

Industry must wake up to rising corporate fraud

OFTEN PERPETRATED BY AN INSIDER, LACK OF SYSTEMS MAKES FRAUDSTER'S JOB EASIER

Why does India continue to ignore warning signs?

2009: Major pharma companies including Ranbaxy indicted in the UK courts for alleged price fixing and conspiracy to defraud the National Health Service

2008: Hoffland Finance collapsed amid a major scandal. Hoffland, a category-II merchant banker, had floated a scheme, called Invest Card, that lured investors with a return of 27% annually

2008: Satyam scandal uncovered

2008: Bernie Madoff is arrested and charged for the creation of a Ponzi scheme in the US with estimated losses of \$50 billion

2008: City Limouzines in Mumbai is uncovered to be India's biggest Ponzi fraud where 2 lakh people were allegedly cheated out of over \$250 million

2010: Shivraj Puri is arrested amid allegations of a major investment fraud within Citibank worth ₹400 crore



GARRY SINGH & ABHINAV MOHINDRU

EXPERIENCE IS A HARD SCHOOL, BUT fools will learn no other." This oft-written line by students being punished in British schools has an apt ring to it considering the rise of high-level fraud taking place in India. Why is India not learning from its bitter experiences with fraud? Corporate India is no stranger to fraud. One of India's largest pharmaceutical companies was indicted in the UK courts for its part in a price fixing and deception case in the late 1990s. So, what lessons have been learnt since then? With the uncovering of the Satyam scandal and recent banking frauds, it appears little heed has been paid to the warnings.

Our corporate community suffers from the cannot-happen-to-me syndrome, also known as ignorance. Corporate crime is an evolving animal that continuously changes its form, which makes it difficult to control. Technological advances have provided the fraudster with a sophisticated arsenal, whereby he can take advantage of archaic accounting and regulatory systems within companies.

A PricewaterhouseCoopers survey confirmed that 35% of the companies that had approached it were victims of at least one significant corporate crime between August 2008 and July 2009. Many of them suffered more than one significant crime. Obviously we can't count those who never got to know what they suffered.

The fact that many corporate houses do not have systems to counter potential frauds has made the fraudster's life easy. The misconception about fraud is that it takes place due to external factors. However, corporate fraud is often committed by an insider. That inside link to an organisation results in the most damage when a fraud is perpetrated. The presence of an insider allows a systematic long-term fraud, as he can avoid suspicion and detection for long periods by fraudulently appropriating small amounts of money on a consistent basis.

Recent cases show that it is no longer possible for companies to be in denial on their susceptibility to fraud. Companies need to adopt a mandate to

escape becoming victims of fraud, and set up a series of systems and procedures to prevent fraud. As India grows into a world power, foreign investors will seek confidence that economic crime or fraud is being addressed and tackled in India.

Fraud reporting in most parts of the globe is consistent, and highlights the human weakness for easy money irrespective of the geography, religion and type of industry. The rise in frauds can be blamed on the recession in the US and high economic growth and economic diversity in Asia. A survey showed that 88% of the companies experiencing economic decline also faced corpo-

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rate fraud. The recent recession saw downsizing of controls and personnel responsible to prevent and/or detect a fraud.

The opportunity to perpetrate a fraud is higher in companies that have restricted their control regime to old-day accounting procedures. Adoption of dynamic controls to use a mix of technology and human intervention could have been delayed due to conservative thoughts or low expenditure appetite. Whatever the reason, the cost of bearing a fraud is far more critical than not adopting the new controls. Some manufacturing firms use traditional techniques to control fraud, and trends indicate they have been suffering the most.

In fact, some companies that have started using modern systems continue to focus on detective

and reactive methodologies and much has to be achieved on the preventive controls. Techniques such as risk management and periodic gap analysis to prevent frauds are not yet popular due to the low interest of organisations and lack of availability of skilled professionals to manage such projects. The Ethical Hotline has produced good results for many organisations. Such hotlines provide crucial workable intelligence along with possibility of throwing false alarms.

The maximum number of frauds are seen as perpetrated by the middle management whereas the high-value ones are mostly attributed to the C-suite. An increasing number of financial frauds is reported through a nexus of multiple authorities and personnel. The most common type of fraud noticed in recent times is due to the collusion of finance department of a company and their bankers. Sharing critical financial processing and authorisation details facilitates easy frauds. Also seen among low-value frauds is fictitious invoicing. Being low value, these transactions don't attract high scrutiny.

Recently, a Gurgaon-based company faced regular outflow of funds from its current account. There were 14 transactions of value ranging from ₹4 lakh to ₹9 lakh over three months; before the company noticed a possible fraud. A discreet investigation revealed that a former employee who had faced hostile termination had, post-termination, used the details of authorised signatures and other financial procedures of the company to conduct the fraud. He was assisted by two others: a technically-savvy individual who forged bank stationery, while the other was a bank employee with responsibility of clearing the counterfeit cheques.

As can be seen, fraud manifests itself in many shapes and forms, and has far-reaching effects. Preventive action is the way forward in this battleground. Fraudsters are being given too many free opportunities to carry out their plans. (G Singh is managing director at Pinkerton Consulting & Investigations, and A Mohindru is partner for fraud prevention and anti-corruption at Kochhar & Co)