minimising fraud and maximising results in the international oil and gas sector

how the oil and gas sector can improve profitability by cutting the cost of fraud

Jim Gee, Professor Mark Button and Martin Moore
<table>
<thead>
<tr>
<th>CONTENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>foreword</td>
</tr>
<tr>
<td>the size of the problem</td>
</tr>
<tr>
<td>how quickly can losses be reduced and by how much?</td>
</tr>
<tr>
<td>what would such a reduction in losses mean?</td>
</tr>
<tr>
<td>conclusion</td>
</tr>
<tr>
<td>about the authors</td>
</tr>
<tr>
<td>about the publishing organisations</td>
</tr>
</tbody>
</table>
MINIMISING FRAUD AND MAXIMISING RESULTS IN THE INTERNATIONAL OIL AND GAS SECTOR – 2013 REPORT

Fraud can lead to less financially stable and healthy companies and its reduction can also significantly improve profitability; it can result in natural resources being more expensive than they should be and its reduction can significantly assist economic growth. These positive outcomes arise from the financial benefits derived from the reduction of the significant cost which fraud represents.

PKF’s new report provides an unprecedented insight into the benefits to the international oil and gas sector of reducing the cost of fraud. In uncertain macro-economic times, cutting the cost of fraud - revealed by the latest global research to represent, on average, 5.7% of expenditure - can massively boost profitability and financial health.

Developments over the last decade or so, to accurately measure the cost of fraud like any other business cost, has allowed organisations from many different sectors, and across the world, to manage and minimise that cost. PKF has worked with companies across the world to help them do this, and, as a result of that work, those companies are already benefitting.

The report outlines the results of research to review data from 71 of the world’s international oil and gas companies with total sales of more than $US 4.7 trillion. We have also examined the position affecting the 78 oil and gas companies registered on the FTSE 100, FTSE 250, FTSE AIM 100, FTSE AIM All Share, FTSE UK 50, FTSE Small Cap, FTSE Fledgling listings where information was available for the last financial year. These companies had total revenues of £6.78 billion. The effect on companies’ results is dramatic whatever the size of the company.

Later in 2013, a book by two of the authors of this report⁠¹ - Countering Fraud for Competitive Advantage - will be published globally by John Wiley and Sons. It will expand on the themes in this report and explain what companies need to do to gain the competitive advantage. What is clear is that fraud - the last great uncontrolled business cost - can now be measured, managed and minimised - both in the international oil and gas sector and beyond.

Jim Gee and Professor Mark Button

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¹ “The Financial Cost of Fraud Report 2011” - Jim Gee, Professor Mark Button and Graham Brooks - published by PKF (UK) LLP and the Centre for Counter Fraud Studies at University of Portsmouth
1 //

the size of
the problem
the size of the problem

1.1 If you don’t understand the nature and scale of the problem how can you apply the right solution? Over the last decade or so it has become possible to accurately measure the nature and scale of fraud – and then to design an informed strategy to address it.

1.2 Fraud is a challenging problem. Its economic effects are clear. In every sector of every country, fraud has a pernicious impact. However, historically, fraud has been described as ‘difficult to cost’ and until relatively recently, it has not been possible to quantify these effects. In the last 10 - 15 years this situation has changed.

1.3 ‘The Financial Cost of Fraud Report 2011’ represents the latest, most extensive global research in this area. The report documents what has been found, across the world, over the period from 1997 to 2009. It also shows the impact of the recession on losses by comparing and contrasting data from 2008 and 2009 with the prior period. It focuses on presenting a credible, accurate and statistically valid picture, in a context where the quality of some information has historically been poor.

1.4 There are still some estimates published which are simply not reliable. Counting only those losses which are detected or prosecuted, or surveying those working in the area for their opinion, will never be accepted as a reliable indicator of the real economic cost of fraud.

