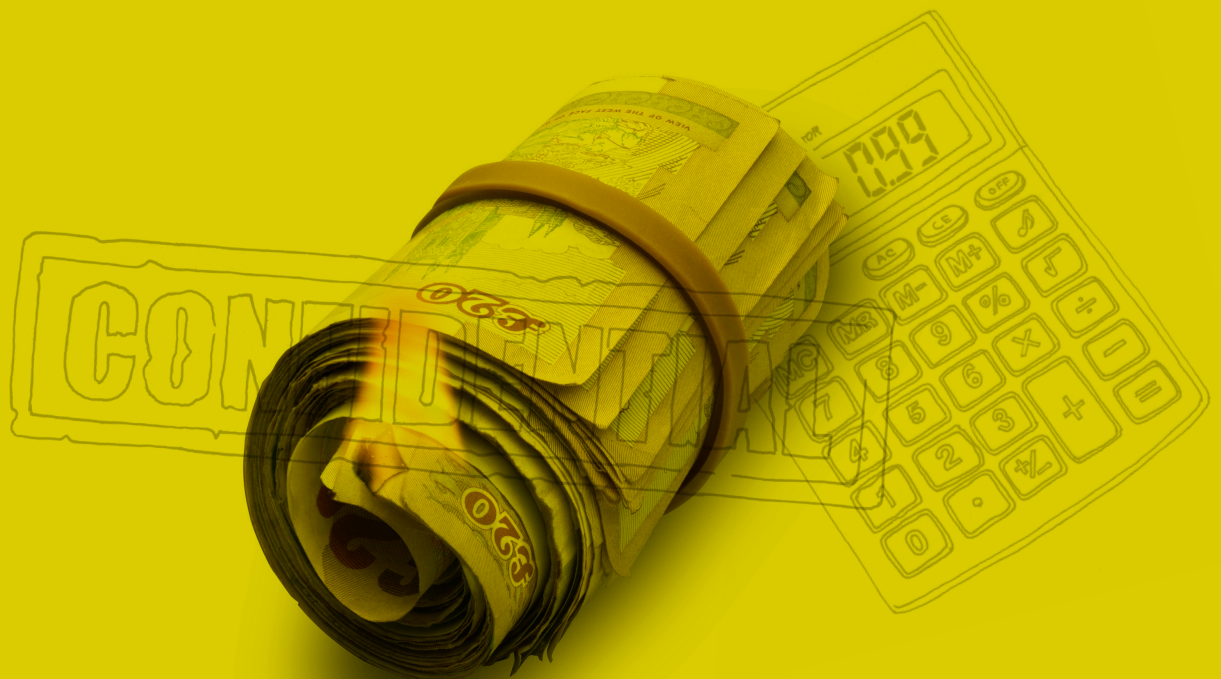


Counter fraud

The resilience to fraud of UK plc

By Jim Gee, Mark Button and Kwabena Frimpong

With a foreword by the Right Honourable Frank Field M.P.



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Foreword

It gives me great pleasure to write the foreword to this important, ground breaking study by the Centre for Counter Fraud Studies. The fact that, in the year 2009, this is the *first* cross-economy study of the effectiveness of arrangements to stop fraud and prevent losses, is shocking.

As the former Minister, I had responsibility for fraud in social security. I prioritised the issue because I knew from my own constituency that failing to prevent fraud effectively has a dual negative impact. It has a serious corrupting effect on human behaviour while at the same time denying all of us the resources to make our society a better place.

And yet, there is a pretty shocking reluctance to act effectively in this area. As a Minister I recall hearing the view expressed (sometimes in the same breath) that, on the one hand fraud was not a serious issue, but that even if it was, nothing could be done about it!

Against that background it is no wonder that fraud involving sub-prime mortgages has emerged as an important cause of our current recession. The mis-selling of so-called NINJA mortgages in the United States to people with No Income No Job or Assets (and therefore no ability to repay them!) lead to massive foreclosures and,

according to the International Monetary Fund, financial institutions around the world holding \$4.1 trillion in securities that will have to be written off.

This Report starts to give us the ammunition to take fraud seriously. Benchmarking has become the norm in other areas of life. Whether we are citizens, consumers, employees, shareholders or taxpayers, what we need to know is how careful the organisations and companies we rely on are being to protect themselves against fraud. The current lack of care that most show, leads directly to us incurring extra unnecessary costs, receiving worse public services, having less secure jobs, or benefiting from a worse return on our investments.

