



SPECIMEN

good practice in

SPECIMEN

tackling external fraud



NAO
NATIONAL AUDIT OFFICE



H.M. TREASURY





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foreword

Reports published by departments, HM Treasury, the National Audit Office and the Committee of Public Accounts show that much good work is being done across departments to prevent and detect fraud against public funds. But billions of pounds of public money are still lost each year through external fraud. These losses arise from a wide range of different types of fraud. At one end of the scale are individuals who see an opportunity to make a small gain. At the other extreme a relatively small number of organised crime groups carry out premeditated systematic attacks for large sums of money. The law abiding public have the right to expect government departments and agencies to safeguard public funds and to crack down on those committing fraud.

All types of fraudsters weigh up the potential gains against the risk of getting caught and the sanctions they may face. Government departments and agencies need to make fraud as unattractive as they can. Not acting against fraud can undermine the reputation, integrity and professionalism of the organisation and perceptions about the quality of the services it provides leading to a loss in public confidence.

A number of departments are carrying out fraud risk assessments to show the scale of the problem and are assessing how these risks can be reduced. Total elimination of fraud is unlikely ever to be achieved, but it is important for momentum to be maintained, and good practices developed and shared.

The purpose of the guide is to demonstrate and explain some of the good practices used by organisations in tackling external fraud. It includes checklists to help you assess your current practices. The guide should be of interest to public sector managers who are responsible for expenditure programmes and for protecting revenue, including policy staff, financial managers and internal auditors. Smaller departments and agencies will need to consider how practices used in some of the larger departments can be adapted and applied to their own circumstances.

We are grateful for the help provided by the departments and other organisations in producing this guide.

Sir John Bourn,
Comptroller and Auditor General

Gus O'Donnell,
Permanent Secretary, HM Treasury

introduction

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- 1** This guide concentrates on external fraud which is where third parties, such as businesses, individuals or organised crime groups, steal money from a department or agency, either by obtaining payments to which they are not entitled or keeping monies they should pay over to the department. Frauds may be opportunistic attempts by individual customers or businesses to obtain a financial advantage. The sums involved in any one such case may be small, but these can mount up to significant losses of public money if there are a lot of cases involved. At the other end of the scale, departments or agencies may suffer from more systematic and premeditated attacks by organised crime groups. These may be fewer in number but the losses in each case are substantial. In some cases fraudsters may work in collusion with the department's staff. As well as diverting money that should be spent on public services fraud can undermine the position of honest citizens and businesses and support the activities of those involved in other serious crime.
- 2** The offences generally referred to as fraud are covered in the Theft Acts of 1968 and 1978 as amended by the Theft (Amendment) Act 1996. But, there are also offences of fraud specific to particular departments' activities. For example, fraudulent evasion of VAT is included in the Customs and Excise Management Act 1979 and the VAT Act 1994, and of income tax in the Finance Act 2000. In July 2002 the Law Commission recommended that the eight offences of deception under the Theft Acts 1968 to 1996 and the common law offence of conspiracy to defraud, be replaced with new statutory offences for fraud and obtaining services

dishonestly¹. The aim was to simplify the law on fraud while making it more comprehensible, effective and responsive to developments in technology.

- 3 All government departments and agencies have a responsibility to develop anti-fraud policies to show those seeking to defraud the government that such action is unacceptable and will not be tolerated.² The annual "*Statement on Internal Control*" summarises the processes used to identify and manage risks including fraud.³ And the Proceeds of Crime Act 2002⁴ and Money Laundering Regulations 2003⁵ have placed responsibilities on regulated entities, and every person carrying out "relevant business" within the meaning of the Regulations, to report where they know, or suspect, or have reasonable grounds to know or suspect, that money laundering is taking place. For example, a Government department may receive an overpayment in order for the money launderer to receive a clean cheque in return. These reporting responsibilities also apply to the National Audit Office as external auditor. Money laundering now involves not only the direct proceeds of crime, but any dealings with criminal property. It now includes possessing, or in any way dealing with, or concealing, the proceeds of any crime. Any failure to report suspicions of money laundering is now a criminal offence. Regulated entities must take appropriate measures to ensure that key staff are aware of the provisions of the Act and the Regulations, and appoint a Money Laundering Reporting Officer to report their knowledge, or suspicions, to the National Criminal Intelligence Service.

- 4 Departments and agencies face a wide range of different risks from external fraud which are demonstrated in **Figure 1 on page 5**. There are also many other types of fraud perpetrated by third parties, such as fraud by contractors. In some departments or agencies external fraud is a sizeable and continuing problem for their main business but in others it may only occur occasionally.
- 5 Departments should consider whether they need to develop a package of measures specifically tailored to each type of fraud. There will not be a one size fits all approach. But there is much value in promoting a wider understanding of how others tackle fraud, and good practices which are successful elsewhere. Smaller departments and agencies should consider whether they can adapt and apply practices used by larger departments in tackling fraud.

1 The Law Commission Report on Fraud No. 276: July 2002 - http://www.lawcom.gov.uk/files/lc_276.pdf

2 Government Accounting 2000 - Section 5, Departmental responsibilities in managing the risk of fraud - <http://www.government-accounting.gov.uk/current/frames.htm>

3 Government Accounting 2000 - Section 21, Departmental responsibilities in managing the risk of fraud - <http://www.government-accounting.gov.uk/current/frames.htm> and

HM Treasury: Managing the Risks of Fraud: A Guide for Managers http://www.hm-treasury.gov.uk/media/404F9/Managing_the_risk_fraud.pdf

4 Proceeds of Crime Act 2002 -

<http://www.legislation.hmsso.gov.uk/acts/acts2002/20020029.htm>

5 The Money Laundering Regulations 2003 (Statutory Instrument 2003, Number 3075) - <http://www.legislation.hmsso.gov.uk/si/si2003/20033075.htm>

6 The guide shows how a number of departments are tackling fraud by taking an integrated strategic approach which are summarised in **Figure 2 on page 6**. It also explains why they are taking this approach and what it involves. The strategic approach accords with the HM Treasury's guidance "*Management of Risks: A Strategic Overview*"⁶ and "*Managing the Risk of Fraud: A Guide for Managers*" which provide guidance on the identification and management of risk, and guidance on controlling identified fraud risk to acceptable levels of exposure.

7 The guide is structured as follows:

- Understanding and managing the risks of external fraud (Part 1);
- Preventing and deterring external fraud (Part 2);
- Detecting and investigating fraud and imposing sanctions (Part 3);

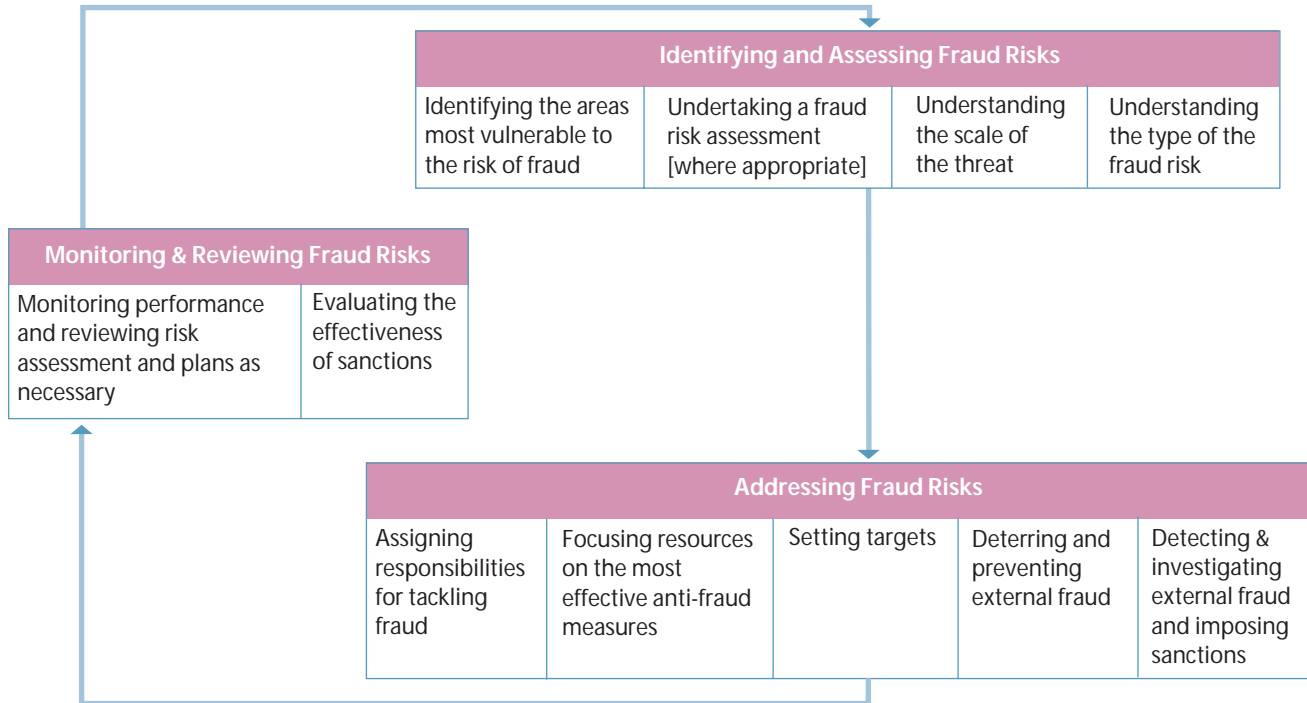
Questions at the beginning of each Part are to help you assess your organisation's practices. If you are not using a particular practice you will need to consider whether that is appropriate given your circumstances.

8 We hope that the guide is a useful source of reference for public sector managers in demonstrating the experience and good practice of others. It does not seek to provide "everything you need to know" to tackle external fraud. To do so would require many volumes. However, the guide provides references to useful sources of information and gives links to where these are available on websites. The case examples in the guide are for illustrative purposes only. There may be many other examples in use in other departments or agencies.

FIGURE 1 | The diversity of external frauds faced by the public sector

- Benefit claimants who fail to declare all earnings, income or capital, or who conceal family circumstances, to obtain benefits to which they are not entitled;
- People who claim exemption from paying for prescriptions to which they are not entitled;
- Dentists who claim for treatments which they have not carried out;
- People who evade vehicle excise duty;
- People or businesses who claim grants to which they know they are not entitled;
- People who work in the shadow economy and do not pay income tax or national insurance contributions on their earnings. They may also claim means tested benefits from the Department for Work and Pensions to which they are not entitled;
- Businesses which operate in the shadow economy and do not declare their activity or pay corporation tax, income tax, National Insurance contributions or VAT;
- People and businesses who register with HM Customs and Excise or the Inland Revenue but fail to declare all transactions/income or assets on which tax is due;
- Staff colluding with criminals to defraud the department or agency. For example in 2002 a manager in a department sold confidential information to a criminal gang enabling them to steal £2.7 million;
- Serious criminals obtaining large sums, for example, through evading tobacco, alcohol and hydrocarbon oil duties. They may set up what appear to be legitimate companies but intend to carry out frauds on the tax authorities, such as to steal VAT. They may also commit organised fraud against the benefit system through stolen, forged or counterfeit instruments of payment and through creating fictitious benefit claims.

FIGURE 2 | The main elements of an integrated strategic approach to tackling fraud



part one

Understanding and managing the risks of fraud

"We know that each pound lost to fraud diminishes the quality of NHS healthcare that can be available."

Jim Gee, Chief Executive,
NHS Counter Fraud
Service

In looking at this Part of the guide, ask yourself whether your organisation:

- takes a strategic approach to tackling fraud risk;
- assesses the size of the threat from external fraud and, where significant, undertakes a separate fraud risk assessment;
- identifies the areas most vulnerable to the risk of fraud;
- knows the size of the fraud threat / types of fraud committed/ who is committing them/ how often/ and how much is involved ;
- has a package of measures in place to tackle losses from fraud where these are significant;
- has targets to stabilise or reduce fraud;
- has allocated responsibilities for tackling, and ownership of, fraud risks to ensure that risks are managed, plans are implemented and progress monitored.