1.5 Unless one imagines that all fraud can be detected – and research tends to indicate that, at best, organisations can only detect in the region of 1/30th of it – then a measure of fraud based on detected losses will always represent a serious underestimate. Bearing in mind that even the crime of murder doesn’t have a 100% detection rate and that the essence of fraud is about concealment, it is unlikely ever to be the case that what is detected will represent the totality of the cost.

1.6 Surveys of opinion are also unreliable. The Association of Certified Fraud Examiners (ACFE) in the United States produces an annual survey of this type. Its most recent edition states that “Survey participants estimated that the typical organization loses 5% of its annual revenue to fraud”. Such surveys can represent a reliable reflection of the opinion of those surveyed (if the sample is representative) but, in the absence of an examination of actual items of expenditure, and the collation of evidence of correctness, error and fraud, they are not grounded in fact.

1.7 It is now possible to do much better than this. The financial cost of fraud and error can be accurately measured in the same way as other business costs. This is not unnecessarily costly or difficult, and most important, an accurate, statistically valid figure can be provided for what the financial cost is estimated to be.

1.8 The latest global research indicates that losses to fraud average 5.7% of expenditure. When measured across 32 types of expenditure with a total value of £5 trillion, and in several different countries, just under 70% of accurate and statistically valid measurement exercises revealed losses of 3% or more. This figure rose to over 75% for the period after the recession of 2008 – 2009. In the two years for which data is available after the recession commenced the cost of fraud rose by over 30%.

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2 ‘The Financial Cost of Fraud Report 2011’ – published by PKF (UK) LLP and the Centre for Counter Fraud Studies at University of Portsmouth – Jim Gee, Professor Mark Button and Graham Brooks

3 ACFE: ‘2010 Report to the Nations’

4 ‘The Financial Cost of Fraud Report 2011’ – published by PKF (UK) LLP and the Centre for Counter Fraud Studies at University of Portsmouth – Jim Gee, Professor Mark Button and Graham Brooks

5 Losses to fraud and error
// the size of the problem

So, research leaves little room for doubt that fraud represents a significant cost.

Indeed, if we take the percentage figure for global losses (5.7%), as a proportion of the global Gross Domestic Product (GDP) for 2011 (US$69.9 trillion or £43.5 trillion⁶), this equates to $US 3.98 trillion or £2.48 trillion, a sum larger than the GDP for Germany.

So it is clear that the cost of fraud is significant and can and has been measured in many different types of organisation. The next logical question concerns the extent of the competitive advantage to be gained from reducing this cost in the international oil and gas sector and how quickly it can be realised.

⁶ IMF Data - Nominal GDP list of countries for the year 2011. World Economic Outlook Database-September 2011.
2 //

how quickly can losses be reduced and by how much?
2.1 Organisations have been measuring and reducing other types of business cost for decades – usually with progressively smaller reductions as time has gone by – but they have mostly not been doing this in respect of the cost of fraud. Indeed, it is still possible to hear those leading sizeable private or public sector organisations comment that ‘there is no fraud in my organisation’. Such comments show a lack of understanding that the first step to solving a problem is to stop being in denial about it. Even where such attitudes are not prevalent, it is still common that organisations have a reactive approach, acting primarily after fraud has taken place and after the losses have been incurred.

2.2 The Financial Cost of Fraud Report 2011 refers to examples where losses have been reduced. Where losses have been measured, and the organisations concerned have accurate information about their nature and extent, they have been substantially reduced.

2.3 The best examples over the 12 year period covered by this Report include, from the UK:

・ where one organisation reduced its losses by up to 60%, and by up to 40% within 12 months;
・ where another organisation successfully reduced its losses by 50% between 1997/98 and 2005/06.

2.4 The best examples over the 12 year period covered by this Report include, from the United States:

・ where one organisation reduced its losses across a $US 12 billion program by 35% between 2001 and 2005;
・ where another organisation reduced its losses across a $US 12 billion program by 28% between 2002 and 2004.