A recent study by the Association of British Insurers estimated that we all pay 6% on our insurance premiums as a result of the cost of fraud. They are to be congratulated for their research in this area, but not for what they found!

Tackling fraud does not have to be a negative story. There are some important examples of the positive benefits from tackling fraud effectively. For example, the work that one of the authors of this Report was involved with, Jim Gee, in setting up a new Counter Fraud Service

in the NHS. Over eight years, fraud losses were reduced by up to 60%, delivering over £800 million of financial benefits to be spent on better patient care.

However, much, much more needs to be done. The Government has established a new National Fraud Authority to provide leadership, but their work must be informed by high quality research about the current position.

This Report starts to provide what is needed. I hope its' authors will quickly complete a second, more in-depth study and, again place their findings in the public domain, so that, we all, as citizens, can make the necessary judgements.

Right Honourable Frank Field M.P.

Introduction

This Report was commissioned by Rt. Hon. Frank Field M.P. from Jim Gee and the Centre for Counter Fraud Studies at University of Portsmouth. The data on which it is based was derived from official survey responses from the organisations concerned.

Research has suggested that fraud could cost the UK anything from £14 billion to £72 billion per year.¹ Whatever the figure, it is a huge drain on the nation's finances, not to mention the damage fraud does to the performance and reputation of organisations.

As fraud becomes a higher profile issue, it seemed the appropriate time to assess the resilience of UK Plc to fraud. There have been a number of assessments of different organisations counter fraud strategies, but what the authors felt was needed was for an assessment to be made across the economy, based upon commonly accepted standards.

Rationale and methods

The Chartered Institute for Public Finance and Accountancy's (CIPFA) Better Governance Forum have produced 'Managing the Risk of Fraud - Actions to Counter Fraud and Corruption'. This document represents the most extensive set of professional standards for counter fraud work ever produced. The standards set out what an organisation should do to counter fraud successfully under 5 sections:

- Adopting the right strategy
- Accurately identifying the risks
- Creating and maintaining a strong structure
- Taking action to tackle the problem
- Defining success

Ideally the research team would have liked to conduct a dedicated survey of public, private and voluntary organisations to assess to what extent they apply all the standards set out by CIPFA. For future years it is intended that such a survey will be undertaken, however, as a starting point and baseline, existing, available information has been used to construct this Report.

¹ *Fraud Review Team (2006b) Final Report. Retrieved July 28, 2006 from www.iso.gov.uk/pdf/FraudReview.pdf; Levi, M., Burrows, J., Fleming, H. & Hopkins, M. (2007). *The Nature, Extent and Economic Impact of Fraud in the UK*. London: ACPO.*

During 2006-7 the research team undertook a survey of Government Departments, Executive Agencies and Non-Departmental Public Bodies, as well as the FTSE 100 companies. The survey assessed the counter fraud strategies of these bodies. It produced a rich database of information concerning the strategies used in 135 public sector organisations with a combined budget of £129 billion and from 32 FTSE 100 companies with a combined turnover of £326 billion. In 2006 total GDP for the UK economy amounted to £1,301.9 billion², so, together, the organisations covered represent around one third (by value) of the UK economy.

The aim was to assess organisations on the basis of all of the CIPFA professional standards. However, the original data was not obtained using the CIPFA criteria, and thus the authors have decided to focus on 13 key standards which could be assessed. These were:

1. Possession of a counter fraud strategy?
2. Measures to assess the effectiveness of the strategy?
3. Does the organisation assess the counter fraud risks?
4. Does the organisation assess those risks at least annually?
5. Does the organisation have a named person responsible for counter fraud?
6. Does the named person report to at least Chief Executive, Board or Audit Committee level?
7. Does the organisation have a dedicated counter fraud/investigative function?
8. Is there professional training for those in this function?
9. Are recruitment checks for Counter Fraud staff and contractors more thorough than for those recruited to 'general' posts?

10. Is there a general programme of fraud awareness training?
11. Are there whistle blowing procedures in place?
12. Does the organisation investigate suspected frauds?
13. Does the organisation seek to apply sanctions beyond disciplinary staff sanctions to those who have been discovered to have committed fraud?

These standards are very important parts of what one would expect in fit for purpose counter fraud arrangements. It was therefore decided to assess the database of public and private bodies to ascertain how many of the 13 standards they met. To avoid accusations of bias the research team allocated 1 point to each of the 13, rather than weight them.

