

Fraud Victimisation of Companies: The Cyprus Experience

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INTRODUCTION

The literature on financial crime is no longer primarily concerned with Sutherland's definition¹ of 'white-collar' crime. Many researchers have proposed variations to this particular crime. Some have concentrated their work on occupational crime,² elite and state crime,³ organisational crime, and financial crime (which is a sub-category of corporate crime⁴). Others have specialised even further in public sector fraud, on Euro fraud,⁵ tax fraud,⁶ pensions mis-selling,⁷ corruption,⁸ consumer offences,⁹ pharmaceutical fraud,¹⁰ and environmental crime.¹¹ Fraud reported in this paper will include a broad range of offences committed by management, employees or third party against their employer/corporation/customer/supplier, involving the taking of material advantage by deception, ie 'obtaining benefit by deception and causing another financial loss'.¹² The frauds concerned involve either breaches of trust by their employer, by the government, by one's customers, or even by their insurance company. As in the UK, in Cyprus fraud does not exist as a specific criminal offence.

As the well-known author on fraud Michael Levi¹³ reminds us, fraud has many victims, a factor that makes it very difficult to identify its cost. Furthermore, as stated by Passas,¹⁴ it is impossible to know the real extent of the problem of fraud or false accounts 'because there is not a way of assessing the dark figure of such frequently sophisticated and well-disguised misconduct'.

LITERATURE REVIEW

Fraud has been described by some¹⁵ as an 'invisible crime' and its identifying features are the following six:

— *No Knowledge*. The victims are not aware they have been victimised, hence they do not report the matter to the police. Croall¹⁶ mentions that this group of individuals are often victims without knowing it. Other characteristics of this form of crime are: (a) it is taken to be a normal

activity (ie everyone defrauds the taxman); (b) there is a blurring effect (ie it is considered OK to pay a secret commission to secure a contract), and (c) there may even be a collusion problem (where the victim is aware that fraud is happening but because he, too, benefits, he does not say anything).

— *Inadequate Statistics*. The police normally provide the statistics, but they are only interested in the number of offences, detection or clear-up rate, but not in the actual cost of the crime. Another issue regarding this feature is the fact that, unlike street crime, there is no visible victim (eg a corpse) so it will not be easily identified as an offence and, similarly, the police must be satisfied that an offence/crime has taken place. There are, of course, the community-based surveys or cross-sectional surveys or even case studies that shed some light on the issue. In Cyprus no such surveys have been carried out other than the one reported in this paper.

— *No Theory*. There is no universal concept of white-collar crime, or economic crime or fraud. As mentioned earlier, research into fraud is non-existent in Cyprus and, in countries where criminological research is undertaken, the focus is on such conventional offences as homicide, robbery and burglary and juvenile delinquency, thus rendering difficult a satisfactory theory of fraud aetiology. Also, the contexts in which fraud occurs cover such a broad spectrum and add to the difficulty of formulating a theory that accounts for fraud in society, including fraud victimisation.

— *No Research*. As stated above, research carried out is limited because fraud is a sensitive topic for many. Therefore, the research that is carried out often relies on whistleblowers (a probably biased sample of cases), or one who is in contact with the perpetrator or even someone close to the perpetrator. This is because conventional social research methods such as observation, simulation or analysis of official statistics will not reveal the real picture of fraud. As will be

seen below, some of the research into fraud victimisation has been carried out by businesses providing forensic accounting services and, who thus have a vested interest to 'fan the flames'.¹⁷

- *No Control*. Fraud is not only difficult to detect but also to investigate and to prosecute. This is because there may be lack of knowledge that crime has taken place, or there may be a close interaction of legitimate and illegitimate activity, or due to diffusion. As already mentioned,¹⁸ agencies like the Serious Fraud Office in London have found it difficult to prosecute many cases successfully and this affects the prosecution cost of the case. Also, the results of the trial may be unsatisfactory and unfair and may not have the intended deterrent effect.
- *No Politics*. As has been the experience in many other Western countries,¹⁹ the issue of fraud victimisation and fraud prevention did not feature in the campaign for the 2001 elections in Cyprus.
- *No Panic*. 'Moral panic' refers to public reaction after there has been media coverage of a spate of such serious crimes as muggings, rapes, and homicides. For reasons mentioned above, frauds are not accompanied by moral panic, even when the cost is astronomical, primarily because the media tend to focus on an individual big fraud and, consequently, do not precipitate a moral outrage.

