INSPIRING FINANCIAL LEADERSHIP

Accountants & business advisers

Countering Fraud

A guide for the UK charity sector

Published by Charity Finance Group and PKF Littlejohn

First published 2016

Designed by Steers McGillan Eves

PKF Littlejohn LLP
1 Westferry Circus, Canary Wharf
London E14 4HD

Tel: +44 (0)20 7516 2200
Fax: +44 (0)20 7516 2400
www.pkf-littlejohn.com

Foreword from CFG

Historically, it was thought that the most that could be done about fraud was to react when a fraud occurred, investigate it and then try and recoup losses through a criminal prosecution or civil litigation.

This approach however doesn't go far enough. Charities need to move beyond merely identifying that a fraud or attempted fraud has occurred, and then reacting as best they can. Such an approach fails to be proactive or preventative. Charities continue to be challenged by a wide range of fraud that can affect all areas of their organisation. Fraud ranges from very general attacks that could affect any business in any sector, to types of fraud that are specific to charitable organisations.

Fraud is a problem that can affect any charity from the very large to the very small. Falling victim to fraud can undermine a charity's reputation, damage donor confidence and reduce a charity's ability to help its beneficiaries. On occasion fraud has even led to the forced closure of a charity.

In short, fraud is prevalent - it's likely to affect a huge number of charities. The 2016 Annual Fraud Indicator (published in May 2016 by Experian, PKF Littlejohn and the University of Portsmouth's Centre for Counter Fraud Studies) found that charities and charitable trusts are believed to be losing up to £1.9 billion every year to fraud – a staggeringly high figure.

How can charities work to combat fraud? This guide is a good place to start for those with a role to play in countering fraud in the sector.

It is our hope that managers and trustees can work their way through this guide, identifying areas for improvement, building their resilience to fraud, and moving towards actively managing the risk of fraud.

The guide provides practical advice and concrete methods to support organisations to work towards achieving best practice in countering fraud. It outlines steps to help charities to achieve real, beneficial outcomes in terms of reduced losses and the consequent financial and reputational benefits.

We are very grateful to PKF Littlejohn who authored this guide, and to the charities that gave their time and knowledge.

Here at CFG, we have recognised the increased threat of fraud facing charities. Along with this guide, we are also running training courses across England throughout 2016 on 'Good Controls and Preventing Fraud'. Additionally, for the first time, our annual Risk Conference has been re-focussed as the Risk and Fraud Conference. It is taking place in November 2016 – do attend if you wish to find out more and hear from other charities about how they are managing the risk of fraud.

This guide represents a change in emphasis in how we think about managing the risk of fraud. Charities must move towards being proactive in treating fraud as a business cost, and just like any other unwanted expenditure, reducing it. This guide is comprehensive in describing the nature and scale of fraud and by providing practical examples. We hope that charities will find it a helpful resource for adopting the best strategy and introducing the necessary actions.

All of us, trustees and staff, have a duty to be proactive to meet the challenge of preventing fraud and to do our best to manage the consequences of fraud, in the interests of our beneficiaries. We hope that this guide provides a useful starting point, and subsequent advice to follow, to enable you to rethink your approach to fraud.

Ian Theodoreson, Chair, Charity Finance Group

Contents

Foreword from PKF Littlejohn

The latest Annual Fraud Indicator for the UK, researched by the Centre for Counter Fraud Studies at the University of Portsmouth, published by PKF Littlejohn and Experian and overseen by the UK Fraud Costs Measurement Committee, estimates that the annual cost of fraud to the UK economy is £193 billion. In the charity sector, fraud is estimated to cost £1.9 billion. Global research, across a substantial dataset, supports the estimates published in the AFI and shows losses for individual organisations to average 5.6% of expenditure.

Is this 5.6% an under- or over-estimate for the UK charity sector? Fraudsters will target any sector that they perceive to be a softer target and where those working in the sector may not be as aware of the various types of fraud as those employed in, say, financial services, where the guard against fraud is perceived as more comprehensive.

Charity Finance Group has worked with PKF Littlejohn to develop this guide to help the sector increase its resilience to fraud. Charities face ever increasing challenges to raise funds whilst at the same time demand for their services and resources is rising. Publishing a guide such as this, to help reduce financial losses to fraud, is therefore timely.

Unlike the rest of the economy, the charity sector has not fully rebounded from the Great Recession. The sector's income has stagnated over the past few years, but demand for services has continued to increase. 70% of respondents to CFG, Institute of Fundraising and PwC's Managing in the New Normal 2015 survey said that they expected demand for their services to increase over the next 12 months.

A recent review of the financial sustainability of the charity sector, carried out by CFG, NCVO and other sector bodies found that charities will be facing a £4.6bn funding gap by the end of the decade. This is driven by increases in operating costs and continued cuts in government spending with the sector.

Given this climate, it is imperative that charities avoid the leakage of funding through fraud. Moreover, all this is happening in the context of ever greater public scrutiny of the charity sector.

PKF Littlejohn has a unique relationship with the University of Portsmouth's Centre for Counter Fraud Studies (CCFS), which has been described as Europe's leading centre for fraud research. Jim Gee, PKF's Partner for Forensic and Counter Fraud Services, is Visiting Professor and Chair of the CCFS. This relationship ensures that the contents of this guide are based on the latest academic research.

Jim Gee and Andrew Whittaker, PKF Littlejohn

1 Executive summary

This is a guide for charities and their trustees to help them to protect themselves against fraud, and thereby to minimise its cost and the risk of reputational damage. The latter, it could be argued, can be more devastating to a charity, its staff and benefactors, than the financial impact.

The guide should be essential reading for those who are responsible for protecting their charity's funds. It is not a technical document but provides a framework for a charity to increase its resilience to fraud. You have a key part to play in ensuring that all appropriate steps are taken to achieve this objective.

Trustees:

You have collective responsibility to look after your charity's money and other assets. The Charity Commission requires you to report serious incidents that result in – or risk – significant:

- Loss of your charity's money or assets
- Damage to your charity's property
- Harm to your charity's work, beneficiaries or reputation

Serious incidents include "*fraud, theft or other significant loss*". If your charity has an annual income of more than £25,000 you must, as part of the annual return, sign a declaration that there have been no serious incidents which ought to have been reported to the Commission but were not. If you are unable to make this declaration the annual return will not be complete and you will have defaulted on your legal requirements.

Your charity should therefore have effective processes to help avoid theft and fraud. Failure to do so is likely to be considered by the Commission as a breach of your duty. You also have a duty to ensure that you report serious incidents of fraud to the Charity Commission and Action Fraud.

Further information on your responsibilities can be found in the Charity Commission's Toolkit – Chapter 3: Fraud and Financial Crime, and CC8: Internal Financial Controls for Charities. You can also find resources on the Charity Sector Fraud Group homepage.

> "A key strand of any counter fraud strategy is the creation of an anti-fraud culture within the organisation"

Finance Officers

As employees of the charity you will have a contractual obligation to look after and to not act against the financial interests of your charity. This will involve putting controls, processes and structures in place to ensure that the charity's funds are protected.

Your experience as a finance professional places an obligation on you to advise trustees how best to safeguard your charity's funds. Although trustees may not be involved in the day to day operations of the charity, they will be ensuring that you have put proper structures in place to protect, deter and detect fraud. You also must ensure that trustees report serious incidents of fraud to the Charity Commission and Action Fraud.

A key strand of any counter fraud strategy is the creation of an anti-fraud culture within the organisation, supported by organisation-wide fraud awareness programmes; this is important not only within the finance function of the charity but in all aspects of its operations.

Chief Executives

As leaders of your charity you will have an obligation to look after the finances of your charity. This involves having oversight of the controls, processes and structures in place to ensure that the charity's funds are protected.

Your role in setting the strategy for your charity and overseeing all operations gives you a unique ability to ensure effective anti-fraud measures are deployed across your organisation. You must also ensure that trustees report serious incidents of fraud to the Charity Commission and Action Fraud.

Leadership from the top is important in tackling fraud. You also have the ability to ensure that all parts of the organisation see tackling fraud as important. You must also ensure that trustees are advised on how best to safeguard your charity's funds with the support of finance professionals.

The sector

The nature of the charity sector implies that everyone is acting for the good of others and, if fraud were to occur, it would be committed by some external source. Sadly that is not always the case. Those working and volunteering for charities will be subject to the same domestic, personal and financial pressures as the rest of society; these pressures can cause a normally honest person to do something that is dishonest. Charities should not blinker themselves to the fact that there may be insider fraud or fraud enabled by insiders.

The sector is incredibly diverse in its funding and operations. Some charities are purely government funded whilst others rely on thousands of people to raise funds. Some charities operate globally in high-risk remote locations whilst others concentrate their operations within a very local part of the UK.

As a result of this diversity of funding and operations, an individual charity will need to examine its own context and identify its own specific fraud risks. Although there is a common range of actions (described in Chapter 5) that all charities can deploy, there is no 'one size fits all' as every charity is different.

“The guide is intended to provide those operating within the sector with practical advice on how to implement a counter fraud framework”

This guide

Where relevant the guide references UK regulatory requirements as defined by the Charity Commission but recognises that many charities operate outside of the UK and fraud detected within or by UK charities may have originated in other jurisdictions. Where references are made to criminal legislation, these are those that apply to England and Wales. In most cases similar legislation has been enacted in Scotland and Northern Ireland. Where a charity operates outside of the United Kingdom it should identify any local laws and procedures that should be followed if fraud occurs. Failure to do so could cause difficulties in the recovery of assets that have been stolen or could expose the charity to liabilities for its failures.

Chapter 2 of the guide provides an introduction. It highlights the cost of fraud to UK plc – £52bn each year according to the National Fraud Authority (NFA) and 5.6% of expenditure, with an increase of more than 30% since the onset of the recession, according to the latest global research. This chapter makes it clear that the guide aims to help organisations to achieve real, beneficial outcomes in terms of reduced losses and the consequent financial and reputational benefits. The guide is intended to provide those operating within the sector with practical advice on how to implement a counter fraud framework. It is not a ‘tick-box’ guide but something to be read, discussed and acted upon.

Chapter 3 outlines what fraud is (and isn’t), how much it might cost an organisation and how it is best addressed. It describes what fraud is in criminal legislation, in civil law and in terms of disciplinary and regulatory sanctions. It also distinguishes fraud from other issues such as bribery, corruption and money laundering – all of which are distinct problems with their own distinct solutions. The chapter refers to UK legislation but acknowledges that many charities operate in different jurisdictions where the laws for dealing with fraud will be different. Charities should identify what these laws are, and adjust their responses accordingly.

Chapter 3 also outlines what is believed to be the cost of fraud – nationally and specifically for the charity sector – and describes the background to these estimates. It also highlights the development over the last decade or so of a more proactive and outcome-based approach to countering fraud, seeking to measure, manage and minimise it as a business cost like any other.

Chapter 4 makes it clear that fraud is a complex, flexible and continuously mutating phenomenon; fraud methodologies become refined and the introduction of new processes and systems provide new opportunities. For this reason, it would be impossible to provide a comprehensive list of types of fraud, however comforting such a document might seem to be. However, this chapter describes some of the main types of fraud affecting charities. These are both generic and sector-specific. A number of case studies are provided to illustrate the examples given.

Chapter 5 describes a modern, strategic approach to countering fraud which is comprehensive, integrated, professional, proactive and ethical. This approach has five phases:

1. Understanding the nature and scale of the problem.
2. Designing and communicating a counter fraud strategy which is specific to the known problem.
3. Creating a structure to implement the strategy.
4. Using the structure to undertake a range of pre-emptive and reactive actions.
5. Delivering beneficial outcomes derived from reducing the extent and cost of fraud.

The chapter continues to explain, in detail, the work that needs to be undertaken as part of each phase of the approach. In respect of the action to be taken it highlights:

- The need to develop a real anti-fraud culture.
- How a strong deterrent effect can be created.
- How fraud can be prevented by designing weaknesses out of processes and systems.
- How fraud can be detected where it is not prevented.
- The importance of investigating suspicions of fraud in an expert, fair and objective manner.
- How a range of criminal, civil, disciplinary and regulatory sanctions can be sought.
- How charities can seek redress and the recovery of any losses that they have incurred.

Chapter 6 describes the measure of how well an organisation is protected against fraud – fraud resilience – and outlines how this is related to the latest counter fraud professional standards.

It introduces the free Self-Assessment Fraud Resilience tool (SAFR) which has been rolled out across the private, public and charitable sectors, and the fraud resilience database which lies behind it, with data concerning 29 different aspects of fraud resilience in respect of more than 700 organisations. The tool allows organisations to be rated (out of a maximum of 50 points), and to understand their relative position compared to other organisations, with respect to fraud resilience. Finally, the chapter explains how increasing resilience has a direct impact to the cost of fraud that an organisation suffers.

Chapter 7 briefly describes the difference that the economic cycle makes to the extent of fraud, outlining research data which shows how, in every recession since 1980, fraud has increased, and how, after the 2008-09 recession, it increased by over 30%. Organisations need to take this into account when resourcing and prioritising counter fraud work.

Chapter 8 provides a page of top 10 tips in countering fraud – simple points to remember and act upon.

Chapter 9 is the conclusion to the guide.

Chapter 10 provides details of how to access the free Self-Assessment Fraud Resilience tool at www.pkf-safr.com and how to use the free ‘Fraud Hub’ at the Centre for Counter Fraud Studies at the University of Portsmouth.

Chapter 11 provides details of other useful organisations and resources which may be helpful to organisations and regulators operating in the charity sector.