This Part of the guide looks at how you can tackle some of these issues and gives examples of how others approach these issues. As you read through the guide you will need to consider how appropriate the practices are to your circumstances.

Taking a strategic approach to tackling external fraud

1.1 Some organisations have taken a strategic approach to understanding and managing the risks of fraud because this:

- fits in with good corporate governance. A major element of good corporate governance is a sound assessment of the organisation's business risks. Fraud risk should be managed in the same way as managing any other business risk and should therefore be approached systematically at both the organisational and operational level;
- helps with developing a range of measures which apply proportionate and well targeted pressure at all levels of the problem;
- can help achieve a cost effective approach in tackling fraud by focusing on areas of greatest risk and where efforts may have the greatest impact. A strategic approach can provide a rational and robust basis in bidding for additional resources to tackle fraud, where needed;
- can be a helpful way of communicating to staff what the organisation is trying to do and what is expected from them. Some organisations have also published their strategies as a way of informing the public that they have a well thought out approach to tackling external fraud. This can also send a deterrent message to potential

fraudsters that they are less likely to succeed in attempts to commit fraud against the organisation. As examples, HM Customs and Excise, the Department for Work and Pensions and the NHS Counter Fraud Service have published their strategies.

Figure 3 shows examples of how Departments and agencies have reduced external fraud and **Figure 4** provides the main elements of a strategy to tackle external frauds.

FIGURE 3 | Examples of how external fraud has been reduced

The Driver and Vehicle Licensing Agency has estimated that enforcement activities (such as prosecutions and out of court settlements) reduced evasion of Vehicle Excise Duty by £69 million in Great Britain in 2002-03. And they consider that the deterrent effect of measures such as publicity campaigns and prosecutions generated some £41 million revenue from "induced" relicensing for the same period. These two types of actions reduced gross evasion loss from £193 million to around £83 million.

The NHS Counter Fraud Service estimate that losses from patient pharmaceutical fraud have fallen by £70 million since 1998-1999 to £47 million in 2002-2003; a reduction of 60 per cent.

FIGURE 4 | The main elements of a strategic approach to tackling external fraud

1.2 In taking a strategic approach, some departments and agencies have taken an across the board approach to looking at external fraud, and some have looked at individual fraud risks and produced a strategy for each. Others tackle fraud within the context of an overall strategy to combat losses from all types of non-compliance. The overall compliance approach recognises that there is a 'loss continuum' ranging from inadvertent customer error at one end of the spectrum to fraud at the other with shades of grey in between. All of these approaches can be equally valid depending on a department's circumstances and the stage they are at in developing their approach (Figure 5). However, a common feature is that the departments and agencies have developed fraud risk assessment tools to identify the fraud risks, their likelihood and impacts, and how to manage them. These need to be reviewed to assess whether they remain appropriate or require updating to respond to the threat from new fraud risks.

"Our strategic approach to tackling fraud has enabled us to protect billions of pounds of public revenue"

Tony Walker, Head of Tax Strategy Division, HM Customs and Excise

FIGURE 5 | Examples of counter fraud strategies

The Department for Work and Pensions have developed a counter fraud strategy for all welfare benefits. First set out in 1999, the strategy proposed action on four fronts:

- Getting it right - aiming to get benefit payments correct from day one;
- Keeping it right - ensuring payments are adjusted as circumstances change;
- Putting it right - detecting when payments go wrong and taking prompt action to correct them with appropriate penalties to prevent a recurrence;
- Making sure the strategy works - by monitoring progress, evaluating the strength of preventive measures and adjusting them in the light of experience.

The Department seek to ensure that their goals of supporting people in their efforts to find work, whilst providing appropriate financial support where necessary, are not compromised by their efforts to prevent fraudulent abuse of the benefits system. Their Fraud Strategy Unit has developed a specification of the resources to be used on fraud investigation and target activity levels for investigations into different types of frauds.

The **NHS Counter Fraud Service's** strategy consists of seven objectives:

- The creation of an anti-fraud culture;
- Maximum deterrence of fraud;
- Successful prevention of fraud which cannot be deterred;
- Prompt detection of fraud which cannot be prevented;
- Professional investigation of detected fraud;
- Effective sanctions, including appropriate legal action against people committing fraud;
- Effective methods for seeking redress in respect of money defrauded.

HM Customs and Excise's approach to tackling revenue losses entailed moving from an essentially tactical approach, where success was defined in terms of outputs, to a strategic approach based on the achievement of outcomes which have a direct and measurable impact on the problem. This change of approach led to the development of the Tackling Tobacco Smuggling Strategy in March 2000, and has now been used to develop strategies to tackle VAT losses, oils fraud and alcohol fraud. HM Customs and Excise's approach to tackling fraud has six key components:

- The development of reliable estimates of the size of fraud across a range of indirect taxes;
- Establishing the nature and economics of the fraud through the analysis of intelligence;
- Operational responses based on the analysis of the fraud and assessment of the most efficient and effective means of tackling it;
- Establishing and delivering ambitious outcomes;
- Assessing any changes required to strengthen the control regime to prevent exploitation by fraudsters;
- Monitoring effectiveness against key outcomes to measure the success of the strategies.

Assessing the scale of the fraud threat

1.3 Assessing the scale of loss from fraud is an important first step in developing a strategy for tackling external fraud. An estimate highlights the scope for potential savings which can then help to determine the relative priority that should be given to tackling fraud in the context of all the other calls on an organisation's resources. Such estimates then establish a baseline against which performance can be judged. If repeated at intervals, estimates can help an organisation assess how well they are doing and whether the threat is changing. There may be circumstances where an organisation decides it is not practicable to produce overall estimates. Nevertheless they may be able to use a range of techniques such as carrying out in-depth research into an area where fraud is suspected to gain a better understanding of the scale and nature of the threat (Figure 6).

1.4 Some may say that:

- It is too difficult to produce estimates of fraud and that it is not worth attempting to do so;
- The resources used to produce an estimate could be better used on tackling fraud, for example, by carrying out more investigations.

These issues are dealt with below.

Producing reliable estimates

1.5 A number of departments have produced estimates of fraud or losses from fraud and error. For example, HM Customs and Excise have produced estimates of overall losses on VAT and of particular types of loss such as missing trader fraud. They have also estimated losses from tobacco smuggling, frauds on hydrocarbon oils duty and spirits duty.

FIGURE 6 | The Inland Revenue's approach to measuring taxpayer compliance

The Inland Revenue are using, or developing, a range of techniques to measure compliance. Their techniques fall under one of three categories:

- audit based studies - random enquiry programmes to provide estimates of non-compliance and to facilitate research into understanding the risks of non-compliance in specific taxpayer and customer groups;
- modelling techniques applied to compliance data to explain or predict taxpayer non-compliance;
- distinct datasets involving the comparison of compliance data and estimates of economic activity, for example comparing Corporation Tax self-assessment payments with reported profits from externally available accounts and comparing like companies to identify irregular behaviour.

1.6 Departments have used operational research and statistical methods to produce such estimates. Two main methods used are **statistical modelling** and **sampling**.

Statistical modelling

1.7 Statistical modelling has been used to produce overall estimates of fraud or loss notably on revenue activities. This involves comparing levels of actual receipts or expenditure with the total level of receipts or expenditure that might be expected using other sources of data on the level of activity under review (**Figure 7**).

1.8 Points to consider for statistical modelling are:

- The data required may be incomplete. Therefore, the model may use a number of assumptions which mean that the results are subject to a margin of error. It is important to take this into account when making decisions on actions to reduce losses;
- Other work may be needed to give an insight into those committing the fraud or the type of action that might deter them. This may include more in depth modelling work (see Figure 12 on the BBC);
- Further research may be needed into the causes of increases or decreases in the level of losses and the extent to which this is due to anti-fraud measures implemented.

FIGURE 7 | Examples of statistical modelling

Estimated evasion rates on the **television licence fee** are calculated using a statistical model. In summary, the model estimates the level of evasion by subtracting the number of licences currently in force from the estimated number of properties for which a licence should be held. Repeating the modelling process at regular intervals has shown an overall downward trend in the evasion rate in recent years.

HM Customs and Excise produce a top-down estimate for losses on VAT. This entails comparing the total level of expenditure in the economy that is theoretically liable for VAT with actual VAT receipts and assuming that the difference represents the total revenue loss. The theoretical tax liability is a global measure based mainly on data from the Office for National Statistics. Bottom up estimates can be used in combination with the top level estimates as a means of validating the level of losses. Methods to produce bottom up estimates include surveys and use of administrative and operational data.

Sampling

1.9 Estimates of loss can be generated by checking a representative sample of cases to see whether fraud is involved, and extrapolating the results to the whole population to estimate the total level of fraud loss in the area of expenditure or revenue (**Figure 8**). When checking individual cases it can be difficult to determine whether any discrepancy is due to fraud or error (recklessness, carelessness

or ignorance) because of the judgements that need to be made. In their work in estimating fraud in individual expenditure streams, the NHS Counter Fraud Service are deciding whether fraud is involved by using the concept of fraud and burden of proof applicable in civil law - that is whether someone knowingly or recklessly obtained resources to which they were not entitled and the balance of probability. This is to ensure that all behaviour which can legally be determined as fraud is measured.

FIGURE 8 | How the Driver and Vehicle Licensing Agency use sampling to estimate the amount of evasion of Vehicle Excise Duty

The Driver and Vehicle Licensing Agency use periodic roadside surveys to estimate the level of Vehicle Excise Duty lost as a result of evasion. Contractors employed by the Department record the number plates of vehicles using public roads at 256 sites throughout the United Kingdom during a given period. The Department's statisticians then compare the number plates recorded in the survey to the details held on the vehicle databases of the Agency to estimate the number of unlicensed vehicles in each area. To ensure a statistically valid estimate of the national evasion rate, the data analysis is weighted for traffic volumes in different areas, and adjusted to compensate, for example, for the likelihood of repeat sightings of individual vehicles.

- 1.10** A key consideration in producing an estimate of fraud loss on an area of expenditure/revenue is the level of accuracy required. A greater degree of precision produces more reliable estimates (essential for assessing any real change in the level of fraud over time) but at additional cost because the size of the sample required increases (**Figure 9**).
- 1.11** For some organisations, producing a national estimate may be sufficient. In others, it may be necessary to produce estimates which are also broken down by region. This will have important implications for the sampling exercise and its costs, as separate samples within each region increase the total sample that must be checked (**Figure 10**).

FIGURE 9 | Generating precise estimates requires larger sample sizes and incurs higher measurement costs

The degree of precision of a fraud loss estimate depends on:

- The size of the sample checked. For example, the NHS Counter Fraud Service set sample sizes so that they can determine the level of fraud in each area to within to +/- one per cent;
- whether the sample is stratified according to the type of risk;
- use of skilled reviewers able to detect where fraud has occurred, the amount of loss suffered and the nature of the fraud;
- the quality control and validation arrangements to ensure the review process is correctly and consistently applied.

FIGURE 10 | Generating regional estimates of fraud loss involves larger sample sizes

Where a department need estimates of the fraud loss within each of their regions, it will have to take a separate sample of transactions in each. To produce estimates that are sufficiently precise to reveal any important differences between regions in the rate of fraud loss requires the sampling of a much greater number of transactions than when generating only a national level estimate.

Regional sampling, will reveal which regions suffer the greatest and lowest levels of fraud loss and whether there are significant changes between regions over time. For example, the Department for Work and Pensions produce annual estimates of the level of fraud and error in each region. The 1997-98 baseline showed wide variation in the level of loss. The Department set internal targets for each region to reduce its level, with a further objective being to reduce the variation in levels between regions. The Department targeted the regions suffering the highest baseline levels of loss to make the greatest reductions. The Department's random sample of over 40,000 cases a year covered each of nearly 100 districts, three times a year, split between each type of benefit claimant.



Costs of estimating fraud

1.12 As indicated above, the costs of measurement vary according to:

- the frequency of the estimating exercise;
- the sample sizes checked;
- the work involved in checking each case sampled;
- the work involved in validating the results.

