Fraud risk up in a faltering economy

A SLOWING economy which leads to a downturn makes fraud more prevalent — there is a direct correlation, several fraud barometer surveys have shown.

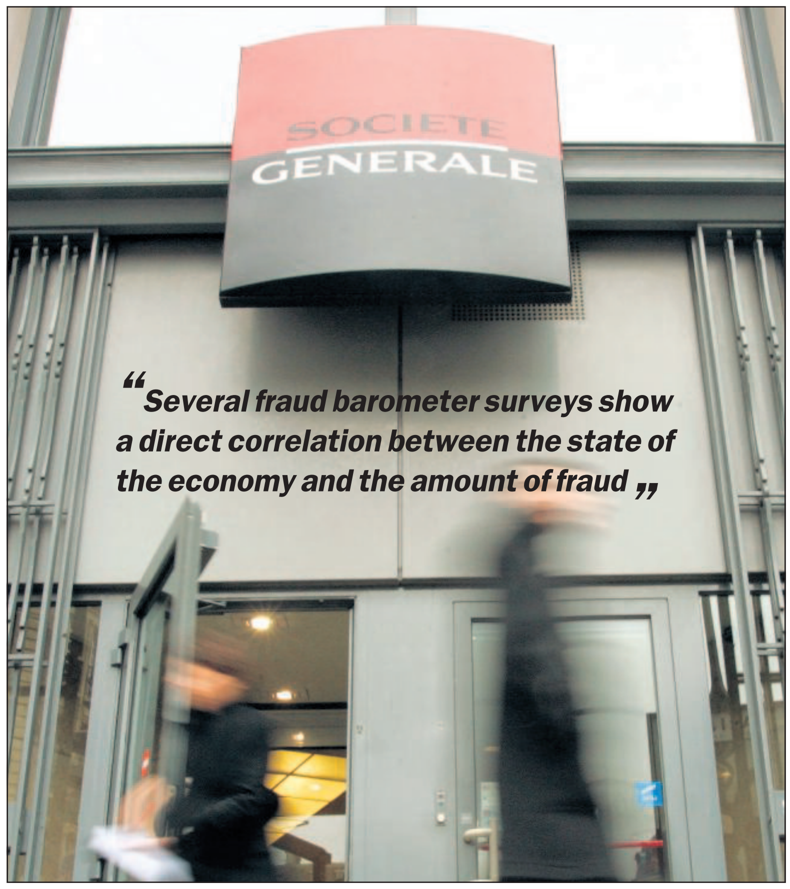
Interestingly, the studies show that the average value of fraud has decreased over the last few years in absolute financial terms but the number of fraudulent incidents has increased. This means that more companies than ever are being affected by fraud and dealing with the aftermath of the fraudulent incidents.

A 20-year analysis of fraud in the UK showed that the last big recession, in the early 1990s, was followed by the emergence of substantial frauds involving Polly Peck and BCCI. There are already signs in the US economy that financial institutions and their customers are struggling under the current economic climate.

In SA with the prime interest rate climbing from 10,5% in April 2005 to the current 15%, coupled with several fuel-price hikes and food price increases, more consumers are struggling to meet their financial obligations. This can be shown in current statistics that show that motorcar repossessions have increased by between 30% and 40% over the last year and the number of house repossessions has increased to such an extent that banks are struggling to sell repossessed houses. A recent report by Lightstone Risk Management estimated that properties worth about R215m are being repossessed across the country each month. This view is supported by Aucor and the Alliance Group who between them have sold in excess of 2 500 repossessed homes in Gauteng since January alone.

Consumers have started to look to alternative avenues to meet their financial obligations with Cash Converters stating that sales of second-hand goods have increased between 20% and 25% since the third quarter of 2007. The signs are evident that fraud is set to increase.

The expectation is now therefore that if there is an increased slowdown this year there will be high-value frauds detected soon thereafter across the world due to the contagion effect of the slowdown. The challenge to business is to ensure that managers don't fabricate the numbers and create "black holes" to meet financial targets that are only uncovered when the accounts are audited at year-end or picked up by accident (the rogue trader at Société Générale comes to mind).



> "Several fraud barometer surveys show a direct correlation between the state of the economy and the amount of fraud"

The reality of an economic downturn and the realisation of a full blown recession forces companies to implement corporate restructuring programmes. These often lead to an increase of fraud risk when the business is at its most vulnerable. In so many of the restructuring programmes, the employee base is reduced to lower costs and to maintain operating margins. This is more prevalent in the labour intensive markets. Fewer employees lead to a lower enforcement, management and effectiveness of the internal control structure and increase fraud risks. This leads to a breakdown in the internal control structure as there are insufficient employees to maintain the internal controls.

Businesses need to identify fraud "red flags" and be vigilant to identify employees and managers under financial distress that may be forced down the road of dishonesty. Red flags are indications that an employee may potentially be involved in illicit activity.

Some of the employee "red flags" are employees with high personal debts, inadequate income for their current lifestyle (houses and motorcar), stock market speculation and gambling, perceived inequality in the business and resentment of their job or superiors.

