According to PWC Global Economic Crime Survey 2012, 43% of respondents in the Middle East were affected by corruption and bribery in 2011, compared to the 24% global figure, what's more is that 39% of executives from the Middle East expect to experience more corruption and bribery. However, Libya, Egypt, Iraq and the West Bank faced severe political turmoil in 2011, especially in Libya and Egypt where political leaders' corrupt activities were unearthed, therefore, the high

corruption and bribery figure might be highly influenced by countries in the Middle East excluding the GCC. *Figure 8* presents corruption scores (attained from CPI) of the GCC countries.

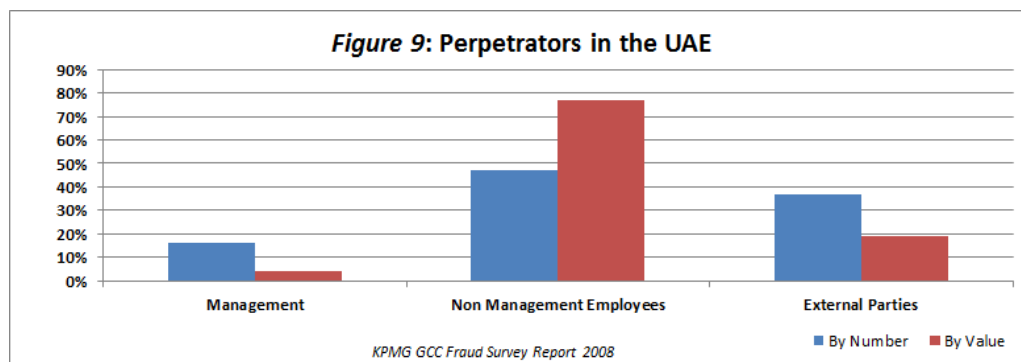


As can be seen throughout the years presented 2007-2011, Qatar maintained the highest CPI score (at least 7.0) amongst its peers, followed by UAE (at least 6.0). Whereas, the KSA, Bahrain, Kuwait and Oman did not follow suit and are moderately to highly affected by corruption. Those countries who have a global presence, or are in any way connected to the UK or the USA should remain vigilant in order to avoid paying hefty fines for violating the FCPA and the UK Bribery Act. As Chance (2011) states, even if companies in the GCC are FCPA compliant, this does indicate that they are not violating the UK Bribery Act as it contains stricter and wider rules.

United Arab Emirates

UAE was and still is a rapid growing economy as Abu Dhabi is an oil rich state, and Dubai is the hub for businesses and investments in the Middle East and had the fastest growing GDP in the world at 13% per annum from 2003 until 2008 (Arabianmoney,2010). Everett Heat (2010, p.4) describes Dubai's growth as "famine has followed feast." Nonetheless, after the start of the global financial crisis in 2007, many companies shut down and many projects

were either suspended or postponed. In order to prevent or mitigate future economic downturns, many corporations began restructuring, and with that many financial crimes were revealed. It is interesting to note that not long before the financial crisis, the GCC Fraud Survey Report 2008 published by KPMG, presented figures of the most common perpetrators in the UAE (as shown in *figure 9*) and they were non-managers and external parties; managers only presented 16% of fraud (by number of incidents), which accounted for 4% of the total value of fraud. Nonetheless, during the economic downturn, it was revealed that managers from tier one firms perpetrated the financial crimes, which crucially affected Dubai's financial markets.

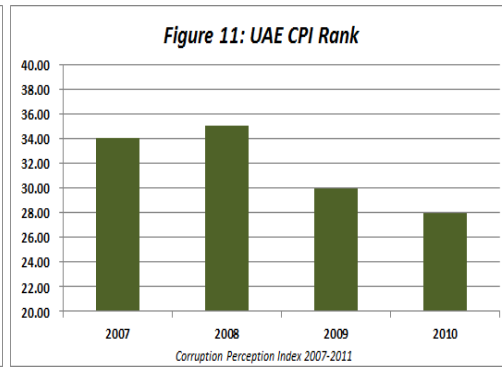
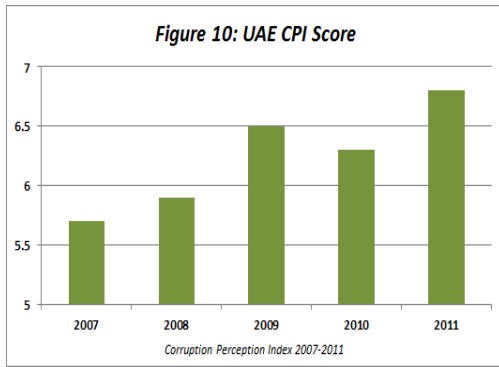


As stated by Oteify (2009), over 60 managers from government related entities are under investigation, and this is where the corruption all began. To name a few, the former chief executive of Deyaar, a property developer, is accused of embezzlement, accepting bribes and using company money for his own expenses; the former chief executive, with the help of nine others, are accused of creating a complex net of land deals and suspicious dealings worth nearly \$218 million (Ghalib, 2010). Ex-Chairman of Dubai Properties¹⁸, a property developer, was accused of embezzling public funds and making millions in illegitimate profits (Fattah, 2009), the defendant was released in mid-2010 after re-paying the \$35.4

¹⁸ Dubai Properties: a property developer that is part of Dubai Holding LLC, which is owned by the ruler of Dubai, Sheikh Mohammed Bin Rashid Al Maktoum.

