

It may be those
you least expect
who commit fraud.

FraudTrack survey

Fraud is a recognised business risk; it can be defined by who commits it – employees or third parties – or by the type of fraud – financial misstatement, breach of regulations, etc.

With the development of new technologies it has never been easier for fraudsters, whether they are an employee or an external hacker, to sidestep an organisation's controls, exploit its weaknesses and better cover their tracks.

Big money cases hit the headlines regularly, giving the impression that fraud is rising in the UK – but in reality most frauds are never detected. As

economic conditions tighten and organisations increase controls and actively search for irregularities, more frauds will be discovered.

BDO Stoy Hayward is conducting research into trends and activities of fraud in the UK. FraudTrack is based on data of UK frauds that were first reported in the press in 2003. The data represents 209 cases, with a total value of £331m.

Defining fraud

Breach of regulations: wilful violations of laws or government regulations that are integrity-related.

Employee fraud: employees by themselves or in collusion with customers or suppliers, perpetrate fraud against the company, resulting in financial loss.

Financial misstatement: management and/or employees issue misleading financial statements with intent to deceive the investing public and the external auditor.

Non-corporate: individuals or entities who commit an act against another individual, resulting in financial loss.

Third party: individuals, suppliers or customers acting by themselves who commit fraud against an organisation, resulting in financial loss.

Unauthorised use: use of the organisation's physical, financial, information and other assets for unauthorised or unofficial purposes by employees or others resulting in loss of competitive advantage.

Sample

FraudTrack is prepared by BDO Stoy Hayward and is based on all reported fraud cases of over £50,000 during the period from 01 January 2003 to 31 December 2003. The sources for the

database include: The Serious Fraud Office; the Department of Trade and Industry; the Metropolitan Police; Public Eye and UK national press.

Beware of the insider

The most frequent fraud cases reported for the first time in 2003 involved employee fraud. In our experience, companies typically take more precautions against fraud by external parties (hackers, organised crime, etc) than they do against fraud by insiders. This is misguided. Our research shows that fraud is equally likely to be committed by employees and directors who know the systems and can override controls.

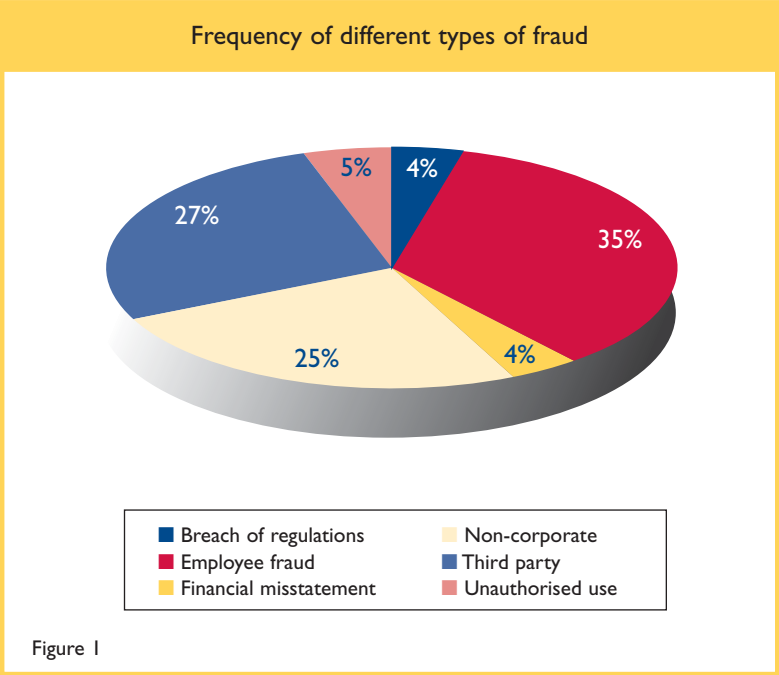


Figure 1

Employee fraud had the second highest average value at £2.2m. Breach of regulations, with an average value of £4.3m, was the most harmful fraud in terms of financial loss.