Some of the manager "red flags" are managers who struggle to cope with the worsening economy and look for quick fix solutions, the high dependence on one to two transactions to meet their financial targets, rapid expansion of new products in a poor economy, insufficient working capital to fund operations and strong desire to beat the system. Strong emphasis should be placed on wheeler-dealer personalities that invent complex schemes to meet business obligations.

A slowing economy results in fraud schemes becoming more complex and difficult to detect. The monitoring of key performance indicators and assessing negative trends can alert internal fraud risk management of the potential increase in fraud. This can be accomplished by the implementation of a five-phase approach:

1. Implement an anti-fraud strategy with specific emphasis on proactive and re-active fraud;
2. Educate your employees on possible fraud risks in your business environment;
3. Renew your fraud awareness programme;
4. Renew emphasis on your code of ethics and code of business conduct; and
5. Establish an anonymous whistle-blower hotline to provide the opportunity to employees to report suspect colleagues or business partners

Businesses need to take proactive steps now to ensure that they are properly protected.

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Telecoms deregulation has still to bear fruit

COMPETITIVE EDGE
Mark Garden & Nontokozo Mahlangu

SOME 16 years after the government sowed the seeds of liberalisation and deregulation in the telecommunications industry, the tree has sprouted, but is yet to bear fruit. Liberalisation is the lowering of entry barriers to all or part of a market, thereby allowing third parties to compete with established — generally monopoly — providers of goods or services.

On the other hand, deregulation includes the removal of laws and regulations to facilitate ease of entry and reduce "red-tape" for people who want to operate in a particular area.

In 2000, the Independent Communications Authority of SA (Icasa) was established, with its origins in the amalgamation of the Independent Broadcasting Authority and the South African Telecommunications Regulatory Authority. Broadcasting and telecommunications were no longer separately regulated.

The benefits associated with liberalisation and deregulation are manifold. In the first instance, this process of opening up the industry to competition would enhance consumer welfare by forcing companies to compete on a more efficient basis, since failure to make such a competitive transition would jeopardise their survival in the marketplace. An increasingly competitive environment would generate a wider range of pricing options for consumers and a wider variety of products on offer due to product innovation. Since liberalisation serves to attract the participation of foreign competitors and new entrants to the industry, better and more reliable technology would become available. Further, the competition in an open market between the service providers incentivises them to provide the consumer with value-for-money services lest they elect to approach a competitor service provider.

Unfortunately, a deregulated and liberalised environment may also generate anti-competitive consequences. Dominant participants in the industry, for example, may seek to use the market power they wield to undermine rivals, unless this behaviour can be restricted by regulators — both sector specific and the competition authorities. The regulator, in this case Icasa, is responsible for policy which will create and foster a fair competitive environment for all participants. Where the dominant firm is state-owned, however, strict measures should be put in place to immunise the regulator against any political interference. In the South African telecommunications industry the government is both a player and a referee, thereby creating additional challenges to the regulator's independence and potentially undermining its ability to create a fair competitive environment for providing telecommunications services.

Although the Competition Commission shares jurisdiction with Icasa when competition issues arise in the telecommunications industry, it does not have the power to determine the technical and policy framework applicable to the industry. That is solely Icasa's responsibility. The commission's involvement in the telecommunications industry is governed by section 3(1A) of the Competition Act of 1998, together with a memorandum of agreement concluded with Icasa in 2002.

Telkom, the dominant player in the South African telecommunications market, is partially state owned and has been and continues to dominate the telecommunications industry in almost all respects. Since Telkom controls most of the infrastructure, the opportunity exists for it to bully all the beggars who come knocking at its door asking for a portion of the pie. By controlling the facilities necessary to function in the industry — whether you wish to engage in the provision of value added network services, or you want to be an internet service provider — you will, to some extent, be dependant on Telkom unless you can somehow procure your own infrastructure. The second network operator ("SNO" or "Neotel") has succeeded in securing infrastructure by purchasing Transtel's infrastructure and simultaneously having access to Telkom's facilities, but is yet to pose a significant challenge to Telkom's position.

Since February 1 2005 there have been some noteworthy and positive developments in the South African telecommunications sector, at least insofar as enhanced competition is concerned. By way of example, value-added network services can be provided by telecommunications facilities other than those provided by Telkom and the second network operator. Persons who provide value added network services are entitled to cede or assign the right to use, sublet, part with control, or otherwise dispose of the telecommunications facilities used for the provision of such services; private telecommunications network operators can resell spare capacity and facilities or cede their rights to use such facilities; and the SNO has existed on paper since 2003 and licensed under the new licensing regime in 2006. By and large, however, the monolith that Telkom continues to operate as before, notwithstanding the growing incidence of pro-competitive gains outlined above.

Icasa is entrusted to create a competitive environment for the delivery of high quality telecommunications services at affordable prices. This role will be significantly enhanced if the probability of punishment being meted out to the guilty is a reality and that the penalty imposed outweighs any benefits gained from the anti-competitive behaviour in question. For the most part, however, South Africans have yet to sample the fruits of liberalisation and deregulation in the telecommunications sector.

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