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Lean times boost white collar crimes

Corporate "shenanigans" are under the spotlight, writes Howard Rapke.

One of the few industries that experiences strong growth during recessions is white-collar crime. As Robert Wright, a financial historian at New York University said in a recent interview: "When markets are going up, it's easy to hide all sorts of shenanigans. When markets start to founder, it's harder to keep up the charade."

Many executives will soon discover that their "shenanigans" may have come at a very high price.

Statistics compiled by the National White Collar Crime Centre, a non-profit organisation funded by the US Congress, show that during the two years after the savings and loan crisis in 1990, white-collar fraud arrests jumped 53per cent and the number of prosecutions grew significantly.

And when the dotcom boom turned into the dotcom bust in 2000, arrests for similar crimes climbed by 26per cent by 2002. Again, prosecution numbers grew.

History is about to be repeated in Australia, particularly as we now have a well resourced corporate regulator, the Australian Securities and Investments Commission.

According to the results of an online survey conducted by Deloitte and published last month, 63per cent of executives polled expect accounting fraud to increase during the next two years.

Industries with the highest risk of experiencing fraud during downturns include computer, retail and other service sectors such as telecommunications and health care, according to Deloitte.

Kerry Francis, chairman and national leader of Deloitte Financial Advisory Services' corporate investigations practice, said: "While fraud is committed during strong economic conditions, it is clearly exacerbated in declining markets. Smaller pay cheques, reductions in employee headcount and internal controls, as well as diminished morale, are just a few factors that can open the door to fraud in a down market."

Directors, executives and staff, pressured by the board to meet sales and profit targets, often feel justified in engaging in criminal behaviour because their salaries, bonuses and even their jobs are at risk through circumstances they consider beyond their control.

Fraud schemes of choice for white-collar criminals include false invoicing, theft of plant, inventory and equipment, stealing cash and cash receipts, diverting sales to the employee's own business, identity and credit card theft, kickbacks and manipulation of data. The fact that most of these types of crimes have been committed for decades during good times and bad, indicates that companies need to implement more stringent internal controls.

KPMG Forensic's 2006 survey of fraud in Australia and New Zealand provides a psychological insight into the white-collar criminal's mind. "Three factors are present when fraud occurs: motivation, rationalisation (justification by the individual of the fraudulent activity) and opportunity (which is often a function of poor internal controls).

"It is not clear from the survey whether motivation precedes the recognition of opportunity. However, our experience suggests that motivation is certainly the reason for the continuation of fraudulent activity." The report continues: "The most common motive for fraud, measured by the value of the fraud committed, was greed and lifestyle. Fifty-four per cent of the total value of fraud was attributed to this motive without any apparent more specific motive. The second most prevalent motive observed was gambling, which accounted for 22per cent."

Corporate financial pressure, including the need to meet business targets, came fourth on the KPMG motivation list. And with the 2006 boom time having been supplanted by the 2009 economic meltdown, that motivating factor may well have risen to No.1.

The type of conduct we are seeing in the Madoff scandal in the US, the Satyam scandal in India and other cases coming to light in Australia will result in a significant increase in work for regulators and therefore white-collar defence lawyers.

Further, the number of prosecutions and class actions will rise when liquidators and administrators, investigating the books and records of insolvent companies, discover that board members, advisers and auditors have engaged in serious misdemeanours.

And if company directors and officers have engaged in criminal conduct, ASIC may bring action under relevant sections of the Corporations Act alleging misconduct, as well as civil claims and criminal prosecutions.

With many of the largest white-collar crimes having been perpetrated by senior executives, non-executive directors have a responsibility to be diligent in ensuring that assessments of fraud risk are updated to meet the new threats posed by a greatly changed financial environment. It is critical for companies to implement effective internal review and assessment programs, which may help to reduce a company's exposure to prosecution.

Equally, boards need to be acutely aware that a crime or even an investigation can cause severe and sometimes irreparable damage to the company's value, image and reputation.

Board members themselves need to be vigilant about their own liability and exposure, as the days of only the company being at risk are long gone. Board members need to be proactive for

their company. In doing so, this may avoid difficult and lonely days in a witness box.

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