

Annual Survey 2006

FraudTrack 3: Rising fraud in the spotlight



Inside Job



BDO Stoy Hayward

In 2003, BDO Stoy Hayward released FraudTrack its first research into reported fraud in the UK. We felt this research would complement existing reports into companies' perceptions of fraud, and also create a measurable baseline for annual fraud.

UK businesses are losing more and more at the hands of their own workers. But although one of your employees is the most likely source of fraud in your company – another is your most likely way of finding out.

Fraud costs UK businesses nearly £1bn

This year marks the third year of our FraudTrack research, and the trend this year is stark: another year upward for fraud, and a significant increase in employee fraud.

The value of reported fraud continued to rise in 2005, up nearly 30 per cent from 2004. The cost of fraud to UK businesses now stands close to £1bn. This is nearly triple the amount of £331m revealed in 2003.

Significant increase in employee fraud

One of the most significant trends witnessed in 2005 is the rise in employee fraud, increasing by over 80 per cent since 2004 (200 per cent since 2003). UK businesses are losing more and more at the hands of their own workers. But although one of your employees is the most likely source of fraud in your company – another is your most likely way of finding out.

What could account for this?
To better understand the attitudes of the UK workforce towards fraud,

BDO Stoy Hayward commissioned the first UK research (see page 9 for information on our sample) into this subject, asking 1,360 people in employment about their personal attitudes to fraud and whistle-blowing (ie reporting on dishonest conduct).

Willingness to report fraud

The good news is that the vast majority of employees, over 90 per cent, would want to speak out if they discovered their boss had committed a serious fraud. However, this was balanced against findings that many employees find dishonest actions acceptable (see Chart 5 on page 6), such as accepting a gift after awarding a lucrative contract.

This highlights the importance of getting honest employees on side through clearly worded definitions of fraud, and whistle-blowing policies that inform them how to report any suspicions. Employees can be your 'eyes and ears' in the workplace, but only if they know what to report, to whom and that it will be taken seriously.

Sentencing no deterrent

Our research showed a lack of confidence in the level of sentencing handed down to fraudsters. In 2005, the typical prison sentence for a fraudster taking £1m was under four years.

People just don't feel this is long enough to serve as a deterrent – and 20 per cent of those polled would like to see sentences of over 10 years for a similar fraud.

With the government currently trying to remove trial by jury on serious frauds to improve the rate of convictions, it is ironic that few people feel that the sentences being handed out when a conviction is secured are adequate.

What companies need to do

In the fight against fraud, businesses are failing to make use of their main ally – the honest majority of workers. While most employees want to report on dishonest colleagues, many would be deterred through not knowing the correct procedure or through fear of recrimination.

Companies should take the following steps to protect their revenue and reputation against fraud.