2.5 Even during the two years after the start of the recession, and in the middle of a period during which fraud losses increased by over 30%, two of the organisations included in this research reported very significant reductions in their losses – one by 33% and the other by 19% - within a single year in each case. As can be seen, the speed of reduction of losses will vary from organisation to organisation, but it is not unreasonable to assert that losses can be reduced by 40% over a two year period – this is what the data shows.

*The Financial Cost of Fraud Report 2011* - Jim Gee, Professor Mark Button and Graham Brooks
what would such a reduction in losses mean?
3.1 This section of the Report reviews data from oil and gas companies to provide an answer.

**78 FTSE registered oil and gas companies reporting revenues**

3.2 In the commercial sector, fraud has a significant effect on profitability. A summary of 78 FTSE registered oil and gas companies for 2011 shows that they had total annual revenues of £6.78 billion, with pre-tax profits of £1.41 billion, representing 21% of revenues. Applying the global average loss rate (5.7%), derived from where losses have been accurately measured, would imply that losses total £386 million, 27.4% of the total profits of these companies.

3.3 What would such a reduction in the cost of fraud mean in financial terms? The beneficial effects to the oil and gas sector are significant. Of the 30 companies which made profits, 22 would increase their profitability by up to 10%; 7 would do so by between 11 - 50%; and one company would increase its profitability by over 50% respectively.

3.4 Of the 48 companies which made losses, 43 would reduce their losses by up to 10%; and 5 would reduce their losses by between 11 - 65%. This would represent a significant boost to corporate health.

3.5 The profitability of the sector would be boosted to £1.56 billion or by 10.9%. The number of companies that would increase their profitability is indicated below:

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3 There are 119 FTSE-registered oil and gas companies; however, only 78 reported any revenues in 2011. Of these 30 were profitable and 48 loss-making.
The 58 largest oil and gas companies

3.6 A summary of 71 of the world’s largest oil and gas companies for which data was available for 2011 - 2012 shows that they had total annual revenues of $US 4.7 trillion, with pre-tax profits of $US 358.9 billion, representing 7.64% of revenues. Applying the global average loss rate (5.7%), derived from where losses have been accurately measured, would imply that losses total $US 267.9 billion, just under 75% of the total profits of these companies.

3.7 All but two of these companies reported making profits for the year but the beneficial effects to the sector are impressive. 4 would increase their profitability by up to 10%; 26 would do so by between 11 - 50%; 22 would do so by between 51 - 100% and 18 would do so by over 100%. In addition one company would turn losses into profits and a second would significantly reduce its losses.

3.8 The profitability of the sector would be boosted by $US 107 billion or almost 30%. The number of companies that would increase their profitability is indicated below:

No. of companies improving their profitability

- 1-10%: 4
- 11-50%: 26
- 51-100%: 22
- Over 100%: 18

What would such a reduction in losses mean?
conclusion
4.1 The competitive advantage to be derived from the measurement and reduction of the cost of fraud could not be clearer. By ensuring that resources are not diverted from where it is intended they be applied, there are real competitive and financial advantages to be reaped.

4.2 We now have the tools to accurately measure fraud as a business cost, and to focus our skills and resources on reducing that cost. Rapid reductions have been shown to be possible and there are very significant financial benefits which can be delivered. As with any new way of doing things, the question initially is ‘Why would we do that?’ – it is now becoming ‘Why wouldn’t we do that?’.

4.3 This report highlights why and how companies operating in the oil and gas sector can start to manage their fraud costs, just as they routinely manage other costs. The statistics revealed indicate that this sector has much to gain from this approach. In such a highly competitive market any opportunity to reduce costs must be an attractive proposition.

4.4 As with other significant developments in business, the new approach is simply a result of looking at a problem in a different way, and then developing the related methodologies. The barriers to progress are often in the mind, not in reality. If you consider fraud just to be a crime, then you police it; if you think of it as a business cost like any other then you manage and reduce it. The new approach has now been tested in organisations from across the world and has delivered proven results. And, as ever, now that this has happened, those who follow next will reap the greatest competitive advantage.