THE COST OF FRAUD

As far as the cost of fraud to society is concerned, 'if there are problems with the recording of corporate offences, then it is unsurprising that there are even greater problems when attempting to assess the costs of such offences'.²⁰ It is even more difficult to guesstimate the cost to society, to individuals in particular, and to corporations when there are so many victims. While the aggregate costs are enormous, if there are a lot of victims it makes it very difficult to identify the actual cost,²¹ not to mention how difficult and how many labour hours it will take the lawyers and police to find the evidence to punish the offender. It is not like a rape or even a serial killing where a number of victims can be estimated. How can one identify the cost for individuals and financial institutions if a bank manager has abused the power entrusted in him/her and defrauded customer funds? Apart from the financial burden, there is, of course,

the social and psychological cost on the individuals who have entrusted the financial institution and have deposited their life-long savings in it, there is the social impact on the family members of the fraudster (hardly ever has anyone been concerned with those as if they are to be blamed in any way) and so on.²²

For the UK, in 1998 the estimated cost of fraud was £11bn.²³ It is stated by Doig that in 1994 KPMG reported fraud-involving £254m, the same year the Serious Fraud Office in England and Wales was dealing with 48 cases with a total over £5bn. In 1995 insurance fraud alone was over £250m, and the same year the National Criminal Intelligence Service was reporting a fraud level of £10bn. In 1996 the Department of Social Security was reporting over £2bn in benefit fraud.

For the USA, in 1997, the cost was estimated to be \$415bn,²⁴ for Australia, in 1999, \$239m.²⁵ In Europe,²⁶ in 2001, for 536 leading European Companies which had been victimised the cost was €3.6bn in the last two years. In Cyprus, in 2001, a fraud victimisation study²⁷ found that out of the 251 companies that had been victimised, only 198 companies reported the cost of the fraud to them (£CY10m). However, after looking at media reports on the island in 2000–01, one can estimate this figure to be hundreds of millions of Cyprus pounds. Media reporting on fraud in the Republic of Cyprus has *inter alia* concerned:

- allegations made by the Auditor General,²⁸ in her Annual Report regarding mismanagement of public funds and media reports of other frauds,
- tax evasion,²⁹
- stolen cheques, bounced cheques and forged cheques,³⁰
- pharmaceutical fraud where no financial cost has been as yet determined by the police,
- bank and financial fraud,³¹
- share price manipulation, many legal cases pending,³²
- defrauding pensioners,³³
- attempted deception and false documentation of £1.4m,³⁴ and
- accountant defrauding his employer for £27,000.³⁵

FRAUD VICTIMISATION STUDIES

Official statistics in many countries vary and rarely state the real volume of fraud. They normally state

the cases reported to, and investigated by, law enforcement agencies. Such official statistics, of course, are not a reliable index of the true volume of fraud in society because, as with other crimes, there is a 'dark figure', ie a large number of offences, which, for various reasons, do not get reported to the police. Fraud victimisation studies provide a more reliable index of the volume of fraud and have been carried out in various countries. Such research has been reported by accounting practices³⁶ (where they normally survey their own clients) and by others.³⁷

While fraud victimisation studies, 'provide information more detailed than that recorded in official police statistics',³⁸ they can be criticised for their reliability because: (a) the respondents may not want to disclose fraud cases if they are involved; (b) they may be reluctant to blow the whistle on a colleague; (c) others may be overconfident and may want to disclose a suspected fraud due to a personal grudge they have against a colleague; (d) the cost of fraud is not only financial but there are social implications if fraud is committed in a business (eg the banking industry may not want to disclose a fraud since it may be taken by its customers that they have very weak internal controls and their deposits are at risk), and (e) because of the financial burden on the government to investigate, prosecute, and sanction an offender.

METHODOLOGY

The sample

In order to select the sample and list the different industries in the questionnaire, the author perused the membership list of the Employers and Industrialists Federation (EIF).³⁹ In addition, discussions were held with officials from the Cyprus Chamber of Commerce to identify any non-service industries/service industries not registered with IEF. The following list of 22 industries was identified: manufacturing, finance, commercial companies, insurance, hotels, building materials/businesses, real estate agents, tourism other than hotels, computing, health, fisheries, transportation, electricity, petrol stations, technology, mass media, gaming, publishing companies, bakeries, retail and wholesale, entertainment, and the public sector. Some industries that have very few businesses allocated to it such as mining were dropped from the study.