Preventing fraud

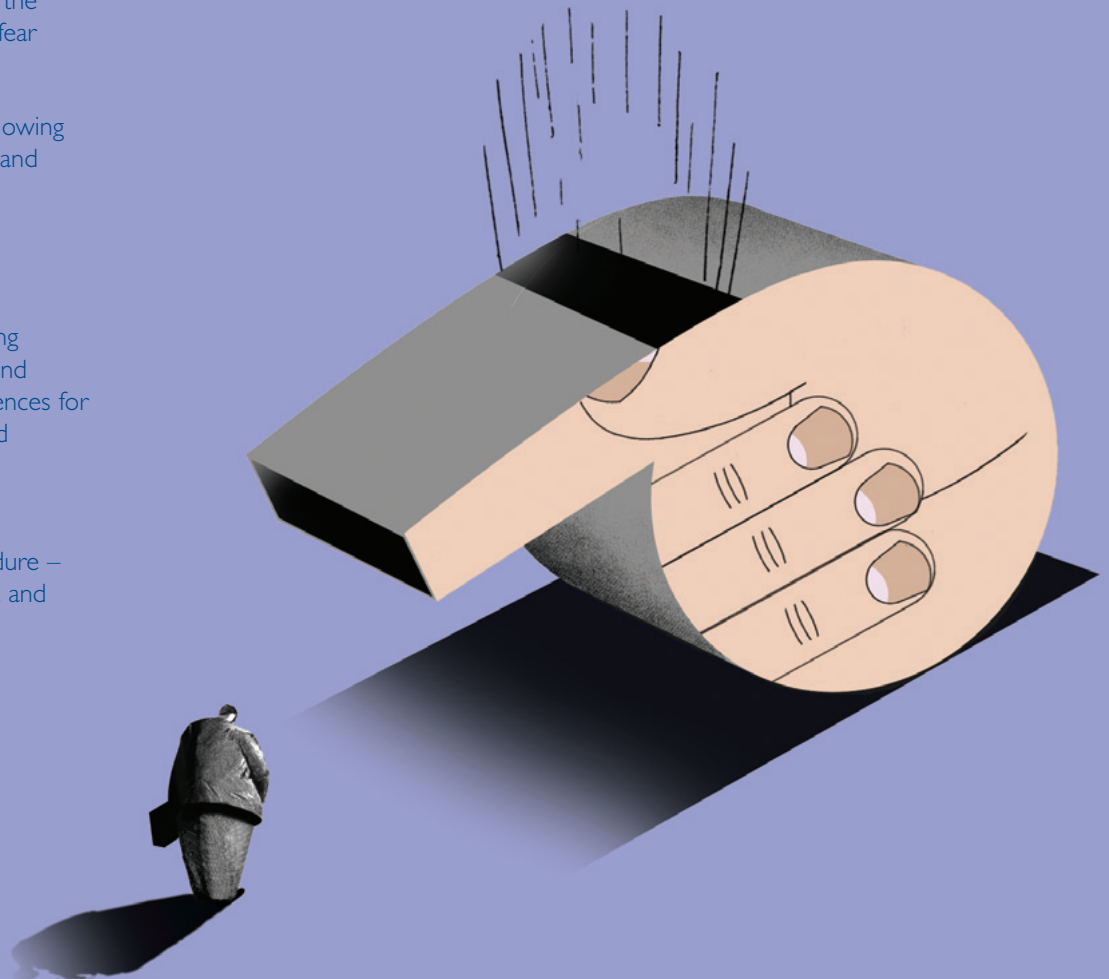
- Take pre-employee screening seriously: conduct background checks and follow-up references for all employees (suppliers and customers too).
- Train new employees on company policy and procedure – especially codes of conduct and whistle-blowing policies.
- Ensure company policies are assessed, updated and communicated regularly.
- Consider adequate fraud insurance cover.

When fraud is detected

- Act quickly and discreetly if you suspect fraud.
- Secure all evidence.
- Do not limit the scope of the investigation.
- Do not make emotional or hasty decisions.

Recovering assets

- Follow the cash – identify where the money has gone.
- Consult with your legal advisers regarding the tracing and freezing of assets.
- Do not be afraid to call the police when necessary.
- Do not give up: investigate all possible avenues.



Fraud nearly triples in three years

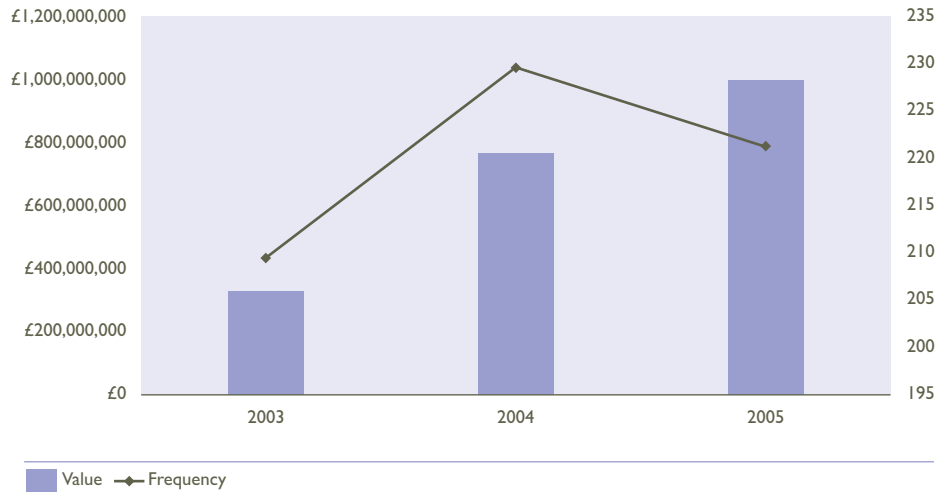
The value of reported fraud in the UK has rocketed to nearly £1bn, having virtually tripled since 2003 (£331m). By value, 45 per cent of all fraud reported (£465m) was committed in London and the South East, with the rest of the UK accounting for £516m.