million, in which he was accused of embezzling (Reuters, 2010). Former Dubai International Financial Center's (DIFC) chief was also accused of embezzling public funds and was released once he repaid the \$14 million he was accused of embezzling (Mustafa, 2011). Five former executives in Tamweel, the largest mortgage provider in Dubai, were indicted of squandering public funds, bribery and corruption, revealing confidential information about the company and financial irregularities, the court ordered them to pay a total of \$12.25 million, \$2.72 of which will go to Tamweel (Za'za', 2010). One of the largest cases in Dubai was the fraud and corruption case revealed in 2009, which took place in Dubai Islamic Bank (DIB), and was worth \$501 million; six expatriates (including two former DIB employees), who are to be jailed for 10 years, were charged of embezzling and aiding others to embezzle public funds, deliberately causing loss to the government, forging documents, and making unlawful profits (Agarib, 2011). In addition, Dubai Financial Services Authority (DFSA) charged the investment firm Shu'ua Capital with share manipulation by deliberately raising the closing price of DP World for accounting purposes, DFSA imposed a fine of \$950,000 on the investment firm (Kerr, 2008). UAE authorities also revealed other fraud related cases, to exemplify, health insurance fraud is rapidly increasing in the country; 1,160 cases were reported in 2010, and increased to 1,400 in 2011 (Emirates 24/7, 2012). The issue that raises concern is the increase in money laundry in the Middle East as according to the most recent PWC Economic Crime Survey 2012, 17% of respondents were involved in money laundering compared with the global average of 9%. Accordingly, money laundering in the UAE is on the rise; foreign and local banks and money exchange shops detected 572 cases in the first quarter of 2011, 2,711 cases were reported in 2010, up from 1,750 in 2009 (Emirates 24/7, 2011). The head of the Money Laundering and Suspicious Cases Unit at UAE Central Bank explained that the drastic increase was caused by the growth in local investments, increased vigilance when detecting suspicious transactions and increase in the

number of auditing professionals in banks (Emirates 24/7, 2011). In 2010, the biggest money laundering case in Dubai was revealed; four individuals and seven companies were accused of laundering almost \$243 million for three years and presenting forged documents to the Central Bank of the UAE. The money was attained by swindling the UK's Revenues and Customs Prosecution Office and the Netherlands Antilles authorities (Za'za', 2010). Another money laundering operation that was recently busted is when a state security tried to smuggle millions of funds and 94,410 kilograms of gold to the country (WAM, 2011). Although UAE's attempts to clean the financial market resulted in a decline in investor confidence and share prices, this downturn is only temporarily, as UAE has adopted a more transparent and zero tolerance policy to financial crime (Benham, 2008). It is interesting to note that in the KPMG GCC Fraud Survey 2008 only 33% of the respondents from the UAE indicated that their firm has a formal anti-fraud policy, the lowest in the GCC; however, according to PWC (2012), Abu Dhabi Accountability Authority was formed in 2008 where it employed anti-fraud programs including a whistle blowing policy. Moreover, the DFSA now complies with the Financial Action Task Force (FATF) requirements and signed scores with global agencies to fight financial crime especially money laundering (Masudi, 2008), the country also applies firmer rules, monitors cash inflows and outflows of public funds, employs improved auditing procedures and applies tougher punishments on perpetrators, which can now reach up to 20 years of imprisonment (Kawach, 2010). This is shown by the country's improvement in the CPI ranks and hence scores as presented in *figures 10 & 11*. UAE has been climbing the ladder to a cleaner economy; this has mainly been influenced by the exposure of corruption cases in 2008 (Kawach, 2010).

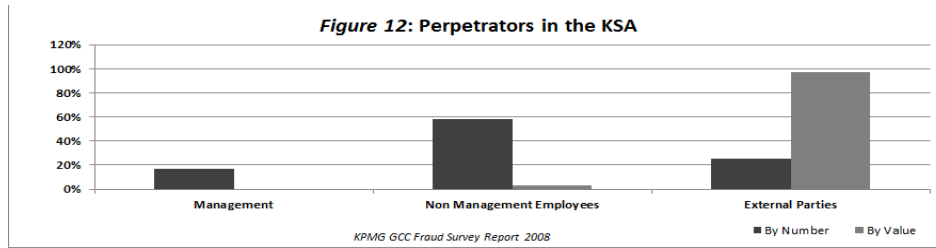


UAE's scores increased from 2007-2011 except for its slight decrease in 2010; the score reached 6.8, the least corrupt country in the GCC after Qatar. In terms of rankings, UAE ranks 28 as of 2011, higher than some European countries such as Spain and Portugal.

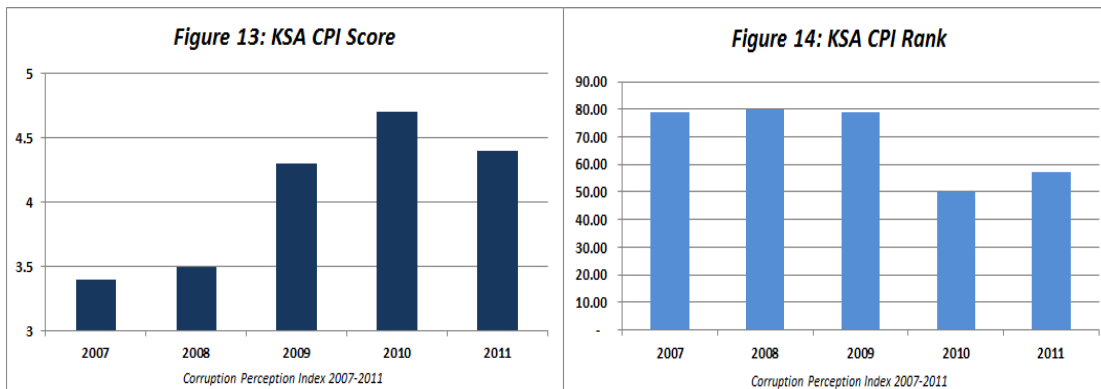
Kingdom of Saudi Arabia (KSA)

