



WORKING PARTY PAPERS

**Study of Published Literature on the Nature & Extent of Fraud in the
Public & Private Sector**

Information Gathering Working Party

assisted by

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EXECUTIVE SUMMARY

This is the first report of the Information Gathering Working Party in response to its terms of reference. The working party assembled a wide variety of material readily available in the public domain which was thought to have a bearing on the scale and nature of fraud and fraud trends.

This material was analysed with a view to answering the following questions:

- What is the nature and extent of fraud in the UK?
- What type of frauds exist in the private sector?
- What type of frauds exist in the public sector?
- Are there any identifiable trends?

It is clear that the large amount of material collected does not provide comprehensive information about the nature and extent of fraud, or allow proper trend analysis. There are difficulties in comparing information from different sources and in the quantification of fraud.

Problems in drawing conclusions were also caused by the lack of a comprehensive or universally accepted definition of fraud and by the way in which organisations collect and present data and categorise fraud. Approaches to policing, investigation and prosecution vary while resources for UK police fraud squads are limited and fraud is often not regarded as a priority in terms of policing objectives.

Nonetheless, despite these well founded reservations, the working party has been able to analyse and consider some of the material.

Results of analysis

Analysis of the material revealed substantial gaps in the data. Indeed often the material is of little direct relevance. This in itself is a valuable discovery and one that indicates a need for further research. There was no information in the material about the consequences of fraud (e.g. loss of employment, business failure) to business, the wider community and the economy.

It is clear from this survey that much fraud is high volume and low cost. Figures from both the public and private sector suggest that the incidence of fraud is increasing, although there are widely differing estimates of the extent of fraud within the UK. It is also clear that the high value frauds tend to be perpetrated by owners or executive directors. A number of the publications reviewed analyse the causes of fraud and suggest that simple controls and fraud awareness training could be very effective at preventing many frauds, although these would be less useful for combating fraud by owners or directors.

Many areas where significant volumes or amounts of fraud occur have already developed specialised means for detecting, investigating and prosecuting fraud. This is particularly true of the public sector and the retail and banking industries. In these sectors, more information is available about the nature and extent of fraud.

Next steps

Additional research is clearly required to fill the gaps in publicly available material and to identify best practice in fraud reporting and prevention. The Panel will continue to encourage and sponsor research, not least through its own information gathering working party. The Panel would encourage others to do the same, particularly government and regulators, to ensure that the fight against fraud is better informed and directed.

One option for further research is a survey of FTSE 100 companies by means of interview and questionnaire to find out the real cost, nature and consequences of fraud in the private sector.

Communication is vital if the work of the Panel is to have impact and value. The working party recommends that the Panel should seriously investigate the possibility of establishing a reliable website and database to communicate information about fraud, fraud trends and prevention.

I INTRODUCTION

1.1 The Fraud Advisory Panel is the result of the initiative on fraud by the Institute of Chartered Accountants in England and Wales, led by the Institute's Audit Faculty. The multiplicity of interests, in business, the professions and the various agencies makes effective co-ordination of the development of anti-fraud measures difficult. The Fraud Advisory Panel was accordingly formed as a forum for bringing all the parties together, and formally launched in February 1998.

1.2 The Panel's main objective is to reduce the incidence and impact of business fraud by:

- establishing the essential facts about the extent and nature of fraud.
- improving awareness of fraud by management.
- improving education and training of all sectors of the business community.
- advising businesses and others on fraud prevention, detection and reporting.
- working to improve the approach to the investigation and prosecution of fraud.

1.3 The Fraud Advisory Panel initially set up three Working Parties with the following broad aims:

- To gather intelligence on the nature and extent of fraud and to assess future information needs, including research, and communication (Information Gathering);
- To establish methods of prevention and provide advice and training on fraud prevention and detection to organisations and people at risk (Education & Training);
- To consider the effectiveness of existing legal practice and procedure on the investigation and prosecution of fraud (Investigation and Prosecution).

1.4 This report was developed by the Information Gathering Working Party, which began its work with the following specific terms of reference:

To understand the nature and extent of major fraud, primarily affecting the business community and the public sector, and to make recommendations to the Fraud Advisory Panel.

1.5 The Working Party developed these terms to include:

- obtaining information about types, scale and reporting of fraud from a wide range of sources
- identifying trends relevant to the nature and extent of fraud
- considering the reasons why it may be easy or difficult to obtain information about fraud

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- considering how best to use available information to help others combat fraud
 - considering what actions to recommend in response to conclusions drawn from information gathered, or where difficulty has been experienced in obtaining relevant information.
- 1.6 The Working Party sought to provide a basis for drawing reliable conclusions by assembling a wide variety of publicly available material about fraud, covering the following categories of information:
- Official reports and statistics published by government bodies, law enforcement and prosecution agencies
 - Private sector fraud surveys
 - Journals and publications, including the Internet
 - Material published by trade associations
 - Material published by private investigative organisations
 - Academic studies.
- 1.7 This report is based on analysis of the material obtained from these sources.
- 1.8 The material collected by the Working Party is not all the material available in the public domain. However, it was all the material that a diverse group of people comprising professional accountants, lawyers, consultants, police officers, academics and businessmen were able to collect relatively quickly and easily. In addition, Professor Doig was able to provide some additional information from his own research sources. As such, it is representative of the sort of information that those responsible for an organisation, such as a managing director or finance director of a company, interested in fraud trends and wanting to understand fraud risks facing their organisation, might obtain within a reasonable space of time.
- The deficiencies in the material serve to emphasise the need for a better, more comprehensive and more relevant information system about the nature and extent of fraud, affecting the private sector in particular.
- 1.9 The Working Party aimed to analyse the information to understand:
- the nature and extent of fraud
 - problems that relate to definitions and categories
 - private sector non industry specific fraud
 - private industry specific fraud
 - public sector fraud; and
 - assessment of fraud trends in each area
- 1.10 The report comments on the quality of information obtained and draws conclusions about the need for further focused information-gathering and research.
- 1.11 The Working Party acknowledges and thanks Professor Alan Doig of Liverpool John Moores University and his researcher Sarah Johnson, who carried out the main analysis of the information obtained and drafted the first version of this report. Thanks are also due to Professor Michael Levi of Cardiff University also provided valuable information and contributed to the draft.