1.13 For smaller departments and agencies, a one-off estimate or one produced at intervals may be sufficient. Accepting less precision by using smaller sample sizes may be one way forward. Although the results will be less reliable, these will indicate whether further work is desirable. Others may require continuous measurement exercises to produce ongoing estimates of fraud loss. While this involves greatest cost, it does mean that a department is able to track changes over time in the estimated fraud loss, and the types of fraud committed. **Figure 11** outlines the Department for Work and Pensions' continuous measurement approach.

1.14 Costs can be spread over several years by carrying out a rolling programme of estimates. For example, HM Customs and Excise have estimated the levels of loss on those taxes where the losses are considered to be highest. Over a period of time they are planning to estimate losses on other taxes where the losses are thought to be less significant. The NHS Counter Fraud Service have set out to estimate the level of fraud within eight main areas. So far they have produced

FIGURE 11 | The Department for Work and Pensions' continuous measurement approach

The Department for Work and Pensions spent £5.8 million in 2001-02 as part of their ongoing measurement of fraud and error in Income Support and Jobseeker's Allowance. The latest estimate shows that in 2002-03, fraud losses were £490 million on Income Support and £130 million on Jobseeker's Allowance (6.4 per cent of expenditure on these benefits of around £9.7 billion) and total losses across all benefits were around £2 billion.

The Department have produced estimates of the incidence and magnitude of fraud, customer and official error in these benefits every six months since 1998.

The Department are now carrying out a continuous measurement review of Housing Benefit (at a cost of £3.2 million in 2001-02). Departmental subsidies and rebates to local authorities for Housing Benefit and Council Tax Benefit were around £9 billion in 2001-02.

The Department have carried out a programme of reviews for other benefits. The Department's aims are to produce snapshot estimates of the amount of fraud and error. The size and risk of potential loss determine which benefits are reviewed and how frequently. They are committed to introducing a measure of fraud and error in Pension Credit.

estimates for four expenditure streams and plan to complete the other areas over the next few years. Another alternative is to carry out a one-off measurement exercise (with possible follow up several years later) to confirm the significance of the level of fraud. This can be a useful approach where the level of fraud is thought to be less significant.

Understanding the types of fraud risks

- 1.15** A department or agency will be unable to develop an appropriate response based only on the estimates of fraud. They also ideally need to know:
- the types of fraud perpetrated against them, for how long and the financial loss involved;
 - who the fraudsters are, their characteristics and behaviours, how often they carry out the frauds, which types of frauds they commit, how they do it, and whether they are opportunistic or organised.
- 1.16** Examination of detected fraud cases either from investigation or from the random samples of cases examined to produce estimates of fraud loss, can give an insight into these risks (**Figure 12 overleaf**). Larger departments which face serious threats also have intelligence analysts and/or commission research into the threats. At the other end of the spectrum, there are some departments and agencies that may have few or no recent instances of external fraud. Checking a sample of cases, or carrying out research into the possible threats, will help to confirm whether the risks from fraud are low.

FIGURE 12 | Examples of work organisations have done to understand and manage fraud risks faced

The **BBC** have commissioned market research programmes, over a number of years, which have shown that evaders of the television licence fee vary both in their behaviour and their attitude to the licence fee. Overall the research indicates that non-payers are more likely to be younger people and less well off. They also tend to regard the licence as unfair or "just a tax you get nothing for". Further research was carried out to model the evader population by matching evasion rates for postcode areas with commercially available data on income and life style. This information helped to identify the characteristics of those most likely to evade. Areas with high evasion rates are most likely to have, for example, a higher than average proportion of younger people, low income households, and students and single parent families, and a level of County Court judgements 50 per cent above the national average.

The **Department for Work and Pensions** collect information about the types of fraud, the characteristics of the customers and the way the fraud and customer errors are detected. These help the Department target resources to detect and prevent fraud.

For example, the Department estimate that the average sum lost on a fraudulent Income Support claim is around £73 a week. Many detected frauds on Income Support are found to have lasted a year or more (indicating an average loss due to Income Support fraud of £3,800 a year).


For Income Support, the Department generate separate estimates of fraud and error for each of their three main client groups - Lone Parents, Pensioners and Disabled people/Others. The measurement reviews also provide estimates of the main causes of fraud and error and the proportion of benefits overpaid due to each cause. For example, this enabled them to estimate that in 2001-02, 1 in 13 lone parent Income Support claims were fraudulent and that the failure to disclose they were living together with a partner was the cause of 40 per cent of the Income Support overpaid in fraud and error.

The **Inland Revenue** have identified groups posing a high risk of understating taxable profits. They have trialled a new 'leverage' approach to exert direct influence on individuals identified as being within these groups. The results show that their approach has reduced understated profits. Based on this success, they are extending both the scope and scale of their work to tackle fraud and evasion.

The Inland Revenue have also taken action to identify and combat specific risks, for example the use of complex offshore financial arrangements to conceal the proceeds of fraud. In response to this significant risk the Inland Revenue created a specialist Offshore Fraud Projects Group, which actively seeks out individuals who have concealed their wealth in offshore trust structures.

HM Customs and Excise have split their estimate of VAT losses into losses from VAT missing trader fraud (a serious fraud which exploits European Community trading arrangements), VAT avoidance, failure to register for VAT and general non-compliance. Splitting their estimate of loss in this way allows Customs to understand the different risks posed by different elements of the trader population and to focus their resources accordingly.





"The Committee of Public Accounts has encouraged departments and agencies to benchmark the effectiveness of their anti-fraud measures and focus their resources on those which either generate the highest financial rates of return or offer significant non-financial benefits."

Edward Leigh, Chairman of the Committee of Public Accounts

Focusing resources on the most effective anti-fraud measures

1.17 There is no single package of measures which can be applied universally by departments and agencies to tackle fraud. Measures need to be tailored to the type and size of threat faced. In deciding which measures to use and the extent to which to use them some departments have assessed the savings that could be achieved by targeting their resources in a better way. Savings could arise in three ways:

- the direct effects from recovering amounts defrauded. Where the measures involve reallocating resources into existing activities the department can look at current costs/savings as a basis for estimating the return from increasing the levels of counter fraud activity. Where new measures are proposed, it is good practice to pilot these beforehand to test and refine their operation, assess their likely effectiveness and the type of savings that can be achieved;
- the preventive effect, through improved future compliance from those previously detected committing fraud. For example, HM Customs and Excise assume that the VAT yield will increase immediately from traders previously detected committing VAT fraud, but that this additional yield will gradually reduce if no further checks are subsequently made;
- the deterrent effects on others that become more compliant as they learn of the greater efforts being taken to crack down on fraud. In practice it can be very difficult to assess these deterrent effects with any accuracy and departments do not always seek to do so.

Setting targets and monitoring performance

1.18 Some departments have set targets to stabilise or reduce fraud over a period of time (Figure 13). Focusing targets on the overall level of fraud or loss is a good way of assessing performance, and generally a better measure than the amount of fraud or loss detected. The latter is difficult to interpret if the full scale of fraud or loss is not known. Other measures of

performance are useful complements to estimates of total fraud loss, such as changes in regional levels of loss, the cost of tackling fraud compared to the return obtained and the rate of recovery of detected frauds.

FIGURE 13 | Examples of Departmental targets to reduce fraud and error

The **Department for Work and Pensions** have Public Service Agreements to reduce the loss from customers of:

- Working age, from Income Support and Jobseeker's Allowance, by 50 per cent by March 2006, against a 1997-98 baseline;
- Housing Benefit by 25 per cent by 2006, against a 2002-03 baseline;
- Pension Credit by 20 per cent by 2006 against a 2001-02 baseline;

The proportion of working age Income Support and Jobseeker's Allowance overpaid due to fraud and error in 2002-03 fell by 30 per cent from the 1997-98 baseline.

The **NHS Counter Fraud Service** have Public Service Agreement targets and have used their measurement exercises to monitor progress against them:

- Reduce by 50 per cent evasion of prescription charges by patients by the end of 2002-03;

Achieved - Pharmaceutical patient fraud reduced from £119 million to £47 million (a 60 per cent reduction).

- Within prescription fraud perpetrated by NHS contactors, to prevent £9 million in fraud and to recover a further £6 million by the end of 2001-02;

Achieved - By the end of 2001-02, prevention savings of £9.3 million had been secured and a further £7.5 million had been recovered.

1.19 Performance data on outcome targets may not be available until long after the period measured due to the amount of work involved in sampling cases, checking, calculation and validation of the results. To monitor performance in-year, managers may rely on output results to indicate whether the outcomes are likely to be achieved. For example, managers may monitor:

- the results of operational checks on transactions;
- fraud investigation activity and outcomes (see Part 3, Figure 30);
- number and types of sanctions imposed (see Part 3, paragraph 3.36 and Figure 38);
- rate of recovery of defrauded amounts detected (see Part 3, paragraphs 3.31-3.35).

Assigning responsibilities for tackling fraud

1.20 The responsibility for tackling fraud and managing fraud risks start at the top of the organisation within the senior management board. At this level, ownership of fraud risks is assigned and responsibilities allocated for managing individual fraud risks. Although everybody in the organisation has a role to play in tackling fraud (paragraphs 2.5 to 2.7), some departments have also set up central units or focal points with responsibility for tackling external fraud. These have coordinated work on developing the department's strategies, ensuring their implementation, monitoring results and providing advice and guidance. Fraud can be a moving target as the scale and nature of the risks change, so that regular monitoring of the situation is needed to identify and respond to new threats. A focal point for tackling fraud can help. The Inland Revenue, HM Customs and Excise, Department for Work and Pensions and NHS Counter Fraud Service each have central units (Figure 14). Where fraud numbers and losses are significant, departments also have teams of professionally trained investigators or enforcement officers dedicated to investigating cases of fraud.

FIGURE 14 | Some examples of how departments have assigned responsibilities

The NHS Counter Fraud Service remit

"To have overall responsibility for all work to counter fraud and corruption within the Department of Health and the NHS with particular priority for countering fraud in Family Health Services. To have direct responsibility for developing policy and strategy and for all operational work to counter fraud and corruption alongside that which is proper to Health Authorities and NHS Trusts. Here the responsibility of the Director of the NHS Counter Fraud Service will involve advice, guidance and the setting and monitoring of appropriate standards."

The Department for Work and Pensions Fraud Investigation Service

The Counter Fraud Investigation Service is part of the Programme Protection Division, in recognition of the importance of prevention as well as detection, and includes:

- A Joint Working Unit to ensure opportunities for working with other investigative agencies are fully exploited;
- A field intelligence function;
- A Professional Standards Unit.

1.21 Regardless of the arrangements in place, departments and agencies need to ensure that someone is fully responsible for implementing the plans for tackling fraud in the way intended and that sufficient resources are in place. Someone should also be responsible for performance against targets. There is no point in having a well thought out strategy if it is not then put into effect.

part two

SPECIMEN

Deterring and preventing external fraud

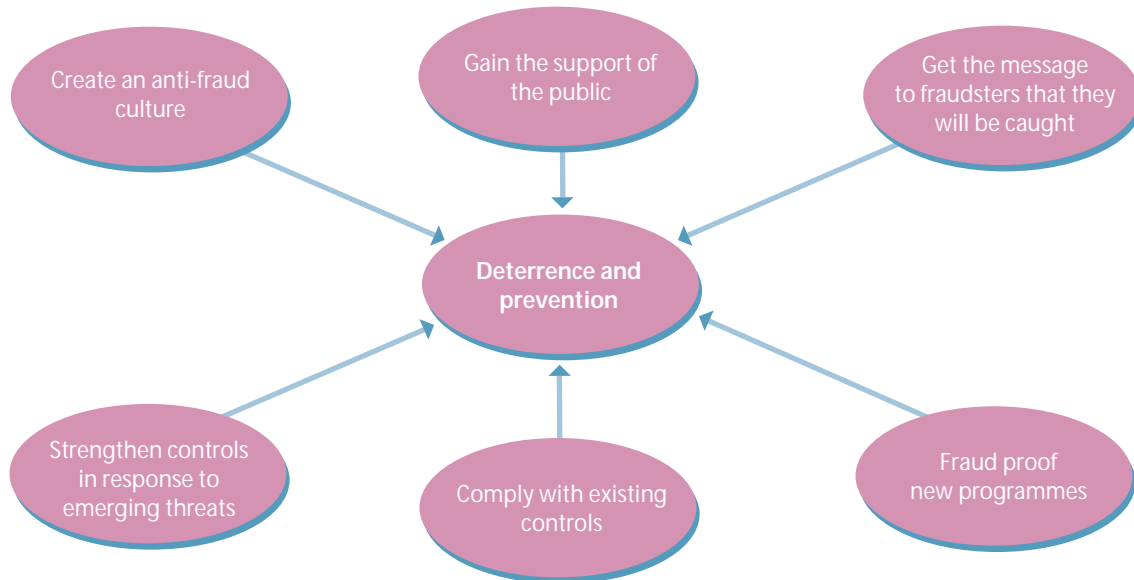
In looking at this Part of the guide ask yourself whether your organisation:

- seeks to influence customers' and the wider general public's attitudes to fraud;
- sends a strong message to potential fraudsters that they are likely to be caught and sanctions will be imposed. For example, are there press releases on people/businesses prosecuted and are there any targeted or wider campaigns regionally or nationally?
- considers the fraud proofing of new programmes;
- ensures fraud controls are applied consistently and their use is monitored. What is the role of Internal Audit in this?
- considers strengthening controls where new fraud risks appear or where fraud starts to escalate;
- has an anti-fraud culture where staff understand the standards of conduct required and their personal responsibilities in preventing fraud, applying controls and reporting cases of suspected fraud.