Financial crime cases in KSA were revealed way before the financial crisis started as KSA is one of the most corrupt countries in the GCC, and in some years, was one of the most corrupt in the Middle East. Kickbacks, bribery and facilitation payments were the norm until the government decided to top up its anti-fraud measures in order to remain globally competitive. Surprisingly, according to the KPMG GCC Fraud Survey 2008, 61% of respondents from KSA confirmed having a formal anti-fraud policy. One of the largest and most scandalous financial crime cases disclosed in KSA and even in the GCC is the multi-billion dollars dispute between Al-Ghosaibi and Al-Sanea families. Al-Sanea, owner of Al-Saad Group, is accused of stealing \$10 billion from his wife's family Al-Ghosaibi, owner of Ahmad Hamad Al-Ghosaibi & Bros (AHAB) over a period of four years (Al Jazeera, 2009). The case started when Mashreq Bank, a Dubai-based bank, filed a complaint in New York Supreme Court against AHAB for failing to make a payment of \$225 million, Al-Sanea was running, among other things, the money exchange shops owned by AHAB and handled workers remittances inside and outside the Kingdom. Al-Sanea allegedly created a fraud

scheme where he entered into transactions for the sole purpose of forging the receipts of funds into accounts under the name of AHAB, which he then diverted to his own account, also, Al Sanea borrowed money from banks using “forged and falsified” documents under AHAB’s name (Al Jazeera 2009; The Economist 2009). Further, Mashreq Bank was one of the main partners, where from January 1st 2008-May 1st 2009 the bank had 52 deals with Al Sanea totaling to \$4.7 billion, despite the fact that the transfers were oddly high and had “non-commercial terms” (Al Jazeera 2009; The Economist 2009; England and Peel 2010). The case does not stop there, as more than 100 international banks lent almost \$20 billion to both groups and repayment is far from near (England and Peel, 2010). Older cases involve three Saudi traders who got a record fine of \$45 million for market manipulation and were banned from trading for three years; the defendants deliberately manipulated stock prices and misrepresented information to investors, also, authorities fined an investor \$640,000 for falsified transactions and illegal trading worth \$23.6 million and ordered the defendant to pay the money back (Reuters 2006). Market manipulation and insider trading are prevalent fraud types in the GCC countries, namely KSA, as investors used to trade by “rumors rather than performance”. In order to improve its reputation; Saudi Capital Markets Authority (CMA) announced the names of shareholders that own more than 5% in listed companies (Wigglesworth, 2008). Additionally, regulators started penalizing traders and investors who committed those crimes in the past. For example, a previous board member of Saudi Telecom was ordered to pay a penalty of \$2 million for insider trading in 2004(Reuters, 2010). According to the KPMG GCC Fraud Survey 2008, non-management employees committed the highest number of fraud in terms of number of incidents (58%), on the other hand, external parties fraudulent activities were the highest in value (97%).



One might expect that corruption would be under control in KSA after many GCC countries were and still are dedicating resources to restructure and eradicate financial crime; conversely, corruption in KSA is getting out of hand; as mentioned in IslamTimes (2009), fraud and corruption among government officials reached the “worst possible conditions”. One of the scandals that were recently revealed was when Shura members (government officials) were accused of wasting \$29 million in government funds (Kawach, 2010). According to Shaheen (2011), in April 2011, the country disclosed 3,014 cases of public funds embezzlement, 1,037 cases of bribery and other indiscretions such as money laundering.

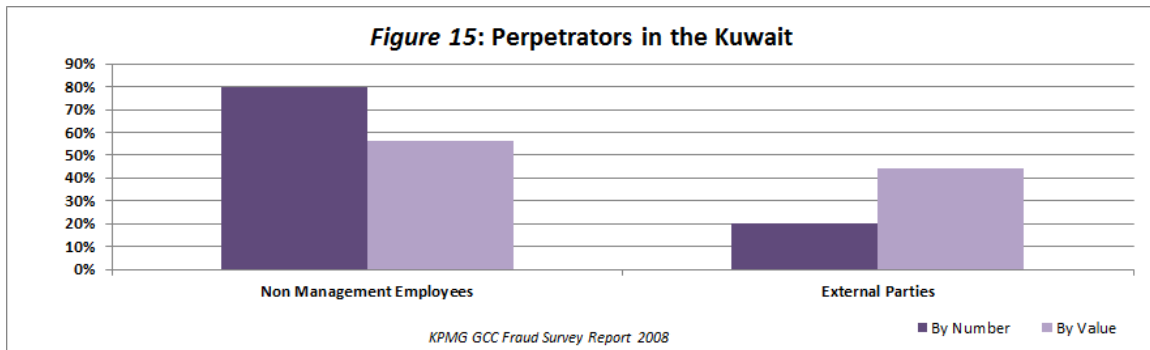


As can be seen in *figures 13 & 14*, the country managed to decrease corruption, as its score increased from 3.4 in 2007 to 4.7 in 2010 but decreased to 4.4 in 2011, subsequently, KSA’s rank dropped from 79 in 2007 to 50 in 2010 but eventually increased to 57. As of 2011, KSA scored the lowest among GCC countries and Rwanda & Korea (CPI, 2011). In an attempt to