The sector most likely to experience fraud was financial services, which accounted for 50 per cent by value – nearly £500m. Next was the wholesale trade at 26 per cent, about £260m.

The most significant increase was in employee fraud, which has increased in value by over 80 per cent since 2004 (and 200 per cent since 2003).

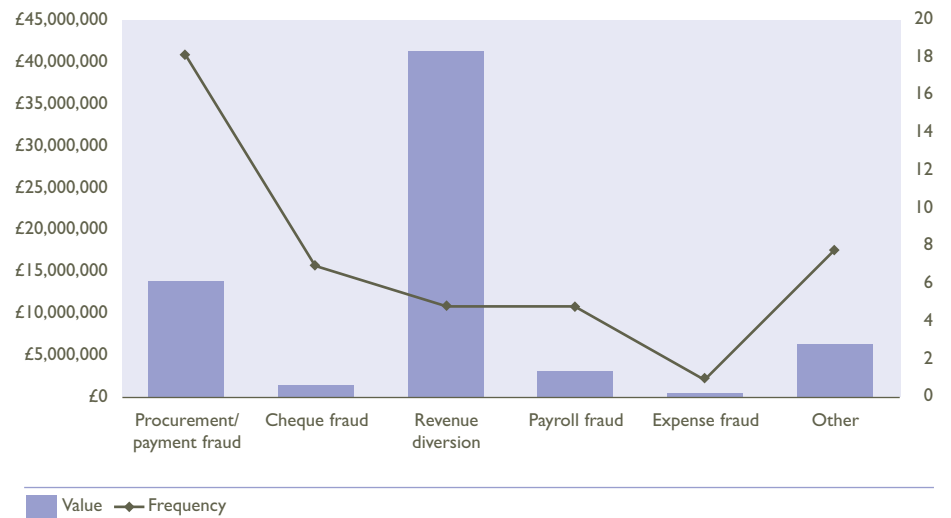
Chart 2 shows that procurement and payment frauds (bribes, kickbacks and diverting money) are the most frequent employee-based frauds, while revenue diversion (interception of money coming in) accounts for the greatest value. (For a full list of fraud definitions, please see page 9.)

Chart 1: Value and frequency of fraud



Source: BDO Stoy Hayward, FraudTrack research

Chart 2: Types of employee fraud by frequency and value



Source: BDO Stoy Hayward, FraudTrack research

Case study: Payment fraud

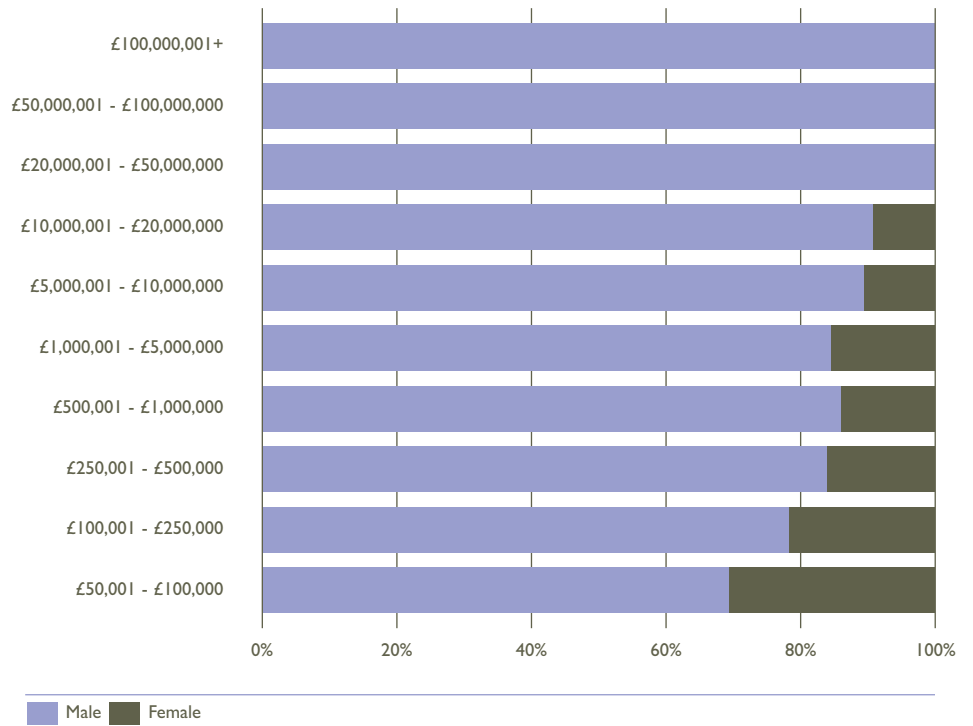
An insurance negotiator stole £900,000 from his employer to support both his wife and his mistress. He set up fake companies and authorised payments to them to splash out on holidays, fund a lavish lifestyle and pay private school fees for his children.