II THE EXTENT OF FRAUD

- 2.1. It is difficult to find any wholly reliable and authoritative information about the nature and extent of fraud affecting organisations in financial terms. Different studies quote different

figures, often based on quite different methodologies.

2.2. For example, the Ernst and Young international survey¹ is world-wide and focuses on perceived incidence and prevalence, not setting an overall figure for fraud costs or levels. The Serious Fraud Office², British Transport Police³, City of London Police⁴ and Ministry of Defence Police⁵ Annual Reports all provide information on cases handled by the bodies concerned.

2.3. However, the statistics are often presented in different ways. This is ably demonstrated by the statistics from the various Police forces. The City of London Police accumulated fraud squad statistics are given as value per type of fraud whilst the Metropolitan Police statistics by number of cases per type of fraud. The West Yorkshire Police⁶ statistics relate only to a six month period and are broken down by value of cases being handled by each of their three offices plus case analysis by victim.

2.4. Some of these reports actually give estimates of the recent annual cost of major frauds in the UK:

£16 billion	Association of British Insurers ⁷
£5 billion	Serious Fraud Office ⁸
£400 — 700 million	KMPG ⁹
£4-5 billion	Ernst & Young ¹⁰
£1-2 billion	Benefit fraud ¹¹

2.5 Two major problems quickly emerge from analysis of the material:

- firstly, there is no legal definition of fraud, which makes identification of types of activity difficult;
- secondly, there is no standardisation of the categories of fraud, which makes comparison of statistics from different organisations difficult.

2.6 Dr Andrew Higson comments upon the absence of an agreed definition of fraud in a report prepared for the Fraud Advisory Panel.¹² In his study, Dr Higson refers to the *obiter dicta* of Buckley J in *Re London & Globe Finance Ltd* that fraud must have two essential elements: Deception or concealment and deprivation or loss to the victim.

2.7 Most of the source materials for this report did not define how fraud was defined for the purpose of the information provided. The only definition in the material is by HM Treasury in their reports, who defined fraud as:

*'The use of deception with the intention of obtaining advantage, avoiding an obligation or causing loss to a third party'*¹³

2.8 In contrast, for the purpose of auditing statutory financial statements, auditors additionally define fraud as including intentional misstatement of financial information¹⁴. Many high profile business failures in recent years that have generally been regarded by the public as involving fraud, have involved such misstatement but it has nevertheless not always been possible to obtain a successful prosecution, reflecting the difficulty of proving deception, obtaining advantage or the causing of loss.

2.9 It is often unclear from the source information the extent to which the figures relate to theft with deception or intentional misstatement or both.

2.10 Different reporting bodies use different categories for types of fraud. The Serious Fraud Office¹⁵ categorises the cases it prosecutes as follows:

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- Fraud on investors
 - Fraud on creditors of companies
 - Fraud on banks and other financial institutions
 - Fraud on central or local government
 - Fraud involving the manipulation of financial markets

2.11 The Metropolitan Police¹⁶ categorise fraud for the purpose of their statistics as:

- Computer
- Fraudulent trading
- Investment
- 'Long firm'
- Public sector
- Mortgage

2.12 The Home Office¹⁷ lists categories under which fraud should be reported as

- Fraud by company director
- False accounting
- Other fraud (including a diverse list of possible frauds from purporting to act as a spiritualistic medium for reward to fraudulently mutilating a stamp!)
- Forgery

2.13 This diversity of reporting clearly illustrates difficulty in drawing reliable conclusions based on different 'headline' figures, particularly as the scopes of fraud and periods addressed are different and as the figures to some extent rely on extrapolation.

III PRIVATE SECTOR NON INDUSTRY-SPECIFIC FRAUD

Introduction

3.1 The Working Party was keen to understand the extent of this type of fraud, defined as involving those who control an entity (usually a limited company) using that entity and their positions within it as a means to enrich themselves at the expense of the shareholders, creditors or employees. This kind of fraud also involves frauds against companies by employees, by outsiders or by employees colluding with outsiders. It is the view of the working party that information about this kind of fraud, which can cause serious loss through business failure or loss, is of significant public interest.

3.2 Unfortunately, little information directly focused on this subject was found in the material. This points either to a serious gap in the accessibility of such published information or a gap in the scope of published information about fraud.

3.3 However, it is possible to gain some understanding of the nature and extent of private sector fraud from some of the material. It has to be accepted that only an incomplete picture is available and there are numerous qualifications and problems with the data.

Types of fraud

3.4 In view of the differing categories used in the various reports, this section reviews the individual reports giving useful data about the nature and extent of fraud in the private sector, with a view to identifying trends or common threads.
Serious Fraud Office (SFO)

3.5 The data in this section is taken from the Serious Fraud Office's Annual Report for 1997/98. This report states that the aim of the SFO is:

*'To deter fraud and maintain confidence in the United Kingdom's business and financial institutions by investigating offences involving serious and complex fraud and prosecuting persons suspected of committing them'*¹⁸

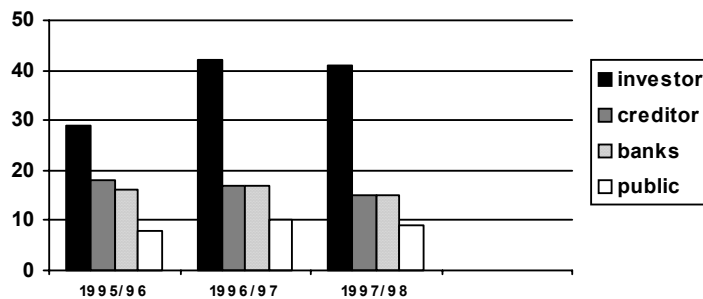
3.6 The SFO's Annual Report contains some statistics and information based upon the relatively small number of cases that the SFO prosecutes. From this information an indication can be obtained of the nature if not the full extent of major fraud affecting business.

