



the control and
investigation of
FRAUD

INTRODUCTION

The purpose of this booklet is to outline the principles of sound business control in relation to fraud and irregular activities for individuals attending courses delivered by Kingdom Management Training.

It is the responsibility of senior management to demonstrate their readiness to handle fraud and irregular activities so that their impact on the enterprise is reduced to a minimum.

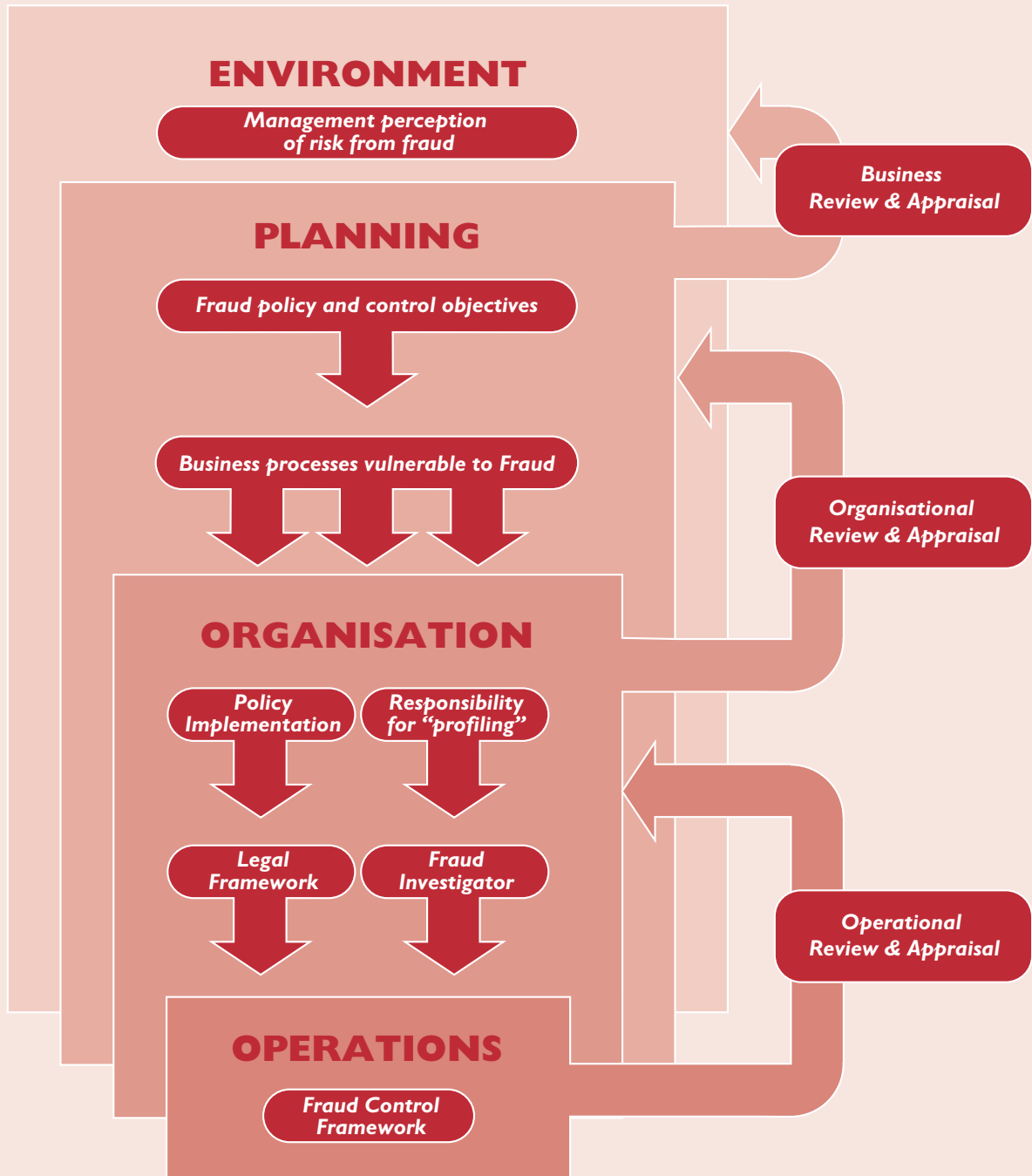
This document is one of a series written by Kingdom Management Training (KMT) which describe KMT's approach to risk management in business. This document relates particularly to the business controls discussed on training courses delivered by KMT on the control and investigation of fraud.