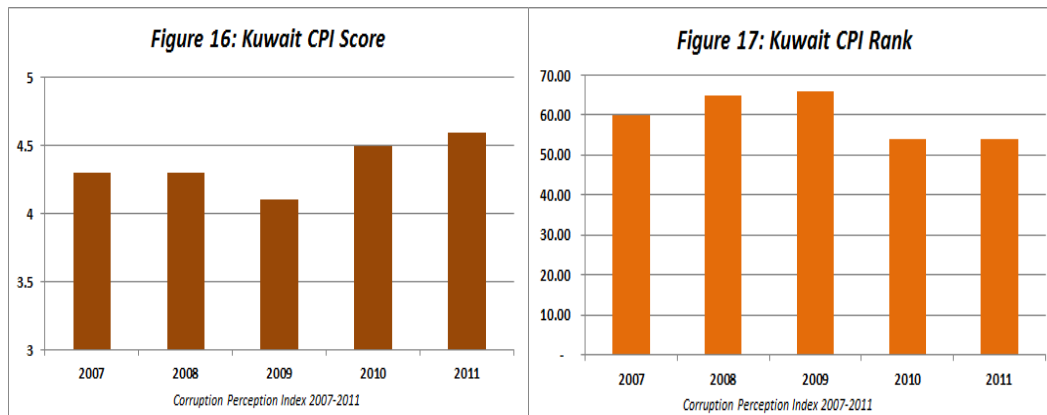
battle corruption and fraud in KSA, King Abdullah instructed the National Anti-Corruption Commission (NACC) to investigate and report any violations or discrepancies carried out by the government sector; however, government officials resisted employing anti-corruption and anti-graft campaigns until King Abdullah announced that all agencies should cooperate with the NACC and to take action on any remarks and recommendations offered by the body (Tago, 2012).

Kuwait

Similar to KSA, fraud and corruption levels are significantly high in Kuwait especially in the government sector. A series of arrests were made against government officials. In one instance, authorities sentenced three Kuwaiti nationals, one of them a member of the ruling family, to 15-30 years of prison for embezzling funds and facilitating illegal transactions during the Gulf war in the 1980s. The judge directed the defendants to recompense the embezzled funds and pay twice the amount as a penalty to the government as the amount they embezzled reached almost \$136 million (Janssen, 2004). In another instance, a former oil minister and a member of the ruling family was arrested for being a part of a multi-million dollar fraud case (Gulfnews, 2007). In consonance with KPMG GCC Fraud Survey 2008, hence as shown in *figure 15* below, non-management employees committed the highest number of fraud (80%) and caused the highest losses (56%), as opposed to external parties.



In a few cases, Kuwaiti companies were accused of defrauding the U.S military; one of the accusations, according to Kelley (2008) was held against the manager of a Kuwaiti company called LaNouvelle Trading & Contracting Co., for over charging the price of fuel sold to the US Army; the original price charged should have been \$1.7 million, however, the actual price charged was \$5.5 million, also, in order to facilitate the scheme, the manager paid \$1 million in bribes to an American employee working for KBR Inc., an engineering, procurement and construction company. In another case, Agility, the Kuwaiti logistics company, was the main food supplier to the U.S military based in Iraq, Jordan and Kuwait and is accused of defrauding the military by overpricing contracts by \$8.5 billion over a 41 month period (Bigg, 2010). As shown in *figures 16 & 17* below, Kuwait needs to strengthen its corporate governance and its fight against corruption as corruption level is high; the country's score increased from 4.3 in 2007 to 4.6 in 2011, however, as of 2011, Kuwait is the most corrupt GCC country after KSA. According to the World Economic Forum Global Competitiveness Report 2010-2011, corruption is the sixth most impeding factor to starting business or investing in Kuwait.



As declared by the Transparency International - Global Corruption Barometer 2009b, 20% of survey respondents from Kuwait admit to paying or receiving bribes, believe that government officials and public servants are the most crooked in the country, and confirm that the issue is getting out of control. In addition, 23% of respondents affirm the ineffectiveness of the anti- corruption measures adopted by the government, while 68% report otherwise. To exemplify, public prosecutors in Kuwait are investigating members of the parliament, after an amount of \$92 million was deposited into the accounts of two parliament members, which raised a lot of questions and led to monitoring the account activities of 9 out of 50 members of the parliament (Stack, 2011).

As predicted by the IMF (2011), the country's fast development and rapid growth, especially once the economy recovers from the financial crisis and the demand for oil goes back to normal, makes it particularly prone to money laundering. Less than a month later, authorities started investigating a suspected money laundering scheme that is worth almost \$300 million and includes intricate links to Germany, Iran, Russia and Britain (Toumi, 2011). The money was deposited in the accounts of a former minister, a businessman and two politicians and was then transferred from Kuwait to Amsterdam to Moscow then Iran and finally moved back to Kuwait (Toumi, 2011). Also, the IMF (2011) states in the report

that there are weaknesses in the anti-money laundering techniques employed by the country, and that there are loopholes that money launderers can exploit. The organization also calls for stepping up supervision and transparency in the country, to add, Kuwait needs a more preemptive approach in preventing, monitoring and investigating money laundering and financing of terrorism (IMF, 2011). Also, according to KPMG GCC Fraud Survey 2008, only 50% of respondents from Kuwait claimed to have a formal anti-fraud policy. In response to the growing concern of corruption in the country, in March 2011, the government created a national anti-corruption authority to investigate fraud and illegitimate racketeering in the public sector (Business Anti-Corruption, 2011).