3.7 The aggregate value of the SFO's workload of alleged frauds in April 1997 was over £2 billion. £800 million of that value was accounted for by the BCCI case. In April 1998 the reported workload value was £1.2 billion. In terms of numbers of cases analysed by victim the SFO provides the following figures:

	1995/96	1996/97	1997/98
Fraud on investors	29	42	41
Fraud on creditors of companies	18	17	15
Fraud on banks or other financial institutions	16	17	15
Fraud on central or local government	8	10	9
Fraud involving the manipulation of financial markets	3	3	5
Other	16	14	17

3.8 It can be seen that investment fraud is the leader with fraud on company creditors and bank fraud ranking almost equally in second place.

Because the SFO can only investigate frauds after a complaint to the police or SFO, these figures give some idea of who are the most popular targets for commercial fraudsters. This is perhaps better seen in graphical format, where it becomes clear that the fraud against investors increased significantly in 1996/97, although not in 1997/98. However, it is not clear to what extent these figures are distorted by the BCCI investigation.



Metropolitan Police

3.9 The Metropolitan Police publish recorded crime statistics in the Metropolitan area and in the Provinces¹⁹. The extract given below would suggest that reported crime statistics for fraud and forgery are increasing, whilst decreasing for many other offences.

	1996/97	1997/98	1998/99
Burglary	157,205	135,138	123,861
Theft & handling	375,916	365,202	383,665
Fraud & forgery	39,442	43,437	80,541

- 3.11 The Metropolitan Police Fraud Squad analyse these in more detail into the types of fraud committed, although it is difficult to make conclusions about trends over the two years due to change in categorisation. These represent the number of cases investigated.

	Year to 31.3.88	Actual Jan-May 98
Advance Fee		36
Computer	40	13
Fraudulent Trading		2
Investment	71	20
Long Firm	11	12
Mortgage	29	16
Public Sector	40	31
Other	83	207
Total	274	337

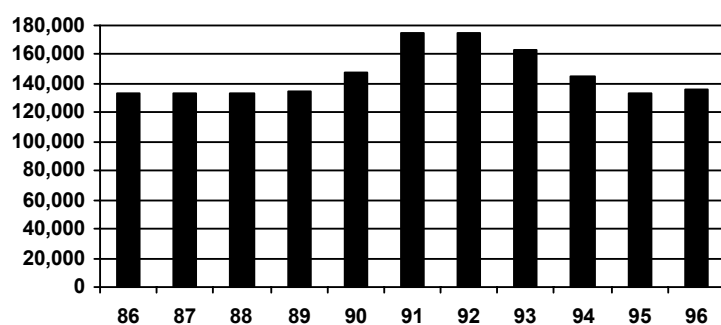
- 3.12 Whatever the differences in classification, it is clear that the incidence of fraud under investigation by the Metropolitan Police appears to be increasing. In addition, some conclusions can be made about the types of fraud committed. Whilst the reports do not explain what comprises 'other', the remaining categories are relevant to fraud affecting business (with the exception of mortgage and possibly computer fraud) and, again, may give some broad indication of the most frequently complained of frauds. There is some comparability with the SFO figures: advanced fee and 'investment fraud' are comparable to the SFO category of fraud on investors. Similarly, fraudulent trading and long firm are comparable to the SFO category of fraud on creditors of companies.

Home Office

- 3.13 The Home Office Criminal Statistics for England and Wales 1996²⁰ contain statistics on criminal offences recorded by police forces and courts, including fraud. It states that 'changes in the number of offences recorded do not necessarily reflect changes in the amount of crime committed because many offences are either not reported to the police or not recorded by them...These factors are apparent when recorded crime statistics are compared with results from victim surveys...**The 1996 British Crime Survey (BCS)...shows that...the amount of crime actually committed is perhaps four times the number of crimes recorded by the police.**'

According to the Home Office, offences of fraud and forgery recorded rose by 2% in 1996, the first rise for 5 years. The total of 136,000 fraud and forgery cases recorded accounted for <3% of total recorded crime. The graph shows the total frauds notified since 1986, with a clear peak in the early

1980s followed by subsequent falls until 1986.



3.14 The Home Office split the total into five categories: fraud by company director, false accounting, other fraud, forgery (including false drug prescription) and other forgery.

3.15 The Home Office figures for fraud by company director (1) and false accounting (2) and other fraud (3), are given in the table below.

Year	Directors	False Accounting	Other
1986	25	1,854	120,923
1987	43	1,816	119,893
1988	40	2,075	119,645
1989	25	2,106	121,756
1990	53	2,001	133,866
1991	24	1,623	159,136
1992	35	1,710	159,146
1993	34	1,427	147,979
1994	41	1,532	128,608
1995	29	1,295	120,699
1996	39	1,728	125,609

3.16 Again, it is clear that there was a peak of offences in the early 1990s followed by subsequent falls, with a rise in 1996. This might suggest that fraud is perhaps less of risk than in the early 1990s.

3.17 Similar tracking of fraud trends over a longer time period in Australia²¹ show a peak of offences in times of recession, such as seen in the late 1980s and early 1990s. Again, these show a peak in fraud convictions in 1990 -1992, with subsequent falls. They too show an increase in 1996, suggesting that the fears about another recession sparked off an increase in fraudulent activity.

Who commits fraud?

3.18 The main evidence comes from two surveys, one by the Association of Certified Fraud Examiners (ACFE)²² and the other by Ernst & Young²³.