KMT's basic philosophy of risk management is that for an enterprise, in the widest sense, to function effectively it needs a clear, well designed management system incorporating a framework of business controls appropriate to the industry, size, culture and management philosophy of that enterprise. Without such a system and framework, the enterprise and all those involved with it may be unwittingly subject to an unacceptable level of risk. In many instances, the occurrence of a major set-back to the enterprise's success is being avoided by good fortune and not management's judgement. All too often the attitude "It hasn't happened here" is common place and results in a failure to identify the risks involved and put appropriate controls in place. In this document we examine the risks and controls appropriate to the occurrence of fraud and irregular activities in an enterprise.

We hope that our courses and the contents of this document will encourage you to review your enterprise's approach to managing its preparations to prevent and handle fraud effectively should it arise and to adopt as necessary the principles expounded therein.

Kingdom Management Training

FRAUD CONTROL MODEL



The process to obtain reasonable assurance of managing risks, particularly fraudulent activity, which would otherwise prevent an enterprise meeting its objectives.

Control strata

Environment

Planning

Organisation

Operations

Control

Business Control is the process by which any enterprise's management obtain reasonable assurance of achieving their specified objectives, and discharging their responsibilities to stakeholders such as shareholders, employees, customers, suppliers and society. This will include the effective prevention, detection and control of fraudulent activities.

The strength of the control model featured in KMT's courses lies in the simplicity of its reflection of all the features of modern management systems and the key aspects of how they relate to the control and investigation of fraud.

The figure opposite shows a Fraud Control model, which comprises four inter-dependent strata: environment, planning, organisation and operations. The model is a basic control structure applicable to any enterprise, which aims to prevent or detect fraudulent activities.

- All enterprises exist within a business environment which is subject to constant and increasingly rapid change, and that should affect management's perception of the risks posed from fraudulent activity.
- Business objectives are the start point for all business controls and an effective fraud policy must be integrated within the business objectives of the enterprise.
- Business process analysis includes the identification of those activities which are vulnerable to fraud and may require fidelity insurance.
- Fraud policy should require implementation of a corporate strategy for "profiling" high risk activities of the business and clearly set out responsibility for establishing and operating appropriate preventative and investigative procedures.
- All personnel should be reminded of their responsibility to report any fraudulent or irregular activities they discover or suspect to a designated fraud investigator.
- Controls designed to prevent and detect fraud should be applied to business operations in an effective and efficient manner, alongside other business controls.
- Operational review and appraisal should reconfirm the appropriateness and adequacy of the application of the fraud control framework.
- Organisational review and appraisal should confirm the appropriateness of the fraud control framework whenever operational or organisational changes are planned or changes occur within the business environment.
- Business review and appraisal should confirm the progress of the enterprise against its specified objectives, including those related to fraud. Changes to an enterprises's Fraud Policy and Fraud Contingency Response Plan may be required to meet new circumstances.

ENVIRONMENT AND PLANNING

Senior management must have a clear view of the potential risk to their enterprise from fraud, if the enterprise is to have effective control procedures.

A fraud policy is management's opportunity to state that fraud will not be tolerated and that everybody working within or for the enterprise must accept their role in assisting management to prevent and detect it.

High-risk business processes must be carefully analysed to construct an effective framework of preventative and detective controls.