2.1 Deterrence involves convincing potential fraudsters that frauds against a department or agency are not worthwhile. **Prevention** measures aim to stop frauds entering departments' systems. Effective mechanisms for deterring and preventing fraud are essential elements in combating fraud. Realistically however, some fraudsters will never be deterred and not all frauds will be prevented. In these cases, prompt detection and professional investigations are needed

(Part 3). Measures to deter and prevent fraud can be costly and departments need to ensure they are well designed for greatest effectiveness. **Figure 15** sets out the main elements for deterring and preventing fraud.

FIGURE 15 | The main elements for deterring and preventing fraud



"Creating the right public climate is important in the battle to reduce benefit fraud. That is why we are using national and local media campaigns to drive home the message that benefit fraud is a crime, that people who cheat get caught and punished, and that the general public can help us defeat fraud."

John Alpass, Head of Fraud Strategy Unit, Department for Work and Pensions

Changing public attitudes to fraud

2.2 Departments have sought to influence the attitude of customers and the wider general public to fraud by deterring those who might consider committing fraud and by making fraud socially unacceptable. The aim should be to get public support in the efforts to tackle fraud. Some messages that departments have used to deter potential fraudsters from attempting fraud are:

- strong controls will stop them from succeeding; followed by
- it is likely they will be caught;
- evidence of their fraud will then be discovered;
- they will thus face penalties; and
- amounts defrauded will be recovered.

2.3 Departments have used a variety of methods to publicise the success of their work, such as issuing press releases and putting information of cases prosecuted on their websites. These are cost effective actions which can be used by smaller departments and agencies. In the United States of America the Internal Revenue Service issues periodic "TAX FRAUD Alerts" on their website warning the public of the risks and costs of buying into tax evasion schemes, as well as providing information on the latest "schemes, scams and cons". The Alerts set out in more detail the main strands of the Service's enforcement programme and the consequences of non compliance. For example, for employment taxes, the relevant "Tax Fraud Alert" provides details of legal requirements, employer and employee responsibilities, examples of tax evasion schemes, and data on how non-compliance has been dealt with in the courts including specific significant examples. To strengthen their message, some departments have used media campaigns (**Figure 16**). Before introducing a national campaign, pilots can be used to test and improve the likely effectiveness.

FIGURE 16 | Examples of Departmental campaigns to change public attitudes and to deter fraudsters

The approach used by the Department for Work and Pensions

The campaign has run in several phases, each with a different message and using different communication media. This aims to:

- reinforce honest behaviour by customers;
- create a climate of intolerance to benefit fraud among the wider public and undermine its social acceptability;
- deter potential fraudsters.

From September 2001, the campaign focused on dishonest claimants. Messages of deterrence and detection aimed to raise the fear of getting caught and portray the likely consequences. Scenarios used in television advertisements showed benefit fraudsters being caught or punished, or both. In addition, the campaign used radio and regional press advertisements, the latter featuring real newspaper headlines from fraud prosecutions.

In June 2003, the next phase used the slogan "We're on to you". It featured a spotlight that followed fraudsters in realistic scenarios, such as at work, to show them that they would be found out if they were continuing to claim benefits to which they were no longer entitled, and to warn potential cheats that benefit fraud is a serious crime.

In August 2003, a new phase used small posters on lampposts and in pub washrooms. Aiming to look like an offer of cash in hand work, the message stated that continuing to claim benefits while working was benefit fraud and would only earn the person a criminal record.

In November 2003, this phase was adapted. Small mock advertisements were placed in pubs, clubs and shop windows. The main message "Do you want to earn £££s and still sign on?" was designed to catch the eye of those considering cash in hand work, while continuing to claim benefits, to fund Christmas celebrations, and then to deter them from failing to report to the Department that they were now working.

The Department evaluate each phase of their campaign.

The approach used by HM Customs and Excise to tackle tobacco smuggling

The tobacco publicity campaign was launched as part of the measures introduced in the *Tackling Tobacco Smuggling* strategy in March 2000. The main aim was to inform the public, potential smugglers and key trade groups of what the law is and to persuade them to comply with it. This included:

- raising awareness that tobacco smuggling is a large scale criminal activity undertaken by serious and violent organised criminals;
- reminding would-be smugglers of the measures that HM Customs and Excise use to fight tobacco smuggling and the penalties for being caught; and
- discouraging ordinary members of the public from buying the illicit goods used to fund organised criminal networks.

Over four years of activity, this has been achieved through:

- Three bursts of national press advertising, supported by regional radio, billboard, washroom and beer mat advertising;

- Four bursts of trade specific advertising with the haulage trade, retailers and publicans;
- Ongoing billboard advertising in a number of United Kingdom ports and in Calais targeting HGV drivers and the travelling public;
- Billboard advertising for the last two years at United Kingdom and Canary Island airports;
- A regional campaign in the northeast of England to focus on the inland illicit selling of smuggled tobacco;
- A new television campaign to link buying smuggled cigarettes to serious crime; and
- An ongoing internet campaign targeting people who buy cheap cigarettes online. This campaign has received three prestigious media awards.


Evaluation of the publicity campaign has shown consistently high levels of awareness and support for HM Customs and Excise' messages amongst the targeted trade groups - the haulage trade, retailers and publicans. Similarly, with general public audiences, awareness of HM Customs and Excise action, the link to organised crime and of the penalties faced by smugglers has increased over the campaign period.

2.4 To maximise the deterrent effect, departments have:

- researched fraudster behaviour and risk taking / aversion to determine which messages will be most effective in changing their behaviour;
- designed media messages to achieve maximum effect;
- used relevant media to ensure potential fraudsters are aware of these messages;
- refreshed messages regularly to maintain a strong deterrent effect;
- developed performance indicators to evaluate the effectiveness of the approach. It can however be difficult to make a direct link between the campaign and reductions in fraud levels, because of other anti-fraud measures also in force;
- fed back the evaluation into renewed campaigns to deter fraudsters.

Changing staff attitudes to create an anti-fraud culture

2.5 Creating an anti-fraud culture, in which all staff understand the standards of conduct required, their personal responsibilities in preventing fraud and the importance of controls, is vital in preventing external fraud, as **Figure 17** illustrates. Publicising internally the organisation's strategic approach to tackling fraud and what it is trying to achieve can be a good way of reinforcing the anti-fraud culture.



"Fraud prevention involves more than compiling anti-fraud policies. It also involves the maintenance of an ethical environment that encourages staff at all levels to actively participate in protecting public money and property."

Brian Glicksman, Treasury Officer of Accounts

FIGURE 17 | The NHS Counter Fraud Service have emphasised the value of an anti-fraud culture in preventing fraud

The creation of an anti-fraud culture was a primary aim in the establishment of the NHS Counter Fraud Service. The Service have implemented a number of initiatives to raise awareness of individual responsibilities of NHS staff, including:

- delivering around 800 fraud awareness presentations to audiences such as primary care trusts and local practitioner committees;
- counter fraud charters covering more than 800,000 staff and professionals, over 100 patient groups and all regulatory bodies;
- a CD-Rom outlining their strategy, business process and policies, which is widely distributed to health bodies and professional associations;
- induction programmes for new staff to emphasise their responsibilities;

- specific training for key staff, such as directors of finance;
- contracts of employment for certain key staff containing a clause relating to those individuals' responsibilities;
- publicity, such as a quarterly newsletter "Protecting our NHS" to spread good practice and advertise their work.

Each NHS organisation employs a local counter-fraud specialist, and it is their responsibility to spread good practice. Internal surveys have shown a growth in awareness amongst NHS staff regarding their individual and collective responsibilities for countering fraud - in 2000-01, 74 per cent of participants recognised that countering fraud was their individual responsibility, up from 34 per cent in 1999-2000.

2.6 Training can help raise staff awareness of the risks of external fraud and the importance of compliance with internal control procedures and security checks to prevent such frauds. And close monitoring of staff compliance with these controls helps ensure their consistent application. Training may take several forms such as:

- fraud awareness workshops for a wide range of staff;
- targeted personal mentoring for staff working in areas found to be vulnerable to fraud;
- closer managerial supervision with feedback to staff on their compliance with security procedures.

2.7 A staff survey or focus group may be used to test staff attitudes to the security of controls and their compliance with controls to prevent fraud. The findings from such research can help identify opportunities to improve prevention and to strengthen internal controls, identify any messages that need to be reinforced, reveal any areas where compliance with prevention controls is insufficient and generate further information about the frauds identified by staff. **Figure 18** features how the Department for Work and Pensions have conducted survey work to assess staff attitudes to security as part of their focus on preventing benefit fraud.⁷

7 "Staff attitudes to security in the Benefits Agency", 1999, Department for Social Security - <http://www.dwp.gov.uk/asd/asd5/ihr66.pdf>

Controls to prevent fraud

2.8 There are a range of controls (for example, physical checks, reconciliation, supervisory checks and clear roles and responsibilities) that address risk, including fraud. Departments and agencies need to consider which controls are most appropriate in their particular circumstances. The consistent application of internal controls can be highly effective in preventing fraud losses. Internal Audit should provide assurance on the operation of those controls and their effectiveness in preventing fraud. Internal controls can impose both internal and external costs from their operation. Controls need to be designed which are proportionate to the risk, while enabling the organisation to deliver the services to its customers to meet their needs.

FIGURE 18 | The Department for Work and Pensions have carried out staff surveys to assess their attitudes to security

The Department for Work and Pensions commissioned qualitative research to assess staff attitudes to security and to consider the extent to which these have changed over time. This has helped the Department evaluate the impact of their drive to tackle fraud and raise the profile of security on frontline staff across the service.

The research involved:

- in-depth interviews focusing on perceptions of security and controls needed to reduce risk of security breaches;
- group discussions in follow up research to assess any changes in attitudes to security since the previous research; and

- workshop sessions to brainstorm strategies and approaches to improve security.

The research yielded valuable information drawing on staff experience and suggestions on:

- types of fraudsters and the nature of frauds committed;
- risk factors and how to manage these;
- the application of existing fraud controls;
- opportunities to strengthen security.

- 2.9** Two key aspects to prevention are:
- "fraud-proofing" new programmes and systems;
 - consistent application of existing controls and strengthening of these where needed.