Chapter 12 provides details to help access further research and training, and this is followed by a glossary.

2 Introduction to the guide

"We have had, as a charity, over two years of stress and police interviews and have been personally affected. The reason we have pushed this through, legally, is that we wanted to protect the name of the charity. Reflecting on what the defendant has put us through, personally and as a charity, we would have expected a custodial sentence."

A Trustee, March 2016

This is a guide for charities operating in the UK to help them to protect themselves against fraud and thereby to minimise its cost and the extent to which resources are diverted away from ensuring the best possible value that can be achieved from donations and grants. It is the first guide of its type for the sector and will have a variety of readers from all aspects of the charity community. Readers will range from trustees and those tasked with senior management, to those responsible for promoting fraud awareness, and those whose duties include the detection and investigation of fraud within their organisation.

The Government's most recent published official estimate of the cost of fraud to UK plc is £52 billion per year (National Fraud Authority, 2013), with the charity sector losing an estimated £147.3 million. The latest, most extensive global research shows average losses to be 5.6% of expenditure with an increase of more than 30% since the onset of the recession. Fraud is therefore an important issue and one which has a real, adverse impact – not only on the financial and reputational health of charities but one which also can have a direct, negative impact on the lives of those who depend on the support of the charity concerned. The Charity Commission regularly refers to the UK National Risk Assessment of Money Laundering and Terrorist Financing – this report found that "individuals, the private sector and the charity sector lose billions of pounds each year to fraud."

Despite the recent positive figures published in relation to the economy, the sector continues to be a challenging area in which to operate, with numerous emerging crises, disasters and good causes all competing for the attention of donors. The merest hint of a charity being associated with financial crime can have a direct and immediate impact on the level of donations that it receives, even though the fraud may have originated externally, with the charity being the 'victim'. Fraud will affect a donor's trust and confidence in deciding whether to donate to a particular charity or not.

Unlike the rest of the economy, the charity sector has not fully rebounded from the Great Recession. The sector's income has stagnated over the past few years, but demand for services has continued to increase. 70% of respondents to CFG, Institute of Fundraising and PwC's *Managing in the New Normal 2015* survey said that they expected demand for their services to increase over the next 12 months.

A recent review of the financial sustainability of the charity sector, carried out by CFG, NCVO and other sector bodies found that charities are facing a £4.6bn funding gap by the end of the decade. This is driven by increases in operating costs and continued cuts in government spending with the sector.

In this context, Charity Finance Group has asked PKF Littlejohn's counter fraud specialists to produce a new guide on countering fraud. This is "good news" as it demonstrates that the charity sector does not have its head in the sand but is doing something positive to ensure that income is properly received and properly spent. Indeed, charities will present themselves with reputational risks and difficult questions if they decide not to put this guide into practice.

This guide has been written to provide advice on best practice and to meet the latest, highest standards. It is also set in a context where the NFA's counter fraud strategies for UK plc – Fighting Fraud Together – has provided an important impetus for this work. The freezing of the Charity Commission's budget puts a greater emphasis on charities to undertake their own work to protect themselves against fraud.

The aim of this guide is to help charities to achieve real, beneficial outcomes in terms of reduced losses and consequent financial and reputational benefits. Fraud affects the third sector in many different ways – ranging from generic types of fraud that can affect any organisation to those types of fraud that are specific to the sector. It is important to be properly protected and fraud resilient, with the capacity to act proactively to pre-empt fraud, as well as to react where fraud has happened and losses may already have been incurred.

The guide is intended to provide readers with practical advice on how to implement a counter fraud framework, to minimise the cost of fraud as it affects them, and to avoid reputational damage. It is not a 'tick-box' guide but something to be read, discussed and acted on. It is also a guide and not a manual. It is comprehensive in that it covers all areas where action is needed; however, there is much more detail than can be included in an accessible and relatively short guide like this. Additional resources are highlighted in Chapters 12 and 13 of the guide.

3 Fraud, its costs and how to address it

"This chapter outlines what fraud is (and isn't), how much it might cost an organisation and how it is best addressed"

Fraud covers a broad range of activities and should not be thought of in too narrow a sense.

The word 'fraud' is often used in too wide a sense as a catch-all for other problems which are distinct and which have their own specific solutions. For example, money laundering, bribery, and corruption are specific problems with their own related legislation and solutions.

Broadly, fraud falls into three areas: false representation; failing to disclose information; abusing a position of trust.

There are a range of sanctions that are used to combat fraud including criminal law, civil law, regulatory sanctions and disciplinary sanctions.

You should make sure that you understand these sanctions and how they can be best used to protect your charity.

Almost one in ten charities reported that they had been victims of fraud within the previous year, with the most frequent type of fraud being related to payments or banking.

About two-thirds of these frauds were originated externally, with a third being committed by employees or volunteers.

Charities should take a proactive approach to fraud, treating it like any other business cost.

What is fraud? How it is defined?

The starting point for any guide of this type should be to outline what is meant by fraud. Fraud is often thought of in too narrow a sense – as something only to be reacted to, with a criminal investigation and a criminal prosecution. In reality, there are four main types of sanctions which can and should be considered:

- **Criminal law:** is primarily of use in punishing individual fraudsters.
- **Civil law:** is best used to recover losses.
- **Regulatory sanctions:** can be useful in removing accreditation and authorisation.
- **Disciplinary sanctions:** are important in removing fraudsters from the context of the fraud that they have undertaken.

This is not a detailed guide to fraud law but it is worth briefly considering what is meant by fraud in these four areas.

It should be noted that the guide refers to the law in England & Wales. Many charities operate in other jurisdictions, each having its own legislation and procedures for dealing with criminal and civil fraud.

> **“Fraud is often thought of in too narrow a sense – as something to be reacted to only”**

Criminal Law

The criminal law concerning fraud primarily relates to the Fraud Act 2006. This relatively new legislation now targets fraudulent behaviour, not the consequences of that behaviour. Compared to previous legislation there is a shift from assessing whether the victim was deceived, to an assessment of what the defendant intended to happen as a result of his or her dishonest behaviour.

There are three ways to commit fraud under the Fraud Act 2006:

1. By false representation.
2. By failing to disclose information.
3. By abusing a position of trust.

Each way requires:

- An element of dishonesty (as defined by the standards of ordinary reasonable people) on the part of the fraudster.
- Evidence of their intent to make a gain or cause a loss. (NB: Gain or loss is limited to money and other property, which can include real, personal or intangible property, or things in action; the gain can also be temporary or permanent. “Gain” includes a gain by keeping what one has, as well as a gain by getting what one does not have. “Loss” includes a loss by not getting what one might get as well as a loss by parting with what one has).

If convicted on indictment (that is, in the Crown Court), these three offences can result in up to ten years’ imprisonment, an unlimited fine, or both.

> ***“A fundraiser for a children’s cancer charity pleaded guilty to 3 offences of fraud by false representation. She was sentenced to 10 months imprisonment, suspended for 2 years.”***

Other sections of the Fraud Act 2006 relate to the:

- Possession of an article for use in fraud.
- Making or supplying articles for use in frauds.
- Carrying on of a fraudulent business by a sole trader or partnership.
- Obtaining of services dishonestly.

The Act also extends the liability for offences under the Act to include a body corporate and, if it can be shown that they consented or connived in the commission of the offence, to the director, manager, secretary or other similar officer of the body corporate, or to a person who was purporting to act in any such capacity.

The common law offence of ‘conspiracy to defraud’ remains in force at the current time, to cater for the few circumstances where the Fraud Act 2006 will not cover fraudulent criminality, despite the Law Commission having recommended its abolition.

A number of other relevant offences also remain on the statute book and these include:

- False accounting: contrary to s.17 of the Theft Act 1968, which covers the falsification, alteration or otherwise dishonest manipulation of any accounting document. This covers the alteration of invoices, delivery notes, consignment notes, etc. The offence will also cover circumstances where someone dishonestly uses a false set of accounts, for any purpose. An example would be a prospective supplier producing a falsified balance sheet to show that their company is healthier than it actually is, with a view to winning a contract.
- Forgery: contrary to ss.1-4 of the Forgery and Counterfeiting Act 1981. This covers the making or using of counterfeit labels (or copies thereof), which purport that the product on which they are affixed is genuine when it is not.

In addition to those listed above, fraudsters may also commit other crimes whilst undertaking their fraudulent activities, such as theft, computer misuse and breaches of the Data Protection Act 1998.

Civil Law

Fraud plays an equally important role in civil law, primarily where it is used to induce parties into contract. In this context it is generally dealt with by the Misrepresentation Act 1967, but its earliest legal definition arose as common law. Perhaps the best known definition of fraud, which is still referred to, was established in the early case of Derry v Peek 1889. Lord Herschell, sitting in the House of Lords, determined that:

Fraud is proved when it is shown that a false representation has been made:

- Knowingly;
- Without belief in its truth; or,
- Recklessly, careless whether it be true or false; and,
- There has been a consequent financial gain or loss.

All elements must be present.

Action may also be possible under the Misrepresentation Act 1967. Under the terms of the Act, a party induced into a contract by the misrepresentation of another may rescind the contract, claim damages, or both. An action may allege negligent misrepresentation or fraudulent misrepresentation. The distinction can be subtle, given the facts, but it is usually the required burden of proof that is the deciding factor.

In alleging fraudulent misrepresentation, a claimant is required to show that the misrepresentation was made by the defendant with an absence of honest belief.

In a claim for negligent misrepresentation the burden of proof is reversed. Where negligent misrepresentation is alleged, the defendant must show in the words of s2(1) of the Misrepresentation Act 1967, that:

'he had reasonable ground to believe and did believe up to the time the contract was made the facts represented were true.'

Given that the available remedy is the same for fraudulent misrepresentation, this is usually the preferred route.

The civil law can also be used to recover what has been stolen by the fraudster. The civil courts have a variety of powers at their disposal, which can include freezing orders, search orders, insolvency and bankruptcy. Where a judgement has been made, the fraudster can have orders placed on their assets and income to repay monies that were stolen.

"A charity boss and his wife who stole from vulnerable disabled people were today ordered by a court to hand over their assets to the tune of £50,000."

Regulatory sanctions

In this section it is important to highlight that the sanctions referred to are those that can be applied to the fraudster. The Charity Commission, as regulator of the sector in England and Wales, should be notified of all instances of fraud that involve significant loss or where there is public or media interest; this may well lead to some regulatory action being taken against the charity, for example where poor financial controls have allowed the fraud to occur.

As far as the perpetrator of the fraud is concerned, where a limited company has been used as a vehicle to commit the fraud a number of sanctions are available that can lead to the company being dissolved or directors being disqualified from holding such positions. If the company has been trading wrongfully (i.e. whilst insolvent) or fraudulently (which means either that the company is being used to facilitate fraud, or that it was created fraudulently, such as by means of false documents), then the matter should be referred to the Companies Investigation Branch (CIB) within the Department for Business Innovation and Skills. CIB can investigate actively trading limited companies and Limited Liability Partnerships; it is unable to investigate sole traders or ordinary partnerships, nor will it investigate a company that is already in compulsory liquidation as this is the responsibility of the Official Receiver. The CIB can be contacted via 0300 678 0017 or via the web at: **www.gov.uk/complain-about-a-limited-company.**

It can also be notified in writing at:

Intelligence Hub
Insolvency Service
3rd Floor, Cannon House
18 Priory Queensway
Birmingham B4 6FD

If the fraud has been committed by a professional, such as a doctor or an accountant, then their regulatory body can take action to remove their professional status, so preventing them from lawfully working in such a capacity. Nearly all of these regulatory bodies have personal probity and integrity as a condition of professional status and an act of dishonesty by the professional will trigger disciplinary proceedings.

These are important sanctions, in effect taking away the fraudster's opportunity to occupy positions of trust as well as removing their ability to earn remuneration as respected members of society.

Disciplinary sanctions

Disciplinary sanctions are most commonly referred to in terms of misconduct by an employee and are another important tool for countering fraud. Some organisations are very clear that fraud will always be considered as representing gross misconduct (and therefore something that will involve dismissal). Others are less clear about the likely sanction to be imposed. What is clear is that taking disciplinary action is another important sanctions 'tool', as well as sending an important deterrent message to others.

The standard of proof in respect of criminal sanctions is 'beyond a reasonable doubt'. The burden of proof for civil, most regulatory and disciplinary sanctions is lower, being the 'balance of probability'.

The different types of sanctions can also be applied in parallel, something which is discussed in Chapter 6 of this guide.

What isn't fraud?

Fraud is a specific problem with a specific solution.

The word 'fraud' is often used in too wide a sense as a catch-all for other problems which are distinct and which have their own specific solutions. For example, money laundering, bribery, and corruption are specific problems with their own related legislation and solutions. They are not fraud in themselves, although in many instances where there is corruption there will also be fraud – for example a corrupt employee may alter financial records (fraud) as a result of being paid a bribe. Dishonesty may lie at the heart of each of the problems but that does not mean that they are the same problem. Corruption is a serious problem faced by many charities operating internationally. It is a separate problem to fraud, with its own motivators and its own solutions.

The ultimate expression of the lack of clarity around the term 'fraud' is apparent when people and organisations use the word 'waste' to encompass fraud and a variety of other problems, such as errors, losses due to poor decision making and those resulting from lack of effective management controls. It is impossible to apply the right solution unless organisations are clear about the specific nature of the problem they face.