He was caught when an undelivered letter was returned to the company, containing a cheque to the fake supplier. He was jailed for four years.

Fraud continues to be dominated by men

Our research revealed that fraud continues to be a male-dominated domain, with women accounting for only 18 per cent of those convicted for fraud. However, for the first time since the analysis was started in 2003, women under the age of 20 have been convicted for involvement in fraud. We also found that women tend to be involved in frauds for smaller amounts, with the highest percentage of women involved in frauds in the lowest value category: £50,001-£100,000.

Chart 3: Fraud by value and gender

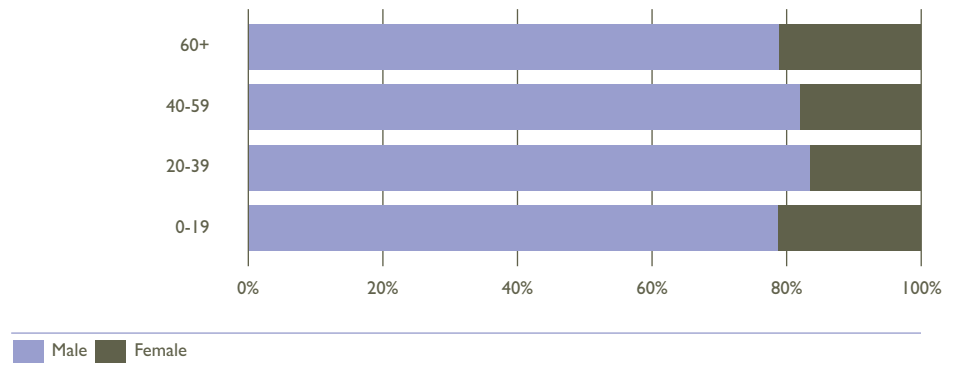


Source: BDO Stoy Hayward, FraudTrack research

Case study: Procurement fraud

A council official started a bidding war for IT contracts, and accepted bribes from IT companies in order to award them business. This resulted in the council paying over-the-odds for PCs, printers and software. The council official split the profits from these inflated prices (in the region of £145,000) with suppliers. After a whistle-blower alerted the council to the scam, the fraud came to light and the corrupt official was eventually sentenced to 15 months.

Chart 4: Alleged fraudsters by gender 2005



Source: BDO Stoy Hayward, FraudTrack research

Case study: IT fraud

The person behind an identity theft known as 'phishing' has been jailed for four years. He captured account details of registered eBay users by tricking them into thinking they were on a secure eBay site – instead they gave bank details to a criminal. He then used these stolen identities to advertise luxury items such as laptops or jewellery. Once the items were paid for, he disappeared with the cash.

Conman or company man?

Given the continued rise of employee fraud, we felt that it would be beneficial to better understand the attitudes of the UK workforce towards fraud and whistle-blowing. We therefore commissioned the first UK research into this subject, questioning 1,360 people in employment.