Volunteer university undergraduates enrolled in a subject on White-Collar Crime offered at the University of Cyprus in the Spring semester 2001 administered the questionnaire. Each student was allocated to a group. Each group selected the businesses to be surveyed, using guidelines provided in order to select a representative stratified sample.

Companies were selected utilising the membership lists of the EIF and the Chamber of Commerce as well as information in the yellow pages, balancing for geographical area (district) and type of industry. For example, more tourism companies are to be found in Limassol, Paphos, Larnaca and Famagusta, whereas more finance companies are located in Nicosia, the capital.

After selecting their sample, interviewers contacted by phone the upper management of the businesses concerned and invited them to participate in the study. A total of 542 contacts were made. As would have been expected, some (19 per cent) declined to participate or said they had never come across fraud. Each student was asked to complete at least ten questionnaires. A total of 441 questionnaires interviews were conducted, thus avoiding the weaknesses⁴⁰ of mail surveys. Interviews as opposed to mail questionnaires were chosen to collect the data because it was felt that this method would have a higher response rate. That prediction was confirmed by the 82 per cent response rate.

The businesses that participated in the survey were primarily private companies (78 per cent), 15 per cent were public companies and (7 per cent) were from the semi-government sector. Public sector departments were selected, using information provided in the most recent Auditor's General Annual Report (1999) where the Auditor General herself outlined possible cases of fraud/deception, abuse of power, or mismanagement.

The questionnaire

This was modelled on a questionnaire previously used by the author in another study in Australia.⁴¹ It was comprised of 22 questions, was used after being piloted and consisted of two parts. The first part asked about characteristics of the respondents themselves while Part B identified relevant characteristics of the business. It then asked the respondents closed questions regarding their perceptions of, attitudes towards, experience with and response to fraud victimisation.

THE FINDINGS

Respondents' details

The respondents were predominately male (72 per cent) and aged 36–50 (60 per cent). Given that Nicosia is the main business district, 58 per cent of respondents were from Nicosia, 18 per cent from Limassol and the rest from the other districts. The respondents held the following positions within their organisation: CEO (43 per cent), Accountant (22 per cent), Financial Controller (14 per cent), General Manager (9 per cent), Internal Auditor (5 per cent), Member of Board of Directors (5 per cent), other 2 per cent. The number of years they held the said position were: 1–2 years (22 per cent), 4–6 years (25 per cent), 7–10 years (17 per cent) and 10 years (36 per cent). Overall, the respondents were fairly experienced individuals who could provide important and reliable information for the survey, and the majority of them were from the two main business districts.

Following recoding of the industry categories due to small numbers in some of the categories, the composition of the sample is shown in Table 1.

The companies involved had gross turnover income as follows: >£CY2m⁴² (27 per cent), 1–2m (9 per cent), 800,000–1m (5 per cent), 400,000–800,000 (11 per cent), 200,000–400,000 (8 per cent), 100,000–200,000 (12 per cent), 50,000–100,000 (13 per cent), <50,000 (15 per cent). Most (67 per cent) of the respondents were very well aware of the risk of fraud against their company, 24 per cent were little aware and 9 per cent were not aware at all. As reported by other victimisation studies, the respondents (88 per cent) believed there

was a problem of fraud in Cyprus. In line with the KPMG (1999) survey which found that 71 per cent of the respondents felt that fraud was likely to increase and, in line with local media reports,⁴³ the majority of the respondents (81 per cent) believed fraud would increase, 13 per cent stayed the same and 6 per cent decrease.

Of the respondents, 57 per cent had been the victim of fraud. Across Europe⁴⁴ this was 42.5 per cent and in the UK and Germany it was much higher (70 per cent). In Cyprus, the companies had been victimised: once (43 per cent), twice (15 per cent), three times (10 per cent), four times (4 per cent), five times (8 per cent), six times (3 per cent), nine times or more (17 per cent). As also reported by other studies,⁴⁵ a company was more likely to be victimised by someone acting alone (83 per cent) than by two or more accomplices (12 per cent).