Management Perception of Risk from Fraud

Risk, broadly defined, is something which may hinder the achievement of business objectives. Fraud is one such risk which management must be alert to, ready for and able to deal with appropriately.

The Institute of Internal Auditors says that "Fraud encompasses an array of irregularities and illegal acts characterised by intentional deception." Management should therefore create a business control framework which addresses each of these factors from the viewpoint of "What do we want to control regarding Fraud?" First, they need to be aware of the different types of fraud which are likely to arise in their enterprise, what frauds have similar enterprises experienced, and what new types of fraud are likely to occur, together with the possible impact on their on-going business.

Fraud Policy and Control Objectives

A policy which sets an unequivocal "tone from the top" is management's opportunity to tell potential fraudsters that they will not tolerate fraudulent activity. However, to be effective, management's reaction to the discovery of fraud must fully match the words of their policy. The terms of this Policy, authorised by the Chief Executive, must be well-known throughout the enterprise and to relevant third parties, and should contain reference to:

- **Clear Corporate Strategy** of management's commitment to controlling fraud and the consequences for any person found to be involved with fraudulent or irregular activity.
- **Invitation for "Whistle-Blowing"** which sets out everybody's duty to report suspected fraud to a designated individual, with a commitment to confidentiality regarding any information provided with no detrimental affect on an informant's employment or contractual status. All anonymous allegations should also be investigated and the possibility for reward stated.
- **Code of Ethics** to remind employees that they are bound to act honestly, avoid conflicts of interest, record openly giving and receiving of gifts, maintain confidentiality of valuable information, and to conduct their personal affairs properly.
- **Personnel Policies** regarding recruitment procedures; validation of business and personal references; appraisal during probationary periods and detailed "exit" interviews.
- **Fraud Prevention Measures** implemented by the enterprise; including a description of "profiling" in the high risk areas of the enterprise, and a notification that every aspect of the business will be subject to a risk-based assessment and that co-operation by employees is mandatory.
- **Fraud Contingency Response Plan's** existence, purpose and outline content.

ORGANISATION AND OPERATIONS

“Profiling” likely perpetrators and their illegal activities is a proactive technique used to prevent fraud.

When fraud occurs, management must choose an appropriate legal framework, within which to deal with the fraudster.

A Fraud Investigator’s responsibility should be to assist line management to protect an enterprise against fraud, and to ensure a rapid and successful outcome for all investigations consistent with the fraud policy.

Business Processes inherently vulnerable to Fraud

Management must have a clear view of the business risks posed by fraud within their enterprise. A key step towards effective control is that every major business activity is carefully analysed, in order to determine the need for implementation of appropriate fraud prevention and detection controls. This should also highlight the need for training supervisors in how to use the controls effectively.

Policy Implementation

Procedures must be devised by line management that result in the full application of the enterprise’s policy.

Responsibility for “Profiling”

To be effective, line management must understand what type of frauds are likely to occur in their areas of the enterprise and thereby be able to profile likely perpetrators and/or the possible methods of defrauding the enterprise.

Legal Framework

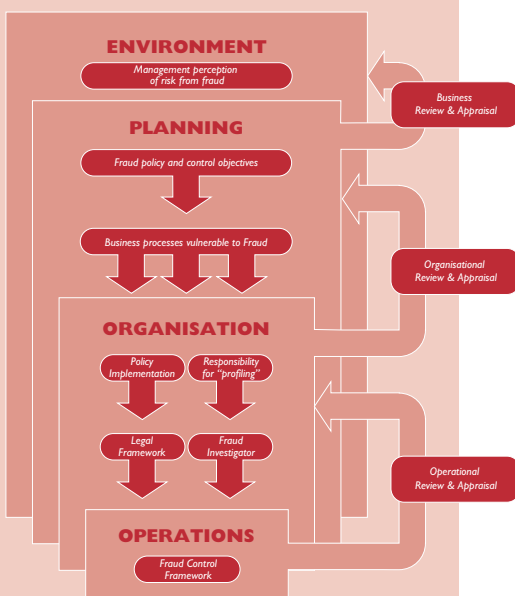
It is important to be aware of the legal implications of how an enterprise handles fraud and to ensure that the fraud control framework operates within those constraints. Management must be aware of the options available to them within criminal, civil and employment legislation and the benefits of complying with the PACE codes of practice.

