

The Fraud
Fight
Advisory
Panel

the fraud fighting fraud -
advisory a guide
panel for SMEs

Introduction

Managing the risk of fraud should be high on the list of priorities for all businesses. Much has been written about fraud in big business. There is much less advice available to directors and managers in small and medium sized businesses. Yet these businesses rarely have the internal controls and resources, such as internal auditors or human resource departments, which can help during the course of their other work in the fight against fraud.

The Fraud Advisory Panel has produced this Checklist and Guide to provide guidance for small and medium sized businesses on managing the risk of fraud. The guidance covers the policies, structures and procedures that a business should have in place if it is to be effective in preventing and detecting fraud.

The Fraud Advisory Panel is an independent body, operating with the support of the Institute of Chartered Accountants in England & Wales. Since its establishment in 1998 the Panel has been working to promote a new response to the problem of fraud. Anti-fraud strategies have often been inhibited by the difficulty of co-ordinating the wide range of business, professional and public sector responses. The Panel works to overcome these barriers via a strongly multi-disciplinary approach.

Disclaimer

Whilst every effort has been made in the construction of this Guide, compliance with it does not guarantee that your business will not be a victim of fraud. Each business should take appropriate independent advice on the management of fraud risk.

The Fraud Advisory Panel and the contributors to the Guide accept no responsibility for any action taken by parties as a result of reading the Guide. Readers should obtain the appropriate professional advice on the issues raised.

A fraud check list for directors / senior managers

Does your business:

- treat fraud as a business risk?
- identify the types of fraud to which it is most exposed?
- ensure that at least one person or department is specifically identified as responsible for managing fraud risk?
- make clear to all employees that fraud prevention and detection is the responsibility of everyone in the business?
- have, and actively promote, a fraud policy statement?
- have a strategy and procedures for managing the prevention, detection, investigation and prosecution of fraud?
- have a fraud prevention education / training programme?
- have a plan of action in the event that a fraud is detected?
- have a clear whistle-blowing policy?
- have recruitment and ongoing personnel policies that address the risk of fraud?
- check that your fraud policies and procedures are complied with?
- ensure that your fraud policies and procedures are regularly reviewed?

What is fraud?

There is no precise legal definition of fraud and no single criminal offence that can be called fraud. It is usually taken to involve theft - the removal of cash or assets to which the fraudster is not entitled - or false accounting - the falsification or alteration of accounting records or other documents.

Your business may be exposed to:

- external fraud, perpetrated by individuals outside the organisation
- internal fraud, perpetrated by management or employees
- collusion, between someone within the organisation and an outsider.

Fraud as a business risk

The management of business risk is one of the most important issues facing business. Any risk may be a serious threat to an organisation's well being. Fraud is a real threat - to the financial health of an organisation and to its image and reputation.

To manage fraud risk

You need to understand the potential consequences of fraud on your business. You then need to reduce the risk through developing an anti-fraud culture across your business and by introducing appropriate policies, controls and procedures.

Identifying possible types of fraud

According to a recent study Indications of Fraud in SMEs¹, the most prevalent types of fraud seem to be ones that impact on the profit and loss account as a result of overstating expenses or understating income. Individually these may be for relatively small amounts and are difficult to spot. Indications of fraud may exist (changes in cash flow patterns, variations in accounting ratios, stock shrinkage, customer complaints, etc) but these signs often go unrecognised. SMEs can be particularly vulnerable to fraud during a period of rapid expansion.

The study also suggests that the popularity of outsourcing may have widened the threat of fraud. The development of stakeholder pensions may also create problems in future years with the introduction of new payroll procedures and cash transfers to pension providers.

Fraud may also involve the theft of information, such as trade secrets, customer databases and pricelists.

The Department of Trade and Industry provides advice on information security management on its website www.dti.gov.uk/cii.

You need to consider the business areas where your organisation may be most vulnerable to fraud.

¹ "Indications of fraud in SMEs" on behalf of the Fraud Advisory Panel by Dr Andrew Higson, Loughborough University Business School, to be published during 2002.

Responsibility for fraud prevention and detection

Management has overall responsibility for ensuring the security and integrity of the assets of a business by putting in place appropriate controls and review procedures. Management may, in turn, designate one person, or department, as having specific responsibility for managing fraud prevention and detection. However, for your business to be effective in countering the threat of fraud, everybody working within the business has to take responsibility for the prevention and detection of fraud.

A fraud policy statement

A formal statement of fraud policy, issued by the board of directors, indicates that the fight against fraud is endorsed and supported at the most senior level within your business. The fraud policy statement should be communicated to all employees and drawn to the attention of all contractors and suppliers.