The following chapters of this guide provide advice on specific action to be taken to minimise fraud and the cost of fraud. Sources of advice about other dishonesty-related problems are provided in Chapter 12 of this guide.

How much does fraud cost the UK?

Up until 2013 the Government's National Fraud Authority published annual estimates of the cost of fraud in its Annual Fraud Indicator (AFI). This work has now been continued by the UK Fraud Costs Measurement Committee. The AFI for 2016 estimates the annual cost of fraud in the UK to be £193 billion. Put into context, this is more than five times the size of the total UK defence budget.

This level of loss impacts every part of society, including the most vulnerable. It represents money that individuals, businesses and Government can ill afford to lose which ends up in fraudsters' pockets.

> "The 2013 Annual Fraud Indicator put the total loss to the UK economy from fraud at £52billion"

The cost of charity fraud

Within the Annual Fraud Indicator the NFA sought to quantify the losses suffered to fraud by charities in Great Britain. They concluded that the total cost was in the order of £147.3 million. Its research measured losses suffered by the 1,599 registered charities each of whose annual income was in excess of £100,000. Almost one in ten (9.2%) reported that they had been victims of fraud within the previous year, with the most frequent type of fraud being related to payments or banking. About two-thirds of these frauds were originated externally, with a third being committed by employees or volunteers. Almost one out of every four frauds was enabled by the actions of an insider; the NFA defines 'insider enabled' fraud as:

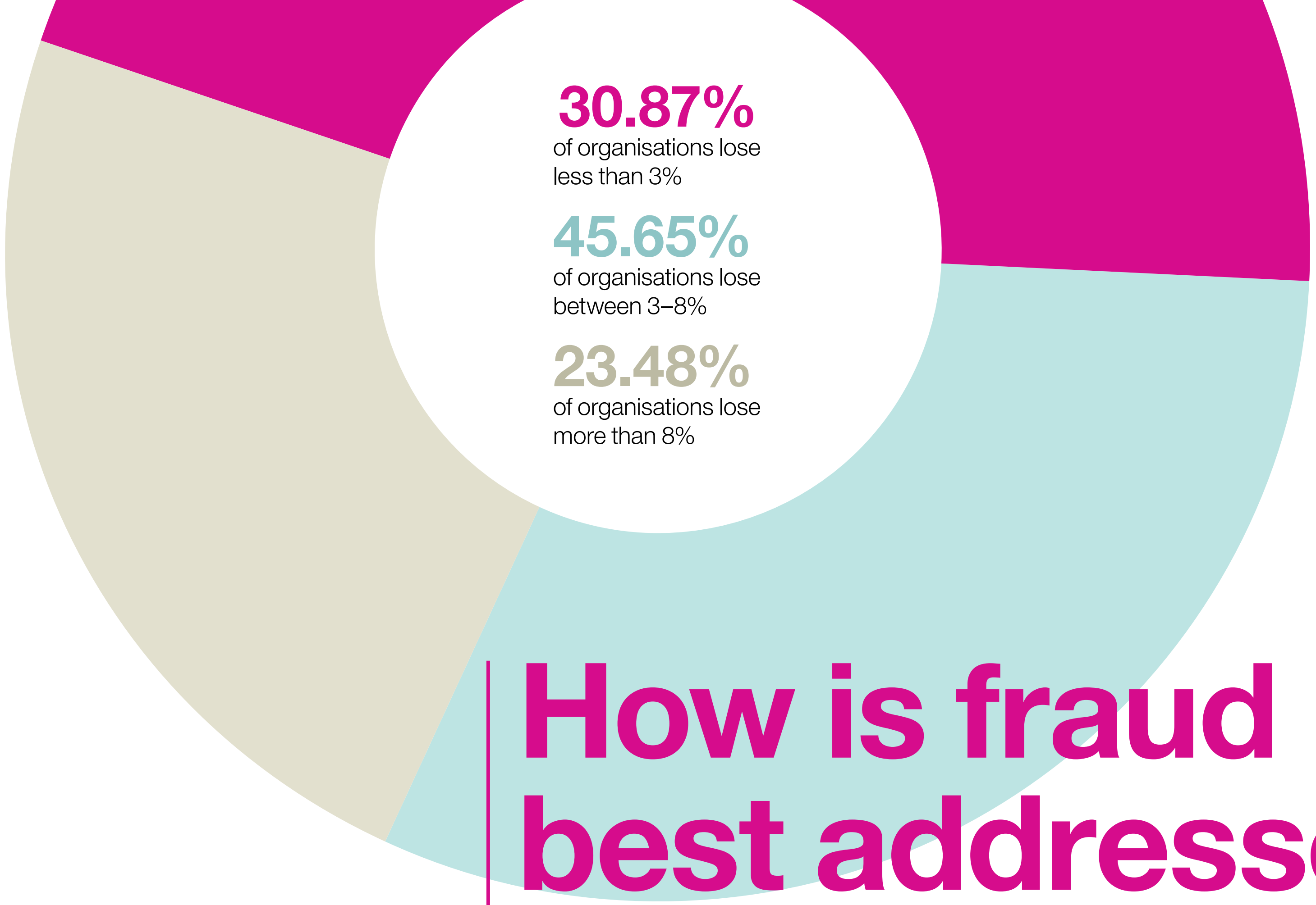
"…any fraud event to which an insider's access to the organisation's assets and systems, or ability to influence the outcomes of organisational processes, is integral to being able to conduct the fraud. An insider can be anyone with this access or ability, most obviously employees and directors, but also volunteers, consultants and contractors."

The data gathered by the NFA related to cases of fraud that had been detected. Of course, the very nature of fraud means that it is secretive and in most cases designed to avoid detection. This means that the true cost of fraud to the sector is likely to be much higher. Research by the Centre for Counter Fraud Studies and PKF Littlejohn has shown that the average loss to fraud is 5.47% of expenditure. Charities should consider what this might mean in respect of their own organisation.

Work undertaken in other sectors has shown that losses to fraud can be reduced by as much as 40% within 12 months - a relatively short time-scale. The beneficial effects of doing this within the charity community would be significant. The NHS, for example, reduced its losses to fraud by 60% over a 2 year period.

The potential benefits of removing the unnecessary cost of fraud are clear. Fraud is not just a one-off high value event which causes reputational damage; it is an ongoing, measurable, high volume, low value cost which has an adverse impact on all of us.

Organisations operating in the sector should consider whether the level of their current counter fraud work reflects the likely scale of fraud affecting them as shown in information available both from the NFA and specific research. The data also provides compelling evidence for trustees to increase the level of resource allocated to the prevention and detection of fraud. Trustees have a legal duty to take any action necessary to protect the funds of their charity, which will include measures taken to increase the resilience of their organisations to fraud.



The average level of losses due to fraud

Source: The Financial Cost of Fraud 2015, PKF Littlejohn

How is fraud best addressed?

Later chapters of this guide provide a detailed answer to this question. However, a new approach to fraud has developed over the last 10-15 years and this diverges significantly from previous practice.

Historically, it was thought that the most that could be done about fraud was to react when a fraud occurred, investigate it and then undertake a criminal prosecution or civil litigation.

That does not mean that internal controls have not been in place in accordance with general good governance and effective management, but in terms of specific counter fraud work, it is true that approaches have historically been much more reactive than proactive. This approach has been summed up in the United States as 'pay and chase'. It was difficult to know how much to spend on countering fraud (because no one knew the size of the problem) and success was often judged on the basis of activity not outcomes.

The crucial change from the mid-1990s onwards was the development of accurate methodologies to measure the cost of fraud. Measurement provided much more information about the nature and scale of the problem, allowing rational judgements to be made about the extent of resources to be invested in countering it, and progress in delivering outcomes (reduced losses) to be tracked. 70% of the fraud loss measurement exercises that have been undertaken reveal losses of more than 3% of expenditure, with the 17-year average running at 5.6% and average losses rising in the last two years by almost 18%. The research data suggests that the average level of losses due to fraud is:

- 30.87% of organisations lose less than 3%
- 45.65% of organisations lose between 3- 8%
- 23.48% of organisations lose more than 8%

The more accurate methodologies revealed that fraud is a more significant problem than previously thought, and does real damage by diverting resources from where they are intended. Revealing the economic damage caused by fraud strengthens arguments about the unethical and immoral nature of fraud, and raises awareness about the risks of reputational damage.

To avoid such significant damage, it became apparent that reacting after losses had been incurred does not make sense. As a result, much more proactive approaches have been developed to measure, manage and minimise the cost of fraud, treating it like any other business cost.

The proactive approach, widely accepted as best practice, focuses on outcomes. Rather than measuring success in terms of the number of investigations and prosecutions, which might just mean that more fraud is taking place, success is determined by the return on investment. The financial return on fraud prevention can be calculated by comparing the cost of efforts to address fraud with reductions in the measurable cost of fraud. Similarly the reduction of corruption within an organisation, although very difficult to measure, will bring beneficial effects.

Treating fraud as a business cost to be managed and minimised is at the heart of the new approach and represents the most effective way to address it.

4 Types of fraud affecting the charity sector

This chapter identifies some typical frauds that impact charities. It is important to remember that, as well as frauds that have happened previously, there will be many others that will be new and innovative in nature. It is the aim of the fraudster to remain undetected, so fraud is often secretive, innocuous and designed to look 'normal'.

Charities should ask themselves 'What could happen in my organisation?' They need to start thinking like a fraudster and work out how a fraud could be committed, given the current systems and controls that are in place. They need to 'think the unthinkable' and ask questions such as 'What could happen if my trusted member of staff had financial pressures in their domestic life and decided to commit fraud at work?' What would they be able to do?

It should also be remembered that some frauds will be specific for particular types of charitable organisation, the nature of their charitable activities and how they are funded. It is important for all charities to develop tailored approaches to countering fraud that fit the operations and risks facing their organisation.

Fraud is a complex, flexible and continuously mutating phenomenon. The response to it also needs to be equally flexible.

Charities need to 'think the unthinkable' and consider how a fraudster would seek to get around the controls and processes that have been put in place to counter fraud.

Many charities try to minimise their 'back office' functions, focussing as much of their expenditure as possible on achieving their charitable aims.

Unfortunately this can result in a lack of effective controls and an inadequate segregation of duties, particularly within smaller charities, so exposing the organisation to a greater risk of fraud.

Some frauds are specific to charities (e.g. fundraising) but others are more generic (e.g. payroll and procurement).

Charities also need to be aware of emerging threats such as cyber-enabled fraud.

Common types of fraud the sector needs to monitor

Types of fraud continually change as fraud methodologies are refined and new processes and systems offer new opportunities. For this reason, it would be impossible to provide a comprehensive list of the types of fraud, however comforting such a document might seem to be. Equally a checklist, even where everything is checked off, can provide the illusion that everything possible has been done. Fraud is a complex, flexible and continuously mutating phenomenon. The response to it also needs to be equally flexible. Continuous vigilance, high levels of fraud awareness and the maintenance of an open mind to what is possible, are essential.

What is described in this section are some of the main types of fraud which the sector may encounter, together with a selection of case studies. Some of these types of fraud are specific and some are generic and prevalent in organisations from across the economy.

The altruistic nature of the sector means that many working within it can give the perception of being trusting and open, and of being prepared to accept what they are told on face-value. Whether this perception is correct or not, it means that charities are often viewed by fraudsters as being vulnerable and as 'easy' targets. This is particularly true where the persons targeted are volunteers. Many charities try to minimise their 'back office' functions, focussing as much of their expenditure as possible on achieving their charitable aims. Unfortunately this can result in a lack of effective controls and an inadequate segregation of duties, particularly within smaller charities, so exposing the organisation to a greater risk of fraud. A survey conducted by Deloitte in East Africa revealed that 88% of people working for NGOs said that they knew how they it would be possible to defraud their organisation, if they were inclined to so.

> "Continuous vigilance, high levels of fraud awareness and the maintenance of an open mind to what is possible, are essential"

Sector-specific fraud

The main type of sector-specific fraud that occurs involves the fraudster representing themselves as a bona fide point of donation for a legitimate charity. There are varying degrees of sophistication in the implementation of this type of fraud, from the basic to complex.

At the lower end the fraud could occur by an individual pretending to be raising money for a charity by taking part in a fundraising event, gathering sponsorship from members of the public whilst having no intention of passing these on to the charity named. Another simple variant can be undertaking a bogus street collection for a charity with the aim of keeping the funds raised. This type of fraud is commonly associated with national campaigns run by particular charities, with the fraudster dressed in fancy-dress and holding a bucket at a busy location, such as a railway station. At the other end of the spectrum the fraud can be quite complex, involving bogus websites and emails that have the appearance of being the legitimate charity in order to lure unsuspecting donors into making payments or disclosing financial information. A review of a domain name website reveals that some variations of major charity domain names are available for purchase at relatively modest sums (less than £20!). The authors are not advocating that every charity should purchase all of the variations that could be used by a fraudster but they should introduce a strategy to monitor their availability and use. If a variant suddenly becomes unavailable for purchase this might mean that a fraudster is about to use it.

In all of these cases the charity itself is not the direct victim; however, the reputational impact can be quite significant and may well have a major impact on the level of future donations. The public will lose trust and confidence in making donations, something which will ultimately have a negative effect on the charity's ability to help its beneficiaries. Charities should consider letting the public know how they can verify that the collector is a bona fide collector for their charity.