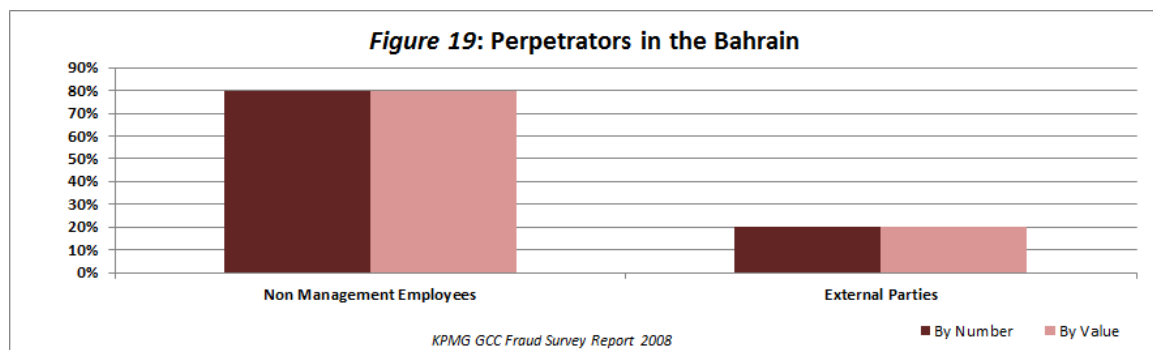
Bahrain

Bahrain is considered moderately to highly corrupt, its CPI score increased in 2011 reaching 5.1 as opposed to 4.9 in 2010, ranking it third between GCC countries. However, the country is dedicated to fighting corruption in the public sector and partially owned government entities as it has detained several public officials who were allegedly accused of corruption, embezzling public funds, misappropriation of assets and/or making illegal transactions (Rahimi, 2007).



The latest corruption case revealed involves a member of the royal family and a London

Based businessman who was recently arrested by the Serious Fraud Office. Both are accused of corruption and bribery for illegally winning contracts worth \$41.1 million between Alcoa, a US based Aluminum Company and Bahrain Aluminum, also called Alba (Kerr, 2011). Next, according to KPMG GCC Fraud Survey 2008, the most common perpetrators are non-management employees, where they were responsible for 80% of the crimes perpetrated in terms of number of incidents and value, followed by external parties who were responsible for 20% of the fraud cases by number of incidents and value. Also, as has been mentioned in the KPMG GCC Fraud Survey 2008, only 44% of respondents from Bahrain have a formal anti-fraud policy.

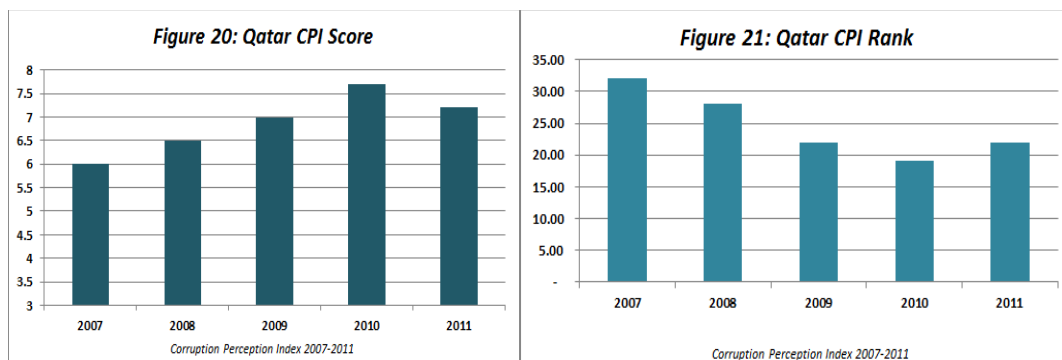


It is important to note that money laundering incidents are surging in the country. One of the incidents that shocked Bahrainis was when the current State Minister got arrested on charges of money laundering (the first government official to get arrested since Bahrain became independent in 1971), the illegal activities which allegedly started in 2009 are not limited to Bahrain but also include other countries (Gangal 2010; Toumi 2010). The scheme involved channeling money from the sale of drugs from Columbia, Azerbaijan & Eastern China to Iran's Revolutionary Guards through the Bahraini minister (Toumi, 2010). In response to the fraud incidents that were revealed and to the surge in corruption levels, Bahrain formed anti-corruption and anti-money laundering bodies and enhanced

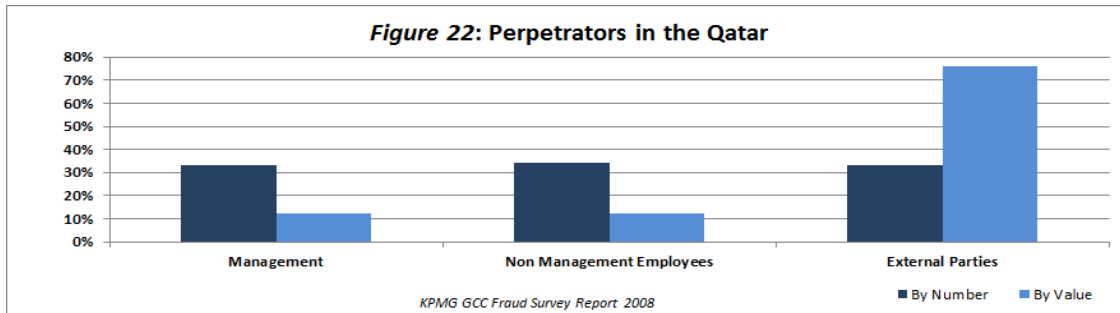
transparency (Kawach, 2010).