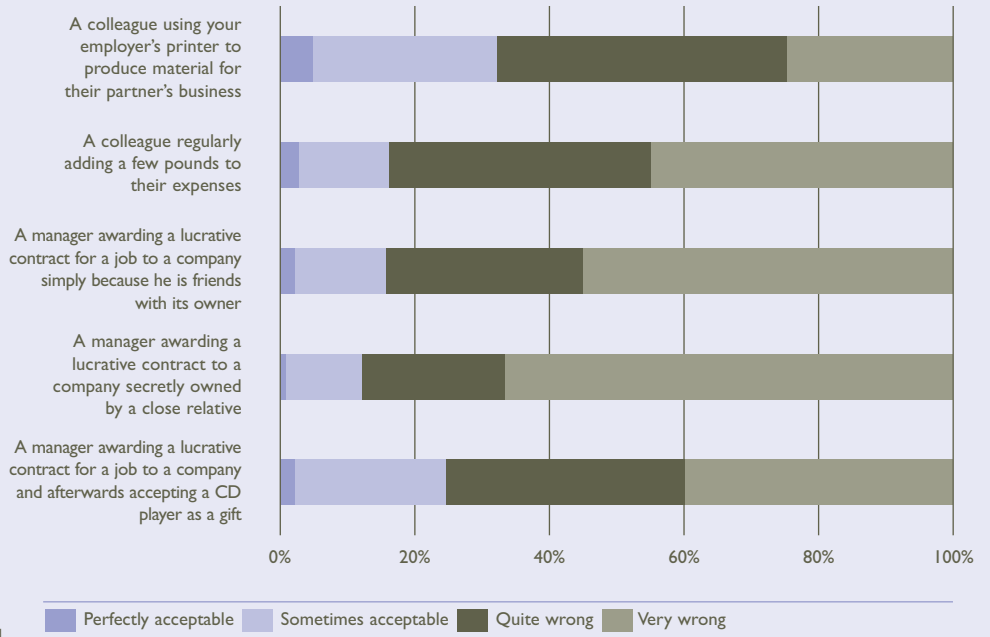
The good news is that the vast majority of employees, over 90 per cent, would want to speak out if they discovered their boss had committed a serious fraud.

This is balanced by a great deal of variation between what different people define as dishonest behaviour or find acceptable. For example, nearly one third felt it could be acceptable to use company resources to produce material for their partner's business. Similarly, almost one quarter believe it could be acceptable to accept a gift such as a CD player after awarding a lucrative contract.

A surprising one in eight felt it could be acceptable for managers to award a lucrative contract to a company secretly owned by a relative. This is a common ruse used by fraudsters, who then use company money to pay for overpriced or non-existent services.

However, the results above did vary by age – with young people more likely to have ambiguous attitudes to fraud than older people. For example, when asked

Chart 5: Acceptability of dishonest behaviour
How serious or not would you regard the following (base, 1,360 employees):



Source: YouGov research commissioned by BDO Stoy Hayward

about awarding a lucrative contract to a company simply because a manager is friends with its owner; more than three times as many people aged 18-29 (19 per cent) felt it would be acceptable than those aged over 50 (6 per cent).

In terms of regions, our FraudTrack research revealed nearly half of all reported fraud (£465m - 47 per cent) was committed in London and the South East, with the rest of the UK

combined accounting for £516m. The YouGov research showed personal attitudes to fraud across regions, reflecting the higher standards of those outside London and the South East.

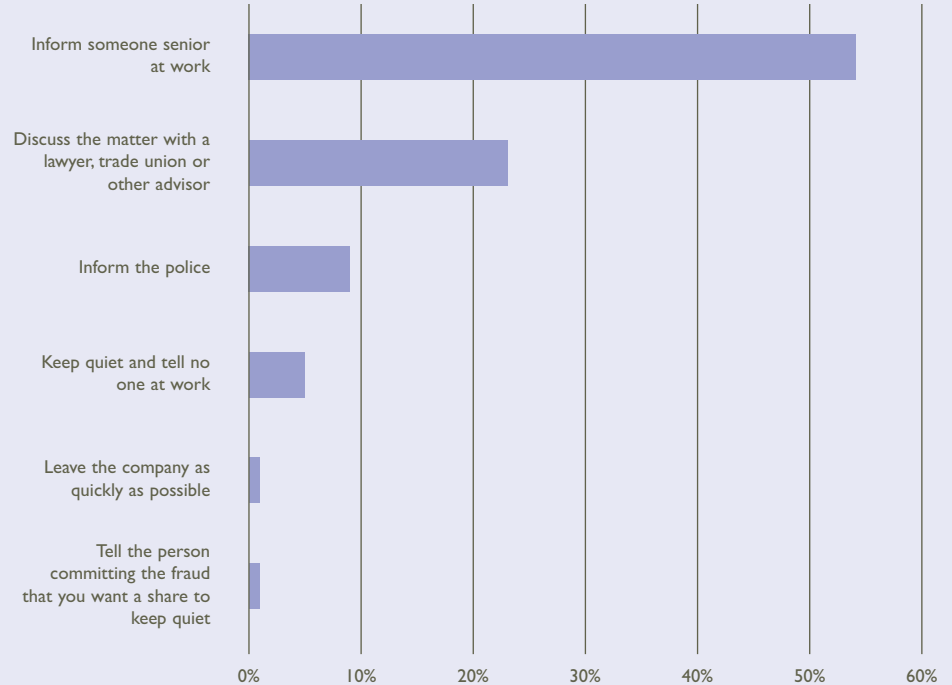
The good news is that the vast majority of employees, over 90 per cent, would want to speak out if they discovered their boss had committed a serious fraud.