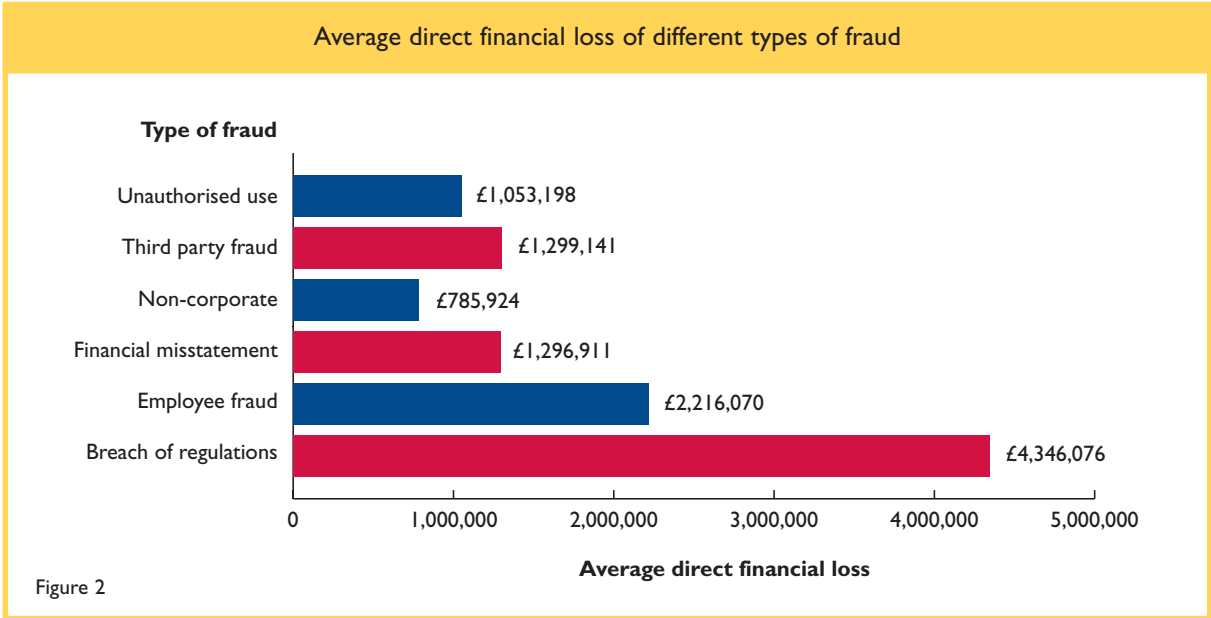


Figure 2

Direct financial losses are not the only cost to an organisation. Other costs can include: consequential losses, legal and investigative costs, regulatory fines, management time, increased insurance premiums, loss of key staff and customers and inability to raise finance or increased cost of raising new finance. These are often far in excess of the direct financial losses.

Fraud is an overwhelmingly male domain

Of the frauds reported for the first time in 2003, 84 per cent of the perpetrators were male. Frauds by men were typically for sums averaging three times those perpetrated by women.

The research found that the median age of fraudsters was 44 years old for men and 41 years old for women. But looking further into the data, it is apparent that there is actually a spread of ages from 20 to 70 years old – demonstrating that whether a person is young or old, anyone with a motive can commit fraud.