A fraud policy statement should be simple, focused and easily understood. Its contents may vary from business to business but you should consider including references to the business's determination:

- to take appropriate measures to deter fraud
- to introduce/maintain necessary procedures to detect fraud
- to investigate all instances of suspected fraud
- to report all suspected fraud to the appropriate authorities
- to assist the police in the investigation and prosecution of suspected fraudsters
- to recover from fraudsters any assets wrongfully obtained
- to encourage employees to report any suspicion of fraud.

You may wish to include the following:

- the allocation of responsibilities for the overall management of fraud
- the procedures to be followed if a fraud is suspected.

The fraud policy statement should make clear that all employees have a responsibility for fraud prevention and detection. It follows that the statement should be actively and regularly promoted throughout the organisation to all employees, irrespective of grade, position or length of service.

Managing the prevention, detection and prosecution of fraud risk

The management of fraud prevention should be integrated into the overall management programme rather than dealt with in isolation. Your anti-fraud plans and procedures should be designed to fit around the particular activities and circumstances of your business.

Key elements of a fraud prevention strategy and its implementation may include:

- identifying the areas within the business most vulnerable to the risk of fraud
- establishing what processes are in place already
- identifying extra or alternative controls needed to reduce the risk
- introducing the extra or alternative controls
- monitoring the controls to check that they are in operation
- regularly assessing the effectiveness of the controls, in particular to take account of the changing circumstances in the organisation.
- ensuring that your strategy and procedures are workable and practical, supported by appropriate resources and regularly reviewed.

If your business is a financial services organisation regulated by the Financial Services Authority you already have many obligations including those related to anti-money-laundering systems and procedures. Your anti-fraud controls should link into those existing systems and procedures.

Case Study

A manufacturer and distributor of electronic products failed to implement adequate stock controls and audit procedures within their product repair shops. As a consequence, a senior member of the repair shop team was able to call off original product spare parts over a number of years and replicate a repair shop environment in his home. The losses over a ten year period exceeded £1 million and could have been avoided through more efficient stock controls and audit procedures.

Case study

A medium sized travel company provided a refund cheque to the value of £10 to a customer. Upon receipt of the refund cheque, the customer fraudulently altered the cheque by amending the amount details to "£10,000" and by altering the name of the payee. The company was alerted to the attempted fraud by the vigilance of their bankers. Following additional enquiries, it became clear that the attempted fraud was part of a wider ring of organised fraud where refund cheques for small values were being altered in an attempt to secure higher amounts.

A fraud prevention education/training programme

All new employees should be provided with the business's fraud policy statement. Fraud prevention and detection matters should be included in your induction programmes and continuous career training.

What to do when a fraud is detected

However comprehensive your fraud prevention controls may be, a determined and skilled fraudster may find a way around them. You need to have prepared a contingency plan in the event that a suspect fraud is uncovered. The scope and scale of this fraud response plan will depend, to a large degree, on the nature and size of your business.

Matters to consider for inclusion in a fraud response plan may be:

- who will lead the investigation
- how to investigate a suspected fraud
- the skills available in-house and contacts for external expertise such as specialist fraud investigators
- how to mitigate the threat of further fraud and what are the lessons learnt for improved controls
- how to secure the evidence without alerting the suspect fraudster at the outset
- how to deal with suspects
- how/when to involve the police
- the public relations implications.

Your business's fraud response plan should be seen as a part of a much wider disaster recovery plan. It should be kept under constant review and should be tested regularly.

A whistle-blowing policy

As part of establishing an anti-fraud culture in your business, you should make clear to all employees that whistle-blowing is an essential element in the fight against fraud.

You should make it as simple and straightforward as possible for employees to report a suspected fraud. All employees should be aware of the fraud reporting lines. You may wish to set up an internal fraud hotline, willing to accept anonymous calls. You may want employees to report fraud to their line manager although it should be possible for employees to by-pass their immediate line manager if they suspect that manager's involvement in

fraud. A third possibility is an external fraud hotline. Whatever fraud reporting mechanism you introduce, employees should be reassured that all reports will be treated on a confidential basis.

Where a report of a suspicion of fraud is made in good faith, the employee making the report is now normally protected in law under the Public Interest Disclosure Act 1998.

Recruitment and ongoing personnel policies

Most fraud experienced by an organisation is committed by its own staff. You must have an effective recruitment policy designed to deter and prevent fraudsters seeking employment and a system of personnel management designed to deter existing staff from committing fraud.

Your recruitment processes must require references to be thoroughly checked and assessed. Temporary staff should be vetted as thoroughly as permanent staff, particularly in vulnerable areas such as finance. You should consider the need for further vetting or screening, as employees are moved to higher risk/sensitive posts; gain access to privileged information; or gain promotion to more senior appointments.

Case study

A finance house needed an extra junior accountant for a short period of time. The company went to a reputable agency and employed an appropriately qualified person. The company relied on the agency's screening policy which had failed to uncover a series of low level lies in the accountant's personal history, including a false address.