Most would report suspicions to their employer

Of the 90 per cent who would report a fraud, the majority (53 per cent) would report it to someone senior at work, which is what most whistle-blowing policies suggest. A quarter would raise it with an outside adviser such as a lawyer or their trade union and only 8 per cent would report it directly to the police.

Chart 6: Reporting suspicions of fraud

If you found out your boss (or your last boss) had committed a serious fraud, costing the organisation you work for thousands of pounds, what would you most likely do?



Source: YouGov research commissioned by BDO Stoy Hayward

Fears of recrimination over whistle-blowing

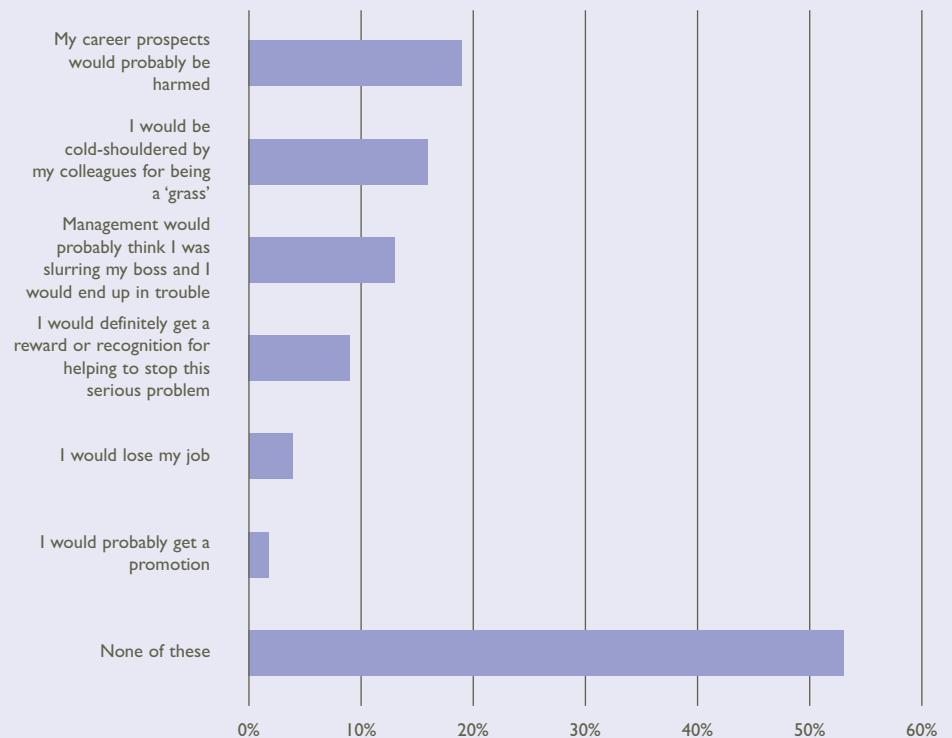
Of those who would report suspicions of fraud to someone at work, over one-third feared some sort of recrimination, whether losing their job, being cold-shouldered by colleagues or in some way having their career prospects harmed – only 8 per cent expected reward, recognition or a promotion.

The finding that employees are still in fear of their livelihood, despite the introduction of the Public Interest Disclosure Act back in 1998, is a shame but not a surprise. Many whistle-blowers have had a rough ride – suffering penalties from demotion to dismissal.

Attitudes clearly need to change, and directors should ensure their businesses move away from a culture of 'shooting the messenger' to rewarding whistle-blowers for serving the company's best interests.

Chart 7: Consequences of whistle-blowing

If you discovered your boss had committed a fraud at your business and you alerted senior management to it, what would be the results for you?



Source: YouGov research commissioned by BDO Stoy Hayward

Prison sentences: no deterrent

In 2005, the average prison sentence for someone committing a fraud worth over £1m was less than four years. In fact, despite the value of frauds going up, the length of sentence declined slightly to just under two years and 11 months. In 2005, 17 per cent of those convicted received a non-custodial sentence, compared to 21 per cent in 2004 and 10 per cent in 2003.

Three quarters of people think the average custodial sentence is insufficient to deter a fraudster. This is supported by the results of our 2005 research: a fraud netting £500,000 was planned while a convict was in jail; another fraud was committed while an inmate was on day release (see case study below).