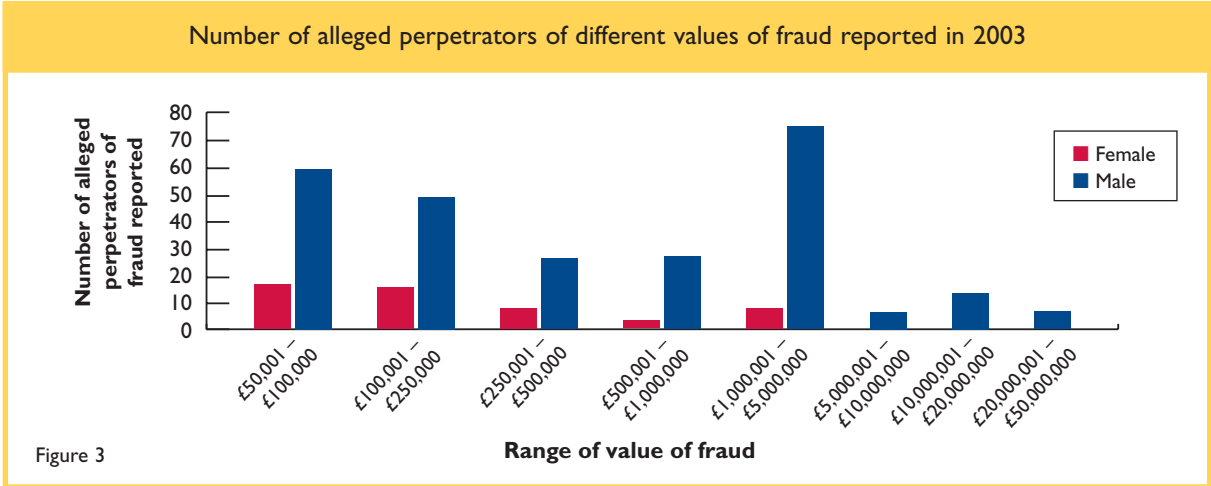


Figure 3

In 2003, no women were convicted for committing a fraud over £4m and only a handful committed frauds over £1m. This compares with over 108 men convicted of frauds over £1m and of these 24 for frauds valued at over £5m.

London and the north are fraud hotspots

The research found that the four top cities for fraud were London, Liverpool, Glasgow and Birmingham. In terms of average value of fraud per person, three regions exceed London and the south east in terms of value per capita: the north west, the midlands and the north east.

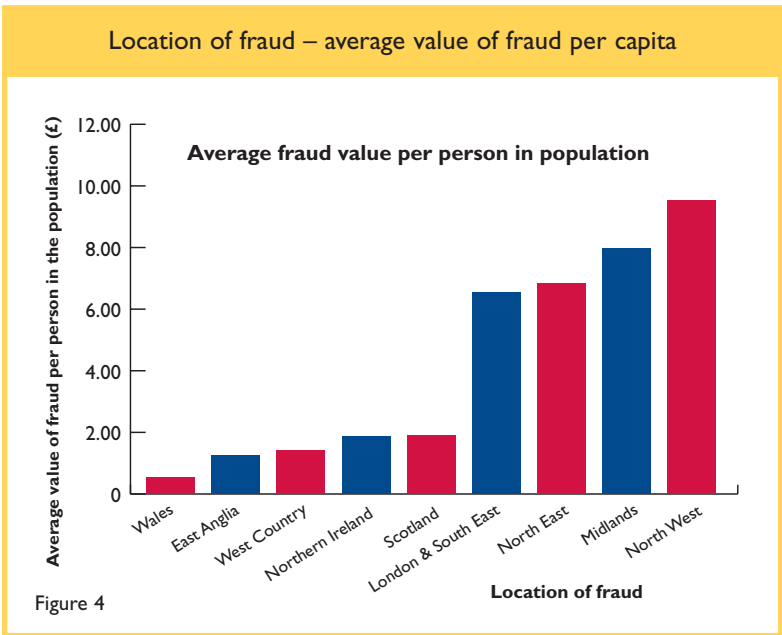
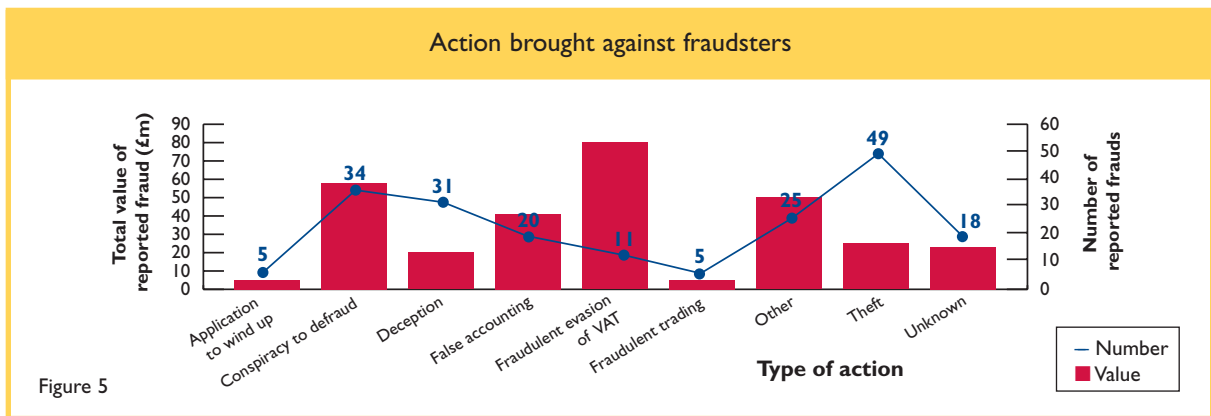


