

The China fraud landscape – Has anything changed?

China markets briefing for risk, legal
and compliance professionals

The [PwC's Global Economic Crime Survey 2022](#), a biennial survey performed to better understand fraud, corruption and other economic crimes at companies, was performed at the end of last year. The report, released in April 2022, highlighted that external fraud is emerging as a bigger threat on a global basis due to recent environmental, geopolitical, financial, and social pressures. 46% of respondents reported that they had experienced some form of fraud, corruption or

other economic crimes over the past two years, and cybercrime was reported as the most common and disruptive type of fraud experienced by organisations across a number of industries, including technology, media and telecommunications, and financial services. This reflects challenges companies are facing when shifting their operations to digital interfaces and how remote working exposes companies to fraud risks associated with weaknesses in digital security.



Traditional fraud types prevail in China

We performed a further analysis of the responses from our China-based respondents and noted that while a similar proportion of China-based respondents (48%) experienced fraud or other crimes in the past two years, cybercrime was not the most common nor disruptive type of fraud experienced. Instead, accounting and financial statement fraud was reported as the most common fraud type experienced, and asset misappropriation was identified as the most disruptive.

Prevalence of these traditional fraud types in Chinese organisations continues to pose a threat to the integrity of financial statements, and we are seeing, in recent years, high levels of scrutiny by external auditors when allegations of fraud come to light. Adequate investigations are expected to be performed, starting from fact-finding and evidence gathering. Questions typically asked include whether all individuals involved have been identified, the root causes of issues, and whether there are deficiencies in the internal controls. Not only are auditors concerned about direct impact to the financial statements, but they also need to consider management integrity and whether any laws may have been broken by the company.

Fraud perpetrated through collusion stays as top concern

On the topic of identifying parties involved in fraud incidents, 50% of our Chinese-based respondents reported that the most disruptive or serious fraud they experienced was perpetrated by collusion between internal and external sources, which is double compared to the global results. One common example of such collusion we have highlighted in our [April](#) article, involving employees colluding with vendors or related parties to misuse a company's marketing budget. Other cases that we have encountered recently and in the past involved collusion between company staff and bank personnel to fabricate banking documents, as well as collusion between company staff and related parties to divert company assets through fraudulent and complex transactions.



Given the heavy reliance yet limited control over third parties, Chinese organisations should take proactive actions in assessing and monitoring their third parties at different business stages. Internally, segregation of duties and due diligence processes should be strictly applied when dealing with business partners.

Is fraud suddenly going away?

Compared to the 2020 results (60%), there is a 12% drop in respondents that reported having experienced fraud, corruption or other economic crime in the past two years. This could be good news to those who have increased their use of fraud risk controls and advanced data analytics¹ as fraud preventive measures and have rendered satisfactory results.

However, this could also suggest that some Chinese companies have been less effective in detecting fraud and hence are less aware of fraud issues. As fewer China-based respondents reported that they have conducted routine internal audits over the past two years, the inability to perform internal audit reviews due to cross-border travel restrictions could have hindered companies' ability to detect fraud. Another factor could be

resource constraints. Of Chinese respondents who identified supply chain fraud as one of their key concerns, 44% of them reported that they are facing heightened fraud risk exposure because of insufficient resources in managing fraud risks. 39% of them shared that they have moved resources away from fraud controls in order to manage other issues.

While the reported fraud / economic crime rate dropped by 12%, the percentage of organisations suffering more than 1 million US dollars through the most disruptive incident of fraud and crime remained similar in the 2020 (40%) and 2022 (38%) results. Companies in China need to continue making sure that their detection tools and internal controls are mitigating relevant risk factors and are adapting to the changing fraud landscape.

¹ Chinese-based respondents reported an increase of 4% in the use of fraud risk controls and an increase of 6% in the use of advanced data analytics as initial detection method of the most disruptive crime / fraud.



The impact of change

As businesses struggle to keep their lights on during an economic downturn, resources and controls that were in place to mitigate fraud risk might have been altered or relaxed in order to expedite business processes, lower costs and to stay agile in an unstable market. Due to the disruptions caused by the pandemic and geopolitical tensions, organisations and individuals may also be tempted to “cooperate” with external parties in order to boost company or personal performance given the pressures of meeting financial targets.

Fraud typologies evolve over time as the external environment changes and technologies advance. However, fraud will not suddenly go away. It is, as a result, important for companies to be actively aware of emerging trends in the market and stay vigilant for signs of smoke. The increased use of technology and analytics could be one of the solutions to mitigate fraud risk, but organisations should also bear in mind that the tools should be fit-for-purpose and tailored according to their business size and nature, and the local market.

Contact us



Brian McGinley 

Partner, Forensic Services Leader
PwC Mainland China and Hong Kong
brian.mcginley@hk.pwc.com



Paul Tan 

Partner, Forensic Services
PwC China
paul.tan@cn.pwc.com



Jessica Li 

Partner, Forensic Services
PwC Hong Kong
jessica.ka.li@hk.pwc.com

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