Ernst & Young

3.19 The Ernst and Young survey provides some general information on the extent and perpetrators of fraud. The survey was by questionnaire and interview in 11 countries. The majority of respondents felt incidence of fraud had increased in the last 5 years with 40% having suffered multiple frauds in that time and 75% having suffered at least one. 84% of the most serious frauds discovered involved employees, 60% of these were by management. The UK Supplement says that 67% of UK respondents had been defrauded in the last twelve months, more than 50% of the worst frauds suffered by companies were by directors and managers, 80% of cases involved an employee.

3.20 This may support a broad conclusion that internal fraud is a more serious threat to business than external fraud.

Association of Certified Fraud Examiners (ACFE)

3.21 The danger of internal fraud is also highlighted by the ACFE survey of 200 ACFE members and Chief Executives. This revealed that the severity of average losses per fraud according to status of perpetrator was:

Owner or executive director	£3,747,633
Manager	£631,546
Non-managerial employee	£111,851

3.16 The finding that the size of fraud increases dramatically the more senior the perpetrator within an organisation is well-known to statutory auditors, who regard 'senior management fraud (including fraud involving directors)' as both the most important type of fraud to seek to detect when auditing financial statements, but also as the most difficult to detect. The Auditing Practices Board makes this point in their publication *Fraud and Audit: choices for society*.²⁴ As the report makes clear 'most material frauds involve management' and 'management fraud is unlikely to found in a financial statement audit'. This is because senior individuals in an organisation are in the best position to over-ride established controls, to direct employees to take actions to conceal the fraud (whether knowingly or not), to collude with third parties to conceal the fraud, and to deliberately deceive the auditors through providing false information and explanations.

3.17 The following table from the ACFE survey shows the severity of fraud in terms of cost according to main class of perpetrator.

	Total	No collusion		Collusion		
		Internal	External	Internal only	External only	Internal & External
Total	£100.9m	£18.8m	£0.7m	£28.6m	£8.0m	£44.6m
Average	£0.79m	£0.38m	£0.05m	£1.80m	£0.90m	£1.00m

3.18 This study indicates that the greatest total cost to business is through collusive fraud between employees and external fraudsters followed by frauds between colluding

employees. When average figures per fraud are taken, the relative positions of these leaders are reversed.

3.19 An Industrial Society article²⁵ gives the following reasons for employee fraud:

- disaffection with the company
- personal finance problems
- drugs or drink problems
- other addictions, e.g. gambling

Types of fraud

3.20 Not surprisingly, the ACFE survey reports that the majority of common frauds involve tangible rather than intangible assets, the most common being cheques and cash. It may therefore be reasonable to assume that the most likely employee fraud will involve the misappropriation of the physical assets and cash of a business.

Consequences of fraud

3.21 It is important to obtain a better understanding of the full economic consequences of fraud, including the true cost of fraud to all the victims. When the full extent of the cost of fraud to UK plc is known, people in positions of authority may take the need to adopt more effective anti-fraud measures more seriously. Too often such people form the view that they will never suffer from fraud. In the strict sense many will indeed go through their careers without becoming direct victims of fraud, but they could still indirectly be worse off as a consequence of it.

3.22 The Working Party hoped that the material assembled would have provided some insight into the overall economic consequences of fraud. No directly relevant material was discovered. This shows a serious deficiency in quality information. Once the true economic cost of fraud is properly understood a better assessment can be made of the cost-benefit of alternative anti-fraud measures.

3.23 Some consequences of fraud are:

- insolvency or winding up
- bankruptcy
- failure of creditors' (suppliers') businesses
- loss of employment
- loss to the Revenue
- greater burden on state benefit system
- loss of confidence in business
- loss to lenders and investors
- opportunity cost, e.g. through diversion of management time

Private sector non industry-specific fraud trends

3.24 There was little relevant material from which trends in fraud affecting the private sector could be determined, at least not without attempting further significant analysis of the underlying data. It is clear from most of the surveys that fraud is on the increase, although this may simply be due to increased reporting of fraud rather than actual increase in incidence.

3.25 The material does reveal some particular concerns about the rise of computer crime and fraud. For example, the survey by Deloitte & Touche for the European Commission in

1997²⁶ listed computer and information technology abuse as an area of concern due to the size of recent growth.

- 3.26 Similarly, the Audit Commission Survey²⁷ on computer fraud and abuse in public and private sector indicates that the percentage of organisations reporting fraud fell from 10% in the 1994 survey to 8% in 1997. Fraud accounted for 13% of all incidents. However, average value of detected frauds rose by 25% from an average of £28,000 in 1994 to £35,000 in 1997. Interestingly, no increased sophistication in the nature of the frauds was detected.
- 3.27 This survey also looked at the causes and perpetrators of such frauds. Poor internal controls was main reason respondents believed incidents had occurred. Increasing computerisation means fraud will be increasingly IT related. Internal controls detected one third of cases compared with half previously. An increasing number were detected by accident. Staff in managerial positions were responsible for nearly one third of frauds. The input of fraudulent data and alteration of data accounted for 70% of cases. Frauds involving misuse of output increased by 25%.
- 3.28 Internet credit card fraud is claimed by Deloitte & Touche²⁸ to have risen by 73% in 1997. Concerns are also expressed about:
- advance fee fraud
 - investment fraud
 - banking fraud
 - counterfeiting/copyright abuse
 - fraudulent bankruptcy/exploitation of cross border corporate structures
 - insurance fraud
 - public sector fraud
 - smuggling
 - money laundering.
- 3.29 HM Customs and Excise note in two reports²⁹ that excise revenue fraud, including the extent of organised crime, continues to grow.

Prevention

- 3.30 Some of the above surveys also considered preventative measures. In the Ernst & Young survey³⁰, 75% of respondents considered that good systems of internal controls and procedures are the best method of both preventing and detecting fraud. Personnel issues were also highlighted as screening procedures, reference checks, exit procedures for employees were recommended. In addition, regularly updated basic compliance procedures for all employees, such as staff independence checklists and password security, were suggested.
- 3.31 As already noted, respondents to the Audit Commission survey³¹ felt that poor internal controls were the main reason incidents had occurred. Increasing computerisation means fraud will be increasingly IT related, highlighting the increasing importance of controls.