Fraud Investigator

Management must designate a suitably competent individual to take full responsibility for dealing with the control of fraud and irregular activity in the enterprise; this person is often called the Fraud Investigation Officer (FIO) and he/she should report directly to a sub-committee of senior management, often referred to as the Fraud Investigation Committee (FIC).

Fraud Control Framework

The Fraud Investigator, working together with line management, must ensure that appropriate preventative, detective and corrective fraud controls are incorporated within existing management systems and business control frameworks, consistent with the enterprise’s Fraud Policy.



FRAUD INVESTIGATION MODEL



The fraud investigation process relies on a clear management policy, which seeks to “find the truth”, distinguish “guilt from innocence” and deal with the fraudster. The recovery of assets, protection of the enterprise and learning lessons for the future are all part of a successful investigation process.

Control levels

Fraud Discovery Framework

Legal Framework

Investigation Processes

Investigation

The figure opposite shows a Fraud Investigation model, comprising three inter-dependent control levels: fraud discovery framework; legal framework; and investigation processes.

This model links with the Fraud Control model - the framework created by management to prevent and minimise the impact of fraudulent activity.

- All enterprises should have a clear corporate policy on the actions to be taken if fraudulent or irregular activities are discovered.
- Fundamental to the effectiveness of any investigation is the direction provided by senior management. There must be: clear terms of reference, a previously designated senior person to take charge, a Fraud Investigation Officer (FIO), who has reporting responsibilities to a Fraud Investigation Committee (FIC).
- Fraud investigation should be controlled through agreed procedures set out in an enterprise's Fraud Contingency Response Plan (FCRP).
- Fraud investigations are carried out within a legal framework and described in a Fraud Action Plan.
- The overall investigation process, whatever the legal framework, involves: maintenance of confidentiality; recovery of assets; insurance claims; forensic investigation and protection of evidence; interviewing witnesses and dealing with employees under suspicion; controlling Police involvement; managing civil proceedings; liaising with experts and regulators; preparing media statements; and reporting progress and findings to senior management.
- The FIO should ensure that effective controls are in place to preserve all forms of evidence. This is a key factor if the fraudster is to be prosecuted successfully, as it must be legally admissible in a court of law.
- The FIO should decide at an early stage the action to be taken with persons under suspicion, and whether suspension or dismissal is necessary. Arrangements for interviewing suspects must be made and if criminal proceedings are initiated the Police must be involved.
- “Finding the Truth” is paramount in all interviews not only to conclude a successful fraud investigation, but also to distinguish “guilt from innocence”. Scrupulous adherence to a “fair and reasonable” approach in interviews must be maintained at all times to be successful in court.
- It is important in handling any major fraud to consider to what extent it will affect the on-going business of the enterprise. Adequate measures to protect the business must be set up and followed throughout the investigation process, particularly when issuing statements to the media.
- The FIO must be responsible for initiating a thorough review of all operating procedures in areas affected by the fraud. Comprehensive reports, presented to the FIC during and at the conclusion of the investigation, should set out: findings, perceived weaknesses, lessons learned and improvements required for the fraud control framework to reduce the risk of a recurrence.

FRAUD DISCOVERY FRAMEWORK

The Fraud Investigation Committee is responsible for enabling the enterprise's Fraud Policy to be applied effectively so as to protect the enterprise from the perceived risks.

The Fraud Investigation Officer must have the necessary knowledge, skills, experience and authority to undertake the responsibilities outlined in this document.

