FRAUD FACTS

Fraud Advisory Panel

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An introduction to fraud detection

Fraud detection should form part of an organisation's overall anti-fraud strategy to identify and stop new or historical fraud at the earliest opportunity. Effective fraud detection saves money and protects businesses and their employees, shareholders and customers.

What is fraud detection?

Fraud detection is the identification of actual or potential fraud within an organisation. It relies upon the implementation of appropriate systems and processes to spot the early warning signs of fraud.

Fraud detection usually includes a combination of the following techniques:

- **Proactive** (eg. risk assessments) and **reactive** (eg. responding to reports of fraud).
- **Manual** (eg. spot audits) and **automated** (eg. specialist data-mining software).

It should form part of an organisation's overall anti-fraud strategy covering the prevention, detection and investigation of fraud.

Why is fraud detection important?

Even the most comprehensive fraud prevention controls can be circumvented by a determined and skilled fraudster. Fraud detection techniques can help to uncover new fraud in action as well as historical frauds.

Effective fraud detection saves money and protects businesses and their employees, shareholders and customers. Promoting the organisation's detection activities can also act as a deterrent to would-be fraudsters. Other benefits include (but are not limited to):

- Reduced exposure to fraudulent activity
- Identification of vulnerable employees at risk to fraud
- Reduced costs associated with fraud
- Refined organisational controls
- Improved financial and operational results
- Improved shareholder confidence and market position.

Key elements

The key elements of a robust fraud detection strategy include:

- Ongoing risk assessments
- Staff training and awareness
- Fraud reporting mechanisms
- Data-mining and analysis
- Manual checks and balances
- Systems, processes and controls review.

Who is responsible?

Every employee has a responsibility for fraud detection:

- **Board:** Setting the tone from the top, governance and fraud risk management.
- **Management:** Implementing policies, controls and processes.
- **Employees:** Keeping an eye out for the warning signs of fraud, and reporting concerns.

In some organisations, internal audit plays a key role in fraud detection through evaluating the potential for fraud and how real incidents are managed in order to provide *'independent assurance on the effectiveness of processes put in place by management to manage the risk of fraud'*.*

Legal considerations

Organisations need to be mindful of relevant legislation, including (but not limited to):

- Bribery Act 2010
- Data Protection Act 1998
- Fraud Act 2006
- Human Rights Act 1998
- Public Interest Disclosure Act 1998
- Regulation of Investigatory Powers Act 2000.

Risk assessments

All businesses are vulnerable to fraud. However, the fraud risk varies according to the nature and size of the business and the sector in which it operates.

Build a profile of potential frauds that your organisation may be vulnerable to and identify where they might occur. Be aware of new and emerging fraud threats affecting your industry or sector and think about how these might be prevented or detected within your organisation.

Staff training and awareness

Educate management and staff about fraud and how to identify the warning signs of common frauds and scams. Include fraud awareness training as part of your induction programme for new joiners, in periodic management briefings and through ongoing staff training sessions.

Ensure staff are aware of the procedure to follow in the event of a fraud being discovered or suspected, including how to report it.

Fraud reporting mechanisms

Make it as simple and as straightforward as possible for staff to confidentially report concerns about suspected or actual fraud.

Set out whistle-blowing arrangements and/or specify a designated individual(s) to whom staff can report concerns. If a separate whistleblowing policy exists, make sure your staff know about the policy and where to find it.

Think about making staff aware of the charity Public Concern at Work (PCaW), which offers free confidential telephone advice to people who witness or are concerned about crime or wrongdoing in the workplace. Make sure your policy takes into account the Public Interest Disclosure Act 1998, which protects employees who raise such concerns.

* Institute of Internal Auditors – UK and Ireland (2003). *Fraud Position Statement.*

Data mining and analysis

Consider data mining which uses computerised techniques to analyse electronic data on an ad hoc, repetitive or continuous basis. It can be particularly useful for analysing operational and transactional information to highlight anomalies or identify fraud 'red flags', such as unusual or suspicious:

- Gaps
- Duplicates
- Patterns
- Trends
- Values

Data-mining and analysis need not be expensive or complicated and can include:

- Spreadsheet queries
- Audit software
- Bespoke software
- Data visualisation

It is important to review and act upon the information derived from data-mining and analysis.

Manual checks and balances

Do not rely solely on automated processes to detect fraud. Introduce regular and ad hoc manual checks, such as:

- Pre-employment screening of prospective staff
- Staff rotation and compulsory vacation periods in high-risk areas
- Spot audits of stock, sales and purchase ledgers
- Reviews of profit and loss accounts
- Independent checks and analysis of operational and transactional information
- Management reviews of procedures and policies
- Comprehensive and resilient controls over key processes.

Data-sharing schemes

Businesses can also choose to join a range of industry and trade schemes to share information to prevent and detect fraud. Common schemes include:

- CIFAS – the UK's Fraud Prevention Service (www.cifas.org.uk)
- Fraud Intelligence Sharing System (www.theukcardsassociation.org.uk)
- Insurance Fraud Bureau (www.insurancefraudbureau.org)
- National HUNTER (www.nhunter.co.uk)
- National Fraud Initiative (www.audit-commission.gov.uk/nfi)

This list is not exhaustive.

Review procedures

Business practices and activities change over time. Regularly review and test fraud detection systems and processes, to ensure these remain up-to-date with the changing fraud threats facing your organisation and technological advances.

Hallmarks of effective fraud detection

DO:

- ✔ Have a fraud detection strategy in place.
- ✔ Introduce a robust system of internal control for the detection of fraud.
- ✔ Establish a credible mechanism for staff to report suspicions of fraud.
- ✔ Ensure that your organisation's exposure to fraud is considered when introducing new, or when amending existing, systems and processes.
- ✔ Keep your risk register up-to-date.
- ✔ Implement systems and processes to detect the early warning signs of fraud.
- ✔ Be alert to possible collusion between staff and third parties.
- ✔ Ensure regular evaluation and monitoring of fraud detection controls.
- ✔ Review your anti-fraud strategy on a regular, preferably annual, basis.
- ✔ Take account of changes in business activities and/or control procedures that may open up new potential fraud risks.
- ✔ Undertake pre-employment screening of prospective staff.
- ✔ Consider conducting ongoing periodic checks for staff in high-risk areas.
- ✔ Ensure regular monitoring of compliance with fraud prevention and detection policies, processes and controls.
- ✔ Introduce a fraud response plan to deal with any frauds that come to light.

DO NOT:

- ✗ Adopt generic control procedures and policies across the business where the risk of fraud varies by business area.
- ✗ Ignore 'red flags'. Certain industries and/or activities are exposed to specific fraud risks.
- ✗ Rely on fraud to be detected by luck or good fortune.
- ✗ Sweep reports of fraud under the carpet!

Further information

See our separate fraud facts on *Anti-Fraud Policy Statements, Pre-Employment Screening, An Introduction to Fraud Risk Management,* and *An Introduction to Fraud Response Plans* for more information.

Action Fraud
www.actionfraud.org.uk

Fraud Advisory Panel
www.fraudadvisorypanel.org

Legislation.gov.uk
www.legislation.gov.uk

Public Concern at Work
www.pcaw.co.uk

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