Case study

Warning over fake charity bins

Adur and Worthing Council has warned charitable people to avoid using the fake pink clothing bins at Tesco in Durrington. Three pink clothing chutes on the Tesco site are believed to not be linked with Breast Cancer Awareness despite appearances. A spokesman for the council said: "These three pink bins at Tesco in Durrington are not charity bins and are in fact run by a commercial organisation with no ties to any charity. If you use these for textile donations you will not benefit any breast cancer charity or organisation and will merely divert your donations from the legitimate charities that do have banks at Tesco."

Worthing Herald
14th November 2015

> “Charities often rely on the goodwill of their supporters and employees, trusting that they will at all times be acting in the best interests of the charity”

Case study

A shamed businessman branded “low” by charities after stealing £650,000 from people who believed they were donating to good causes

Harris Polak set himself up as a charity representative paid to organise collectors standing outside supermarkets with collection buckets. The 54 year-old swindled thousands from shoppers who threw in cash while he hawked outside supermarkets across Merseyside with his team of ‘chuggers’. But instead of sending the money from his collection buckets to the charities he claimed to be working for, Polak used it to pay for luxury holidays, a car and his mortgage. After being jailed for three years and nine months last July, prosecutors have now revealed the amount he swindled is three times more than originally thought - growing from £200,000 to £650,000.

Daily Express
19th February 2014

Case study

Man jailed for Help for Heroes con at Wembley Park tube station

A fraudster who posed as a charity collector has been sent to prison after scamming football fans out of loose change. Daniel Malone, of Falcon Green, Larkfield, claimed he was collecting money for Help for Heroes at Wembley Park underground station. But when stopped, officers found his charity ID to be fake. Malone, 40, was collecting alongside his friend Kevin Rowbotham who lives in Abbey Wood, London. The pair were spotted on March 5, 2014, the same day thousands of football fans passed through the station on the way to watch England play Denmark at nearby Wembley Stadium. Both men have been sentenced to 12 months in prison. The pair were wearing Help for Heroes jackets and carrying made up identity cards. Help for Heroes, which raises money to help British servicemen and women injured in conflict, later confirmed the two men were not registered collectors, but they had both raised money for the charity previously.

Kent Messenger
4th September 2015

Generic fraud

Charities often rely on the goodwill of their supporters and employees, trusting that they will at all times be acting in the best interests of the charity. However, a small minority will seek to abuse this trust, particularly if external motivators (such as addictions or debt) are present. These motivators can be quite powerful, causing a previously honest person to take advantage of an opportunity that has presented itself.

The reliance on this goodwill by trustees and managers can often mean that important financial controls are absent or ignored, that warning signs are missed or discounted, or that voluntary staff are used to perform key functions but without having the accountability of paid staff.

Many charities have irregular income, which can be predominately cash; this makes it difficult to perform analysis to identify trends or to detect suspicious records or transactions.

Payroll fraud can include situations where charity employees knowingly receive levels of salary or allowances which they are not entitled to or where they claim to have qualifications or an employment history they do not have, or where expenses are claimed when they have not been incurred. It can also encompass unauthorised absences from work (which undermine an organisation’s capacity to fulfil its functions), the falsification and over-claiming of overtime and expenses, and even ‘ghost’ employees or volunteers where additional salaries or expenses are paid to the fraudster.

Case study

A renowned charity boss famed for his work in Africa lied about his qualifications when attempting to apply for a multi-million dollar grant in the United States.

‘Doctor’ Mike Meegan now admits he got his doctorate from Knightsbridge University which trades from a Danish post office box. Meegan is a former International Man of the Year (2003) for his work as the head of a charity called Icross in Africa. However, events that same year led to an audit being ordered by the development arm of the US government into the financial affairs of Icross Kenya. Former FBI consultant and ‘degree mills’ expert, Dr John Bear, said: “Knightsbridge most emphatically is not licensed or recognised by the Danish government (or any other government on Earth), and its degrees are as useless in Denmark as they are in Ireland or anywhere else. “It is my belief that if ‘Dr’ Meegan were to call himself “Doctor” (in person, in a speech, or a letter) in New Jersey, Illinois, Oregon, Texas, and the various other such states, he would be committing a criminal offence, subject to fine and even, in some places, imprisonment.”

Irish Independent 13th July 2006

"A person working for the charity may have access to the charity's funds and abuse their position of trust to make a financial gain for themselves or others"

Abuse of position

Abuse of position fraud often occurs for the reasons outlined at the start of this section – a reliance on trust coupled with ineffective controls. A person working for the charity may have access to the charity's funds and abuse their position of trust to make a financial gain for themselves or others.

Case study

Accountant stole £325,000 from charity to fund lavish lifestyle

A top executive who stole £325,000 from a social housing charity to buy a chain of sandwich bars and fund a lavish lifestyle has been jailed. Accountant Lakhbir Jaspal created a bogus firm to steal money from the West Bromwich-based Accord Group – even though he earned £147,000 a year as deputy chief executive. Jaspal – a member of The Chartered Institute of Public Finance and Accountancy – submitted a series of invoices between 2011 and 2012 from the fake company he created purely to steal from Accord, which receives taxpayers' cash from the Government to build affordable homes for low-income families and vulnerable people. The 47-year-old fabricated six bills – the largest for £97,980. But Accord identified the fraud and confronted Jaspal when two more invoices emerged from a mystery firm called 'Serus' in May this year requesting a further payment of £67,860.

Birmingham Mail
20th November 2015

Case study

A former charity worker has been jailed after admitting stealing more than £260,000 from his employer, the humanitarian charity Article 25.

Scott Golding, 47, of no fixed address, was last week sentenced at Snaresbrook Crown Court in north-east London to four years and eight months in prison after pleading guilty to using the charity's money to pay for designer goods and rent.

The charity, which provides housing and shelter in disaster zones, said the fraud almost caused it to close after it was left with just £611 in its account. It was only saved by members of the architectural and construction industry who stepped in to provide emergency funds, the charity said. Golding joined the charity to look after its accounts in 2013 after being released from a six-month prison sentence for stealing £9,500 from the Bristol children's hospital charity, Wallace and Gromit's Grand Appeal. Golding used his middle name, William, during the 18 months he worked for the charity, and presented the charity's senior management with fictitious accounts which portrayed a healthy picture.

In reality Golding had been stealing £260,479 from the account by paying himself an inflated salary and bonuses, paying his rent from the charity's bank account and using the charity's bank cards to pay for goods from stores including Alexander McQueen, Gucci, Prada and Harrods, the Crown Prosecution Service said. The fraud came to light in July when the charity's bank contacted it to say there was not enough money in the account to cover a credit card bill. The same day, Golding sent a text to a colleague saying he would not be in work that day and never returned, according to police.

Third Sector
22nd December 2015

Procurement fraud

Procurement fraud may include the under-provision or over-charging of goods or services, or where contractors know they don't have the capacity to provide the service which has been procured, or in some cases where they do not exist.

Case study

A charity entered into a contract for materials for refurbishing some of its shops; the materials were to be delivered to several sites. When checks were made, it was found that there was a serious deficiency in the quantity provided, despite invoices appearing to tally with the order made. Further investigation showed that deliveries had been dispatched with the total volume of material significantly short of what had been ordered. The investigation showed that this had been done deliberately, with the aim of deceiving the charity into paying for goods that hadn't been supplied.

Case study

An organisation was contacted to request that bank details be altered over the telephone. The call was taken by a member of staff and the purchase ledger system allowed access to the employee to amend the bank account details to those of the fraudster. Payments were made to the false bank account of almost £250,000.

Mandate Fraud

Mandate fraud has become more common recently. This is where fraudsters purport to represent contractors and seek to change payee bank account details so that monies are fraudulently misdirected. This has increased dramatically over recent years, across all sectors, despite the fact that simple preventative measures can be put in place. The charity sector is particularly vulnerable to this type of fraud – imagine: a late Friday afternoon, a disaster unfolding in a remote part of the world, an email being received from the Head of Operations requiring urgent life-saving funds to be transferred immediately to a local bank account to enable relief to be delivered. Charities must be aware of the threat posed by people purporting to be the Finance Director, Chief Executive, Chair of Trustees or other persons who have control over financial decisions within the organisation.

Case study

Fraudulent payments were being made to a member of a company's purchase ledger team. The employee was able to manipulate fields in the IT system to change the payee details following authorisation to proceed with payments, and utilising the one-off payment ledger code to set up their payee details to divert the funds.

Cyber fraud

Cyber fraud is increasing in its sophistication but also in its frequency. The ready availability of phishing, hacking and ransomware toolkits means that criminals are increasingly resorting to technology enabled fraud, commonly known as 'cybercrime'. Good data security is an essential part of countering cyber fraud – a common weakness exploited by criminals is social engineering, using impersonation (by phone or email) to obtain user names and passwords as this is a much easier way to gain unauthorised access to the charity's IT system than by trying 'brute force' password attacks (in a brute force attack, automated software is used to generate a large number of consecutive guesses as to the value of the desired data).

Case study

A charity was being used by fraudsters as part of a card washing scheme, where the on-line donation portal was being used to test whether stolen or cloned cards were still 'live'. A £1 donation will tell the criminal whether the card can be used for larger purchases.

5 The modern strategic approach – beyond reporting

This chapter starts by describing the key features of the modern strategic approach to pre-empting fraud that is comprehensive, integrated, professional, proactive and ethical.

It then describes what the approach involves, covering each main area:

1. Understanding the nature and scale of the problem.
2. Designing a strategic solution to the defined problem.
3. Creating a structure with the right remit, authority, investment and skills.
4. Using the structure to undertake a range of pre-emptive and reactive action.
5. Performance managing counter fraud work and delivering real financial benefits.

Section 4 then proceeds to further describe each of the seven areas where action needs to be taken and what is involved:

i. Developing a real anti-fraud culture.

ii. Creating a strong deterrent effect.

iii. Preventing fraud by designing weaknesses out of processes and systems.

iv. Detecting fraud where it is not prevented.

v. Investigating suspicions of fraud in an expert, fair and objective manner.

vi. Seeking to apply a range of sanctions where fraud is believed to be present.

vii. Seeking redress and recovering losses where they are incurred.

The diagram on page 36 provides an overview of the modern strategic approach.

A modern strategic approach to countering fraud in your organisation must be comprehensive, integrated, professional, proactive and ethical.

Charities should seek to understand the nature and scale of fraud in their organisation.

Charities should learn from examples of fraud in their organisation, resolve weaknesses and spread learning throughout the organisation.

Charities should make sure that they have the appropriate skills in their organisation to counter fraud.

Charities should proactively look for weaknesses in their processes and systems, mobilise the honest majority of staff to detect fraud and deter the dishonest minority that may consider defrauding the charity.

Charities should take an ethical approach to combating fraud based on fairness, objectivity and proportionality.

Many different issues compete for time and attention in any organisation; however, with fraud, the right messages from leadership can have a major impact.

Trustees, chief executives and other senior leaders are just as much responsible as finance professionals.

Comprehensive, integrated, professional, proactive and ethical

A genuinely strategic approach to fraud should be all of the above. But what does this mean in practice?

Comprehensive

Charities should consider the full range of action necessary to counter fraud:

- Find out more about the nature and scale of fraud.
- Ensure that they have effective arrangements in place to counter fraud (with the right specialist skills and resources).
- Make sure that a full range of pre-emptive and reactive action is taken.

To support the actions listed, the issue of fraud should be performance-managed like any other business activity.

Integrated

Charities should seek to get the optimum value and impact from the resources spent in this area, and to understand the synergy between different types of counter fraud activity.

For example:

- Learning from each example of fraud about the process or systems weaknesses that allowed it to happen – and resolving each weakness.
- Using examples of fraud to raise awareness and to strengthen anti-fraud cultures.
- Strengthening the deterrent effect by publicising the charity's commitment to countering fraud, and working with stakeholders to maximise peer group pressure that any form of fraud is unacceptable.

> "Charities should consider the full range of action necessary to counter fraud"

> "If counter fraud work is not undertaken professionally then this can lead to unnecessary losses"

Professional

Charities should apply the right professional skills to undertake this work. For example, there are now over 15,000 counter fraud specialists in the UK, trained at foundation, diploma, degree and master's levels and accredited by the Government-backed Counter Fraud Professional Accreditation Board (CFPAB). If counter fraud work is not undertaken professionally then this can lead to unnecessary losses, specific cases of fraud not having a successful outcome, and reputational damage to the organisation concerned.

A dedicated resource should be identified within a charity to develop appropriate skills so that when a fraud is detected, it can be dealt with in such a way that the full range of sanctions remain open. A range of organisations offer training that leads towards CFPAB accreditation and details can be found on the CFPAB website, more information can be found in Chapter 11. Small charities will need to consider the skills that are appropriate for their size of organisation; this may involve sending staff on training or joint-funding a resource with other charities.

Proactive

Charities should:

- Look for weaknesses that might allow fraud to take place and seek to remove them.
- Mobilise (and increase the size of) the honest majority.
- Deter (and reduce the size of) the dishonest minority.

These three areas of action are all unrelated to the reaction necessary when a potential fraud comes to light.

Ethical

Charities should undertake counter fraud work in accordance with principles of fairness, objectivity and proportionality:

- Fairness: those undertaking counter fraud work should act in a courteous, polite and considerate manner, and conduct all work applying proper standards of fairness and without discrimination.
- Objectivity: counter fraud specialists should undertake all work with an open mind and, in particular, ensure that any evidence or information obtained is assessed without preconceptions. Consideration should be given to all interpretations that may be placed on such evidence or information.
- Proportionality: the extent, cost and length of time devoted to counter fraud work should reflect the seriousness of the problems being addressed.