The Fraud Contingency Response Plan should be in place to enable an enterprise to make a speedy and effective response when fraud is discovered.

Fraud Investigation Committee – FIC

The FIC is a management sub-committee specifically responsible for ensuring overall consistency in dealing with fraud and irregular activities. Committee members should be appropriately selected, and if necessary trained, in the light of the committee's terms of reference , which should include:

- consideration of specific incidents identified or reported
- initiation and monitoring of progress of investigations
- reporting to the Board of Directors and the media
- assessing the potential for cost-effective asset recovery
- determining the form of legal action to be pursued
- assisting the fraud investigator to achieve his objectives
- determination of improvements to the control framework.

Fraud Investigation Officer – FIO

The skill, experience and authority of the FIO is likely to determine the success or otherwise of an enterprise's fraud control and investigation framework. It is therefore important that a person with appropriate knowledge, skill and experience is appointed. The chairman of the FIC should be responsible for appraising the FIO's performance.

The Fraud Contingency Response Plan – FCRP

The FCRP is developed and maintained by the FIO and approved by the FIC. In its entirety it is a confidential document, however, parts of it must be circulated on a "need to know" basis to those individuals who have responsibilities to regularly review and update information for the FIO. It is used if a fraud or irregular activity occurs, to effect a speedy and focused response and to facilitate the resolution of policy dilemmas , as the facts about the fraud become known to the FIO and FIC.

Topics to be included in the document are: the FCRP's primary objectives and instructions to line management about when and how it is to be used within the enterprise; particular management and investigation responsibilities; general information about fraud; and tailored checklists for the following activities:

- recovery of assets
- notification to insurers
- damage limitation within the business
- clearing innocent people of suspicion
- dealing with offenders
- improvement of defences for the future.

LEGAL FRAMEWORK

A Fraud Action Plan must be prepared by the the Fraud Investigation Officer, to manage the investigation in line with senior management's expectations so that the fraud has a minimal impact on the on-going business.

Fraud Action Plan and Investigative Approach

Suspicion or discovery of a fraud should result in various predetermined actions, some immediate (e.g. freezing a suspect's bank account) and others longer-term (e.g. determining the form of legal proceedings). A clear and up-to-date Fraud Contingency Response Plan will assist the Fraud Investigation Officer to create quickly an effective Fraud Action Plan to control the investigation; this will be a tailored version of the documents and checklists prepared as part of the Response Plan. This helps the Fraud Investigation Officer to set up the most appropriate approach in the circumstances. However, the Fraud Investigation Committee must consider to what extent the fraud is likely to affect the on-going business, and build appropriate actions into the Plan.

Criminal, Civil and Employment Law

Criminal

In the UK a variety of criminal legislation has been enacted to pursue a fraudster, such as the Theft Act, the Financial Services Act and the Criminal Law Act, which cover theft, conspiracy to defraud and fraudulent trading respectively.

Fraud need not be reported to the Police. However, once fraud is reported to the Police they will be responsible for its prosecution and only the Crown Prosecution Service (CPS) can decide to cease the action against the perpetrator.

Civil

Action through the civil courts may be commenced by the defrauded party, to seek:

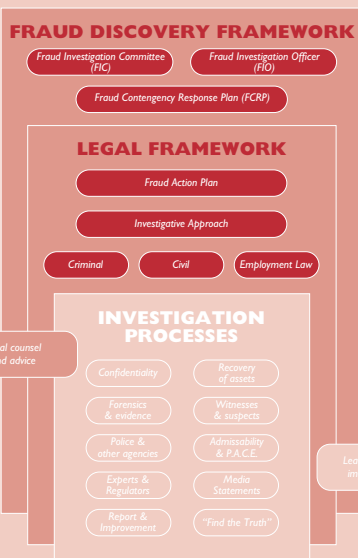
- recovery of assets or compensation for damages incurred
- an injunction to prevent further transgressions
- an order requiring a person to comply with an existing Court order.