Of those polled, 61 per cent felt sentences should be longer and 20 per cent wanted a sentence of over 10 years for frauds exceeding £1m.

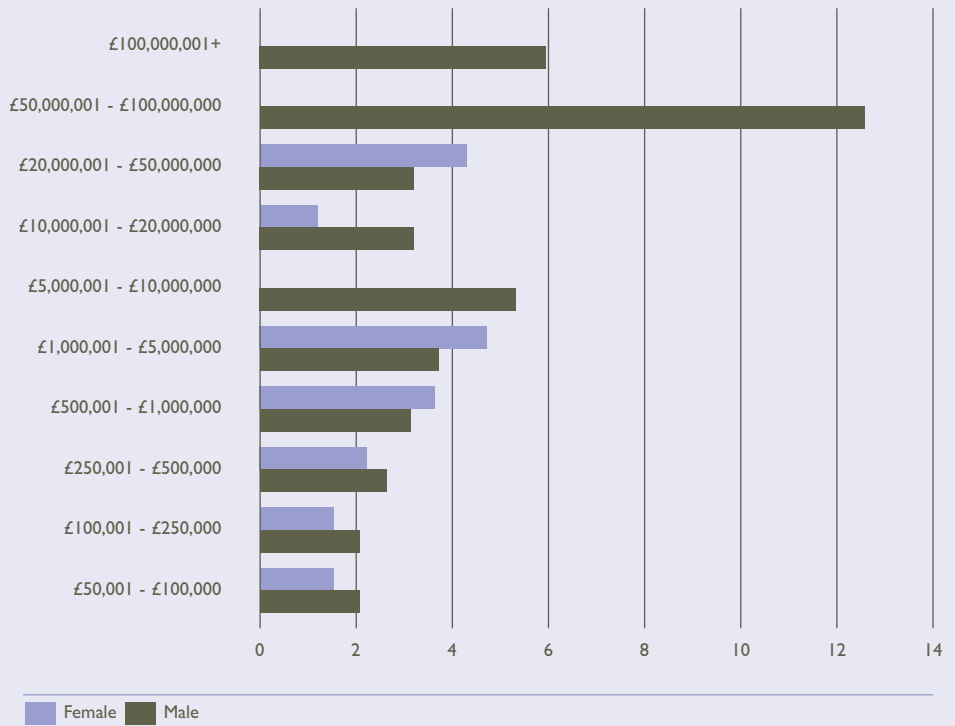
Case study: Fraud committed on day release

A convicted criminal on day release was caught defrauding his employer of £500,000 over a period of just months. Told he was a changed man, a finance firm employed him under a prison resettlement programme. But prison officers warned that he was a serial offender that wasn't about to change his stripes.

After obtaining the company's bank details, he established an account and ran up debts at a five star hotel, took cars as kickbacks, and conned a client into paying tens of thousands of pounds to set up a loan.

Prison officials began an inquiry when prison staff caught the conman with £100,000 in cash and driving a brand new car. A Prison Service source said: "Trusting a crook with a record as long as your arm for deception wasn't the best idea in the world. What this criminal got up to is quite frankly unbelievable. To say there's embarrassment is the understatement of the century."

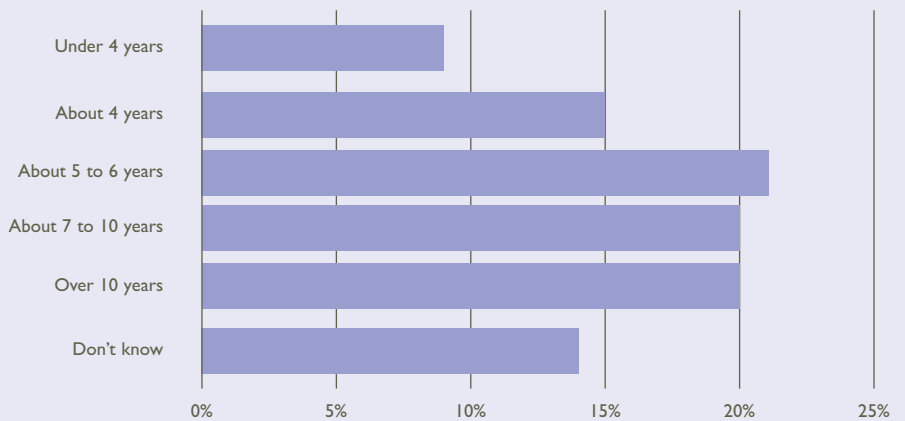
Chart 8: Average custodial sentence 2005



Source: BDO Stoy Hayward, FraudTrack research

Chart 9: Desired sentence for fraud of £1m

What prison sentence do you think a fraudster who takes £1 million from their employer should get?