Qatar

Qatar's real growth rate of 17% makes it one of the fastest growing economies in the world; the government's revenue is mainly dependent on oil (62%) increasing its GDP to \$129 billion (as of 2010), moving it from the world's poorest to one of the highest per capita income countries in the world (U.S Department of State, 2012). In order to maintain its reputable image, Qatar strives to fight corruption and succeeds in some ways, as according to the *figures 20 & 21* below it is the least corrupt country in the GCC; as of 2011, it scores 7.2 down from 7.7 in 2010, and as of 2011, it ranks 22 in the world, up from 19 in 2010, yet still scores higher than some developed countries, such as the USA and France (CPI, 2011).



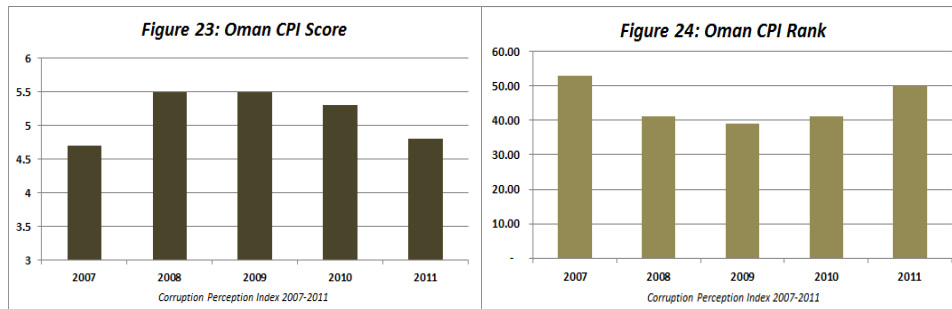
As has been said, the risk of fraud is part of doing business, and like any other country in the world, Qatar has suffered from financial crime. According to Sambidge (2008), two banks in Qatar (HSBC and Qatar Islamic Bank) have fallen victims to ATM fraud. Also, in 2005, when the GCC was hit by a series of insider trading, Qatar has arrested two senior business executives on the charges of insider trading, the case originally involved 30 more companies but the charges were dropped once the companies re-paid the illegal proceeds gained from market manipulation (Gulfnews, 2005).



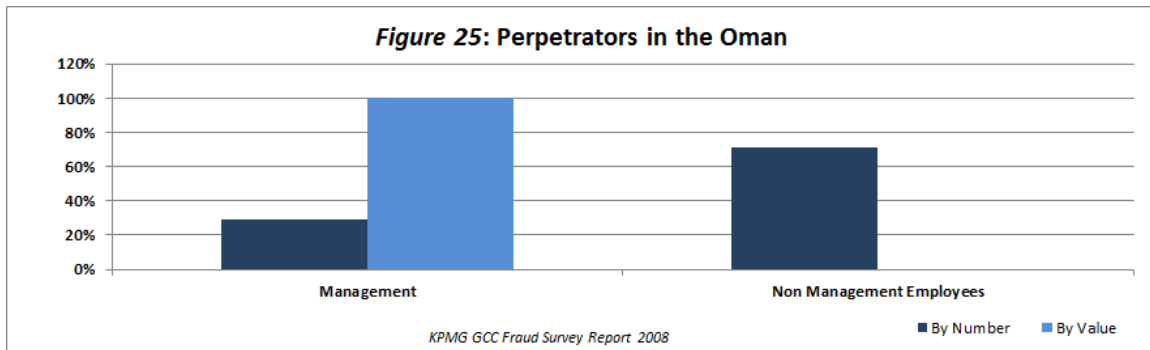
As presented by the KPMG GCC Fraud Survey 2008, and as displayed in *figure 22* above, the number of fraud incidents that took place in 2007 were equally distributed between the three categories (management, non-management and external parties), however, in terms of value, the hugest losses were caused by external parties, where they carried the weight of 76%. Despite the robust anti-fraud policies adopted by the country, it was criticized by the IMF for its weak anti-money laundering and countering the Financing of Terrorism (AML/CFT) regulations (Cronin, 2008), Qatar was even added to the FATF list of countries with deficient AML/CFT regulations but was later removed after it implemented new anti-money laundering legal and regulatory framework (Zawya, 2010). Qatar is the least corrupt country in the GCC and almost ranks in the top 20 of the cleanest countries in the world; it addresses issues raised by international bodies in order to further improve its risk management approaches and 60% of companies surveyed by KPMG (2008) claimed to have a formal anti-fraud policy in place. According to Sambridge (2012), Qatar intends to rank in the world's 10 most transparent countries in the coming years, especially after establishing an anti-corruption watchdog and an Administrative Control and Transparency Authority, which scrutinize the activities of the public sector and government related entities, and tackle violations such as the abuse of power and public funds, asset misappropriation, corruption and bribery and money laundering.

Oman

Oman was acclaimed for its robust and strict anti-fraud measures, yet corruption levels has been soaring and its CPI score has been deteriorating, as presented in *figures 23 & 24* below, the country's scores dropped from 5.3 in 2010 to 4.8 in 2011, and its rank simultaneously jumped from 41 in 2010 to 50 in 2011.



Fed up with the corruption in the public sector and fear that government officials will never be punished for misusing power and swindling millions of Omani riyals, 300 people protested in March 2011 requesting the investigation of government officials (Shaibany, 2011). Additionally, according to the KPMG GCC Fraud Survey 2008, only 37% of respondents from Oman reported to have a formal anti-fraud policy, as opposed to 63% who do not have one (the lowest figure after UAE). Later that year (2011), the Omani ruler ordered authorities to eradicate corruption and address suspicious issues of the public sector (Vaidya, 2011).