Fraud proofing new programmes and systems

- 2.10** Organisations need to recognise their responsibility when designing and implementing new policies, programmes and systems to build good controls in to manage fraud where there are vulnerabilities, or to fraud proof them by designing them to be inherently less vulnerable to fraud. Complex rules can increase the risks of fraud. Fraudsters can exploit the situation in two ways. The rules may be difficult to police effectively, requiring officials to consult volumes of guidance in their everyday work. Where customers are often uncertain of their obligations, it is easier for fraudsters to misrepresent their circumstances and if discovered claim that it was a genuine error.
- 2.11** Sufficient weight should be given to expert advice on the risks of fraud in new programmes and effective counter fraud measures should be integrated into the design. Where innovative schemes are being proposed, it is good practice to pilot these to identify any further risks of external fraud. Early consultation with internal audit and counter fraud specialists can help to identify the risks, and to obtain advice on how these can be minimised, at key stages during design and implementation of new programmes. An evaluation process is helpful in determining whether early risk assessments have

been effective in countering fraud risks during development, piloting and initial implementation.

- 2.12** The NHS Counter Fraud Service liaise with policy sections across the Department of Health and Government in an exercise called "fraud proofing the Department's future policy initiatives". The aim is to ensure that, as far as possible, new initiatives are protected from fraud from the outset. HM Customs and Excise are also carrying out work to try and guard a new tax from fraud (**Figure 19 overleaf**).

"It is always possible to have controls which prevent fraud, but such controls need also to enable Departments to give a timely service to honest customers, without unacceptable burdens. Designing effective controls depends on understanding the scale and nature of the risks and the costs."

Caroline Mawhood,
Assistant Auditor General, National Audit Office

FIGURE 19 | The steps HM Customs and Excise are taking to guard a new tax from fraud

In designing the Lorry Road User Charge off-setting duty reduction (a charge to ensure that hauliers pay an amount related to the distance that they travel on United Kingdom roads), HM Customs and Excise developed two options - a new marked fuel, or a reclaim system. Customs Law Enforcement Policy (responsible for developing strategies to tackle fraud losses) were asked to apply their anti-fraud expertise to each option to mitigate the fraud risks. To do this, Law Enforcement:

- analysed the options to identify how eligibility for duty reduction would be gained;
- examined each option to identify how ineligible claimants could secure a financial advantage;
- broke the possible frauds down into three groups (misuse, bogus claims, carousel frauds);
- applied their experience of similar frauds, especially in the road fuel and VAT regimes, to these fraud groups to devise general anti-fraud approaches;
- built on their understanding of the working of the affected trade sectors through direct dialogue on technical issues;
- examined the proposed working of the options to produce specific fraud proofing proposals;
- produced, with others in HM Customs and Excise, assumptions about the working of the options, and the possible anti-fraud checks that could be built-in;
- examined the interdependencies of the fraud proofing measures to identify the most effective package of measures in order to reduce the fraud risk for each option;
- examined the resourcing requirements for reducing fraud under each option.

Strengthening internal controls and checks

- 2.13** It is important that the effectiveness of controls is continually reviewed. Controls which have traditionally worked well in countering fraud may no longer be effective where fraudsters have launched determined attacks. Detected cases of fraud may show that fraudsters are using new methods to circumvent controls, indicating that these need to be strengthened. Internal Audit's work may also identify system weaknesses which could lead to fraud.
- 2.14** In 2003, the NHS Counter Fraud Service set up a Fraud Prevention Unit to identify specific areas of weakness in systems, recommend policy change where appropriate and issue instructions and guidance to make them less vulnerable to fraud (**Figure 20 overleaf**). One case which illustrates their approach is where a hospital Trust was defrauded of £300,000 by the relatives of a patient falsely claiming travel allowances for visiting a child no longer at the hospital. The Fraud Prevention Unit recognised that the system of travel reimbursement universally adopted by Trusts was open to similar abuse and issued instructions on how the weakness could be addressed. Implementation of the revised procedures and publicity surrounding the original case has already uncovered other instances of fraud that are now being investigated.
- 2.15** Strengthening internal controls can also help prevent or reduce criminal attacks. For example, the most serious VAT fraud that HM Customs and Excise currently face is VAT missing trader fraud - a Europe-wide systematic attack on the VAT system orchestrated by organised crime groups. As part of their strategy, introduced in September 2000, to tackle this fraud, HM Customs and Excise enhanced their VAT registration checking procedures to make it easier for them to detect and prevent bogus registrations. Each VAT application form is assessed according to various risk criteria to identify potential fraudsters. Further checks are carried out on suspect applications and those that remain suspect are visited. In 2002-03, over 5,700 pre-registration visits to new traders resulted in the identification and refusal of over 900 suspect registrations which could have cost as much as £1.5 billion in stolen VAT if left unchecked.
- 2.16** New legislation may be required to improve controls or to deter fraudsters. **Figure 21 on page 37** illustrates how improved legislation has helped to reduce fraud in HM Customs and Excise.
- 2.17** Developments in technology can provide opportunities to strengthen controls in a cost effective manner to reduce the level of external fraud. **Figure 22 on page 37** illustrates how the private sector is making use of technological advances.

FIGURE 20 | Methodology used by the NHS Counter Fraud Service Fraud Prevention Unit

Action by the Fraud Prevention Team

- 1 Identify possible areas of high risk of fraud in the NHS arising from system weaknesses. Sources include the staff within the Counter Fraud Service including the Central Intelligence Unit, Risk Measurement Team, Quality Team and feedback from Local Counter Fraud Specialists;
- 2 Research the areas of system weakness and establish the amounts at risk;
- 3 Organise a programme of visits to selected NHS Trusts to gain experience of how the systems work in practice;
- 4 Issue questionnaires to NHS Trusts to assist in identifying the scale of any system weaknesses;
- 5 Collate the findings and recommendations from the research, reviews and questionnaires;
- 6 Issue instructions, best practice guidance and / or recommend policy change taking into account the amounts at risk;
- 7 Request compliance statements from NHS Trusts to provide assurance that good practice is being applied;
- 8 If appropriate, recommend that Local Counter Fraud Specialists carry out proactive fraud prevention work in the areas of high risk identified;
- 9 Measure the financial impact of the introduction of any new procedures;
- 10 Report findings, recommendations and action taken, to the NHS Counter Fraud Service policy, operational, and intelligence services as appropriate.

FIGURE 21 | How HM Customs and Excise have improved controls by introducing new legislation

To prevent illicit cigarettes from penetrating the legitimate retail market of **HM Customs and Excise** introduced fiscal marks for cigarettes and hand rolling tobacco. The fiscal mark shows that the product is United Kingdom duty paid, where it is offered for sale. Fiscal marks legislation makes it an offence to 'possess, transport, sell, or offer for sale, or otherwise deal in specified tobacco products that do not bear a compliant fiscal mark'. It also makes it an offence to use, or to allow the use of, premises

for the sale (by retail or wholesale) of unmarked products. Such actions are 'absolute' offences (that is there is no requirement to prove intention, negligence or recklessness) carrying a fine up to £5,000. Additionally, the Courts have the power to restrict sales of tobacco in those premises for a maximum period of six months.

FIGURE 22 | Examples of how new technology is being used to prevent and detect fraud in the private sector

The Association for Payment Clearing Services (APACS) estimate that the total amount of plastic card fraud losses in 2003 amounted to £402 million. The introduction of "chip and pin" technology by 2005 is expected to reduce the level of fraud substantially. The chip cards will prevent counterfeiting of cards by holding data so securely that they cannot be feasibly copied or altered. The use of a four digit PIN number will also help reduce use of stolen cards.

The Association of British Insurers estimates that motor and household insurance fraud costs insurers more than £1 billion each year. In attempting to reduce this type of fraud insurers use a range of techniques such as electronic data sharing, conversation management and voice stress analysis.

The insurance company **Admiral** began a three month trial of the voice stress analysis technology in May 2003 on claims for vehicles which have been stolen. The claims handler asks general questions such as the claimant's name and address, so the software can monitor the voice and identify normal stress levels. Admiral takes care to ensure that the conversation is not confrontational. However, if during the course of the conversation about the claim, the software indicates that the claimant demonstrates areas of stress, Admiral will investigate further and ring the claimant back, giving them a chance to withdraw the claim. The use of this technology has led to a quarter of Admiral policyholders who make a claim, subsequently withdrawing their claim.

part three

Detecting and investigating external fraud and imposing sanctions

In looking at this Part of the guide, ask yourself whether your organisation:

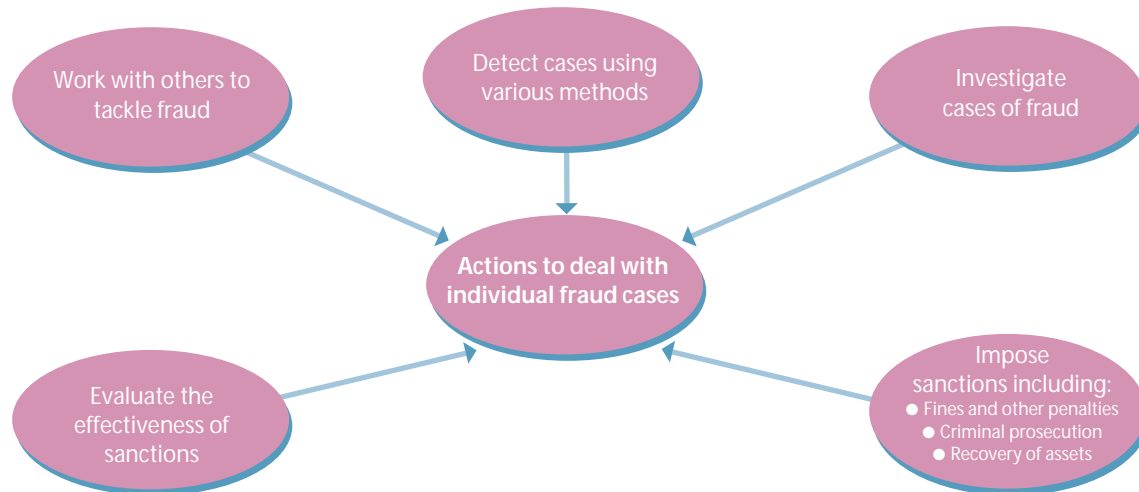
- has a well publicised telephone hotline, email and freepost address to which the public can report cases of suspected fraud;
- uses techniques proactively to detect cases of suspected fraud such as in-depth investigative work into "hotspot" areas, data matching exercises, data mining and neural networks as appropriate;
- assesses whether suspect cases of fraud need to be investigated further such as through use of scoring systems;
- assesses whether the number of investigations is proportionate to the potential sums lost from fraud;
- tracks the progress of individual investigations;
- has sufficient investigative staff with the essential technical knowledge and experience;
- reviews independently the way fraud investigations have been conducted;
- imposes appropriate sanctions on fraudsters such as fines or, other penalties, or criminal prosecution in appropriate cases;
- seeks to recover the amounts lost from fraud;
- evaluates the effectiveness of sanctions;
- works with others to tackle fraud.

SPECIMEN

3.1 To show that departments and agencies are serious about tackling external fraud, they need to detect cases of fraud against them; investigate them where appropriate and impose sanctions which are proportionate to the crime. This will help to deter potential fraudsters in the future by showing that crime does not pay, especially if the outcomes of cases are well publicised. Departments also need to consider whether the frauds detected show new threats are emerging, or are on a larger scale than originally thought. From this

work, departments and agencies will need to consider whether their strategic approach needs updating. They will also need to assess whether any frauds reveal systemic weaknesses which need to be tackled (**Figure 23**).

FIGURE 23 | Actions to deal with individual cases of fraud



"Effective work to detect and investigate fraud must lie at the heart of any professional, integrated approach. Such work is not only about eventually applying appropriate sanctions, it has to be about learning as much as possible about the nature of the problem, about deterring fraud where this is possible and about identifying the policy or systems weakness which has allowed it to occur."

Jim Gee, Chief Executive,
NHS Counter Fraud Service

Detecting fraud

- 3.2** Frauds may be detected in a number of different ways. Referrals may come from staff who have carried out checks on transactions and suspect a fraud. Members of the public may contact the department about their suspicions. Departments also use a range of techniques and technologies to identify suspicious cases for further investigation. They may also carry out special pro-active exercises to detect fraud in high risk areas. Fraud investigators may develop their own intelligence by following leads on existing cases where there may be links to other frauds. This section focuses on the use of hotlines and computer software techniques.