4.5 A first step may be to use PKF’s free Fraud Resilience Self-Assessment Tool, which draws on data from the two largest databases in the world concerning fraud losses and fraud resilience, to rate and rank organisations and to provide an indicative figure for the financial cost of fraud. The UK Government has endorsed this methodology and the tool can be accessed at www.pkfapps.co.uk/fraud.
Jim Gee is Director of Counter Fraud Services at PKF (UK) LLP, the leading accountancy and business services firm and Chair of the Centre for Counter Fraud Studies at University of Portsmouth. During more than 25 years as a counter fraud specialist, he led the team which cleaned up one of the most corrupt local authorities in the UK - London Borough of Lambeth - in the late 1990s; he advised the House of Commons Social Security Select Committee on fraud and Rt. Hon. Frank Field M.P. during his time as Minister of State for Welfare Reform; between 1998 and 2006 he was Director of Counter Fraud Services for the Department of Health and CEO of the NHS Counter Fraud Service, achieving reductions in losses of up to 60% and financial benefits equivalent to a 12:1 return on the costs of the work. Between 2004 and 2006 he was the founding Director-General of the European Healthcare Fraud and Corruption Network; and he has since worked as a senior advisor to the UK Attorney-General on the UK Government’s Fraud Review as well as delivering counter fraud and regulatory services to public bodies and private companies both in this country and internationally. He has worked with organisations from more than 35 countries to counter fraud including for natural resources companies in Africa and South East Asia. He has also advised the Chinese Government about how to measure, pre-empt and reduce the financial cost of fraud.

Professor Mark Button is a Reader at University of Portsmouth and Director of the Centre for Counter Fraud Studies. Mark Button is a Reader in Criminology and Associate Head of Curriculum at the Institute of Criminal Justice Studies, University of Portsmouth. He has also recently founded the Centre for Counter Fraud Studies of which he is Director. He has written extensively on counter fraud and private policing issues, publishing many articles, chapters and completing four books with one forthcoming: Private Security (published by Perpetuity Press and co-authored with the Rt. Hon. Bruce George MP), Private Policing (published by Willan), Security Officers and Policing (Published by Ashgate), Doing Security (Published by Palgrave), and Understanding Fraud: Issues in White Collar Crime (to be published by Palgrave in early 2010 and co-authored).

Martin Moore is a Senior Manager within the Counter Fraud Services team at PKF (UK) LLP. Before joining PKF in 2007 he followed a career which spanned 30 years with Humberside Police. During the last nine years of his police service, he specialised in white collar fraud investigations and confiscating criminally gained assets. He became the head of economic crime in January 2000. Martin is an Accredited Counter Fraud Specialist and most recently has been involved in advising and assisting companies in a variety of different sectors especially the mining industry in Zambia, Cameroon and Indonesia. He has conducted fraud investigations in Australia, New Zealand, Indonesia, Turkey, California, Florida, Sierra Leone and throughout Europe.

He is also a Director of the Security Institute, and Chairs its Academic Board, and a member of the editorial advisory board of ‘Security Journal’. Mark founded the BSc (Hons) in Risk and Security Management, the BSc (Hons) in Counter Fraud and Criminal Justice Studies and the MSc in Counter Fraud and Counter Corruption Studies at Portsmouth University and is Head of Secretariat of the Counter Fraud Professional Accreditation Board (CFPAB). Before joining the University of Portsmouth he worked as a Research Assistant to the Rt. Hon. Bruce George MP specialising in policing, security and home affairs issues. He completed his undergraduate studies at the University of Exeter, his Masters at the University of Warwick and his Doctorate at the London School of Economics. Mark has recently been working on a research project funded by the National Fraud Authority and ACPO looking at victims of fraud.
how much does fraud cost your business and how resilient is it to fraud?

Fraud is a problem that undermines the stability and financial health of oil and gas companies from across the world. It is not a victimless crime, but one which undermines their profitability and capacity for a beneficial impact locally.