IV INDUSTRY-SPECIFIC FRAUDS

- 4.1 Fraud is generally recognised as a greater risk in certain industry sectors. As a result, trade associations for those sectors have tended to develop information networks and fraud

counter-measures.

- 4.2 There are examples of effective sector information-sharing in financial services and retail. Other sectors for which some information is available include airlines, telecommunications and solicitors.
- 4.3 In a few cases material dealt with shared areas; for example, both the Association of British Insurers Report and CII Journal deal with insurance fraud from a UK perspective and an international view respectively. Similarly the British Bankers Association tables and the Banking Ombudsman materials both deal with banking but not on a comparable basis. The first dealt with fraud losses to banks and the latter with fraud complaints against banks.
- 4.4 The British Retail Consortium Surveys provide information on detected incidents, losses therefrom and estimates of losses from undetected frauds but only those which are a direct cost to the retailer. The fraud value also includes deliberate bad debt. Extrapolations are made from the data. Percentage changes in the data are noted from year to year.
- 4.5 Similarly the Audit Commission Surveys on Computer/IT Fraud and Abuse map changes in incidence across both the public and private sector, though respondents and corporate mixes may vary over time, rendering comparisons potentially misleading.

Industry specific fraud trends

Banking

- 4.6 Figures published by the British Bankers Association ³² show an increase in fraud losses.

	1994	1995	1996	1997
Total no. of cases	15,587	15,825	17,967	19,526
No. of cases with nil loss	5,171	5,511	7,026	8,088
Potential losses	250,875	315,945	213,559	317,782
Initial losses	40,613	37,653	55,672	47,939
Actual losses	25,455	26,183	26,857	33,742

Retail

- 4.7 Data published by the British Retail Consortium ³³ shows a decrease of total fraud losses which were a direct cost to retailers. There appears to be an overall downward trend save in the case of credit card fraud:

	1992/3	1993/4	1994/5	1995/6	1996/7	Change
Total loss	£25m	£32m	£22m	£38.5m	£26.7m	- 31%
Cheque	£13m	£17.5m	£8.3m	£16.2m	£9.7m	- 40%
Credit card	£6m	£9.1m	£3.6m	£4.6m	£6.3m	+ 36%
Counterfeit	-	£1.8m	£1m	£1.5m	£0.7m	- 54%
Other	£6m	£3.2m	£9.1m	£16.2m	£10m	- 39%

- 4.8 It is interesting that fraud is falling in this sector, when crime statistics suggest that fraud as a whole is on the increase. This could represent the effects of concerted anti-fraud measures adopted by the retail industry.

Insurance

- 4.9 The Association of British Insurers, through their Crime and Fraud Prevention Bureau, publishes figures on the level of insurance fraud in their annual reports. The 1998 report includes a survey from a sample of ABI members on trends in the number and cost of fraudulent insurance claims³⁴. The insurance companies were asked to estimate their net written premiums for 1998 and the number of claims paid, together with the number and cost of fraudulent claims. The report includes a summary of these responses.
- 4.10 Their key findings were:
- fraud, expressed as a percentage of premiums, increased from 3.6% to 3.7% in 1998.
 - fraudulent non-life insurance claims were estimated to be £645 million in 1998, a rise of 8.4% over 1997.
 - motor claims fraud cost £26 million more than in 1997.
 - fraudulent house claims rose by £8 million.
 - commercial property fraud rose by £3 million.
 - personal accident and travel insurance fraud both rose from £140 million in 1997 to £168 million in 1998.

Conclusions

- 4.11 The material assembled contained more limited information about industry-specific fraud than was expected, although this may indicate deficiencies in the information gathering process. It is therefore difficult to make firm conclusions on trends within specific sectors.
- 4.12 However, the figures suggest that some industries have been effective in tackling the extent of fraud, whilst others still have much work to do.
- 4.13 Of more concern is the fact that the vast majority of UK industry does not appear to collect data on fraud within their specific sector. The only sectors publishing information tend to be those perceived as having a higher incidence of fraud, and have therefore established organisations and procedures to detect and prevent fraud in that sector. However, these cannot be the only sectors affected by fraud and the Working Party is very concerned that ignorance and failure to acknowledge the existence of fraud is hiding a serious drain on UK business resources.
- 4.14 The Working Party believe that there is considerable room for development of more effective sector-based information-gathering, both on the incidence of fraud and the reasons for not recognising the problem.

V PUBLIC SECTOR FRAUD

General

- 5.1 The figures published by the Serious Fraud Office and the Metropolitan Police deal with fraud on central or local government and public sector fraud respectively. These figures are tabulated at paragraph 3.9 and 3.10 of this report.
- 5.2 Little of the fraud recorded by the police, nor the fraud figures produced either by industry-representative bodies such as the ABI or BBA or by firms of consultants, encompasses fraud against local and central government departments, either on the income or expenditure side. It is clear that on the government expenditure side, the principal costs lie

in social security fraud. Government estimates are that out of a total annual expenditure of £90 billion on 20 million persons, fraud totals up to £4 billion, a quarter of which is on Housing Benefit.