The country has experienced the largest securities fraud in the GCC, when seven people conned a total of 3,254 people causing losses of \$220 million (Shaibany, 2010). *Figure 25* above shows that managers commit the lowest number of fraud yet cause the hugest losses. However, most of the incidents disclosed to the public involve external parties without mentioning cases involving government officials or inside jobs in the private sector.

Summary, comments and criticisms

The GCC countries suffer from high levels of financial crime; the countries are combatting crime by following international standards and forming sterner guidelines and regulations, nonetheless, economic crime still prevails. As can be concluded from the incidents of crime revealed, GCC countries suffer from corruption in the public sector where government officials and political figures are involved in money laundering and corruption that is worth hundreds of millions of US dollars. The region is specifically threatened by money laundering partially because of high liquidity and previous laxity of regulators. However, many money-laundering cases are being detected, which proves that countries are investing in tools for fighting it. UAE was the first country to fight fraud in the public sector and succeeded in doing that, however, other fraud types are surfacing such as insurance fraud and IP theft. Furthermore, Qatar is working towards achieving a cleaner country by signing scores with international bodies and severely punishing perpetrators, and is already

considered to be one of the least corrupt in the world. Kuwait, Bahrain and Oman have weak anti-fraud tools as despite employing them fraud rates are still high. It has been mentioned in the introductory section of this research paper that financial crime is condemned by all religions, and it has been clearly denounced in Quran. KSA is Islam's holiest place on earth; they claim to be following the Sharia and they sometimes abuse it for their convenience. It is ironic how the most religious country in the Middle East is the most corrupt when it should be the other way around, and how the country started fighting it when it became an impeding factor for investors to start business rather than to comply with Sharia.

VIII. Recommendations

Countries are on their way to recovering from the 2007 global financial crisis, and since the crisis exposed many weaknesses in the financial systems that could have otherwise cushioned some of the massive losses of companies and in some cases prevented them from happening, governments and companies from many countries are adopting new rules, improving existing strategies and implementing new and existing measures to weather the effects of the financial crisis and prevent a future one from happening. Recommendations will be divided to three parts, which are: strategic, technical and GCC specific.

Strategic

1. According to LRN (2011a), Kroll (2007) and Kroll (2011a), compliance tools and risk mitigating techniques are imperative in preventing financial crime; however, changing the culture of the organization is crucial. “To be truly effective in moving behavior, and moving an organization forward, leadership must move from a compliance to a culture mindset.” (LRN p.1, 2011a), organizations can achieve that in three ways; embedding a culture of ethics from the top down and creating a code of conduct, training and educating employees, and detecting and acting on financial crime instances (Kroll, 2011a).
2. Compliance should not be considered a nuisance to doing business, on the contrary, it should be included in daily activities across all departments, to quote Kroll (p.1, 2011b), “An essential start is the underlying attitude toward compliance: it needs to be approached as a tool to engineer a better-run, more profitable company rather than a burden to be endured.”
3. According to Kroll (2009), companies should implement integrity programs instead

- of adopting compliance-based approaches, as rules usually “scare” employees, unlike integrity programs that are implemented from the top down.
4. Research suggests that one of the methods that impedes corruption and inside jobs is whistleblowing systems (Deloitte, 2011a), this method, Deloitte (2011b) adds is one of the most operative way to get fraud-related information from employees and the most effective way to encourage a culture of integrity, honesty and transparency.
 5. Firms should include financial crime in their social responsibility business models. Instead of not communicating the crimes discovered with internal employees and the public, companies should launch fraud-free campaigns raising awareness about the issue. This type of dedication and commitment will show companies’ stakeholders and prospective customers their ethical and moral behavior.

Technical

1. Companies are advised to adopt a risk-based approach by conducting due diligence on less risky employees, third parties and any party that conducts business on behalf of the company, and enhanced due diligence on those who are considered risky and operate in a country or industry that is risky (Kroll, 2007). According to Kroll (2007, 2011b), performing the three types of due diligence (financial, reputational and legal) can reduce the risk of financial crime and expose possible fraud and the information collected can help firms improve business relationships. Also, effective due diligence can reduce long-term costs for the companies as insufficient due diligence may lead to engaging with corrupt firms, countries or individuals, which lead to hefty fines imposed by the FCPA and the UK Bribery Act (Kroll, 2011c).

2. Deloitte (2011a) advises organizations to have a stand-alone policy for corruption instead of including it in the broader policy. Most importantly, if an investment is too good to be true, then it probably is (Kroll, 2011c).
3. Fraudsters find loopholes in organizations and exploit them; therefore, internal and external audit teams need to think like fraudsters and adopt a “fraud risk management strategy”, “fraud control plan”, and conduct a fraud vulnerability test (Kroll, 2007).
4. Firms, especially large corporations should internally develop software that rates their corporations using mathematical formulas, statistical methods (hard information) and subjective judgment instead of solely relying on credit rating agencies.
5. Companies are advised to consult professional services firms (Kroll, Deloitte, KPMG...etc) when encountering white-collar crime instead of relying on their own internal audit teams. Professional services firms can aid in minimizing the losses and addressing weaknesses in the company’s anti-fraud strategies, risk management techniques, IT security...etc.