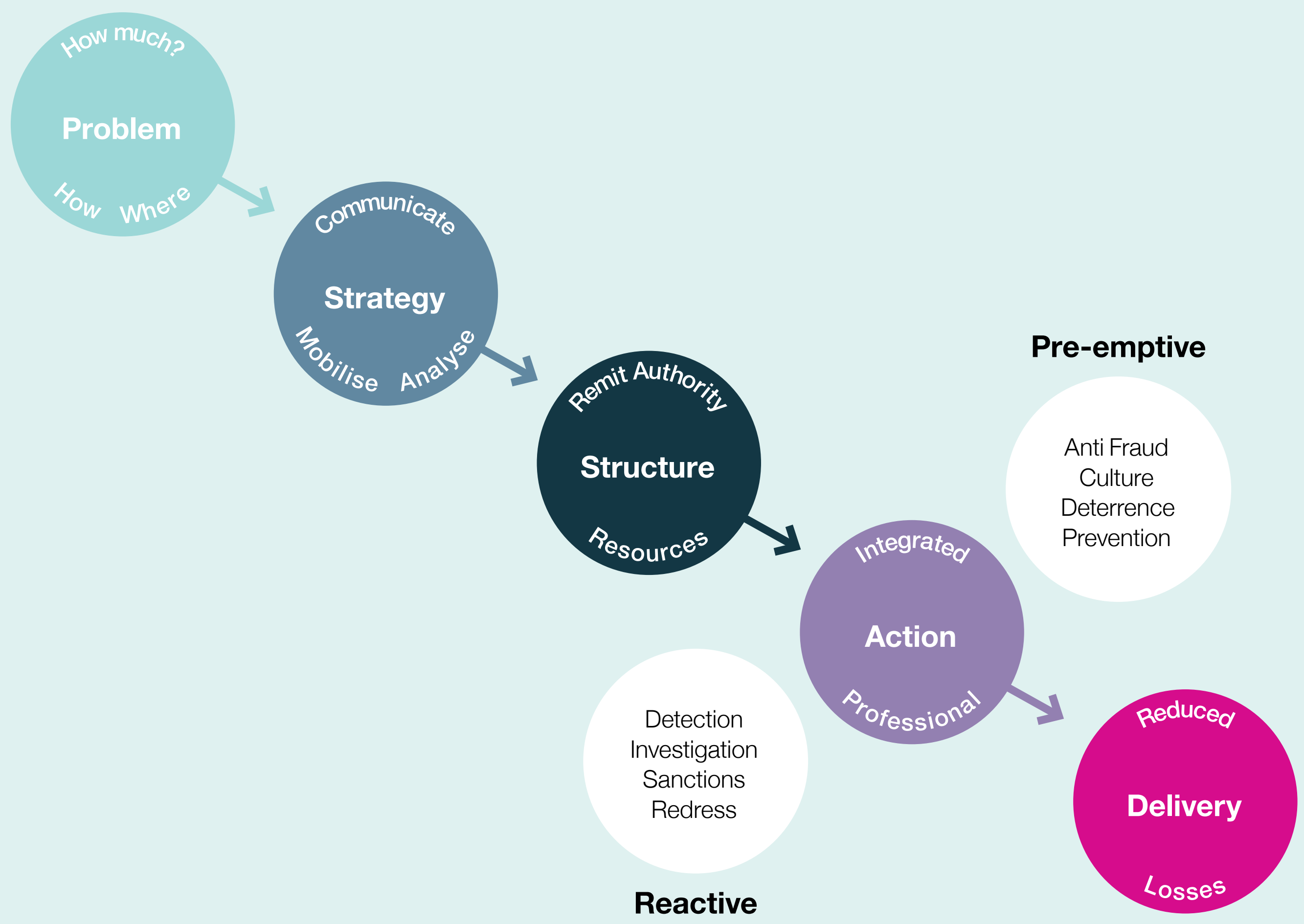
The modern strategic approach

The modern strategic approach to countering fraud is comprehensive and is encapsulated in the outcomes of the Government's 2006 Fraud Review. This comprehensive approach has five phases:

1. Understanding the nature and scale of the problem.
2. Designing and communicating a counter fraud strategy which is specific to the known problem.
3. Creating a structure to implement the strategy.
4. Using the structure to undertake a range of pre-emptive and reactive action.
5. Delivering beneficial outcomes derived from reducing the extent and cost of fraud.

An organisation which is fully effective in each of these respects will be as fraud resilient as it can be.

The comprehensive approach to managing the risk of fraud



Understanding the nature and scale of the problem

The first phase of this modern approach involves organisations seeking to understand the nature and scale of their own fraud 'problem'.

There are several ways to do this, ranging from fraud loss measurement exercises that have different levels of accuracy and statistical validity (and thus vary in cost), through to indicative losses figures derived from assessments of fraud resilience (see Chapter 7). Specialist university-accredited fraud loss measurement training is now available to enable charities to undertake fraud loss measurement exercises in their own organisation. Key staff from a range of central government departments have recently undertaken fraud loss measurement training with a view, for the first time, to accurately measure losses to fraud across a range of expenditure.

Fraud loss measurement exercises are now routinely conducted by many government organisations as part of their accountability to the public, not just in the UK but around the world and there is a recognised model that these organisations adopt to undertake this work:

Stage 1:
Scope, understand and prepare for the exercise

Stage 2:
Train and prepare staff, communicate with data holders

Stage 3:
Obtain and review data sample

Stage 4:
Determine the presence of fraud and related weaknesses

Stage 5:
Undertake statistical analysis to determine the cost of fraud across the full area of expenditure, with up to +/-1% accuracy.

Stage 6:
Report

It is important to understand that fraud loss measurement exercises measure the actual financial cost of fraud. This is very different from a 'risk assessment' because the result is derived from examining a representative sample of items of expenditure and considering information and evidence that demonstrate the presence of correctness, error and fraud.

> **“Research shows that the largest part of the fraud ‘cost’ comes from high volume, low value rather than low volume, high value fraud”**

A fraud risk assessment is an exercise that seeks to identify the likelihood of a fraud occurring given the existing controls, based on the opinion of those undertaking the assessment, and doesn’t seek to quantify the level of fraud that may actually be present.

In seeking to understand the nature and scale of fraud, organisations should be aware that detected fraud is likely to represent only a small proportion of what is actually taking place. This is not likely to be because of any particular weaknesses in arrangements to detect fraud, rather it is because of fraud’s intrinsic nature as something to be hidden and concealed. Global research suggests that, even in the best performing organisations, detected fraud can represent as little as one-thirtieth of its total cost[1]. The Annual Fraud Indicator includes undetected fraud in its estimates, recognising the significant value this represents.

Research shows that the largest part of the fraud ‘cost’ comes from high volume, low value rather than low volume, high value fraud. Individual low value frauds can seem insignificant and not worthy of extensive efforts to prevent them; however, in aggregate they usually add up to the greatest cost. It can also seem disproportionate to investigate a low value fraud, and this may be true – a more proactive response seeking to remove the process or systems weakness which allows it to take place may be the best solution. The large, high value cases which are sometimes reported in the media are reported on precisely because they are unusual. Understanding the balance of different levels of fraud is important to agreeing how to address the problem.

Fraud takes place because a dishonest minority exploit process and systems weaknesses. Organisations of any size will always be affected by fraud, but the extent to which this is the case will vary according to what efforts are made to tackle it. If the focus of counter fraud work is solely on detecting fraud and fraudsters then, however many are found, there will always be others who will seek to exploit the same opportunity. Therefore, the focus of counter fraud work should include the process and systems weaknesses which allow fraud to take place, and on removing the weaknesses in a systematic, prioritised way. Doing so will reduce the number of opportunities the dishonest minority can exploit.

Learning from each example of fraud is key. It should be made as hard as possible for a particular type of fraud to recur, because processes and systems have been re-designed. Failure to address frauds may only encourage others.

1 Fraud and Punishment’ - Dr. Mark Button, Chris Lewis, David Shepherd, Graham Brooks and Alison Wakefield. 2012 Centre for Counter Fraud Studies, University of Portsmouth.

Designing a strategic solution to the defined problem

A well-written counter fraud strategy is important. It needs to:

- ✓ Explain to the uninitiated what is being done and why.
- ✓ Contain messages which can be used to communicate the importance of counter fraud work and to mobilise support.
- ✓ Define the beneficial outcomes for the organisation, so stakeholders can see how they gain from the work.
- ✓ Provide a framework for assessing the value of particular courses of action.
- ✓ Reflect the nature of the charity’s concerns with the right balance of activity to reflect what is known about the nature and scale of fraud.

A good counter fraud strategy is one which is communicated extensively to trustees, employees, volunteers, suppliers, agents, contractors and others and which is ‘owned’ by the organisation concerned. What is required are simple clear messages about:

- ✓ The seriousness of fraud.
- ✓ Its impact on the organisation.
- ✓ The potential benefits from tackling it effectively.
- ✓ The responsibility of everyone to work together to pre-empt fraud.

More detail about the issues that should be considered and addressed are provided in subsequent chapters of this guide.

> **“Failure to address frauds may only encourage others”**

Creating a structure to implement the strategy

Having sought to know as much as possible about the nature and scale of the problem and then having designed a counter fraud strategy to address it, the next step is to put in place an organisational structure with the appropriate remit, authority, skills and resources to implement the strategy effectively. The strategy should be designed so that it encompasses volunteers as well as employed members of staff and there should be the same behavioural expectations and responsibilities placed on both.

Defining the right remit and authority

The remit of those tasked with countering fraud needs to be clear and comprehensive. Counter fraud responsibilities should be centralised rather than divided between an organisation's units/teams. The issue needs a focus and a profile, both of which are harder to achieve if different groups are each undertaking different aspects of the work. Splitting counter fraud responsibilities also means that it is much more difficult to create synergy between different aspects of the work, or to achieve the optimum return on costs.

Countering fraud is not an easy task. Not just because of the need to deal with fraudsters; making the necessary changes to processes and systems to prevent fraud recurring can be much more difficult. Sometimes the systems and processes will have been developed over many years (although often without any specialist counter fraud input) and counter fraud staff will need clear authority from senior levels of the organisation to secure the necessary changes. A reporting line to trustees is important to ensure that those specifically charged with countering fraud have the mandate to make the appropriate changes.

An individual at board level should take responsibility for championing counter fraud activity but it should be remembered that there is a collective responsibility for protecting the charity's funds.

Professional counter fraud skills

As with any role, ensuring that the right level and blend of skills are applied is important. In respect of fraud, the Government formed the new counter fraud profession in the late 1990s. More than 15,000 counter fraud specialists have now been trained and accredited in all economic sectors at foundation, diploma, degree and masters levels. In some parts of the public sector, having the foundation level Accredited Counter Fraud Specialist qualification is mandatory. Increasingly in Government grant awards and contracts, provisions are written in requiring the recipient organisation to have in place suitably trained and accredited staff to protect those funds from fraud. Charities bidding for such awards or contracts should ensure that they have the right resources in place. The accreditation provides an assurance that its holder has the necessary technical skills and ethical understanding to undertake the work to a satisfactory standard. Training courses are widely accessible and links to the Counter Fraud Professional Accreditation Board (CFPAB) are included in Chapter 12 of this guide; it should be noted that CFPAB accredits an International Counter Fraud Specialist award, which may be of relevance to those charities operating overseas. The Certified Fraud Examiner qualification, offered by the US-based Association of Certified Fraud Examiners, is widely recognised internationally.

Another factor to take account of is obtaining the right blend of skills, including ensuring access to a specialist external resource where this is needed.

Deciding on what professional skills are required within your organisation will depend on an assessment of the risks to your charity and to the size and scale of your activities.

> "Increasingly in grant awards and contracts, provisions are written in requiring the recipient organisation to have in place suitably trained and accredited staff to protect those funds from fraud."

Investing proportionately in counter fraud work

It is very difficult to make a rational judgement about how much to invest in counter fraud work without having an idea of the nature and scale of fraud, its cost, and the extent to which the organisation is already effectively protected against fraud, that is, the extent to which the organisation is fraud resilient.

Charities should seek the best information they can about the cost of fraud and fraud resilience before making such decisions.

What is clear is that the cost of fraud is many times what is detected. Investment decisions based solely on the levels of detected fraud will result in serious under-investment, with organisations consequently failing to benefit from the financial gains which can result from reducing their fraud costs.

Using the structure to undertake a range of pre-emptive action

Having ensured that an effective structure is in place, it is important to use it to undertake a range of actions to tackle fraud. This should include work in the following seven areas:

(i) Developing a real anti-fraud culture

The right tone from the top, in the context of effective governance arrangements, sends a clear message about what is acceptable and what is unacceptable. Many different issues compete for time and attention in any organisation; however, in respect of fraud, the right messages from leadership levels can have a major impact. Trustees, chief executives and other senior leaders are just as much responsible as finance professionals.

Clear messages should not be confused with rhetoric. Over the years, some organisations have grown used to using the phrase 'zero tolerance' to describe their stance on fraud. This is understandable, but there are dangers inherent in using this phrase. Research shows that the cost of fraud cannot be reduced to zero. Nevertheless, the cost of fraud can be massively reduced where specialist counter fraud work takes place. Research shows that fraud losses can be reduced from an average of 5.6% of expenditure to around 1% (but not to zero). Using the phrase 'zero tolerance' can result in an unhelpful gap between rhetoric and reality, which in some cases has led to undeserved negative publicity as, inevitably, individual examples of fraud occur.