The accountant removed a company chequebook from his work place and used it to make a series of high value purchases on his own behalf. The matter came to light when a routine enquiry was made with the finance house, to verify the issue of one of the cheques. By this time the temporary accountant had left the company. He could not be traced and the matter is in the hands of the police.

Compliance with fraud policies and procedures

Any system of controls can only be effective if the prescribed processes and procedures are complied with at all times and throughout the business. Over time, controls can be eroded as short cuts are introduced, processes are changed unofficially to meet new circumstances or are dropped without approval. You should ensure that regular checks are undertaken to ensure that all the necessary controls are in operation throughout the business and remain effective, in particular to take account of changes in the business.

Case study

A company involved in international trade, where large amounts of cash were exchanged, granted authority to draw off cash to one senior manager with sole authority. As a consequence, the manager was able to fraudulently call off small amounts of cash over a period of months without the withdrawals being spotted. Ultimately the total amount of cash stolen from the company exceeded £80,000. An internal investigation and enquiry revealed that at least two signatures should have been required to withdraw cash and that there had been a complete failure of internal controls and procedures.

Review of fraud policies and procedures

Organisation structures are constantly changing. A control system which may have been effective on its introduction may no longer fit readily with the latest company structure or meet the organisation's changing circumstances or needs. A regular review of systems and procedures is therefore essential to ensure that the current systems meet the current needs of the your business and that they address the risks facing your business today.

Conclusion

Fraud is a major threat to any business but there are steps that can be taken to minimise the risks. A business that is alert to the risks, that takes steps to put in place appropriate controls and procedures, monitors the operation of these controls and their ongoing effectiveness and maintains an anti-fraud culture, is going to be better placed to deter, prevent, and at worst, detect fraud. Taking the risk of fraud seriously can help protect a business's bottom line, its image and reputation.

Education, Training & Events Working Party

Martin Robinson (Chairman)	Lloyds TSB Bank Plc
Mike Bluestone	Berkeley Security Bureau Ltd
Mark Prentice	Ernst & Young

Additional Contributions by Working Party Members

Steve Allen	IJA International
Paul Barnes	University of Nottingham
David Cafferty	Ministry of Defence Police (Fraud Squad)
Peter Connor	The Risk Advisory Group Ltd
Sue Grossey	Thinking About Crime
Noel Inge	Institute of Legal Executives
Brian McCarthy	Prudential plc
Terence Palfrey	Leeds Metropolitan University
Steven Philippsohn	Philippsohn Crawford Berwald
John Rafferty	Tenon Lathams
Adam Smith	Bentley Jennison
Hema Vithlani	Control Risks Group
John Webb	Cazenove & Co
Ian White	HLB Kidsons
Colin Wilcox	National Audit Office
Sue Diggins (Secretary)	The Fraud Advisory Panel
Helen Fay (Executive)	The Fraud Advisory Panel

and from

Ruth Eisenberg, Linda Findlay and Clive Lewis of the Institute of Chartered Accountants in England & Wales

Fraud Advisory Panel

For a printed copy of this document or for information about the Fraud Advisory Panel, please contact Helen Fay by e-mail on helen.fay@icaew.co.uk or write to
The Fraud Advisory Panel,
Chartered Accountants' Hall
PO Box 433
Moorgate Place
London EC2P 2BJ

Useful Organisations

Serious Fraud Office
Tel No: 020 7239 7272
www.sfo.gov.uk

Companies House
Tel No: 0870 333 3636
www.companieshouse.co.uk

City of London Police Fraud Squad
Fraud Desk Tel No: 020 7601 2222
www.cityoflondon.police.uk/level1/crime/fraud_main.html

National Audit Office
Tel No: 020 7798 7000
www.nao.gov.uk

Metropolitan Police Fraud Squad
(for high value fraud involving
amounts of at least £750,000)
Tel No: 020 7230 1212
www.met.police.uk/so/so6.htm

Institute of Chartered Accountants
in England & Wales
Tel No: 020 7920 8100
www.icaew.co.uk

National Criminal Intelligence
Service (NCIS)
Tel No: 020 7238 8431
www.ncis.co.uk

Law Society
Tel No: 020 7242 1222
www.lawsociety.org.uk

Financial Services Authority
Tel No: 020 7676 1000
www.fsa.gov.uk

Home Office
Tel No: 020 7273 4000
www.homeoffice.gov.uk

Confederation of British Industry
Tel No: 020 7395 8195
www.cbi.org.uk

Public Concern at Work
Tel No: 020 7404 6609
www.pcaw.demon.co.uk

Department of Trade and Industry
Tel No: 020 7215 5000
www.dti.gov.uk

Crimestoppers
Tel No: 0800 555 111
www.crimestoppers-uk.org

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Chartered Accountants' Hall PO Box 433 Moorgate Place London EC2P 2BJ