Type of fraud being committed against the responded

The European study found that 51 per cent of the frauds in Central Europe are external whereas in Western Europe only 39 per cent are external. In Cyprus 53 per cent of the frauds were external. In an international study⁴⁶ it was found that the fraud experienced was committed in 82 per cent of the cases by the employees. There are certainly a lot of differences and these may stem from the issue of who the respondents are. It was expected in the Cyprus study that management would understate the internal fraud, as they were the respondents. Differences between the findings reported below and these reported by the survey most probably reflect differences in the population of corporations surveyed.

Fraud committed by management

A total of 33 respondents had experienced management fraud yet only 19 (58 per cent) of those disclosed the financial cost they faced which amounted to £304,306. Some 22 per cent did not want to disclose the method or the cost. The main types of management fraud were: expense accounts (15 per cent); purchase for personal use (12 per cent), unnecessary purchases (12 per cent), conflict of interest (9 per cent).

Fraud committed by employees

There were 122 cases, but only 80 per cent (ie 98) disclosed the financial loss, which totalled £919,000.

Table 1: *Industry classification of companies surveyed*

Industries (<i>n</i> = 441)	%
Retail and wholesale	26
Transportation, communication and publishing	18
Gaming, tourism, and recreational services	17
Public sector and health	14
Finance and insurance	11
Property and construction	9
Manufacturing	5
Total	100

Some 11 per cent did not disclose the method or the cost. The main type of employee frauds were: theft of inventory or cash (29 per cent), petty cash fraud (22 per cent), purchase for personal use (10 per cent), and falsifying invoices (6 per cent).

Fraud by third party

There were 173 external party fraud and 120 (ie 70 per cent) disclosed the financial loss, which was £1.4m. The main types of third-party fraud were: bounced cheques (38 per cent), forging cheques (18 per cent), theft of inventory or assets (14 per cent) and false invoicing (6 per cent). It is evident from the above that cost of management fraud is highly understated, which is to be expected as the respondents were mainly from management.

Fraud-prone industries, fraud detection, investigation, action taken and prevention

Fraud-prone industries

Cross tabulating the victim industries by the fraud committed, the fraud-prone industries were: (a) transportation, communication and publishing and (b) retail and wholesale. More specifically, however, as far as *management fraud* is concerned, it appears that the vulnerable industries are: (a) transportation, communication and publishing, (b) retail and wholesale, (c) gaming, tourism and recreational services. For *employee fraud* the vulnerable industries are: (a) finance and insurance, (b) electricity, transportation, communication and publishing, (c) property and construction, (d) gaming, tourism and recreational services. As far as *third-party fraud* is concerned, the vulnerable industries are (a) manufacturing, (b) transportation, communication and publishing and (c) retail and wholesale.

The public sector has not featured as a fraud-prone industry. A plausible explanation is not that fraud does not take place in the public sector but that the respondents were reluctant to report it perhaps in order to protect colleagues and/or themselves.

Detection of fraud

As discussed earlier, fraud is an 'invisible' crime which makes it difficult to detect. It is not like theft whereby the victim will notice his purse missing. The offender is an educated, well-informed individual who knows how to cover his/her tracks and override the system. The methods used to detect

the fraud were primarily by investigation from management or internal audit review (55 per cent), from tip off (32 per cent), accidentally (8 per cent) and external auditors (5 per cent). The European study found that detection of fraud was primarily (53 per cent) due to changes in management and (57 per cent) accidentally (using multiple response).

Factors that facilitated fraud

The conditions that made it possible for fraud to take place were: (a) weak internal controls (50 per cent), (b) external criminological factors (26 per cent) (ie country's economy, stock exchange crash, loopholes in the legal system, police are ineffective, banking system, type of people, personal vested interests, perception that everyone steals from the government), (c) type of industry (13 per cent), (d) internal criminological factors (9 per cent) (ie management override, collusion with third people, incompetence, ignorance) and (e) no reason (2 per cent).

Action taken after the fraud was detected

It appears Cypriot companies, like many international ones,⁴⁷ fail to put into place 'relatively simple fraud awareness measures which need not be overly expensive in their fight against fraud'.

The action taken after the fraud was detected (multiple response) was primarily legal action (73 per cent), immediate dismissal (34 per cent), internal or external investigation (28 per cent), nothing (12 per cent), disciplinary action taken (4 per cent) and inform someone (1 per cent). By comparison the corresponding findings in the Ernst and Young⁴⁸ study states that 38 per cent of the offenders were prosecuted, 28 per cent dismissed, the rest were formally reprimanded, downgraded, or asked to resign. As stated in the European study, 'a higher proportion of central European organisations have a policy to report all incidences of fraud to authority';⁴⁹ whether they do is another issue. It appears these organisations are concerned with negative publicity, fear a long drawn-out legal process and perceive the chance of prosecution or recovery of the stolen assets to be low.