GCC Specific

1. Firms in the GCC countries should respond to red flags, as according to the KPMG GCC Fraud Survey 2008, 49% of respondents reported that their companies ignored red flags and warnings.
2. Companies in the public and private sectors must have formal anti-fraud policies, code of conduct, and a stand-alone policy for corruption.
3. Survey results of KPMG (2008), Deloitte (2011b) and PWC (2012) suggest that cybercrime is a growing risk in the region. Therefore, companies should heavily

- invest in IT security and hire experts to find gaps in the existing software, fix them and train employees. Companies are required to have in-house capabilities to identify, investigate and prevent cybercrime. This needs to be done before the crime occurs, as usually, cybercrimes, namely IP theft incur massive losses to companies.
4. Charles Robson, a Forensic Director in KPMG in the UAE, states that hard control measures are essential for detecting, investigating and preventing fraud from taking place in a company, however, soft control measures are also crucial for mitigating and in some cases preventing fraud risk. He also says soft controls have to be clear, implementing them from the top down, encouraging openness and transparency, and providing the necessary confidentiality when reporting misconduct (C. Robson, personal communication, 02 February 2012).
 5. Since money laundry is rampant in the GCC, countries should not only rely on FATF recommendations and international guidelines, but should also customize a set of standards, rules and regulations that are country specific. By following international and local rules money laundry risk will be mitigated.
 6. There is an apparent lack of training and commitment from internal audit teams in the GCC region, therefore, companies should invest further into making those teams more effective, as well as investing in strengthening internal controls.

IX. Conclusions

Financial crime is a part of doing business, its presence unequally covers all parts of the world across all sectors. The recent global economic crisis (2007) uncovered many deficiencies in the world's economies, some of those deficiencies caused the financial crisis, and others precipitated it. Global surveys conducted by Kroll and GCC surveys conducted by Deloitte state that respondents believe the financial crisis is a main factor for the increase in financial crime, namely, fraud. This might be the case in some sectors, such as the financial sector, where the financial crisis originated; however, it decreased in other sectors that relied on the sale of tangible products, such as the consumer goods and manufacturing sectors, because cash inflow and outflow decreased due to the financial crisis. Most importantly, research suggests that the financial crisis did not only increase the incidents of financial crime, it also increased the discovery of it, which what usually happens during tough times; income decreases so perpetrators get affected by cash shortages, investors become illiquid so they ask for their money back from hedge fund managers, hence the unraveling of Ponzi schemes (example, Madoff), and last but not least, companies start scrutinizing operations and expenditures, leading to the discovery of fraudulent activities caused by insiders. In the after math of the financial crisis, regulators stepped up by enforcing stricter rules and becoming more attentive, as they took part of the blame for turning a blind eye to companies' reckless behavior and by ignoring red flags. But will applying new or modified policies diminish the chance of another economic crisis rocking the global financial system in the near future? History proves otherwise; Kroll (2011a) mentions that history repeats itself when it comes to fraud; from Enron to WorldCom and AOL Time Warner, to name a few. Nonetheless, as Mark Twain once said, "History does not repeat itself, but it does rhyme." Massive frauds are occurring every few years, yet, the

schemes and types of fraud used are ever changing. Therefore, by employing effective anti-fraud policies, hiring and training the right people, and creating a culture of ethics, fraud prevalence will to some extent decrease. Although Kroll Survey results convey that fraud is decreasing, executives believe that their vulnerability to fraud has increased; companies are more concerned about corruption & bribery and internal fraud than they were in previous years. Research suggests that companies globally are not taking the issue of bribery and corruption lightly any longer and are heavily investing in measures to fight it. Lastly, as it has always been, IP theft remains a major concern for most of the industries across all countries.

As to the GCC countries, since they are still developing, so is their fight against financial crime. Prior to the global financial crisis, GCC countries were not as transparent as they should have been; therefore, many financial crimes that were taking place in a company were not disclosed or reported, as usually Middle Eastern employees are more loyal to individuals (managers, senior managers, board members...etc.) than they are to the companies they work for. However, after many financial crimes were unearthed following the financial crisis, most of the countries in this region are signing scores with developed countries and are dedicated to fight financial crime. UAE and Qatar are doing better than other countries in the region; their score in CPI is increasing, which means less corruption. UAE is considered to be the most transparent in the region, unlike Qatar, so this raises the question; is Qatar the country with least corruption or is it the least transparent? In short, the region is still at their early stages of fighting financial crime, yet, it is on its way to tackling it.

The global financial crisis of 2007 has caused immense losses to companies and economies; many are recovering from it and still have a long way to go. However, at the risk of sounding

optimistic, companies should take this unfortunate event to their advantage by creating more ethical work environments, thus, financially stable economies. The recent economic downturn revealed how unethical and irresponsible large corporations can be. Therefore, companies should take this opportunity to resolve the problem from its roots in order to prevent a future economic crisis.

“When it rains it pours. Maybe the art of life is to convert tough times to great experiences: we can choose to hate the rain or dance in it.” Joan Marques

X. References

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XI. Appendix

Fraud types listed in Kroll Global Fraud Survey Reports 2007-2011 are:

1. Information theft
2. Corruption & bribery
3. Theft of physical assets
4. Management conflict of interest
5. Vendor, supplier or procurement fraud
6. Regulatory or compliance breach
7. Intellectual Property (IP) theft
8. Financial mismanagement
9. Internal financial fraud
10. Market collusion
11. Money laundering

Anti-fraud measures suggested by Kroll Fraud Survey Reports 2007-2011 are:

1. Financial (financial controls, fraud detection, internal & external audits, anti-money laundering policies)
2. Information (IT security, technical countermeasures)
3. Assets (physical security systems, stock inventories, tagging, asset register)
4. Management (management controls, incentives, external supervision such as audit committee)
5. Employee background screening
6. Staff (training, whistleblower hotline)
7. Partners, clients and vendors (due diligence)
8. Reputation (media monitoring, compliance controls, legal review)
9. Risk (risk officer and risk management system)
10. IP (intellectual property risk assessment and trademark monitoring program)