Global research shows that fraud costs organisations an average of 5.7% of expenditure but also that this figure varies considerably according to how resilient to fraud they are.

PKF (UK) LLP and the Centre for Counter Fraud Studies (CCFS) at University of Portsmouth have jointly undertaken the most extensive and most comprehensive research yet in this area and now have the world’s largest databases concerning measured fraud losses and fraud resilience.

One affects the other - the more resilient to fraud that a company is the lower its losses will be. By increasing levels of fraud resilience losses have been cut by up to 40% within 12 months.

by combining specialist experience and academic rigour…

PKF and the CCFS represent a unique combination of specialist hands on experience, academic knowledge and rigour and natural resources sector experience. Together we offer a confidential Fraud Resilience Review service which rates and benchmarks natural resources companies operations against both best practice and their peers. This service reviews counter fraud arrangements against 29 measures of resilience and 170 different criteria derived from the best professional standards. We have delivered this service on-site in different countries around the world.

The review covers

- the extent to which an organisation understands the nature and cost of fraud to it as a business problem;
- the extent to which it has an effective strategy in place which is tailored to address this problem;
- the extent to which organisations maintain a counter fraud structure which can implement this strategy successfully;
- the extent to which the structure efficiently undertakes a range of pre-emptive and reactive action; and
- the extent to which results are properly measured, identified and delivered.

…we can provide the answers

We let the data speak for itself to identify weaknesses in counter fraud arrangements. Our work results in the provision of a clear and concise Report detailing our findings with recommendations for improvements based on a wealth of experience drawn from more than 30 countries around the world.

find out more

The cost of the Fraud Resilience Review service varies according to the nature, size and complexity of the company concerned. However, it is designed to be a cost-effective response to fraud which provides information and evidence to allow further decisions to be made.

To find out more please ring 020 7065 0557 or email jim.gee@uk.pkf.com
PKF Forensic Services

PKF (UK) LLP is one of the leading firms of accountants and business advisers in the UK offering counter fraud, forensic accounting, expert witness and litigation support services on a national and international basis including:

- fraud resilience checks
- fraud loss measurement and reduction
- asset tracing and confiscations
- forensic IT, including data mining, data imaging and recovery
- fraud and financial investigations

www.pkf.co.uk

The Centre for Counter Fraud Studies at University of Portsmouth

The University of Portsmouth’s Centre for Counter Fraud Studies (CCFS) was founded in June 2009 and is one of the specialist research centres in the University’s Institute of Criminal Justice Studies. It was founded to establish better understanding of fraud and how to combat it through rigorous research. The Institute of Criminal Justice Studies is home to researchers from a wide cross-section of disciplines and provides a clear focus for research, knowledge transfer and educational provision to the counter fraud community. The Centre for Counter Fraud Studies makes its independent research findings available to support those working in counter fraud by providing the latest and best information on the effectiveness of counter fraud strategies.

www.port.ac.uk/departments/academic/icjs/CentreforCounterFraudStudies
// notes
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PKF (UK) LLP is one of the UK’s leading firms of accountants and business advisers and specialises in advising the management of developing private and public businesses. We pride ourselves on creating and sustaining supportive relationships where objective and timely advice enables our clients to thrive and develop.

Our clients benefit from an integrated approach based on understanding the key issues facing small and medium-sized businesses. This enables us to meet their needs at each stage of development and allows them to focus on building the value of their businesses.

The principal services we provide include assurance and advisory; consultancy; corporate finance; corporate recovery and insolvency; forensic and taxation. We also offer financial services through our FSA authorised company, PKF Financial Planning Limited.

We have particular expertise in the following sectors:

- Hotel consultancy
- Healthcare
- Mining & resource
- Not-for-profit
- Pensions
- Professional practices
- Public sector
- Real estate & construction

We have more than 1,300 partners and staff operating from offices around the country. Wherever you do business, we can offer you local expertise backed up by the resources of a national firm.

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