- 5.3 In 1994, the DSS assessed the levels and patterns of income support and unemployment benefit fraud by interviews with some 6000 claimants to review benefit entitlement and non-compliance with benefit rules. The survey suggested that departmental error was under 5%, claimant error was 9%, proven fraud was over 5% - rising to nearly 10% when the 'strongly' suspicious and 'certain' categories were included. The monetary value of the first two areas of error were approximately the same - between £125 and £131 million - but fraud was estimated as costing over £1.3 billion. The groups most likely to commit fraud were lone parents and the unemployed while the least likely group to commit fraud were pensioners; the latter received over £30 billion in benefits, but the survey estimated the possible cost of fraud involving pensioners at £40 million.
- 5.4 In 1995, the DSS turned their attention to Housing Benefit fraud. The 1995 assessment involved nearly 5000 claimants. Departmental error was assessed at 2.6% (costing nearly £10 million), claimant error at over 10% (costing over £100 million) and fraud (using the same categorisations as the earlier survey) was assessed at 6.3% (costing over £700 million). Two-thirds of Housing Benefit claimants also claimed Income Support; 74% of the total expenditure lost through fraud occurred in this group. In monetary terms this involved £536 million, £412 million of which related to private sector tenants. The survey estimated that overall HB fraud was 8% which, with a total HB claimant population of 4.75 million, represented some 300,000 people involved in fraud.
- 5.5 In the light of this, other frauds against central and local government — including the data produced by HM Treasury on internal fraud — pale into insignificance. However, those figures do give some indication on the trends within the public sector.

Public sector fraud trends

- 5.6 The Fraud reports of HM Treasury deal with types and scale of frauds within government departments excluding those perpetrated by outsiders. They map percentage changes in incidence of categories and in addition contain useful information on managing the risk of fraud, fraud prevention and detection, with discussions on vulnerability and model fraud policy statements.
- 5.7 The H M Treasury Fraud Report for 1997/98³⁵ reviews the type of fraud committed, the cause of fraud and the means of discovery.

Type of fraud

- 5.8 The report analyses fraud by departmental staff into the following categories and gives comparatives for the last three years:

Type of fraud	1995/96	1996/97	1997/98
	£	£	£
Cheque fraud	27,000	333,200	13,300
Travel & subsistence	81,500	165,900	50,700
Misappropriation of cash	333,400	137,800	95,700
False documentation	716,200	866,600	977,000
Theft of assets	191,400	479,100	640,100
False claims for hours worked	18,500	15,300	6,500
Works services projects	0	13,400	40,000
Other	1,480,700	88,800	128,200
Total	2,848,700	2,100,100	1,960,500

5.9 As already noted, these figures are minor compared with the estimates for benefit fraud highlighted above. However, the figures are useful in that they review the causes of fraud. In 1997/98, the main causes of fraud were failure to observe existing control procedures (42%), collusion with person(s) outside the department and absence of proper control (10%). This would suggest that a proper system of controls, properly enforced, could cut more than 50% of such fraud, supporting conclusions from the private sector surveys (see paragraph 3.30 and 3.31).

5.10 These conclusions are supported by the data on the means of discovery, where the normal operation of control procedures detected 45% of frauds by departmental staff. However, third parties were other main source of information (37%). A very small proportion were detected by internal auditors (2%), with external auditors only finding one case totalling £2,500.

VI MATERIALS ON FRAUD PREVENTION

6.1 The Working Group obtained through its information-gathering process material relating to fraud prevention that it considers to be of value to the work of the Fraud Advisory Panel. It was not the job of the Working Party to consider fraud prevention or draw conclusions on it but this section is included for general consideration.

6.2 While much of the material related to diverse subject areas such as procurement fraud, IT fraud, retail and plastic fraud, the nature of much of the guidance provided makes it suitable to differing scenarios or to a general model. Many of the suggestions and observations are couched in broad terms, and similar themes, such as adequate security, controls and staff vetting reoccur across subject areas.

6.3 HM Treasury provides advice on risk management. The 1995-96 report outlines matters to be included in a fraud policy statement. It states that managing the risk of fraud is the same as managing any other risk, and outlines the steps which should be taken to do so as;

- Identify risk areas
- Assess scale of risk
- Allocate responsibility for risk

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- Identify additional controls
 - Implement the additional controls
 - Monitor implementation of controls
 - Evaluate the effectiveness of controls.

6.4 Similarly, Deloitte & Touche give a summary of anti-fraud measures in the 1996/97 report:

'Deloitte and Touche identified nine key organisational features of those organisations which have... significantly reduced their losses from fraud... conspicuous in these features is that the emphasis is on cultural controls and not on increasing the volume of detailed systematic or supervisory controls. It is also clear that the most effective companies are not passively waiting for fraud before they react to it, but are actively and continuously reviewing their operations for susceptibility to fraud...'

6.5 The key features of such organisations are:

- They state their intentions (in a fraud policy document).
- They have assigned roles.
- They learn more about fraudsters.
- They assess the risk.
- They assign priorities for action.
- They make best use of staff.
- They make the best use of information.
- They make the best use of financial assets.
- They motivate all areas to fight fraud.

6.6 Another publication by HM Treasury³⁶ concentrates on fraud risks which require specific control measures. While some aspects of managing fraud risks are specific, many of the controls designed to address fraud risks will have a wider application and will therefore form part of a general approach to risk management. This includes promoting an anti-fraud culture to create conditions in which staff have neither the motivation nor the opportunity to commit fraud, fraud policy statements to communicate the organisation's approach to fraud, fraud response plans to enable managers to act without delay in the event of a fraud and an outline of how fraud occurs, and its elements and types.

6.7 Risk management for line managers at operational level is outlined in this publication, including:

- Identify risk areas.
- Allocate responsibility for risk.
- Identify need for revised controls.
- Implement revised controls and monitor implementation.
- Evaluate controls effectiveness.

6.8 Fraud prevention and detection measures are discussed, including: Physical security - preventative measure to control or monitor access, Organising - the allocation of responsibility to efficiently achieve objectives, Supervision and checking outputs - managers scrutinise work and performance of staff, Audit trail - detective control with deterrent effect, Monitoring - measures and indicators of performance, Evaluation - of policies and activities for efficiency etc., Staffing - adequate staffing is essential for effective functioning, Asset accounting, Budgetary and other financial controls, Systems development.