Source: YouGov research commissioned by BDO Stoy Hayward

Defining fraud

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

Employee: 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 stakeholders and the external auditor.

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

Tax: individuals or entities who commit fraud against HM Revenue & Customs or other tax related government departments.

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 a loss of competitive advantage.

Defining employee fraud

Procurement frauds typically involve an employee rigging the tender for a contract in return for a bribe or placing orders with businesses in which they have a secret financial or family connection.

Payment frauds involve payments, whether for real or false bills, being diverted to the fraudster.

Revenue diversion frauds typically involve payments to the business being intercepted by the fraudster, who then destroys evidence that the money is owed (eg by erasing the original invoice).

Cheque fraud is usually where a cheque or other negotiable instrument contains a forged signature or where the amount payable or payee has been altered.

Payroll fraud typically involves an employee creating ghost workers on the company's payroll and diverting their salaries to their own or an acquaintance's account.

Expense fraud involves claiming for fictitious expenditure, exaggerating genuine expenses to the company or claiming personal expenditure.

Sample

FraudTrack is prepared by BDO Stoy Hayward and is based on all reported fraud cases of over £50,000 during the period from 1 January 2005 to 31 December 2005. The sources for the database are publicly available and include the UK's national, regional and local press. The data represents 221 cases of fraud with a total value of £981m.

Additional research was conducted for BDO Stoy Hayward by leading opinion polling firm YouGov in February 2006. The survey of employee attitudes was based on a representative weighted sample of 1,360 people in employment (from 1,426 interviews). Questions about sentencing were based on a representative sample of 2,010 responses from adults.

About BDO Stoy Hayward

BDO Stoy Hayward is the UK Member Firm of BDO International, the world's fifth largest accountancy network, with more than 600 offices in over 100 countries.

How we can help you

If you would like more information about this publication or our wide range of fraud and forensic accounting services please contact your local BDO Stoy Hayward business centre:

Ayr

david.hill@bdo.co.uk
0141 249 5253

Belfast

ciaran.hunter@bdo.co.uk
028 9043 9009

Birmingham

sat.plaha@bdo.co.uk
0121 352 6210

Bristol

paul.jelley@bdo.co.uk
0117 934 2841

Bromley

rowan.williams@bdo.co.uk
020 8315 8788

Chelmsford

gary.miller@bdo.co.uk
01245 264644

Epsom

sophie.hill@bdo.co.uk
01372 734327

Glasgow

judith.scott@bdo.co.uk
0141 249 5263

Guildford

lesley.wills@bdo.co.uk
01483 565666

Hatfield

geoff.kinlan@bdo.co.uk
01707 255880

Leeds

simon.p.bevan@bdo.co.uk
0113 204 1286

London

andrew.durant@bdo.co.uk
020 7893 2562

Manchester

brent.wilkinson@bdo.co.uk
0161 817 3751

Reading

martha.thompson@bdo.co.uk
0118 925 4439

Southampton

mike.mason@bdo.co.uk
023 8088 1765

www.bdo.co.uk/fraudtrack

BDO Stoy Hayward LLP operates across the UK with some 2,500 partners and staff. BDO Stoy Hayward LLP is a UK limited liability partnership and the UK Member Firm of BDO International. BDO International is a world-wide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country. The Belfast office is operated by a separate Partnership.

BDO Stoy Hayward LLP and BDO Stoy Hayward - Belfast are both authorised and regulated by the Financial Services Authority to conduct investment business.

BDO Stoy Hayward LLP will be the Data Controller for any personal data that you supply. We may disclose your information, under a confidentiality agreement, to a Data Processor (Coad, Cole and Burey Limited (CCB) and AbleData).

To correct your personal details or if you do not wish us to provide you with information that we believe may be of interest to you, please telephone Emily Smith on 020 7893 2271 or email emily.smith@bdo.co.uk.

Whilst every care has been taken to ensure the accuracy of this information at the date of publication, the information is intended for general guidance only.

Copyright © March 2006 BDO Stoy Hayward LLP. All rights reserved.