Instead of 'zero tolerance', some organisations have committed to reduce fraud to 'an absolute minimum'. The absolute minimum may reduce over time and will be based on evidence on the measured cost of fraud. Framing efforts to address fraud in this manner is helpful as it does not exclude the possibility of fraud, increasing the likelihood that addressing fraud will remain an active issue. Charities should consider carefully reputational concerns when communicating their approach to combating fraud.

There are many ways of communicating the importance of addressing fraud, and of working to reduce its extent and cost. These include e-learning packages for staff, face-to-face fraud awareness training sessions, roadshows, short video clips, fraud awareness weeks, newsletters, special website pages, and many others.

When strengthening anti-fraud cultures, particular messages have been found to resonate with the honest majority:

- ✓ The professional and ethical nature of counter fraud work.
- ✓ The importance of protecting donors from fraud.
- ✓ The importance of protecting the charity, its reputation and its resources against fraud.
- ✓ The potential financial benefits of reducing the cost of fraud and what this would mean in terms of improved outcomes for beneficiaries.

It is important to avoid using language that is opaque, technical, or panders to stereotypes about those undertaking counter fraud, for example, 'cracking down', 'fraud-busters' etc. Such language de-normalises the work and makes it harder for some to support it.

Throughout this guide, the word 'counter' is used consistently to describe work to address and reduce fraud. A strong anti-fraud culture requires a good level of stakeholder support for counter fraud work. In many organisations, memorandums of understanding and/or counter fraud charters have been agreed with stakeholder and partner organisations. The memorandums set out respective responsibilities of the organisation and groups that have 'signed-up' and agreed to work together to tackle the problem. This is a common approach in local government and the NHS and has been adopted in some parts of the private sector, such as by the Association of British Insurers. The use of a charter or memorandum of understanding will provide an opportunity for a charity

> **"The right tone from the top, in the context of effective governance arrangements, sends a clear message about what is acceptable and what is unacceptable."**

to engage with a supplier or partner organisation in setting-out their joint stance on countering fraud as well as helping to promote an anti-fraud culture. However, a piece of paper is just that unless there is ongoing work to strengthen and embed good relationships.

It is important to assess and track progress in the development of anti-fraud cultures. Doing so is relatively simple, two factors are key:

1. The extent to which those concerned acknowledge that they have a responsibility to protect the organisation (and by wider definition, the consumer) against fraud.
2. The extent to which those concerned understand how their responsibility is exercised.

Many organisations regularly survey their staff about a variety of issues. Adding questions about the anti-fraud culture can provide important information about the effectiveness of efforts to change attitudes about counter fraud.

(ii) Creating a strong deterrent effect

The development of a strong anti-fraud culture involves communicating messages designed to mobilise the honest majority. The creation of a strong deterrent effect involves communicating very different messages to a different group – the dishonest minority.

How does deterrence work? Prospective fraudsters make an assessment, their own 'risk assessment', about possible gains to be made from perpetrating fraud versus the risks that they might face (including the potential social opprobrium). Key deterrence factors include:

- The strength of peer group pressure that fraud is unacceptable.
- The perceived strength of arrangements to prevent fraud.
- The perceived likelihood of fraud being detected.
- The perceived likelihood of a professional investigation uncovering evidence of how the fraud was perpetrated.
- Considerations of the likelihood that proportionate sanctions will be applied if they are sought.
- The extent to which it is thought likely that the charity will recover its losses.

Each factor is important to deter fraud. The relative importance of each depends on whether the prospective fraudster understands the extent of the risks they face. For example, if the fraudster understands the nature and strength of arrangements to prevent fraud he is less likely to undertake the fraudulent activity. If the factors are not publicised, then the fraudster will not be made to understand the risks that he or she faces.

Peer group pressure is important. Making the impact of fraud as concrete as possible helps to increase peer group pressure. For example, by describing to employees the impact of the global 5.6% average losses to expenditure in terms of their charity – what would this mean in real terms? Similarly, describing the beneficial impact of reducing the losses in terms of their organisation, its ability to better meet its objectives, and their job security and salary, can help to galvanise support against fraud.

Stakeholders are important to help establish a strong deterrent effect. For example, trade organisations condemning fraud by their own members, or a group of competitors coming together to condemn particular frauds that affect them all. It is important that prospective fraudsters believe that no one will defend them if they undertake fraud and are caught. Rationalisation is a key element of the fraudster's decision-making process. Taking the first dishonest step is easier if fraudsters can justify their actions in their own mind. A strong culture that stresses that fraud is never acceptable, whatever the circumstances, is a very good deterrent.

The impact of deterrence can also be reviewed by considering changes in human behaviour after instances of fraud are publicised, as revealed by data[2]. Sometimes, depending on the extent and nature of the publicity, major changes have taken place in the short term, only for the position to revert over time. Where such an impact is found to have taken place, it is important to consolidate these gains with further publicity. Charities need to be continuously vigilant when it comes to combating fraud.

2 'Fraud and Punishment' - Dr. Mark Button, Chris Lewis, David Shepherd, Graham Brooks and Alison Wakefield. 2012, Centre for Counter Fraud Studies, University of Portsmouth.

> "Process and system weaknesses enable fraud, however, the weaknesses will be only be exploited by dishonest people"

(iii) Preventing fraud by designing out weaknesses in processes and systems

An important aspect of any investigation into fraud is to consider the process and/or system weakness that allowed it to take place. Information about processes and/or system weaknesses should always be included in any investigation report. The purpose of including the information is to ensure they can be resolved so that similar frauds cannot be repeated. That is, the processes and/or systems should be redesigned so that the weaknesses are 'designed out'. Over time, it is helpful to develop a register of process and/or system weaknesses linked to prioritised actions to resolve them. It is essential that investigative work and work to redesign processes and/or systems are linked.

As well as designing out revealed weaknesses, it is best practice to design fraud out of new processes, systems and contracts from the outset and before fraud can occur. It is important that the redesign of existing, and the design of new, processes and/or systems involve those undertaking counter fraud work. The advantages of doing so are self-evident, but it does not happen as extensively as it should. Whenever a major new venture or system is being introduced, charities should ensure that systematic consideration is given to ensuring that opportunities for fraud are considered and removed. Ensuring that at least some staff have the appropriate counter fraud skills and expertise will aid the development of fraud resilient processes and systems.

It is also important that the results of routine internal audit work, involving the review of systems and processes and the identification of weaknesses, are considered in the context of the weaknesses potentially allowing fraud to take place. Furthermore, where fraud is found to have taken place, the process or systems weaknesses which have allowed this to occur should be identified and notified for the purpose of properly targeting audit work.

Process and system weaknesses enable fraud; however, the weaknesses will be only be exploited by dishonest people. Efforts to increase fraud resilience should include an objective to minimise the number of dishonest people. Pre-employment (propriety) checks on staff are important, as are comprehensive due-diligence enquiries on prospective suppliers and contractors. The work of many charities is often global, often in trying and challenging circumstances, posing difficulties for those attempting to undertake checks on suppliers and contractors, particularly where urgent action is required. The authors have seen many examples when mere Google searches have been deemed sufficient to satisfy this purpose. Specialist resources and tools are available to undertake pre-employment and due diligence checks. Using these resources and tools can be extremely cost-effective, especially in the context of the reputational and financial damage caused from a scandal involving fraud. While checks on staff are a normal human resources function (although there are additional areas to be considered in respect of fraud) checks on contractors may be less usual, other than beyond exploring their capacity to meet the terms of the contract.

Charities should demonstrate that they care about their staff and will support them when they face personal difficulties, particularly involving debt, where they might otherwise be tempted from moving from being an honest person to one who is dishonest.

(iv) Detecting fraud where it is not prevented

There are several ways to maximise the likelihood of fraud being detected, but, as discussed above, the nature of fraud is about hiding the truth and charities should expect that some fraud will remain undetected. Wherever research has been undertaken, it shows that the value of undetected fraud exceeds the value of what has been detected.

Easy-to-use and secure channels of communication can be important in this respect. Many organisations have their own confidential reporting telephone lines where information concerning suspected fraud can be provided. Nationally, the Government's 'Action Fraud' website and telephone lines allow members of the public to do this; however charities may also wish to have their own arrangements in place. Many larger organisations have 'whistleblowing' processes; to increase the deterrent effect the process should be publicised beyond the organisation's own boundary.

All charities should ensure that they have effective whistleblowing arrangements in place where, for whatever reason, employees who wish to provide information can do so while minimising the risks to themselves and their employment and these should have references to reporting fraud. The Public Interest Disclosure Act 1998 (c.23) protects whistleblowers from detrimental treatment by their employer. Under the Act, employees that make disclosures of certain types of information (such as reporting suspicions of illegal activity or damage to the environment) are protected from retribution by their employer, such as dismissal or being passed over for promotion. In cases where such retribution takes place, the employee may bring a case before an employment tribunal that can award compensation. As a result of the Act, many more employers have instituted internal whistleblowing procedures. The charity Public Concern at Work (www.pcaw.org.uk) is an excellent source of further information in this area and can provide information about other whistleblowing avenues.

A charity's expectations about speaking up and reporting concerns should be made clear to staff, agents and contractors. Where a particular fraud is known or suspected, it should be reported to a designated person. Arrangements to do so should be clearly stated and widely publicised, with detailed records kept and speedy processes for investigative work to commence where this is appropriate.

Charities should undertake proactive counter fraud exercises that look for fraud taking place rather than waiting for it to be detected and reported. Close liaison between counter fraud specialists and those responsible for the audit function can be very helpful in this respect. Fraud is more likely where processes or systems are known to be weak. Proactive counter fraud exercises should first focus on the weakest processes and/or systems.

Finally, organisations should consider whether more work can usefully be undertaken to analyse available data, with a view to finding anomalies that may represent fraud. The Audit Commission's National Fraud Initiative undertook data matching work for many years and cross-checks data taken from across the public and private sector to identify inappropriate matches; with the abolition of the Audit Commission in March 2015 the National Fraud Initiative has moved to the Cabinet Office, which is continuing with this work.

It may be useful to consider more modern 'model based' data analytics and data visualisation techniques (techniques that look for anomalous data rather than any specific data 'match'). There are many providers of such services and software to undertake such work in-house.

When considering the use of data analytics there are two important issues to keep in mind:

1. Is the quality of the data good enough for data analytics to produce meaningful results?
2. Any data analytics exercise will produce a list of issues for examination. Working through the list will take time and resources, and it is important to plan accordingly.

All of the techniques described above can prove useful in detecting fraud and should be considered by charities.

(v) Investigating suspicions of fraud in an expert, fair and objective manner

Steps taken at the start of an investigation can determine whether or not there will be a successful outcome. Decisions at the outset must be thought through – it is easy to 'jump in' without considering the potential consequences of an investigator's actions. The aim of an investigation is to establish the truth and an investigator must retain an open mind – there may be an innocent explanation for what has happened. Initial concerns should be recorded in a durable and retrievable format, noting what has been said and by whom. This will help to identify potential witnesses and the location of evidence.

An organisation's strategy should describe who will undertake the investigation and who they will report to. The aim of the investigation, including the terms of reference, should be documented so that the investigator has a clear goal to achieve. The aim and terms of reference should be reviewed periodically to ensure the investigation progresses as necessary. Who knows what, and who should be notified of the allegation, should be established during the early stages of the investigation. The number of people who know about the investigation should be restricted as far as possible and it should be made clear to them that their knowledge should remain confidential.

At the outset of an investigation, it is important to keep all possible sanction options available. It is often the case that the fraud that has been detected will not be the first that has been committed and what has first appeared to have been a minor fraud may be one of many, amounting to a significant loss and requiring a different sanction. Compliance with procedural legislation and best practice is required to ensure that the investigation is conducted in a manner that enables criminal, civil, disciplinary or regulatory action. The investigator should adopt the criminal standard and consider whether the Human Rights Act 1998 and the Regulation of Investigatory Powers Act 2000 will apply to the case being examined. The requirements and obligations of the Data Protection Act 1998 will apply to the investigation, although there are exemptions where a criminal investigation is taking place[3].

Gathering evidence is a key component of an investigation, whether by collecting documents, securing digital evidence, interviewing witnesses and taking statements, or by interviewing the suspect. Each evidence gathering method requires specialist skills and the investigator should demonstrate best practice, ensuring that the evidence collected is admissible in criminal, civil, disciplinary or regulatory proceedings. The Criminal Procedure and Investigations Act 1996 requires that material collected during the course of an investigation must be recorded, retained securely and revealed to the prosecutor. Anything that may undermine the prosecution case or assist the defence has to be revealed. All material gathered must be continually reviewed to determine whether this is the case.

Although it is possible to undertake a private prosecution where fraud has occurred, it is preferable that the Crown Prosecution Service (CPS) takes such action. Action by the CPS requires police involvement during the course of the investigation. Police involvement brings additional benefits as they have investigative techniques and powers outside the scope of a charity fraud investigator, such as powers of search and arrest. It is important that charity fraud investigators develop good working relationships with local police services.

The above paragraphs demonstrate that specialist knowledge and skills are required to conduct an investigation in a way that ensures it will be legally and ethically compliant. During the course of the investigation, a charity's investigator will most likely come into contact with law enforcement investigators from a range of public sector bodies as well as the Charity Commission, many of whom will be trained to at least foundation level (Accredited Counter Fraud Specialist) and are accredited by the Counter Fraud Professional Accreditation Board. Such accreditation demonstrates knowledge and skills and provides holders with a common professional qualification. By obtaining such accreditation, charity fraud investigators will be able to demonstrate their own competency and will share a common language with their peers in other agencies.