Before the results are outlined, it would be worth setting out some caveats. First, the data for the public sector was collected between 2005-6 and the FTSE 100 in 2007. The quality of strategies may have therefore improved since then. Second, some of the responses from organisations were such that the assessment of, whether the body meets that requirement or not, were left to subjective judgement. However, where this has occurred the research team have erred on the side of the organisation and in that sense it may present a better picture of the reality at that time.

To reiterate, the research team do not see this Report as the definitive assessment of UK Plc's resilience to fraud, rather as an exercise that will stimulate debate about the strength of UK Plc's counter fraud infra-structure and as a forerunner to a much more comprehensive assessment.

Results

Before the results of the exercise are set out it would be worth identifying what the financial value of the organisations assessed amounted to.

- FTSE 100 - £326 billion
- Central Government Bodies - £129 billion

As stated above, UK GDP in 2006 was £1,301.9 billion and total government expenditure for 2005-2006 was £481.9 billion³. The survey does therefore represent a significant snapshot of UK Plc.

² House of Commons Library Research Papers (2007). Research Paper 07/83: Economic Indicators December 2007. Retrieved from www.parliament.uk/commons/lib/research/rp2007/rp07-083.pdf

³ Public Expenditure Statistical Analysis (2006). Retrieved from HM Treasury Website www.hm-treasury.gov.uk/d/cm6811_comp.pdf

Results

Figure 1 and 2 set out the number of organisations that have achieved between 0 and 13 points based upon the authors' assessment.

The figures show that the private sector performs generally better than the public sector. In the latter there are a significant number of bodies scoring 0 to 5 points, whereas in the private sector the majority score 8 or more.

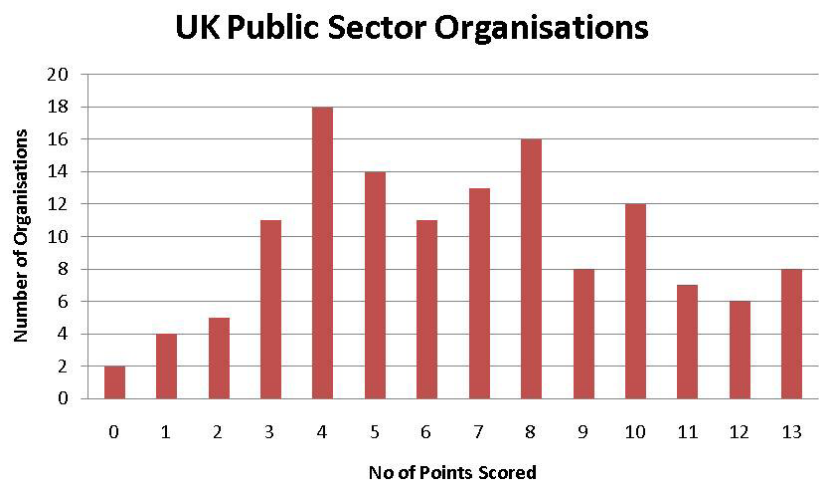


Figure 1. Distribution of public sector organisations by score.

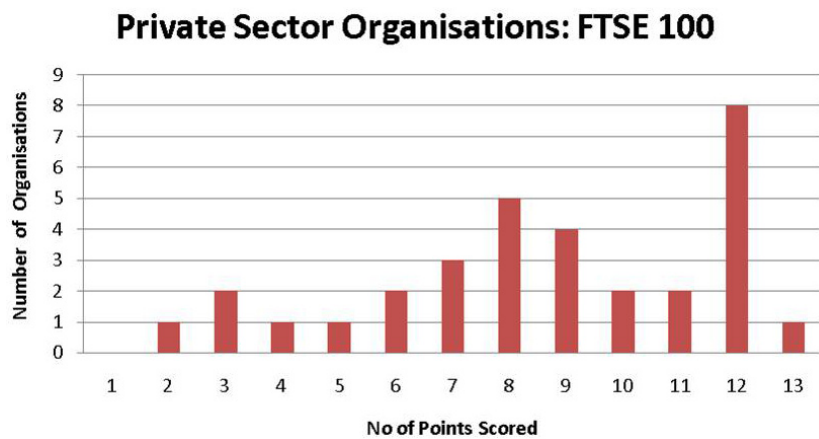


Figure 2. Distribution of FTSE 100 companies by score.

The authors would be concerned in most cases if bodies did not have all 13 actions. However, for the purposes of debate they decided that 8 or less posed a significant risk. The pie charts to the right show the significant proportion of organisations scoring 8 or less.

The charts show that there would seem to be a bigger problem in the public sector with many more organisations not scoring 9 or above.