Successful recovery of assets depends on being able to get to the assets before they have disappeared, and obtaining and preserving evidence which is needed to prove ownership. A Mareva Injunction can be obtained to freeze assets and an Anton Pillar Search Order permits the inspection of potentially relevant documents and goods.

Employment Law

An enterprise may also act under employment law by either dismissing or suspending the person suspected of fraud or irregular activity. Whatever action is taken should be seen as "fair and reasonable" in the circumstances.

The dismissed party can initiate an action for unfair dismissal and this may lead to a hearing before a Tribunal which can award damages and/or order re-employment.



INVESTIGATION PROCESSES

The Fraud Action Plan (the Plan) should include directions on the following issues:

Confidentiality

The Fraud Investigation Officer (FIO) must ensure that all aspects of the investigation are treated strictly on a “need to know” basis. The Fraud Investigation Committee (FIC) should be informed of major new discoveries and consulted where they need to make decisions as noted in the Plan and/or their terms of reference.

Recovery of Assets

The Plan should identify key personnel who must be alerted “on discovery” of a suspected fraud so that they can immediately prevent the further release of assets and where it is too late, commence the following actions:

- **Tracing** – the success rate for recovery of assets, especially money, is inversely proportional to the time between misappropriation and tracing of affected assets. Specialist legal and accountancy advice should be obtained. The golden rule “follow the asset” often leads to the fraudster.
- **Freezing** – in consultation with legal advisors establish a plan, approved by the FIC, to freeze assets whilst methods of recovery are being evaluated.
- **Return** – the most reliable route for recovery of funds, within the UK, is through the civil courts since recovery under criminal proceedings is less likely.
- **Insurance** – companies should be notified.

Forensics and Evidence

Forensic and technical examination may be needed to test the validity of evidence. Competent professionals must be used who can provide reliable expert testimony and present complex issues so that they will be easily understood by the judge and jury. Evidence must be carefully preserved in a secure place with all documents recorded and kept under the exclusive control of one person.

Witnesses and Suspects

- **Employees** – prompt action should reduce the number of employees under suspicion. The FIO should work closely with the personnel department.
- **Interviewing** – how suspects are to be interviewed will be decided by the FIO and, if the police or another agency is likely to be involved, approved by the FIC.

Police involvement and other Agencies

A decision to involve the Police must be approved by the FIC in line with the enterprise's fraud policy. If the objective is to press for criminal prosecution the sooner the Police are involved the better.

The Police's objectives are to obtain a conviction and not to recover stolen assets. Therefore an enterprise may have to undertake its own action (simultaneously with the criminal action) through the civil courts to recover its

Confidentiality is important in any fraud investigation and all parties involved must ensure that information is only released on a “need to know basis”

Recovery of assets is a key concern for management and they must act quickly and decisively to protect the enterprise and maximise recovery by using the entire specialist services available to them and notifying insurers.

Forensics and evidence requires careful control to ensure that evidence is available to support either a criminal or civil case and that it is not ruled inadmissible by the court.

Witnesses and Suspects must be dealt with early in the investigation and proper procedures, under employment law and PACE, followed to ensure they are treated fairly and reasonably.

If Police involvement and other investigating bodies are to be involved, because criminal proceedings are justified, call them in early so that they can act promptly in questioning suspects (whilst the “trail is still hot”) and can provide maximum assistance with the recovery of assets.

In considering admissibility and PACE the main point is that by complying with the codes of practice, when taking a suspect’s statement, it is more likely that it will be admissible as evidence in court.

Experts’ and Regulators’ advice should be sought to ensure that the enterprise operates within the law and their help and advice is used as appropriate.