Some evidence-gathering techniques will be beyond the scope of the charity investigator and will require the use of an expert. The charity investigator should be able to identify situations where crucial evidence may be revealed by the use of such a professional, for example digital evidence, forensic accounting, surveillance and specialist legal tools.

3 S.29 provides exemptions where a criminal offence is being considered and s.35 provides similar exemptions where prospective legal proceedings are being prepared

"Steps taken at the start of an investigation can determine whether or not there will be a successful outcome"

(vi) Seeking to apply a range of criminal, civil, disciplinary and regulatory sanctions where fraud is believed to be present

Chapter 3 outlines the different types of sanctions that should be considered in respect of fraud and the main ways in which they can be useful. Additional information about appropriate and available fraud sanctions are described in detail in a study, titled 'Fraud and Punishment', recently published by the Centre for Counter Fraud Studies at the University of Portsmouth[4]. Trustees should remember that they have a legal responsibility to take action where funds are lost to fraud.

Criminal prosecution: There are advantages to pursuing a criminal prosecution The threat of a criminal prosecution can sometimes secure the co-operation of the fraudster (and repayment of the sums defrauded), and there is a general deterrent effect of knowing that a criminal prosecution will be pursued in the event of fraud being identified.

Barriers and disadvantages include:

- The Crown Prosecution Service may not wish to pursue a case. In deciding whether to proceed with a case the Crown Prosecutor must be satisfied that the two tests as set-out in the Code for Crown Prosecutors have been passed.
- The complexities of disclosure rules, which may lead to commercially sensitive information coming into the public domain.
- The delays sometimes involved in criminal investigations.
- The challenges in securing compensation as the criminal courts are designed to punish offenders, rather than to recover losses.

Private prosecution: A private prosecution is a prosecution brought privately under s.6 of the Prosecution of Offences Act 1985. A number of bodies regularly use private prosecution, including the Royal Society for the Prevention of Cruelty to Animals, the League Against Cruel Sports, and the Federation Against Copyright Theft.

The advantages of private prosecutions include the possibility of triggering police interest and the recovery of the costs of private prosecution from the State. The disadvantages and barriers include the same up-front costs of prosecution, the potential hostility of the CPS and the police, a concern about the quality of such prosecutions and their 'independence', and reluctance by the courts to remand in custody those being prosecuted.

Civil sanctions: Civil litigation can be used in fraud cases to pursue fraudsters for losses and damages. Usually the desired outcome is to freeze a defendant's assets to encourage them to negotiate a settlement out of court. There are a range of powerful legal tools that can be used to support this approach.

Benefits of the civil approach include:

- Speed of action.
- The claimant's control of the process.
- Flexibility.
- A lower standard of proof to be achieved (balance of probability rather than beyond reasonable doubt).
- The lack of a need to rely on the police to gather evidence.
- The ability to obtain orders to compel:
  - o The fraudster to desist from their actions, and
  - o To produce documents and other evidence.
- A focus on the recovery of losses.

Barriers and disadvantages include:

- The cost.
- A relative lack of knowledge and understanding of the civil law (although professional advice can remedy this).
- The difficulty of knowing who to engage to undertake the related work.
- The fact that civil cases do not result in a criminal record for the fraudster.

Parallel sanctions: It is also possible to apply different sanctions at the same time, such as:

- Civil litigation and a criminal prosecution.
- A staff disciplinary process and civil litigation.
- A staff disciplinary process and a criminal prosecution.
- A staff disciplinary process, civil litigation and a criminal prosecution.
- Civil litigation and regulatory sanctions.

The advantages of parallel sanctions include:

- The flexibility.
- Sending out a potent signal for deterrence purposes.

Barriers and disadvantages include:

- The perceived complexity.
- The desire to rely on 'traditional methods'.
- The lack of understanding of the interplay between different types of sanctions.
- Police/CPS hostility.

However, barriers and disadvantages have been overcome in the United States, where there is evidence of much more effective use of parallel sanctions. In some parts of the UK public sector (such as the NHS), the consideration of parallel sanctions is also legally mandatory; in the private sector there is a growing trend to pursue parallel sanctions, with a number of reputable professional services and law firms providing these services.

A link to the CCFS report is included in Chapter 11 of this guide and organisations are encouraged to read it, particularly its review of the range of possible sanctions and their usefulness and applicability.

4 Mark Button, Chris Lewis, David Shepherd, Graham Brooks and Alison Wakefield, 'Fraud and Punishment'. Centre for Counter Fraud Studies at University of Portsmouth, 2012.

"Civil litigation can be used in fraud cases to pursue fraudsters for losses and damages"

(vii) Seeking redress and recovering losses where they are incurred

One of the most important 'harms' that fraud causes is the losses which are incurred and thus, the resources which are diverted from funding the core activities of a charity. When a fraud takes place, it is important to recover such losses.

One way in which this may be achieved is through appropriate insurance cover, and charities should make sure that they have such cover. They should remember that, in order to ensure recovery from insurers, they must act to mitigate losses. In most circumstances, acting to mitigate losses means that there are adequate fraud prevention measures in place and that civil litigation is pursued when appropriate.

It may be appropriate to pursue civil litigation to recover losses when larger sums are involved. Doing so is a simpler and easier process than is often believed. The civil law can be a flexible and powerful weapon, allowing plaintiffs to trace, freeze and recover assets. The costs of civil litigation also do not need to be excessive, especially with the potential availability of After The Event (ATE) insurance. ATE insurance can cover the costs of both an investigation and the subsequent legal process, with even the premium for the ATE insurance being recovered from the defendant.

Of course, civil litigation will require accurate quantification of losses to a standard that is acceptable to the civil court. This is a specialist area of work, but one that is undertaken quite routinely by a variety of accountancy firms; specialist resources may also be required to undertake work to assess the level of assets that are held by the fraudster.

This section on seeking redress and recovering losses is intended to highlight what is possible rather than providing detailed information. In respect of particular cases, charities should seek specialist professional advice.

Performance-managing counter fraud work and delivering real financial benefits

It is often said that people focus on activities where their performance is measured at the expense of activities where performance is not measured, irrespective of the relative importance of the different activities. As such, Key Performance Indicators (KPIs) are important, influencing human behaviour. KPIs can drive performance, define outcomes and provide clear indications of progress.

Historically, it was unusual to find KPIs applied to counter fraud work. For much too long it was assumed that counter fraud work was primarily reactive, responding to suspicions of fraud with an investigation which would sometimes (if the evidence allowed) be followed with a criminal prosecution. The effectiveness of counter fraud work was seen primarily in terms of how many referrals concerning suspicions of fraud were received and how many investigations and prosecutions followed them. Alternatively, if few suspicions were brought to light and few investigations and prosecutions resulted, then it was assumed that little fraud was taking place.

Neither proposition is correct. More reactive activity concerning fraud may just mean that there is more fraud. Conversely, low levels of activity may mean that detection rates are poor and, consequently, that the cost of fraud is higher. Neither is a helpful indicator of the success of counter fraud work.

The example of historical counter fraud practices, in terms of KPIs related to referrals, investigation and prosecutions, is a good example of how the wrong KPIs can incentivise the wrong activity. In the case of the example above, the KPIs should have focused on the desired outcomes such as the reduction in the cost of fraud and the consequent financial benefits.

Thankfully, over the last decade there have been advances in methods to accurately measure the financial cost of fraud[5], and measure the extent to which organisations properly protect themselves against it, a measure known as 'fraud resilience'. Both are outcome and quality-based measurements that enable the implementation of very different KPIs; KPIs that were not previously possible. It is very difficult to manage something without measuring it; the new measurements allow much more effective management of the issue of fraud.

There are four types of KPI that this guide urges charities to consider:

- ✓ An outcome-based KPI concerning the most important aspect of fraud – how much it costs.
- ✓ A quality-based KPI concerning the extent to which the organisation is fraud resilient – the key factor to determine the cost of fraud.
- ✓ Activity-based KPIs concerning the nature and extent of different types of activity –important factors to determine the level of fraud resilience.
- ✓ A return on investment-based KPI concerning the financial benefits derived from counter fraud work.

> "Over the last decade there have been advances in methods to accurately measure the financial cost of fraud"

In respect of investment-based KPIs, the last 10-15 years has also seen more structured approaches to assessing the financial benefits of counter fraud work and the return on investment. There are three main areas of financial benefit:

- ✓ Measurement and reduction in the aggregate cost of fraud.
- ✓ Recovery of specific losses.
- ✓ Interventions that curtail a fraud before it would have otherwise ceased.

Both the development of KPIs and the calculation of the financial benefits arising from counter fraud work are quite technical areas. There is insufficient space in this guide to describe them in detail; organisations should seek further advice as necessary.

The general point, however, is an important one. Counter fraud work should be performance-managed like any other area of work, with clear management information being available concerning both its cost and the financial benefits which have been delivered.

5 Jim Gee & Professor Mark Button, The Financial Cost of Fraud 2015. PKF Littlejohn LLP and the Centre for Counter Fraud Studies, the University of Portsmouth.

6 Fraud resilience

Fraud can be hugely damaging to any organisation, but especially so to charities. Furthermore, fraud in the charity sector (like the healthcare sector) often has a direct, negative impact on beneficiaries and wider society that is not found in other sectors.

Research found that on average, organisations lost 5.6% of their expenditure through fraud.

A fraud assessment tool found that charities were good in a range of areas including: creating arrangements to report fraud, having robust attitudes to fraud and seeking to design fraud out of processes and system.

However charities were poor at ensuring that counter fraud staff are professionally trained, estimating losses in order to make judgements about how much to invest in fraud and understanding the cost of fraud alongside other areas.

"This chapter describes the measure of how well an organisation is protected against fraud – fraud resilience."

Charities should assess their fraud resilience and report it regularly to trustees.

"It is important that levels of fraud resilience are regularly monitored and reported to the charity's trustees"

It is the cost of fraud which has a very damaging impact. The most extensive research on the cost of fraud which considered data on the measured cost of fraud over 17 years in different countries and across 40 different sectors, showed losses averaging 5.6% of expenditure, based on the total value of the expenditure where the cost of fraud was measured exceeding £9.7 trillion.

In 2015 PKF Littlejohn and the Centre for Counter Fraud Studies (CCFS) published the most extensive and comprehensive report yet undertaken into the resilience of charities in England and Wales to fraud. PKF Littlejohn and the University of Portsmouth worked with the Charity Commission to develop a charity-specific version of the Self-Assessment Fraud Resilience (SAFR) tool (originally sponsored by the Government's National Fraud Authority) which was released for use in February 2015.

The report found that there had been a slight improvement in charities' resilience to fraud compared to 2010, when the research had previously been undertaken.

In which areas did the charity sector perform best? Charity sector organisations performed best in the following areas:

- Effective arrangements to report fraud and corruption;
- Having a robust attitude to fraud and corruption;
- Seeking to design fraud and corruption out of processes and systems;
- Including fraud and corruption risks in risk registers;
- Having reports following investigations on identified policy and systems weaknesses; and
- Considering the application of all possible sanctions where fraud is found to be present.

In which areas did the charity sector perform worst? Charity sector organisations performed worst in the following areas:

- Ensuring counter fraud staff are professionally trained;
- Using estimates of losses to make judgements about how much to invest in countering fraud;
- Understanding the cost of fraud;
- Regularly reviewing the effectiveness of counter fraud work;
- Evaluating the extent to which a real anti-fraud culture exists; and
- Using analytical intelligence techniques.

But what is fraud resilience? In 2009 the CCFS published its first report: The resilience to fraud of UK plc. The report highlighted inherent weaknesses in the strategies and structures in place in the public and private sector to counter fraud. The report was the first of its type and was based upon the latest professional standards for counter fraud work.

The authors surveyed many public and private sector organisations to assess the extent to which they met the professional standards. Only a partial assessment was possible as the research was not designed to fully encompass all relevant professional standards. In addition, the research did not cover the voluntary sector.

In 2010, the CCFS and PKF Littlejohn surveyed the public, private and voluntary sectors. The survey was more comprehensive than the 2009 research, fully reflecting all of the professional standards. The survey included 29 questions to assess the extent to which respondents' organisations met all professional standards relevant to effective fraud resilience.

Building on the fraud resilience methodology developed for the 2010 research, the CCFS and PKF constructed the largest database in the world about fraud resilience, with data from almost 700 organisations on 29 factors relevant to fraud resilience. The database has enabled the CCFS and PKF to examine in detail, and publish reports about, the fraud resilience of a number of different sectors, including the UK charity sector[6].

The database has been used to create a Self-Assessment Fraud Resilience (SAFR) tool and this has been promulgated to large charities by the Charity Commission. With the support of the NFA and the Cabinet Office Fraud, Error and Debt Team, the tool has also been promoted to local and central government organisations. With the support of the Insurance Fraud Investigators Group, the tool has also been promoted to the insurance industry and with the support of The Institute for Food Safety, Integrity and Probity to the UK food sector. Charities should remember that this is not a competition, and that getting a 'good' mark should not encourage complacency, or a 'bad' mark encourage despondency. The value of the tool is in highlighting the strengths and weaknesses of your organisation and then taking appropriate measures.

The fraud resilience database has grown to the extent that it is possible to compare it with CCFS and PKF's fraud loss measurement database (referred to in Chapter 2). The comparison reveals that there is a strong correlation, as would be expected, between levels of fraud resilience and the losses suffered. Organisations with a fraud resilience rating exceeding 40 out of a maximum 50 points typically incur losses of around 1.5% or less. Organisations with a rating of 20 or less out of 50 experience losses of around 9.5% or more. The correlation demonstrates the importance of fraud resilience for reducing the cost of fraud.