Prevention

The preventive measures taken in Cyprus (allowing for multiple response) were: (a) internal control measures set up or tightened (86 per cent), (b) audit review (39 per cent), and (c) nothing (12 per cent). From cross tabulations between the conditions that

enable the fraud to take place and the action taken after the detection, it appears that if the defrauded company:

- had weak internal control, they were more likely to dismiss the offender,
- was involved in an internal criminogenic environment, they were likely to carry out an investigation internally or externally,
- was involved in an external criminogenic environment, they were likely to take disciplinary action, and
- was in a high-risk industry, they were likely to carry out some internal or external investigation.

Cross tabulating the industry and the action taken after the fraud was detected it was found that:

- finance and insurance companies as well as those in the manufacturing industry are more likely to take disciplinary action,
- transportation, communication and publishing are more likely to notify someone and take legal action,
- retail and wholesale are more likely to notify someone and take disciplinary action,
- property and construction as well as gaming, tourism and recreational services are more likely to immediately dismiss the offender, and
- public sector and health are more likely to do nothing.

OFFENDER PROFILE

Extensive research effort has focused on the profile of offenders.⁵⁰ However, limited work has been done on fraud offender profile.⁵¹ As expected on the basis of the relevant literature, most culprits were male⁵² (83 per cent). This is not to suggest that women do not commit fraud but rather that males are normally better placed to hold a position where financial trust can be abused. Some⁵³ have even gone as far as to say that there is a group of women who are 'calculating, fascinating, and intelligent, who capitalise on their charm and femininity'. Unlike other offenders, they were aged 30–40 years (43 per cent), 40–50 (26 per cent), 22–50 (25 per cent), 51 or more (6 per cent). Many studies⁵⁴ indicate the age group 30–46 tends to be the high risk one these people are at a state in their life where they have a family and need more money. Regarding the issue of marital status, Ross

wrote that the white-collar crime perpetrator is not anti-social and 'is likely to keep his marriage vows, pay his debts, mixes well, stands by his friends, he is ready to protect maidens, or help poor widows'.⁵⁵ Rusnack from the *Allfirst* case was described⁵⁶ as an ordinary churchgoer, married with two children, in his 40s, who took time to establish himself and his family at work and community, not a hot-shot. Similar to other studies,⁵⁷ in Cyprus more than half (53 per cent) of the fraud offenders were married.

The next issue of concern is why someone would commit a fraud. The offender had financial problems (47 per cent) and or greed (41 per cent), the opportunity to defraud was available (7) and, finally, due to vice (5 per cent).

Cross-tabulating age and why someone would commit the offence, it was found that the younger offenders (ie 22–30-year olds) were more likely to defraud due to financial problems (mostly created due to the stock market crash and greed), the 31–40 year olds due to vice (mainly extra marital affairs), and finally the 41-year olds and older due to opportunities being available and the same applied for those aged 51 or more.

CONCLUSIONS

Authors on fraud have refined the concept since it formed part of Sutherland's white-collar crime, identifying a number of distinguishing features. The cost of fraud to society is multidimensional and impossible to calculate accurately. Official estimates of the cost indicate it is astronomical. Official statistics on fraud are a reliable index of its nature and extent. Victimisation surveys are one established method for estimating the volume of fraud.

The survey of a stratified sample of companies in Cyprus documents that fraud victimisation is both widespread and its financial cost, at least, immense. Of course, the cost of such offending to the local society goes beyond its value in pounds. More than half of the frauds were perpetrated by individuals outside the companies. Different types of fraud were involved depending on whether management, employees and or a third party were the perpetrators. The study also found that different industries are vulnerable to different types of fraud and an internal audit review discovered more than half of the frauds. A number of factors, both endogenous and exogenous to a company, appear to facilitate the crime. Legal action and setting up or tightening internal

control measures were the most likely responses following discovery of the fraud. Regarding the person likely to defraud a company it emerged that a male, aged 30–45 years, who is facing a financial problem or acting out of greed, exploits an opportunity. The survey confirms findings reported in other studies and helps to demystify both the crime and the culprit.

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