FRAUD DISCOVERY FRAMEWORK

Fraud Investigation Committee (FIC) Fraud Investigation Officer (FIO)
 Fraud Contingency Response Plan (FCRP)

LEGAL FRAMEWORK

Fraud Action Plan
 Investigative Approach
 Criminal Civil Employment Law

INVESTIGATION PROCESSES

Confidentiality Recovery of assets
 Forensics & evidence Witnesses & suspects
 Police & other agencies Admissibility & P.A.C.E.
 Experts & Regulators Media Statements
 Report & Improvement “Find the Truth”

Legal counsel and advice

Learn lessons and improve controls

assets. The advantages of involving the Police include: the professionalism, thoroughness and resources at their disposal and their ability to gain access to information not readily available to businesses (i.e. a suspect’s bank statements).

In serious or high profile cases it may be necessary to inform either the Serious Fraud Office or the fraud investigation unit of the Crown Prosecution Service, particularly if criminal proceedings are to be undertaken. These agencies will make their own independent investigations and determine if they wish to take legal action. The FIO should liaise within the enterprise with Police and other agencies.

Admissibility and The Police and Criminal Evidence Act 1984 - PACE

It is crucial that evidence is not rejected on the grounds of inadmissibility. This is affected by whether it was obtained by oppression or inducement, and its overall reliability; a defense council will try to get statements rejected on either ground.

For interviews to be effectively controlled it is best to follow the Codes of Practice, for interviewing suspects, issued under PACE. PACE was enacted to control the Police but some key points from the Act and Codes that affect how an enterprise conducts an investigation are:

Section 67

- (9) Persons other than a Police officer who are charged with the duty of investigating offences must have regard for the code
- (10) Persons other than a Police officer not using the codes are not liable to prosecution
- (11) In all criminal and civil proceedings any such code shall be admissible in evidence and taken into consideration by the court or tribunal.

The FIO can be more confident that evidence will be admissible in Court if statements are obtained in accordance with the PACE codes.

Experts and Regulators

The Fraud Action Plan should maintain a list of solicitors, fraud investigators, and accountants to be contacted for expert advice by the FIO. They should also advise when the Fraud Contingency Response Plan is initially developed or amended.

Where an enterprise is subject to regulatory control (e.g. banks - by the Bank of England; companies – by the DTI) the regulator should be kept informed if fraud or irregular activity is suspected (particularly if the sums involved are significant). Senior management should keep them advised of progress throughout the investigation.

Media Statements

Personnel responsible for media liaison must be briefed with the exact information they are allowed to release to the press, subject to FIC clearance. They should also record who they release it to and treat any relevant information received by them from the press as confidential and to be reported to the FIO.

INVESTIGATION PROCESSES

Media statements must be carefully vetted in order that accurate information is made available to the press so that the enterprise avoids unnecessary criticism.

The FIO's **report and recommendations** for improvement must provide a clear, accurate and independent picture of the fraud investigation and its implications for the enterprise.

Senior management must **"find the truth"** about the fraudulent activity discovered in their enterprise, and take positive steps to learn lessons and implement improvements for better control in the future.

Report and improvement

The preparation of a report for management is key to the fraud investigation process. The Fraud Investigation Officer should provide a clear concise document under the following headings:

- Introduction/executive summary
- Background information
- Suspect assessment
- Discovery and investigation
- Main fraudulent transactions
- The Legal process
- Continuation of enquires
- Internal control weaknesses
- Recommendations
- Lessons for the future

A formal presentation may be required by the Fraud Investigation Committee at various stages of the investigation with a final presentation of the formal report.

"Find the Truth"

Senior management must find the truth about any fraudulent activity discovered in their enterprise, and make improvements to create better control for the future.

FURTHER INFORMATION

Kingdom Management Training is a consultancy which specialises in Risk Management. We offer training courses and consultancy services in related areas, including Risk Assessment and Business Control Frameworks, Internal Auditing, Audit Report Writing, and HSE Management, as well as the Control and Investigation of Fraud.

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