6.9 Warning signs that fraud may be occurring are listed. Particular areas where fraud may occur together with suggested controls which managers can use as a checklist to assist in risk management are also considered. Areas of risk are: cash handling, payroll, grant

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- funding, purchasing, use of contractors, assets, sensitive information. The guide concludes by outlining what to do if fraud is suspected, fraud investigation and reporting, and by annexing two model fraud policy statements (long and short versions). The statements cover the definition of fraud, allocation of responsibility for fraud prevention and detection, procedures for reporting suspected cases, responsibility for investigation and policy on prosecution and disciplinary action.
- 6.10 There is a useful listing of high level fraud warning signs appended to the Auditing Standard dealing with fraud and error, SAS 110, issued by the UK Auditing Practices Board for the guidance of external auditors.
- 6.11 A number of the risk assessment and response models referred to in publications are based on generalised internal control and risk assessment frameworks such as those developed in the United States, Canada and the UK. These include respectively 'COSO', 'COCO' and, in the UK, the criteria for reviewing the effectiveness of internal financial control contained in the guidance on Internal Control and Financial Reporting issued in December 1994 for directors of listed companies after the publication of the Cadbury Report on the Financial Aspects of Corporate Governance. This subject continues to be discussed in the UK with new guidance currently being prepared by the Internal Control Working Party under its chairman, Nigel Turnbull.
- 6.12 The working group is aware that fraud risk management is further advanced in some countries than others, for example a fraud risk quality standard has been developed in Australia. The process of risk management in general and fraud risk management in particular is far from static and new tools and techniques are being developed. Increasing emphasis is being put on the overall control environment or culture within an organisation, focusing on the fact that people create risk as well as contribute to its management.

VII CONCLUSIONS AND RECOMMENDATIONS

The value of the material collected to date

- 7.1 The analysis of the abstracted material suggests that it does not provide the basis for an authoritative overview of fraud. As it stands, the material forms neither intelligence nor a source from which many trends can be detected or conclusions drawn. What is highlighted is the difficulty of drawing conclusions unless the base data is sufficient, relevant and reliable.
- 7.2 There are many statistics quoted, but they often relate to diverse and non-comparable areas. For example, statistics on insurance fraud make no distinction as to whether the fraud was reported or not, while those from the Home Office on recorded frauds give no detail as to the nature of the fraud (though recent changes in the counting rules should provide greater illumination as well as a more faithful representation of the impact of recorded fraud). The problem is exacerbated by the lack of a legal or uniform working definition or categorisation of fraud.
- 7.3 Problems also exist with the quantification of fraud. Are values perceived, suspected, proven, reported or potential? Does it contain extrapolation from representative samples? Are the samples truly representative or merely purporting to be such? Does the extrapolated figure contain a multiplier or is the figure derived from an investigation truncated by available time and resources? Is the figure limited to complaints received or detected or to frauds by a certain category of perpetrator such as employees?
- 7.4 There is no means reliably to assess the quality of the figures without an explanation of methodology. Sometimes the published material contains partial information, such as the

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- number of respondents, but not the overall size of the industry. Basic issues arise, such as the divergent time frames for figures presented and the geographical areas covered.
- 7.5 Similar issues apply to statements about trends and risks. For example, the British Retail Consortium (BRC) state that retail fraud losses (which are limited for these purposes to those of direct cost to the retailer) from plastic card fraud increased from the previous year by 44%. BRC explain, however, that this does not necessarily mean an increase in incidence but may be attributable instead to an increase in the proportion born by the retailer due to changes in bank practice or an increase in staff collusion.
- 7.6 Difficulties also arise from some but not all of the material being industry-specific, from some of the material being outdated and from the context in which it is presented. For example some reports from the accountancy firms, while valid for the relatively limited purposes they serve, are selective in the data provided and conclusions drawn and are not a suitable basis of comprehensive analysis.
- 7.7 There is very little information in the material about the causes and effects of corporate fraud. Such data as is available is subject to the problems of reliability mentioned in the preceding paragraphs.
- 7.8 It is therefore apparent that any serious study of the causes and effects of fraud in the business and wider community must look elsewhere for truly helpful and meaningful data. Whilst it may exist, it is not, it seems, readily available in the public domain. However, the identification of gaps is in itself of value and indicates the direction of possible future research.

Conclusions on the level of fraud reporting

- 7.9 The information, official or academic, concerning fraud is episodic and does not share common definitions or methodology. On the other hand, fraud is pervasive and significant. Approaches to policing, investigation and prosecution vary while resources for UK police fraud squads are limited. It may be concluded from this brief overview of current issues in fraud today, as well as the perceptions of those engaged in policing and in academic research, that:
- much fraud is high volume, relatively low cost and concentrated in certain sectors.
 - where fraud is high volume and the victims have recognised the value of co-ordinating counter-measures it is considerably more likely that actions are being taken, e.g. the development of specialised means for detection, sharing information, investigation and prosecution.
 - serious 'management fraud' or other major fraud affecting organisations is more random in the sense that it tends not to be concentrated in particular sectors. Common, though not universal, factors are its complexity and cross-border nature.
 - Police resources are limited and fraud is rarely a priority for them; the bigger the business or industry in the private sector, the less likely that policing resources will be devoted to countering fraud unless it is judged to have general 'public interest' or unless the specific activity or person(s) involved is(are) considered especially dangerous.
- 7.10 The private sector is thus both vulnerable and unprepared (in the sense that they may not be fully aware of the implications for the successful resolution of a discovered case of fraud). Its focus should therefore be on awareness, prevention and risk management, continuity and contingency.