Hotlines

3.3 Hotlines can be a cost effective way of obtaining from staff and the public details of possible cases of external fraud which can be assessed and investigated further. **Figure 24 overleaf** outlines the arrangements in place in some departments. Good practices include:

- Setting up a single freephone telephone number, with alternative means of contacting the department including an email and freepost addresses;
- Advertising the telephone number and contact details on the department's website, in leaflets and posters, and advertisements during anti fraud campaigns; and
- Giving undertakings on confidentiality; indicating the information that is useful in a referral, including the types of frauds that the department are particularly interested in hearing of and how the department will deal with the information provided.

3.4 It is also good practice to record information received onto a standard form. This can help in prompting the person making the referral into providing as much relevant information as possible. An electronic version of the form can be included on a website, which can be completed and submitted anonymously online. The person may want to know what action may be taken and feedback on what has happened. While it is possible to give general information on how referrals are handled, it may well not be possible to give specific details on individual referrals where this would breach confidentiality requirements.

3.5 Hotlines should be evaluated at regular intervals, for example, analysing the number and type of referrals received, what has happened in each case, and overall results.

FIGURE 24 | Sets out how some departments are using hotlines

The **Department for Work and Pensions** introduced a dedicated telephone hotline (0800 854440) and website (www.targetingfraud.gov.uk) to encourage the public to refer individuals alleged to be committing benefit fraud. The website emphasises the value of those referring cases providing as much information as they can. And the online reporting form (<https://secure.dwp.gov.uk/benefitfraud/>) seeks detailed information to support the allegation and to improve the quality of intelligence. In 2001-02, the Department received some 667,000 referrals from Departmental staff, the public, the telephone hotline and data matching.

The **NHS Counter Fraud Service** have introduced an NHS Fraud and Corruption Reporting Line (08702 400 100) for staff to use to bring suspicions of fraud to the attention of trained specialist investigators. The service received 460 calls in its first 18 months, resulting in 271 referrals to regional investigation teams. The NHS Counter Fraud Service place an emphasis on the quality of the information provided via this route.

Since April 1999, **Inland Revenue** have had a free-call Business Anti-Fraud Hotline (0800 788887), providing a confidential facility for legitimate companies and their employees to give information, in confidence, about suspected fraudulent activities.

The **Driver and Vehicle Licensing Agency** undertook a pilot exercise to provide a free of charge telephone "Hotline" to members of the public who wished to report apparently unlicensed vehicles. The availability of this facility was advertised through local campaigns. The Agency found that the pilot scheme was self financing and popular with the public. The scheme will be available to 95 per cent of Great Britain by the end of 2004.

Customs Confidential (0800 59 5000) was established by **HM Customs and Excise** in 1996 from a series of 'hotline' numbers based on regional and commodity lines - the first one, the drugs hotline having been established in the late 1980s. The hotline is staffed 24 hours a day, seven days a week and in February 2004 over 3,100 calls were recorded. One or two referrals a month usually result in large seizures/ detentions or VAT assessments. For example, in February 2004, information from the Hotline was directly responsible for a seizure of 7.7 million cigarettes in Felixstowe. And between November 2002 and March 2003, over 600 calls were received regarding oils fraud offences.

The use of computer techniques to detect fraud

- 3.6** A range of techniques using computer software and technologies can be used to detect cases of fraud. These include techniques such as data matching, data mining and neural networks. Smaller departments and agencies may be able to draw on the experience and lessons of others in the use of these techniques.
- 3.7** Data matching involves computerised scanning of data held in different data files either within the same organisation or in different organisations. It can be used by management for a range of purposes including detecting potential fraud. With increasing computer power, data matching across files is possible on a very large scale.
- 3.8** The Department for Work and Pensions have developed a Matching Intelligence Data Analysis Service which produces a series of data matches between their benefits and information systems as well as with other departments. It has access to over 100 different types of matches which results in around 300,000 matches per year, identifying potential fraud and error. The Audit Commission's National Fraud Initiative is the largest data matching exercise in Europe in relation to fraud (**Figure 25**). **Figure 26 overleaf** shows how the Driver and Vehicle Licensing Agency use data matching to detect vehicle excise duty evasion.

FIGURE 25 | The Audit Commission's National Fraud Initiative

The Audit Commission's National Fraud Initiative involves more than 1,100 public bodies in the NHS and central and local government, and analysis of over 14 million data records. The primary targets of the Initiative are the detection of a range of frauds including Housing Benefit, occupational pension, housing tenancy and payroll. The data-matching technique identifies potential inaccuracies and instances where fraud may be occurring, for example, an individual claiming Housing Benefit whilst receiving a salary or pension which precludes any entitlement to benefit, or possible duplicate Housing Benefit claims. The Audit Commission return these matches to participating bodies for investigation, along with supporting guidance. The Initiative is part of the Commission's statutory external audit of local authorities.

In May 2002, the Audit Commission reported that this exercise detected £24 million in local authority benefit fraud, an increase of 60 per cent from two years previously. Individual cases of benefit fraud detected included overpayments of up to £83,000. Total savings to date exceed £190 million.

FIGURE 26 | How the Driver and Vehicle Licensing Agency use data matching to detect vehicle excise duty evasion

The Automatic Number Plate Reader project is a computerised system that collects images of moving vehicles from roadside video cameras. Computer software digitalises the images, searches for the number plates and reads the registration mark. The scanned mark is then compared with a listing of unlicensed vehicle registration mark details, extracted from the Agency's vehicle database. If a match is found, the image and event details are stored on disc as evidence of the offence. The images of vehicle registration marks that are not matched to the unlicensed vehicle data bank are discarded.

- 3.9** To help focus resources on the matches which indicate possible fraud, data matching software:
- Highlights the highest priority matches;
 - Allows users to filter only those matches that meet investigators' criteria for investigation;
 - Explains the importance of each match type and protocols for sharing information between matched bodies.

3.10 Data matching between different bodies is facilitated greatly by common data descriptors but is possible only if there is appropriate authority for data to be transferred or shared between these bodies. This authority may derive from a statutory basis for demanding, or disclosing, the data or both. Uncertainty regarding powers to share data may sometimes have hindered the use of data matching. Data matching has also raised concerns about the possible infringement of individual rights to privacy. Concerns about individual privacy are the subject of the Data Protection Acts and the Human Rights Act 1998.

3.11 Data sharing was considered in the Grabiner Report on the Informal Economy published in March 2000.⁸ It reviewed the legal basis for data sharing between different Government departments focusing on the Inland Revenue, Department for Work and Pensions and HM Customs and Excise. The report highlighted that there are extensive powers to share between these departments. Lord Grabiner lent support for a general primary power to allow information sharing in any cases specified in regulations. This would ease the process of legislating for data sharing "gateways", by obviating the need for legislation for both sides of the data sharing gateway. This approach is used in the Social Security Administration (Fraud) Act 1997. Lord Grabiner also recommended that:

"departments should agree common guidelines for staff about what data sharing is legally permissible and how it should be carried out in practice. There should be a central point of contact to co-ordinate the exercise and monitor effectiveness."

3.12 Data matching exercises should comply with the provisions of the Data Protection Acts and to help ensure they do, the Information Commissioner has issued guidance on his website listing the eight principles put in place by the Data Protection Act 1998 which ensure that information is handled properly. These are that data must be:

- Fairly and lawfully processed;
- Processed for limited purposes;
- Adequate, relevant and not excessive;
- Accurate;
- Not kept for longer than is necessary;
- Processed in line with the individual's rights;
- Secure; and
- Not transferred to countries without adequate protection.⁹

The Commissioner has also produced guidance on implementing these principles in the document, "Compliance advice: Data sharing between different local authority departments".¹⁰ Although this document specifically refers to local authorities, the principles within it can be applied to other public sector bodies.

3.13 Schedule 8 of the Human Rights Act 1998 can give rise to questions about the extent to which data matching complies with the provisions regarding personal rights to privacy. There are exceptions to these provisions where:

*"necessary in a democratic society in the interests of national security, public safety or the economic well being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others."*¹¹

3.14 Data mining is the process of selecting, exploring and modelling large amounts of data to reveal previously unknown patterns, behaviours, trends or relationships which may help to identify cases of fraud. Because of the large amount of data that needs to be analysed, specialist computer software is used which usually contains a range of data mining tools (**Figure 27 overleaf**). A number of software companies have developed such products. Data mining can be a powerful way of interrogating data and revealing anomalies that would not be revealed by other techniques. However, to enable it to function most effectively, staff need to be trained in the use of the software, and to gain experience in selecting the most appropriate tools to scrutinize the data and in following up anomalies to detect cases of fraud. In December 2003, HM Treasury published "Anti-fraud advice and guidance", which includes an article on "The case for data mining."¹²

⁹ Eight principles of the Data Protection Act 1998, Information Commissioner's Office. <http://www.informationcommissioner.gov.uk/eventual.aspx?id=302>

¹⁰ Compliance advice: Data sharing between different local authority departments - <http://www.informationcommissioner.gov.uk/cms/DocumentUploads/Data%20sharing%20between%20different%20local%20authority%20departments.pdf>

¹¹ Human Rights Act 1998 Chapter 42. <http://www.hmso.gov.uk/acts/acts1998/19980042.htm>

¹² 2002-2003 Fraud Report: Anti-fraud advice and guidance, HM Treasury, December 2003. http://www.hm-treasury.gov.uk/media//03C56/fraud_anti_fraud_adv_02-03.pdf

FIGURE 27 | Shows some organisations have used data mining

The **BBC** uses data mining software tools to match details of licensable places with external commercially-available data to identify specific places or segments of the population for targeted enforcement activity. The facility has been used to target mailshots, posters and telephone chasing on specific groups, such as students, and offers opportunities to focus enforcement activity on places or segments of the population where the likelihood of evasion is greatest.

The **NHS Counter Fraud Service** have developed computer intelligence software that examines pharmaceutical, dental and optical data. The software is capable of advanced data analysis that establishes data profiles and highlights cases with an unusual profile. These can indicate potential fraud for further investigation. For example, NHS dentists are expected to have a similar profile for the amount of complex dental work they carry out and claim for. The software will highlight any individual dentist that is claiming for an unusually high level of complex work. These cases will be identified for potential investigation of whether the dentist is making fraudulent claims. As an example, the Service investigated one case and found that the dentist was submitting claims for non-existent patients. The dentist was sentenced to community service and ordered to repay the full amount, along with costs.

3.15 Neural networks are computer based multiprocessing systems which are designed to connect data from multiple sources to identify structures and patterns and exceptions to an identified structure or pattern. The ability of neural networks to identify patterns of activity and exceptions to a pattern that may be associated with fraud, gives organisations an ability to focus their detective efforts on these exceptions.

3.16 One of the problems of using these techniques more widely in the public sector is that the data may not be held in a way that lends themselves to such analysis. The move towards providing services online may change this and allow real time analysis of transactions through the Department's websites using some of these techniques.

Investigating cases of fraud

3.17 Where fraud has occurred, the department or agency should consider:

- stopping the fraud at the earliest opportunity and looking at whether weak controls have been exploited which need to be tightened up;
- whether to prosecute the case criminally or impose a penalty;
- collecting any arrears and any penalties to ensure that the economics of the crime are undermined and to deter others.

3.18 Some departments have criteria or scoring systems to determine those that should be investigated with a view to prosecution with the remainder subject to other forms of sanction. An intelligence and risk-based approach to assigning cases for investigation is used by the Department for Work and Pensions (**Figure 28 overleaf**) and the Inland Revenue have set out criteria for which cases are submitted to their Special Compliance Office when serious frauds are suspected (**Figure 29 on page 49**). Unlike the larger Departments, smaller departments and agencies may not have trained fraud investigators, in which case they will need to involve the Police in dealing with detected cases of external fraud. They also need to have plans in place so that they know the steps to take if cases are uncovered.

"The days when those countering fraud resembled characters out of the Bill, the Sweeney or Raymond Chandler novels have long gone. A new breed of counter fraud specialist, professionally trained and accredited and working within a clearly defined ethical framework is at work, protecting public funds and freeing up resources for better systems and services."