In several sectors fraud resilience is an accepted measure of how effectively an organisation protects itself against fraud. It is important that levels of fraud resilience are regularly monitored and reported to the charity's trustees.

6 The Resilience to Fraud of the Charity Sector in England and Wales 2015, Jim Gee and Professor Mark Button. PKF Littlejohn LLP and the Centre for Counter Fraud Studies, the University of Portsmouth.

7 The impact of the economic environment on fraud

The increasing prevalence of specialist research into fraud means that much greater knowledge is available about the relationship between levels of fraud and the economic cycle. Research by PKF and the CCFS looked at the relationship over the last 35 years.

During the recession of 1980-81 the UK's Gross Domestic Product (GDP) (the predominant way in which the size of the economy is assessed) shrank by a total of 6.1%; during the same period reported fraud and forgery offences increased by 9.1%.

During the recession of 1990-91 GDP shrank by a total of 2.5%; during the same period reported fraud and forgery offences increased by 30.5%.

During the most recent recession, originating in 2008-09, GDP has shrunk by 6% and research shows increases in fraud of more than 30%.

The relevance of the economic cycle to the extent of fraud is clear and organisations should bear this in mind when seeking to ensure that they are fraud resilient. It is important to review and adjust expenditure on counter fraud work to reflect the changing levels of risk. Charities are not immune to changes in the wider economic environment.

Coupled with all of the above is a growing body of research that shows that there has been a decline in moral attitudes over recent years. For example, a YouGov and Sunday Times poll in January 2012 found that 65% of people thought that people in Great Britain had become less honest in the past decade and that 79% of people thought that most people regard personal gain as more important than integrity or honesty. Further research by Professor Paul Whiteley at the University of Essex had similar findings and in the US the evidence paints a similar picture.

8 Top ten tips

The overriding factor charities should remember is that fraud will occur, even if it hasn't already. All charities are different, and measures should be proportionate and appropriate for the threats posed to your organisation.

However the following top 10 tips summarise how all charities can improve their fraud resilience:

1. Action is a must – don't do nothing.
2. Understand what fraud is and is not – it is a specific problem with specific solutions.
3. Concentrate on the cost of fraud (financial and reputational) – this is where damage is greatest.
4. Focus on the outcomes to be derived from counter fraud work (primarily the reduction in that cost and safeguarding of reputation and income) not just on counter fraud activity (number of investigations and/or prosecutions).
5. Set the right tone from the top – this includes trustees, chief executives and all senior leaders within the charity - using appropriate language.
6. Remember that pre-empting fraud is better than reacting to examples when they occur (two-thirds of the financial benefits from reducing the cost of fraud come from changing human behaviour) whilst considering the reputational risks to your organisation.
7. Make sure that you have the right skills in place for your organisation, whether that is professionally accredited counter fraud available specialists (either in-house or externally) to undertake counter fraud work or training counter fraud staff.
8. Understand the importance of a real anti-fraud culture (to mobilise the honest majority) and a strong deterrent effect (to deter the dishonest minority).
9. Highlight the financial benefits of reducing the cost of fraud and the additional stability and financial health that these can bring to your organisation.
10. Performance-manage counter fraud work like any other area of work – fraud is a business cost to be measured, managed and minimised. Counter fraud work should be driven through the use of performance indicators.

9 Conclusion

Fraud is a pernicious problem which can affect any charity, however large or small, undermining reputation and donor confidence. This is the latest guide to be produced by the Charity Finance Group and represents a change in emphasis – one of treating fraud as a business cost and, just like any other unwanted expenditure, reducing it.

The guide is intended to be comprehensive, describing the nature and scale of the problem and providing examples for the sector, as well as outlining the most effective strategic approach and necessary practical actions. Overall, the objective of the guide is to encourage charities to appreciate that the nature and scale of fraud can be accurately assessed, that its extent can be reduced, and that significant financial and reputational benefits will be derived by doing so. This view has been shown to be correct in other sectors, and the charity sector would benefit from the adoption of counter fraud best practice.

The guide has been written for all those with a role to play in countering fraud in the sector but is essential reading for trustees and those responsible for managing a charity's finances; the guide contains tangible and practical advice which, if implemented, will deliver obvious and beneficial outcomes. In the current macro-economic climate such gains will contribute to maintaining and increasing the beneficial effect of donations.

As the charity sector expands its work in this area, the experience gained will be incorporated in subsequent versions of this publication.

10 Fraud resilience tool

There is a free, online Self-Assessment Fraud Resilience tool (SAFR) for the sector which PKF Littlejohn and the CCFS have made available to UK charities. It can be accessed at www.pkf-safr.com and provides an initial insight into how well a charity is protected from fraud. It only takes a few minutes to complete and provides a rating (out of a maximum of 50 points) and ranking (by percentile) in relation to over 1,100 organisations about which data is held.

Data is held securely and confidentially and charities should view the tool as a means of accurately understanding where their resilience to fraud sits in comparison to other organisations. It's not a competition or league table but an opportunity to take stock and to review what can be done to minimise losses to fraud.

The SAFR tool also provides links to a comprehensive set of reports about the financial cost of fraud, fraud loss measurement methodologies and fraud resilience, as well as to the (free) Fraud Hub at the CCFS at the University of Portsmouth (Europe's premier fraud research institute).

The tool and related information provide an invaluable resource to charities to better protect themselves against fraud.

Don't be too alarmed if you get a low score! If this should be the case the result should be taken as a 'call to arms' and an opportunity to motivate the charity into acting to increase its resilience. This doesn't necessarily mean incurring significant expenditure as many things described in this guide can be done at little or no cost but it does mean that action must be taken to reduce the charity's vulnerability to fraud.

Completing the SAFR tool will highlight those areas where action is needed to increase resilience.

11 Other useful organisations and resources

The Charity Finance Group:
www.cfg.org.uk

The Charity Commission (you can also sign up for regulatory alerts):
www.gov.uk/government/organisations/charity-commission

The Fraud Advisory Panel:
www.fraudadvisorypanel.org

Counter Fraud Professional Accreditation Board:
www.port.ac.uk/centre-for-counter-fraud-studies/counter-fraud-professional-accreditation-board

Public Concern at Work is the whistleblowing charity:
www.pcaw.org.uk

The Action Fraud reporting process:
www.actionfraud.police.uk/report_fraud

The City of London Police (the lead police force in respect of fraud):
https://www.cityoflondon.police.uk/advice-and-support/fraud-and-economic-crime/Pages/Reporting-fraud.aspx

The Association of Certified Fraud Examiners:
www.port.ac.uk/ccfs

The Centre for Counter Fraud Studies, University of Portsmouth:
www.acfe.org

12 Further research and training

The best place to look for further information about fraud is the website of the Centre for Counter Fraud Studies at University of Portsmouth: http://www.port.ac.uk/centre-for-counter-fraud-studies/fraud-and-corruption-hub/. The CCFS is Europe's premier research institute concerning fraud and offers a free Fraud Hub with a wealth of documentation, reports, articles and data.

Professional Accredited Counter Fraud Specialist training is available from a number of providers. More can be read about this training, and its links to diploma, degree and masters courses, as well as the Counter Fraud Professional Accreditation Board by going to www.port.ac.uk/centre-for-counter-fraud-studies/counter-fraud-professional-accreditation-board/.

As referred to earlier in this guide, the CCFS has recently published a report reviewing the advantages and disadvantages of different types of sanctions as they are applied in cases of fraud. It is entitled 'Fraud and Punishment' and is available from Professor Mark Button, Director of the CCFS. He can be contacted at: mark.button@port.ac.uk

Charity Finance Group holds regular events and training throughout the year for charities on fraud. Check www.cfg.org.uk/events for more information.

13 Glossary

"The objective of the guide is to encourage charities to appreciate that the nature and scale of fraud can be accurately assessed, that its extent can be reduced, and that significant financial and reputational benefits will be derived by doing so."

ATE - After The Event Insurance	ATE insurance allows organisations or individuals who believe that they have suffered a fraud and who wish to undertake civil litigation to recover losses, to be insured retrospectively for all the costs of the investigation and litigation. Even the premium for the insurance can be charged to the defendant and graduated costs arrangements increase the pressure on the defendant to settle the claim.
AFI - Annual Fraud Indicator	The AFI is an assessment, originally undertaken by the Government's National Fraud Authority, now overseen by the UK Fraud Costs Measurement Committee (representing all sectors of the UK economy) to estimate the extent of detected and undetected fraud across the UK economy and, in as far as possible, every sector. The estimate for 2016 was that £193 billion is lost annually.
Criminal Procedure and Investigations Act 1996	This legislation provides for how criminal investigations should proceed and especially how any evidence which is obtained should be disclosed to a defendant.
Data Protection Act 1998	The Act defines UK law on the processing of data on identifiable living people. It is the main piece of legislation that governs the protection of personal data in the UK.
Fraud Act 2006	Legislation applying to the general offence of fraud or other fraud offences.
Fraud Loss Measurement (FLM)	FLM is a methodology for estimating, to high levels of accuracy and statistical validity, the cost of fraud (and error). It is based on obtaining a representative sample of expenditure, then examining each item within the sample against available information which would indicate the presence of correctness, error and fraud. The representative nature of the sample allows extrapolation of highly accurate financial information.
Human Rights Act 1998	This legislation aims to give further effect in UK law to the rights contained in the European Convention on Human Rights. The Act makes available in UK courts a remedy for breach of a Convention right, without the need to go to the European Court of Human Rights in Strasbourg.
Misrepresentation Act 1967	This legislation regulates English contract law and unjust enrichment, so far as relevant for misrepresentations.

Money laundering	This is the process of concealing the source of money obtained by illicit means. The methods by which money may be laundered are varied and can range in sophistication; they also do not always involve cash.
Prosecution of Offences Act 1985	Its main effects were to move the responsibility of prosecution of offences from the police to the Crown Prosecution Service and to codify the prosecution process.
Regulation of Investigatory Powers Act 2000	Regulates the powers of public bodies to carry out surveillance and investigation, and covers the interception of communications.
Risk assessment	Risk assessment usually involves discussions about the seriousness of a given risk and the likelihood of it materialising. Each characteristic is given a subjective score and the two scores are multiplied to provide an overall rating.
Self-Assessment Fraud Resilience tool (SAFR)	This tool is based on methodology developed over several years by PKF and the Centre for Counter Fraud Studies at the University of Portsmouth. It provides an assessment of 29 different aspects of protection against fraud – based on the latest professional standards – and rates organisations out of a maximum of 50 points. Drawing on the largest database of its type in the world (with data on more than 700 organisations) it also ranks organisations by percentile. Overall, it provides a first look for organisations about how well protected they are against fraud.
Theft Act 1968	This legislation creates a number of offences against property in England and Wales. On 15 January 2007, the Fraud Act 2006 came into force, redefining most of the offences of deception.
The Public Interest Disclosure Act 1998	This legislation protects whistleblowers from detrimental treatment by their employer. It protects employees who make disclosures of certain types of information, including evidence of illegal activity or damage to the environment, from retribution from their employers, such as dismissal or being passed over for promotion.
Whistleblowing	This is where a person chooses to draw attention to any one of a wide variety of potential adverse events (including fraud, as well as health and safety risks, discrimination and corruption and several others). The term is normally used where customary internal channels of communication have been frustrated. People choosing to do this – 'whistleblowers' – are protected, in some circumstances under the Public Interest Disclosure Act 1998 (see above).

The authors

Jim Gee is Partner and Head of Forensic and Counter Fraud Services at PKF Littlejohn and Visiting Professor and Chair of the Centre for Counter Fraud Studies at the University of Portsmouth.

During more than 25 years as a counter fraud specialist, he has advised Ministers, Parliamentary Select Committees and the Attorney-General, as well as national and multi-national companies and some of the most prominent charities. To date he has worked with clients from 38 countries. He specialises in helping organisations to reduce the cost and incidence of fraud through strengthening the resilience to fraud of relevant processes and systems.

Andrew Whittaker is a Senior Manager at PKF Littlejohn and Chair of the Training and Education Committee of the UK's Government-backed Counter Fraud Professional Accreditation Board.

He has over 35 years' experience in countering fraud. He works with clients to increase their resilience to fraud but has also undertaken complex investigations for a variety of organisations, including in the NHS, and in the insurance and many other sectors.

Acknowledgements

The report has benefited from the insights and support of a number of individuals, but in particular, the authors would like to thank the following people:

- **Mark Baynham** (Head of Counter Fraud at Plan International)
- **Oliver May** (Head of Counter Fraud at Oxfam GB)
- **Mike Haley** (Deputy Chief Executive at CIFAS)
- **Lesley McIntosh** (Head of Internal Audit at Practical Action)

About CFG

Charity Finance Group (CFG) is the charity that champions best practice in finance management in the charity and voluntary sector. Our vision is of a financially confident, dynamic and trustworthy charity sector. With this aim in sight, CFG delivers services to its charity members and the sector at large which enable those with financial responsibility to develop and adopt best practice.

With more than 1,350 charities in membership, managing over £21 billion, we are uniquely placed to actively shape policy and legislation, drive efficiency and help charities to make the most out of their money.

Charity Finance Group

15–18 White Lion Street
London N1 9PG

info@cfg.org.uk
www.cfg.org.uk
T: 08453453192

Registered charity no. 1054914
Company no. 3182826