Recommendations

- 7.11 While the material may not provide the basis for any meaningful cross-industry comparisons in terms of costs, risks or preventative measures it does provide an overview of existing types of fraud, and associated costs, which, with the caveats above, shows its pervasiveness in the public and private sectors. This report illustrates current weaknesses in determining the extent and cost of fraud, in particular putting a figure on the overall cost of fraud
- 7.12 The gaps in the Working Party material do, however, suggest where the Working Party may wish to concentrate its focus for future work. Much of reported fraud is high-volume, low cost. Thus cheque and credit card fraud, retail fraud, and benefit fraud may be costly in their totality but they involve significant numbers of individuals at a low level either in the organisation or at the levels at which they are interacting with the organisation. These frauds do not appear to threaten business reputation or continuity. At the same time, the existence of either significant anti-fraud capabilities (as with the 6000 investigators in the Benefits Agency) or a functioning industry representative organisation, part of which is dedicated to dealing with the fraud (such as the ABI or CIFAS), suggest that the issues have been identified and addressed by the industry concerned.
- 7.13 While the Fraud Advisory Panel may want to take an overview on the impact of such fraud on an industry basis, or on the cross-industry impact, or on the best practice from one industry that may be of interest to another, it is fraud that is either being addressed elsewhere or it is fraud that does not threaten the overall well-being or reputation of business or of major businesses.
- 7.14 The Fraud Advisory Panel may wish to concentrate on both these aspects, in part to take the lead in developing common approaches to (and a possible database for) reporting of fraud, risk management or fraud prevention.
- 7.15 It may wish to concentrate on the private sector, with a particular focus on those parts of the sector where reputation and size have significant impact or visibility in the sector and on those levels within organisations and relevant agencies where attitudes and approaches to the risk and vulnerability to fraud will have a sector wide impact - that is, at senior management or Board levels. Focusing attention at such levels may have much more impact in terms of awareness, education and responsiveness than at other levels.
- 7.16 This latter approach may wish to address a number of issues:
- a focus on major/FTSE 100 companies at Board level.
 - evidence of material threat to business - what threats, what vulnerability, higher level fraud - through confidential surveys and/or case-studies.
 - fraud in the post-Cadbury and Greenbury contexts in terms of risk management, priority management and fraud policies linked to governance.
 - how other sectors deal with fraud at executive or organisational levels, such as the NHS control assurance project for Trusts or the Audit Commission.
- 7.17 Any detailed review of the private sector could adopt two main approaches:
- Industry specific, i.e. concentrating on fraud in specific industries to fill the very obvious gaps in published material, e.g. telecommunications, banking and insurance industries;
 - Fraud specific - a particular kind of fraud known to afflict industry generally, for example fraud in purchasing, could be targeted by a cross industry approach.

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- 7.18 Research should focus on types of fraud affecting large companies, the consequences of fraud in terms of the impact on all stake holders and economic consequences, organisations most at risk, effectiveness of corporate governance including risk management and consideration of effective anti fraud measures from the public and private sectors should be considered.
- 7.19 Co-operation with major industry and commercial bodies is vital to achieve effective and relevant results. Research methods should be tailored to desired aim and a new working party should be appointed to carry out the research.
- 7.20 The work of the Panel will lose impact and value if it is not communicated effectively to UK business. Standard methods of publication should be considered and it is also recommended that:
- Research into the design and content of an Internet Website be carried out.
 - The design and content of an information database on fraud information, trends and prevention be considered. This could be accessed through the Website or be a stand-alone product transmitted electronically.

¹ Ernst & Young *Fraud: the Unmanaged Risk* 1996

² Serious Fraud Office *Annual Report 1997-98*

³ British Transport Police *Crime Statistics 1996*

⁴ City of London Police *Crime Statistics 1996*

⁵ Ministry of Defence Police *Crime Statistics 1996*

⁶ West Yorkshire Police *Crime Statistics 1996*

⁷ Association of British Insurers Press Release 13 May 1999 (www.abi.org.uk)

⁸ Serious Fraud Office *Annual Report 1997-98*

⁹ KPMG *Fraud Barometer* 1996

¹⁰ Ernst & Young *Fraud: the Unmanaged Risk* 1996

¹¹ Benefit Fraud Inspectorate *Annual Report 1996/97*

¹² Dr A Higson *Why is Management Reluctant to Report Fraud? An exploratory study*. Fraud Advisory Panel, 1999

¹³ HM Treasury *Fraud Report 1994-95*

¹⁴ Auditing Practices Board *Fraud and Audit: Choices for Society* 1998

¹⁵ Serious Fraud Office *Annual Report 1997-98*

¹⁶ Metropolitan Police *Fraud Statistics 1997/98*

¹⁷ Home Office *Criminal Statistics for England & Wales 1996*

¹⁸ Serious Fraud Office *Annual Report 1997/98*

¹⁹ Metropolitan Police *SO6 Fraud Statistics*

²⁰ Home Office *Criminal Statistics for England & Wales 1996*

²¹ Institute of Chartered Accountants in Australia *Taking Fraud Seriously - issues and strategies for reform* 1998

²² Association of Certified Fraud Examiners *Fraud Survey 1997*

²³ Ernst and Young *Fraud the Unmanaged Risk, An international survey of the effects of fraud on business* May 1996 plus UK Supplement.

²⁴ Auditing Practices Board *Fraud and Audit: Choices for Society* 1998

²⁵ AEM/The Industrial Society - Article in Personnel Today *Industrial Espionage, A Secret Affair*

²⁶ Deloitte & Touche *Fraud without Frontiers A Study for the European Commission of International Fraud within the EU*

²⁷ Audit Commission, Audit Commission Update *Ghost in the Machine, An Analysis of IT Fraud and Abuse* February 1998

²⁸ Deloitte & Touche *Inside Fraud* January 1998

²⁹ National Investigation Service *Annual Report 1995/96 and 1996/97*

³⁰ Ernst and Young *Fraud the Unmanaged Risk, An international survey of the effects of fraud on business* May 1996 plus UK Supplement

³¹ Audit Commission, Audit Commission Update *Ghost in the Machine, An Analysis of IT Fraud and Abuse* February 1998

³² British Bankers Association *Tables of Combined Member Banks General Fraud Losses 1995 - 1998*

³³ British Retail Consortium *Retail Crime Survey 1997*

³⁴ Association of British Insurers *Crime and Fraud Prevention Report 1998*

³⁵ HM Treasury *1997 - 98 Fraud Report. An analysis of reported fraud in government departments* December 1998.

³⁶ H M Treasury *Managing the Risk of Fraud, A guide for managers* December 1997