Jim Gee, Chief Executive,
NHS Counter Fraud Service

3.19 Departments also need to look at whether the total number of investigations is commensurate with the potential sums lost from fraud. Investigating cases can be resource intensive. Assessing the financial return achieved on the overall caseload, and different categories of case will indicate the likely benefits of undertaking more investigations or a different mix.

3.20 Tracking the progress of fraud investigations allows managers to assess the overall workload (such as whether investigations are concentrated on the main types of fraud set out in the Department's strategy); identify problem areas such as where progress is slower than would be expected; understand the cost implications of investigations and the effects on planning future resource usage or the consequences of increasing or decreasing resource levels (**Figure 30 overleaf**).

FIGURE 28 | The Department for Work and Pensions have a dedicated intelligence function to evaluate cases of potential fraud and decide which to investigate

The Department for Work and Pensions, in response to the Scampton Report, which recommended that an intelligence-led approach was a key element in addressing fraud, now have a National Intelligence Unit with a network of Operational Intelligence Units in their regions and their serious and organised fraud arm. The role of the Units covers:

- Identification of cases most suitable for investigating, based on a set of risk-based criteria and the subsequent tasking of investigators;
- The gathering and evaluation of intelligence on cases through a series of systems;
- Analysis of intelligence to ensure continuous identification and focus on key risk areas;
- Legal exchange of data with other agencies;
- Future analysis of benefit system threats following inclusion of European Union accession countries.

FIGURE 29 | Inland Revenue have a special investigation service to which cases of suspected serious and high value fraud are referred

Inland Revenue use pre-defined risk criteria to select referrals for investigation by the Special Compliance Office. These include the value of any potential understatement and the circumstances that may suggest serious fraud. Sufficient and obtainable evidence must exist as well as scope to add significant value over what could be achieved by a routine enquiry.

3.21 Where departments investigate frauds they will need to consider whether there are sufficient staff with the right technical and investigative knowledge and experience. The Counter Fraud Professional Accreditation Board was set up in 2001 as a professional body for counter fraud specialists. It sets professional conduct guidelines for its members who have successfully completed the specialist counter fraud training and university courses. **Figure 31 overleaf** shows the development of a professional and ethical approach to countering fraud by the NHS Counter Fraud Service.

3.22 Other large departments provide a range of training for fraud investigators. For example, HM Customs and Excise have developed new procedures, provided training on these for all

FIGURE 30 | Information to help managers track fraud investigations

Useful information can include:

- Number of investigations carried out;
- Value of fraud loss identified;
- Duration of individual investigations;
- Costs of individual investigations;
- Methods of investigations used;
- Outcome of investigations (prosecutions; fines etc.)

investigators and implemented an assurance process to ensure that investigators adhere to them. New investigation recruits are given 14 weeks of training in basic investigation techniques which can be followed by more specialist courses such as the handling of informants. The investigators are also supported in their work by specialists such as forensic accountants and computer analysts. HM Customs and Excise are in the process of introducing National Occupational Standards. In common with other Law Enforcement Agencies future training will be geared to meet the standards set by the Police Skills and Standards Organisation. HM Customs and Excise will use these standards as the basis of accredited training to professionalise investigation work.

FIGURE 31 | The NHS Counter Fraud Service approach to counter fraud work

In 1999, the NHS Counter Fraud Service developed a professional strategy, which set out the competencies required for Counter Fraud Specialists, and established a series of practical skills-based training courses that collectively formed a Foundation Level. It is mandatory for everyone in the NHS who counters fraud to receive this training and by early 2004, 700 people had done so.

The Department for Work and Pensions, Inland Revenue, HM Customs and Excise, local authorities, the Child Support Agency and Abbey National have also all adopted the Foundation Level. In 2001, all of the above launched the joint and common qualification of the Accredited Counter Fraud Specialist and the Counter Fraud Accreditation Board to oversee work in this area. By early 2004, there were over 6,500 Accredited Counter Fraud Specialists from these organisations. Other organisations are due to join the Board.

The Foundation Level has been accredited by the Institute of Criminal Justice Studies at the University of Portsmouth. The Certificate of Higher Education in Counter Fraud and Criminal Justice Studies (Advanced Level) is the first academic qualification specifically designed for the counter fraud fields and several hundred students have proceeded from the Foundation Level to study for the Advanced Level. There is also now a Bachelor of Science in Counter Fraud and Criminal Justice Studies. The first graduations will take place in Summer 2004.

Further details are available at:
<http://www.cfsms.nhs.uk/files/counterfraudethical.pdf>

3.23 In the Department for Work and Pensions, a programme of training is provided for investigative and intelligence officers and managers as well as those from local authorities. This covers legal aspects of the criminal justice system and operational techniques. In the Inland Revenue, the Special Compliance Office is involved in coaching schemes for local staff, and has developed a new advanced investigation skills course aimed at enhancing the quality of enquiry work. The

fraud investigators for the Special Compliance Office are largely recruited following the demonstration of considerable in-depth knowledge of tax and compliance work, and the competencies required for investigation work. Additional training is then provided. The Special Compliance Office has also been a front runner in using computer forensic techniques in gathering evidence in its fraud investigations.

3.24 Investigations into fraud should be consistent with the aims of the criminal justice system to reduce crime and the fear of crime and to dispense justice fairly and efficiently, promoting confidence in the rule of law.¹³ Independently reviewing the way in which fraud investigations have been carried out can help to ensure that appropriate standards and legal requirements have been followed. The findings can highlight areas where improvement is needed. The reviews can be undertaken by:

- Independent internal teams, with expertise in fraud investigation, to review the conduct and quality of fraud investigations;
- Surveillance Commissioner reports (<http://www.surveillancecommissioners.gov.uk/>) for covert investigations;
- The appointment of an external assessor.

Figure 32 overleaf sets out how the Department for Work and Pensions ensure professional standards are maintained through their emphasis on standards assurance. Inland Revenue's approach to assuring standards is set out in **Figure 33 on page 53**.

13 Aims and Objectives; Criminal Justice System. <http://www.cjsonline.org/working/aims.html>

FIGURE 32 | How the Department for Work and Pensions review investigations

The Department operate a number of systems to ensure they are compliant with the criminal justice system:

- Investigation and prosecution are run separately;
- Authority to gather intelligence under the Social Security Act 2001 is only available to a limited number of authorised officers who must have undergone relevant training and hold an appropriate licence;
- A series of checks on key elements of the intelligence and investigation processes are carried out to ensure these comply with instructions.

The Department for Work and Pensions have established a Head of Profession and a Professional Standards Unit to improve and maintain standards of fraud investigation. The Unit provides support, guidance and training. Their Standards Assurance Team and the Surveillance Commissioner report on the conduct and quality of fraud investigations and control and use of surveillance in investigations and compliance with the Regulation of Investigatory Powers Act (2000), Data Protection Act (1998) and Human Rights Act (1998). The results of these assurance and compliance checks are used to identify areas for further development and scope for quality improvements.

For example, the Department have adjusted their approach to the Regulation of Investigatory Powers Act (2000) following feedback from checks and discussions with the Surveillance Commissioner. The Head of Fraud now receives regular assurance reports to ensure compliance with the Act.

The Professional Standards Unit has developed a revised Fraud Procedures and Instructions Manual for investigators when engaged in fraud investigations and authorised surveillance to ensure that sufficient, relevant and reliable evidence is gathered in a legally compliant manner for use in any sanction or prosecution. This guidance was developed in liaison with local authority partners and made available to them. The Department used Home Office guidelines as a basis for their written procedures on use of surveillance.

FIGURE 33 | Inland Revenue appointed an external Council to review standards of investigation processes

The Special Compliance Office undertook a wide review of criminal investigation procedures. An experienced Council was asked to comment on their investigation processes. This was followed up by a series of internal reviews each looking at specific areas of criminal investigation casework. This work culminated in a seminar for all investigators and the introduction of University accredited training for all new investigators.

Imposing sanctions

3.25 Where investigations find evidence of fraud, departments will usually seek to impose some form of sanction. The purposes are to deter others from carrying out similar types of fraud against the organisation; recover the money defrauded and punish the fraudster by imposing a penalty, such as a fine, or confiscating an asset, or by prosecuting them criminally in the courts. Some departments have published their approach to deter potential fraudsters and ensure that a consistent approach is taken ([Figure 34 overleaf](#)). The NHS Counter Fraud Service impose parallel sanctions to increase the deterrent effect. Departments need to consider whether the level and range of sanctions imposed on fraudsters provide a sufficient deterrent.

"Effective sanctions do more than punish the individual, they have a wider deterrent impact and change behaviour. They support and reinforce the compliant behaviour of the majority."

Keith Moore, Assistant Director,
Cross Cutting Policy, Inland Revenue

FIGURE 34 | Examples of departments' approaches to imposing sanctions

Where the **Department for Work and Pensions** have sufficient evidence of fraud to take a case to court they will give a formal caution or impose an administrative penalty; or prosecute those involved.

- Formal caution is used where the value of the fraud is less than £400 - the amount overpaid must be returned. If it is the first time they have committed the offence, they are given a formal caution;
- Administrative penalty where the value of the fraud is £400 to £1,500 - the customer must repay the overpayment and will receive an administrative penalty of 30 per cent of the amount overpaid;
- Prosecution where the value of the fraud is over £1,500 - the customer may be prosecuted, subject to evidential and public interest tests, and may receive any form of penalty as decided independently by magistrates or the Crown Court.

The **NHS Counter Fraud Service** seek to combine the application of disciplinary, civil and criminal sanctions where fraud is found;

to dismiss an employee or suspend or de-register a professional; to obtain civil law orders to freeze assets and recover funds and to impose a criminal sentence. The approach is set out in "Applying Appropriate Sanctions Consistently", published in April 2003.

Copies can be obtained from www.cfsms.nhs.uk.

The **Inland Revenue** operate a progressive regime of sanctions against fraud which is aimed at deterring and penalising fraud and evasion through significant financial penalties. Whilst the deterrent threat of prosecution remains, and is applied in the most serious cases, the majority of evaders can be "hit where it hurts most" through financial penalties of up to 100 per cent of the sums being evaded. This approach seeks to match the size of the penalty to the extent of the evasion.

Fines and other penalties

- 3.26** Fines and other penalties imposed on those committing fraud need to be recovered to ensure that they act as a deterrent. The Department for Health impose a penalty on patients who make false financial claims on the NHS. If the fine is not paid by the due date then a surcharge of 50 per cent of the penalty charge can be made up to a maximum of £50.
- 3.27** It is important to monitor progress in recovering the fines and penalties involved, including the enforcement of fines imposed by the courts for convicted fraudsters. Although in such cases it is not the departments that collect the fines, they should consider working with the Department for Constitutional Affairs to determine the level of fines actually paid. The extent of re-offending may indicate whether sanctions provide a sufficient deterrent. The Department for Work and Pensions estimate that nine per cent of those fraudulently claiming Income Support and Jobseeker's Allowance had been caught before. To help combat recidivism, since April 2002 the Department have been able to stop all benefits for 13 weeks if individuals are convicted of committing benefit fraud twice within the space of three years. The NHS Counter Fraud Service will take criminal proceedings against patients who persistently make false financial claims against the NHS. The offence of repeated or persistent evasion attracts a fine on conviction of up to £2,500.

- 3.28** Departments need to be aware of Article 6 (1) of the Human Rights Act 1998, which provides for rights to a fair trial, which says, *"In determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law"*. As a final recourse, someone who has been subject to a fine or other sanction should be allowed to dispute the sanction in either the magistrates or the county court.

Criminal prosecution

- 3.29** Preparing cases to the state of proof required for a criminal prosecution can take a long time and involve significant resources. Decisions on whether to prosecute may depend on whether:
- there is sufficient evidence to obtain a conviction;
 - the case involves a systematic attack on the department's systems and has led to substantial amounts of money being lost;
 - there is a history of re-offending;
 - professionals such as lawyers and accountants are involved in the fraud;
 - prosecution will increase the deterrent effect.