Figure 4

Taking action

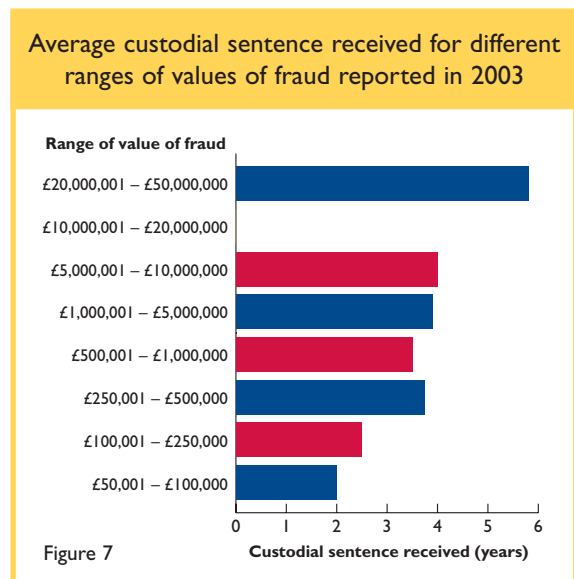
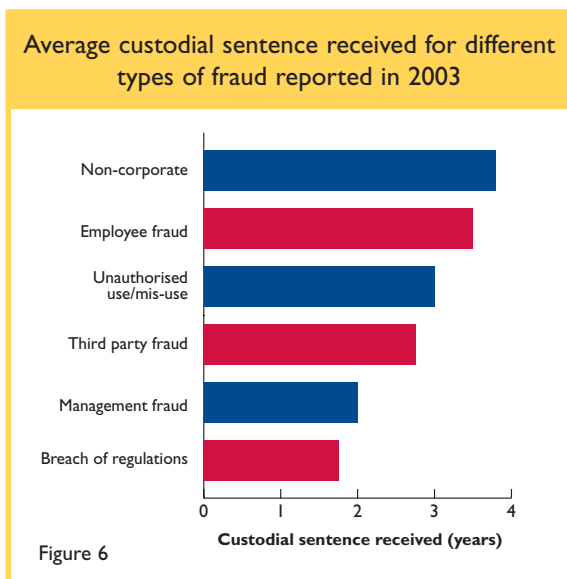
When action was taken against fraudsters, it was most frequently by the police charging an individual with theft – this accounted for 49 cases. With a total value of only £21m, however, theft accounted for one of the lower total values.

The highest overall value of fraud cases came from VAT evasion cases undertaken by Customs & Excise, indicating their effective and targeted approach to combat VAT evasion. Their 11 cases reported accounted for a total value of £77.5m.



Custodial sentences a reality

The longest sentences, on average, were handed down for non-corporate fraud. In relation to frauds committed against corporates – employee fraud obtained the higher sentences. Interestingly, breach of regulation fraud had the highest average value of financial loss – £4,346,076 (Figure 2) but had the lowest sentences.



Size does matter: Our research shows that the higher the value of the individual crime the higher the sentence. However, the increase in value of the fraud is not proportional to the length of sentence the perpetrator receives. It appears that the base level sentence for any fraud case is two years.

Protecting your business

There are six steps any business can and should take to protect itself against fraud.

1. Take pre-employee screening seriously. Conduct background checks and take references for all employees – including senior management – and follow them up. This can be extended to suppliers and customers.
2. Train new employees on company policy and procedure – especially codes of conduct and whistleblowing policies. Ensure that long-standing employees are updated regularly.
3. Raise awareness amongst staff and management of the warning signs of fraud and the types of fraud that they are likely to face in their organisation.
4. Take action to identify specific fraud risk and implement effective controls.
5. Set up monitoring processes and search for unusual transactions. Fraudsters will always look to find weaknesses in existing controls.
6. Plan for the worst – fraud can never be prevented but actions taken at the outset can minimise future losses.

How we can help you

If you would like more information about our wide range of Fraud and Forensic Accounting services, please contact your local BDO Stoy Hayward business centre.

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