



SARS = Fraud (?)

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SARS will lead to more fraud being uncovered in the region due to sharp declines in revenue and some asset prices.

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BACKGROUND ASIA is certainly no medical expert but we have seen more than one economic shock hit Asia over the last ten years and one thing that is consistent, despite the varied nature of those shocks, is fraud.

As asset prices fall, as sales targets and budgets get thrown out the window, now is the time for vigilance and, for some, response.

Alex Duperouzel advises as follows:

SARS has been tragic and upsetting for those involved directly. In addition to the human cost, the economic costs are already being felt and will continue to have an impact across the region in a variety of sectors.

SARS is a severe economic shock to the region. At this time it is not possible to accurately say which countries are going to be worst affected and indeed which industries will be hit hardest although airlines and hotels are already in crisis mode. As well as not being medical experts we are also only armchair economists and leave those sorts of predictions to our more formally qualified colleagues. But it is clear that the outbreak is causing a short and immediate contraction in demand for a number of businesses as well as additional costs for others.

When **BACKGROUND ASIA** looks back at the fall of Suharto, the Thai baht collapse, the Asian Economic Crisis and the bursting of the Japanese bubble we see one common denominator - fraud.

The Risks

Frauds will come out of the SARS outbreak for a few key reasons:

Firstly, a short collapse in asset prices, particularly share prices, often leads to margin calls on retail investors who find that the only way to

Now is the time to carefully monitor employees who are known to have sizeable market positions that have lost out in any share market declines.

Execs who are reliant on performance bonuses may find that SARS has destroyed their revenue projections and may, in isolated instances, look to fudge the numbers by some other means.

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keep themselves from bankruptcy is to steal from their employer.

Sometimes these leveraged employees turn to loan sharks, who in turn look at the work that their 'client' does and seek to benefit from it. I remember one case in Japan where Yakuza had figured out that they had an employee stealing to pay off loans and so they just got him to steal directly for them as well.

Firms should be wary of employees that they know or suspect to have sizable market positions when there is and has been significant downward market volatility.

Brokers, investment banks and asset managers need to be very careful during these times as this is when employees under financial pressure will look at using inside information or sell inside information to help rescue their personal position.

Secondly, SARS is effecting sales and deal flow in a large variety of businesses. Salesmen who survive on commission or executives tied to performance related bonuses who are facing a no bonus year because of SARS will, in some cases, be looking to find other means to supplement their income.

We recommend being watchful for debtors who are said to be so close to a salesman that only they can deal with them. If your collections are ballooning out then you should ensure that you confirm the debt directly with the debtor and do not just rely on the salesman.

Likewise execs who are reliant on performance bonuses may now look to tweak the system so that they are not adversely affected by the sales slowdown. Little accounting tricks like fiddling the value of obsolete stock, reducing the provision for doubtful debts and (that old chestnut of) pre-booking sales, all become popular in times like this.

The pressure on execs is also likely to lead to stringent cost cutting as firms attempt to meet profit targets by slashing cost. Given the amount of cost reduction that has already occurred in a number of businesses across the region over the last two years, firms may now find that they will sacrifice functions and resources that are actually part of the control and oversight process. The short term reduction in cost in these areas will lead to a greater risk of medium term malfeasance.

We are already seeing some silly decisions being made in this respect.

Firms who do lay off employees will need to put in place the proper controls and procedures to ensure that they are not victims of one last grab for assets as the employee leaves. I am always very wary of when IT staff are let go and what they may have left behind. I remember a case where a firm let an employee go and forgot to change the bank signatories. No prizes for guessing what that employee ended up doing

Opportunistic business partners may try and use SARS to explain away other failings.

If you would like a copy of our brochure on fraud investigation and consulting please contact Ric Beggs or visit our website at www.backgroundasia.com

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after they stole the check book.

Lastly, unscrupulous firms will use SARS as the excuse for shipment delays, collapsing markets, an increase in intellectual property abuse, quality control problems, currency remittance problems and a host of other issues that in actual fact are either false or completely unrelated to the outbreak.

During the Asian Economic Crisis we saw a number of firms simply stop paying their bankers because they felt that they did not have to as others were doing the same, not because they were actually suffering from the sharp decline in local currencies. Some were benefiting from the decline.

If you have a business partner in the region that is opportunistic in this way (and unfortunately there are a great many firms like this) then you may end up being the victim of a SARS fraud.

What To Do

Firms operating in the region need to be aware that this type of shock will lead to irrational behaviour from otherwise normal and trusted employees in a small but, if it affects you, significant way. Internal audit teams and compliance officers need to recognise this and increase their vigilance and skepticism at this time.

One of the key factors in preventing a large fraud is effectively dealing with small ones. If you uncover something of concern we always recommend dealing with it forcefully even if the dollar value is small.

Today's small fraud often becomes tomorrow's business killer if the culprit(s) is let off with a warning.

Companies need to think about the type of remuneration packages that execs are on and whether those packages need to be reconsidered or the activities of the execs monitored more closely given the potential sharp revenue declines that has been a characteristic of the SARS outbreak.

Head office finance needs to be wary of window dressing techniques that may be used to disguise poor regional sales and profitability figures.

Financial institutions should refocus on staff members who may be overly exposed to trading losses due to sharp negative movements in stock prices.

Firms need to be skeptical about accepting SARS as an excuse for non payment of debts, non delivery of goods or for other failures. SARS may be the reason but it should not be just blithely accepted and some

If SARS is used as a reason for a business failing it needs to be independently verified.

form of independent confirmation should be sought. While SARS will have an effect on some businesses and in some particular ways it has nothing to do with other failures like the failure to protect intellectual property or maintain quality.

Some third parties are likely to use SARS to explain away other malfeasance or failures and this needs to be closely monitored and independently verified if it is taking place.

Firms need to be wary about cutting away too much of the oversight functions when looking at cost cutting as the short term results are often blown away by bigger failures down the track.

Minority investors and joint venture partners need to be wary of SARS being used as an excuse for other failings where intuitively it does not make sense.

We have found that most frauds that are bought about by this type of economic shock take from three to six months to uncover after the event.

This 'incubation period' varies depending on how cunning the employee or perpetrator is and how easily misled is the victim.

By being vigilant at this time clients can reduce the magnitude of losses both directly from the fraud and from a fraud's consequences.

What We Do

BACKGROUND ASIA specialises in fraud detection, response, investigation and in tailoring solutions for firms hit by fraud. We have a lot of experience in supporting multinationals and governments hit by fraud in the Asian region.

If you are the victim of a fraud, or suspect that you might have been a victim, we are able to help you and your legal advisors with strategies and solutions to minimise the damage, find out what went wrong, go after those involved and recover what can be found.

We can respond to fraud 24/7 anywhere in the Asian region.

Please note that this newsletter is for information purposes only and, as we are not lawyers, does not constitute legal advice. See your lawyer if you would like legal advice, drop us a line if you would like specific advice on these topics relating to your specific circumstances.

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