3.30 These factors need to be balanced against the time and cost of bringing a case to court, and the availability of other forms of sanction which may be more appropriate. Some departments have laid down the circumstances in which they will prosecute to ensure that they take a consistent approach in each case (Figure 35). Departments will need to consider whether the number of prosecutions is commensurate with the potential sums at stake in lost revenue and provide a sufficient deterrent.

FIGURE 35 | HM Customs and Excise prosecute for the most serious cases of evasion

Prosecution is an important part of HM Customs and Excise's armoury to tackle VAT fraud, but it is used for the most serious cases of evasion not as a routine response to all VAT fraud. They normally only consider prosecution where a strong deterrent message is required and it is considered that the use of other options will not achieve this. However HM Customs and Excise may investigate any case of suspected dishonest evasion of VAT with a view to bringing criminal proceedings. HM Customs and Excise decide on the appropriate course of action according to the merits of each case. Generally they prosecute only the more serious or aggravated cases where specific criteria apply such as whether the business was set up with the intention to carry out fraud, whether other criminal activities have occurred and whether lawyers, accountants and others who advise on VAT matters are involved.

The recovery of money defrauded

3.31 The means of recovering assets whether in or outside of the United Kingdom may be achieved through the criminal process or through the civil courts. In some circumstances it may be appropriate for an organisation to proceed with a civil action while a criminal prosecution is underway. As part of an investigation, departments may look into the financial affairs of the suspected fraudster to see whether evidence can be provided to the court on the extent of the benefit obtained by the defendant, and to make a confiscation order. Before the suspected person or persons become aware that an investigation is taking place, action may be needed to secure misappropriated funds by seeking a civil injunction or a criminal restraint order.

3.32 Where an organisation seeks to recover stolen monies through the civil courts it will have to prove, on a balance of probabilities, that it has cause of action against the defendant. Further the plaintiff will have to prove the amount taken. If successful the court will then make an order against the defendant requiring him or her to compensate the plaintiff together with an award of costs in most cases. Legal costs can be high. Organisations will need to consider:

- the amounts stolen and therefore could be recoverable ;
- the prospects of winning the case;
- the value of assets held by the suspected fraudster;

- the likely legal costs;
- whether it will be possible to pursue a civil action whilst a criminal investigation is underway.

3.33 Organisations may be able to recover stolen monies as part of criminal proceedings. This can be through restraint, confiscation, forfeiture and/or compensation orders but these are only commonly obtained during trial, after conviction or at the earliest when criminal proceedings are about to be commenced. Further information about civil and criminal actions to recover assets is contained in the Treasury's 2002-03 Fraud report which has annexes on anti-fraud advice and guidance.

3.34 The powers to deprive criminals of their assets increased substantially as a result of the Proceeds of Crime Act 2002. The legislation brought together and strengthened in one Act the drug and non-drug confiscation legislation previously contained in the Drug Trafficking Act 1994 and Part VI of the Criminal Justice Act 1988. Under the Act, any offence that generates proceeds is capable of attracting criminal confiscation, and the availability of "restraint" (court freezing of property pending confiscation) is brought forward from the point at which a person is about to be charged to any time from the start of a criminal investigation. The Act also provided for the establishment of the Assets Recovery Agency to investigate and secure criminal assets. Law enforcement agencies and prosecutors can now pass confiscation cases to the Director of the Agency to enable her to apply for restraint,

"I feel a passion for getting the bad guys out of the picture. If you have a large house and five places in the Caribbean with no visible means of support, no rich aunties who have recently died leaving the odd five million and no successful lottery tickets, it won't do to say that someone gave you the money."

Jane Earl,
Director, Assets Recovery Agency

to undertake the confiscation hearing or to enforce confiscation cases. In addition, the Act established a new civil recovery scheme, empowering the Director to sue in the High Court to recover property derived from crime without the need for anybody to have been convicted of an offence. The Director also has the option to tax the proceeds of crime where there is reasonable grounds to suspect a person's income, profit or gain was derived from crime. **Figure 36** outlines actions taken by the Department for Work and Pensions to recover assets and **Figure 37** provides an example of Inland Revenue's application of criminal confiscation powers.

FIGURE 36 | Action to recover assets and seek criminal compensation

The **Department for Work and Pensions** have emphasised the punitive, deterrent and disruptive effects of the recovery of assets deemed to be the proceeds of crime and are making use of the new powers of confiscation for offences committed under the Proceeds of Crime Act 2002. They have expanded their financial investigation capability in response and aim to secure £1 million in 2003-2004 and to secure higher amounts in future years.

3.35 The Assets Recovery Agency deals with cases which are referred, according to agreed criteria, by police forces, HM Customs and Excise and other law enforcement agencies, including the National Crime Squad, the National Criminal Intelligence Service, the Serious Fraud Office, the Department for Work and Pensions and local authority trading standards departments. For a case to be considered for adoption for civil recovery, criminal prosecution must have been considered and either failed or proved impossible to complete; recoverable property must have been identified and have an estimated value of at least £10,000; the recoverable property must include property other than cash or negotiable instruments (although cash is recoverable if it is in addition to other property); and there must be evidence of criminal conduct that is supported to the civil standard of proof, that is, on the balance of probabilities. A standard referral form, available from the Asset Recovery Agency, sets out the detailed information required.

FIGURE 37 | Inland Revenue use criminal confiscation powers to recover the proceeds of crime

The **Inland Revenue's** Special Compliance Office view confiscation and restraint powers as an essential adjunct to a successful prosecution by depriving convicted fraudsters of the proceeds of their crime. It is used in conjunction with a Restraint Order to prevent the removal of the defendant's assets and to preserve their value for the purposes of meeting a Confiscation Order should one be made.

In February 1999 the Special Compliance Office began a criminal investigation after receiving information that the principal shareholder and Chairman in a company was operating a concealed company bank account to fund personal spending. Information obtained from the bank confirmed the existence of an account linked to the company finances and concealed from both the company auditors and the Revenue. Between 1990 and 1998, over £1 million of company monies had been diverted involving £400,000 of evaded tax. Given the deliberate nature of the concealment and the amounts involved, the Inland Revenue

executed search warrants at personal and business properties and the business properties of third parties. The company chairman was prosecuted on examination of the seized documentary evidence.

Additional information gathering notices were served on other financial institutions. Evidence showed that the chairman had used the account to fund his personal lifestyle and a restraint order was successfully sought. The company chairman pleaded guilty to diverting company monies as a Common Law Cheat. He was sentenced to imprisonment and debarred from serving as a director. A confiscation order was granted in an amount in excess of £1million which was the benefit of the crime as opposed to the tax lost. This was the first time the Inland Revenue had successfully applied confiscation powers to the full proceeds of the crime.

Evaluating the effectiveness of sanctions

3.36 Evaluating the effectiveness of sanctions is not straightforward, mainly because of the difficulties in assessing the deterrent effect. In broad terms, the deterrent effect of sanctions will be reflected in whether the amount of fraud has reduced, although it is hard to disentangle the effects of sanctions from other action to reduce fraud as well as wider economic effects. Trends in the indicators given below in **Figure 38** can help to determine whether the level of activity may be having a desirable effect. The Department for Work and Pensions have carried out a full review of the deterrent effect of their current sanctions policy and plan to use the outcome of the review to inform their future approach.

FIGURE 38 | Examples of indicators

- Number of frauds identified;
- Number of identified frauds with no sanction imposed;
- Number of cases where re-offending has occurred;
- Number of formal cautions given;
- Number of penalty charges imposed;
- Amount raised by imposition of penalty charges;
- Number of cases recommended for criminal prosecution;
- Number of convictions achieved;
- Amount of fraud loss and amount recovered;
- Number of confiscation orders and amount recovered;
- Amount of assets seized from the fraudsters.

Working with others in tackling fraud

3.37 Individuals and businesses may be committing frauds against more than one government department or agency. Joint working enables departments to identify common threats and pool their knowledge and expertise to investigate fraudsters. Other benefits of working together to tackle fraud are:

- Good practice can be shared across departments;
- Information can be exchanged more efficiently;
- Skills, informal systems and culture are developed across participating departments;
- A more consistent approach from the different departments can be developed;
- The consistency of information provided by customers to different departments can be tested;
- Trust and understanding can be built across departments.

3.38 Lord Grabiner, who examined how departments tackle the shadow economy, noted that there needs to be sufficient incentives for departments to work closely together particularly where one department is likely to derive greater benefits than another from the arrangements (**Figure 39 overleaf**). Joint targets could be considered in those cases.

3.39 Joint working arrangements can be set up by having Memoranda of Understanding with other organisations to enable sharing of data and carrying out matching and profiling with their data. This may be facilitated through data warehouses accessible to the organisations involved. The data warehouse can include data from each organisation and from external sources, such as the population register which includes data such as national insurance numbers, driving licences, passport holders and electoral rolls. The Closer Working Intelligence Project set up by HM Customs and Excise and the Inland Revenue looked at how they could combine their customer and third party information to generate intelligence through data matching to support their investigation teams. Computer software was developed to enable the exchange of information between departments using the internet.

FIGURE 39 | The contribution of Joint Shadow Economy Teams in detecting external frauds

Lord Grabiner in his report "The Informal Economy" (March 2000), made a number of recommendations to combat tax and benefit fraud covering incentives to join the legitimate economy, prevention, detection, punishment and publicity. His recommendations, published in 2000, have driven the way in which government departments are working together to tackle the shadow economy.

Lord Grabiner recommended that departments set up a specific function for detecting and investigating shadow economy businesses.

Joint shadow economy teams bring together work being carried out by HM Customs and Excise, the Inland Revenue and the Department for Work and Pensions. There are currently 22 joint teams across the country. Four main sources of intelligence are used: direct from members of the public; cases referred by other officers; intelligence generated by Joint Team initiatives such as risk assessment; and intelligence generated by other teams

within the three departments. Many investigations are initiated using intelligence received from individuals, such as traders who are facing unfair competition from unregistered businesses.

In 2002-03, the teams made 3,633 new VAT registrations of which 1035 were worked on jointly, and raised over £65 million in VAT. They also uncovered 245 'ghosts' resulting in £2.1 million in additional tax and identified over 900 cases of benefit fraud.

The Departments have in recent years established a number of other joint teams such as Joint Fashion Industry Teams to tackle common concerns. Some staff are also involved in joint working on non-compliance involving 'gangmasters' operating mainly but not exclusively in the agriculture sector, typically associated with non-registration for tax and working and claiming benefits.

3.40 Joint working may also include co-operation on fraud investigations. This enables departments to identify and investigate cases of common interest, avoiding duplication of effort. The Department for Work and Pensions, through their Joint Working Unit, have joined with local authorities to target local areas of fraud and common risks and identify best practice. In July 2001, HM Customs and Excise and Inland Revenue signed a protocol which set out the requirements for the notification and joint working of fraud cases. Factors that need to be considered for effective joint working in fraud investigations are set out in **Figure 40**.

FIGURE 40 | Good practice in joint working to investigate external frauds

Aim to establish with the other organisations involved in joint fraud investigations:

- common criteria for selecting which cases to investigate;
- the time scales for investigations;
- agreed procedures for dealing with cases by either the civil route or criminal prosecution;
- the different powers of the departments to investigate and the sanctions that can be used.

appendix one

SPECIMEN

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Head of the National Audit Office

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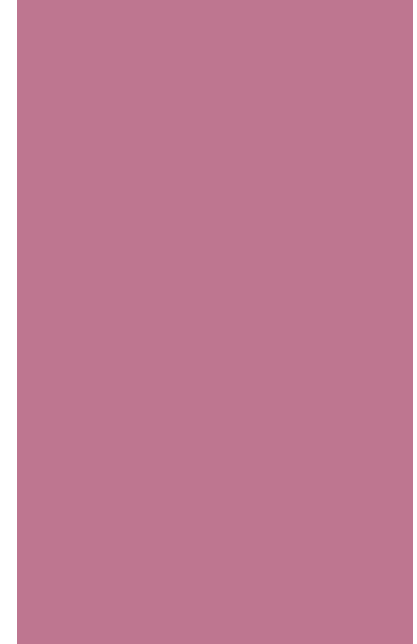
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appendix two

Contributors to the guide

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