Public Sector: Fraud Resilience

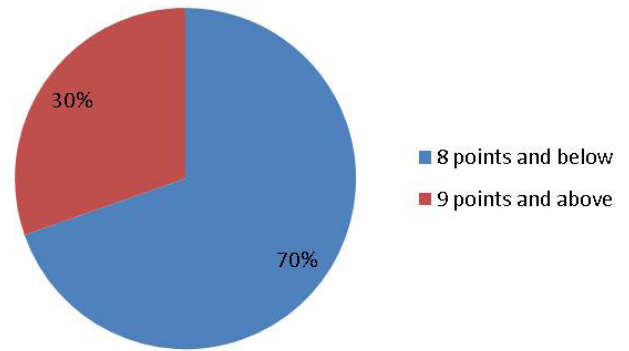


Figure 3. Public sector division between 8 and below and 9 and above

Private Sector (FTSE 100): Fraud Resilience

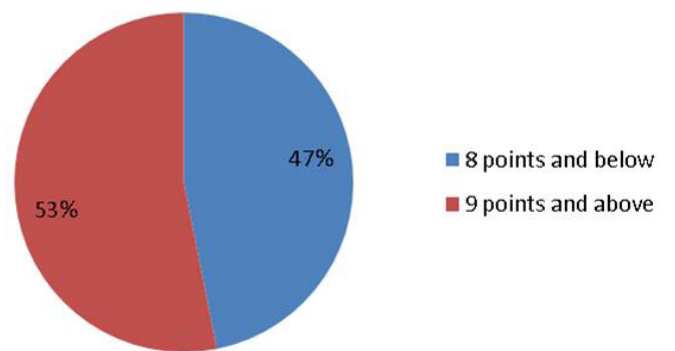


Figure 4. FTSE 100 sector division between 8 and below and 9 and above.

To highlight what is actually at risk the research team then calculated the points scored by turnover of the company in the case of FTSE 100 and expenditure in terms of public organisations.

This shows that in the case of public bodies only 6 per cent of monies was at risk (8 or below), compared to 55 per cent with the FTSE 100. What this reveals is that in the public sector organisations assessed there were a larger number scoring 8 or less, but they were generally small. In the FTSE 100 sample however, 8 or below was more evenly spread no matter what the size of the company.

Public Sector : Monetary Value

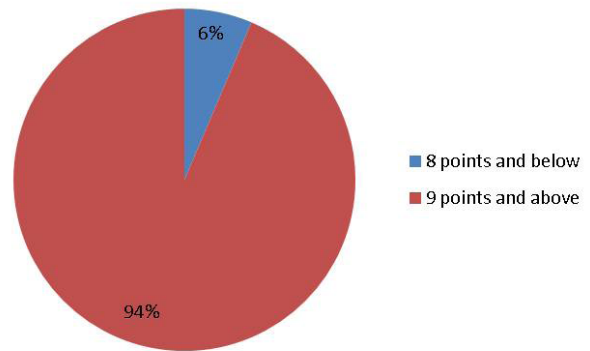


Figure 5. Public sector division between 8 and below and 9 and above by expenditure.

Private Sector : FTSE 100 Monetary Value

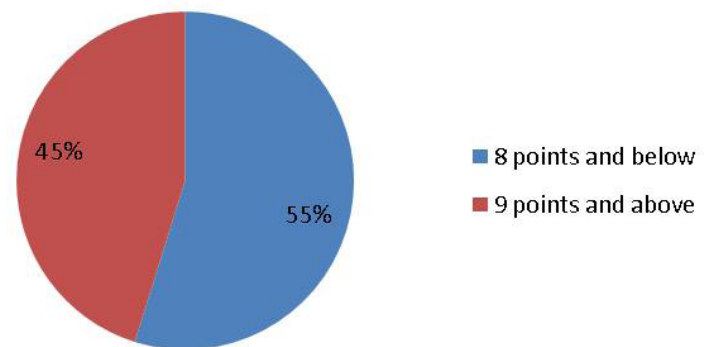


Figure 6. FTSE 100 sector division between 8 and below and 9 and above by turnover.

It would be useful now to examine the 13 points and where organisations generally scored their points. As was mentioned earlier, the authors took the decision for methodological reasons not to rate each of the 13. However, there are some of these that clearly are more important than others. The bar charts illustrate where the organisations assessed secured their points.

The analysis shows the public sector bodies are best on the issues of whistle blowing and having a named person responsible for counter fraud. The weak points are professional training for counter fraud staff, having dedicated staff (although many are small bodies), having a counter fraud strategy and the assessment of their effectiveness.

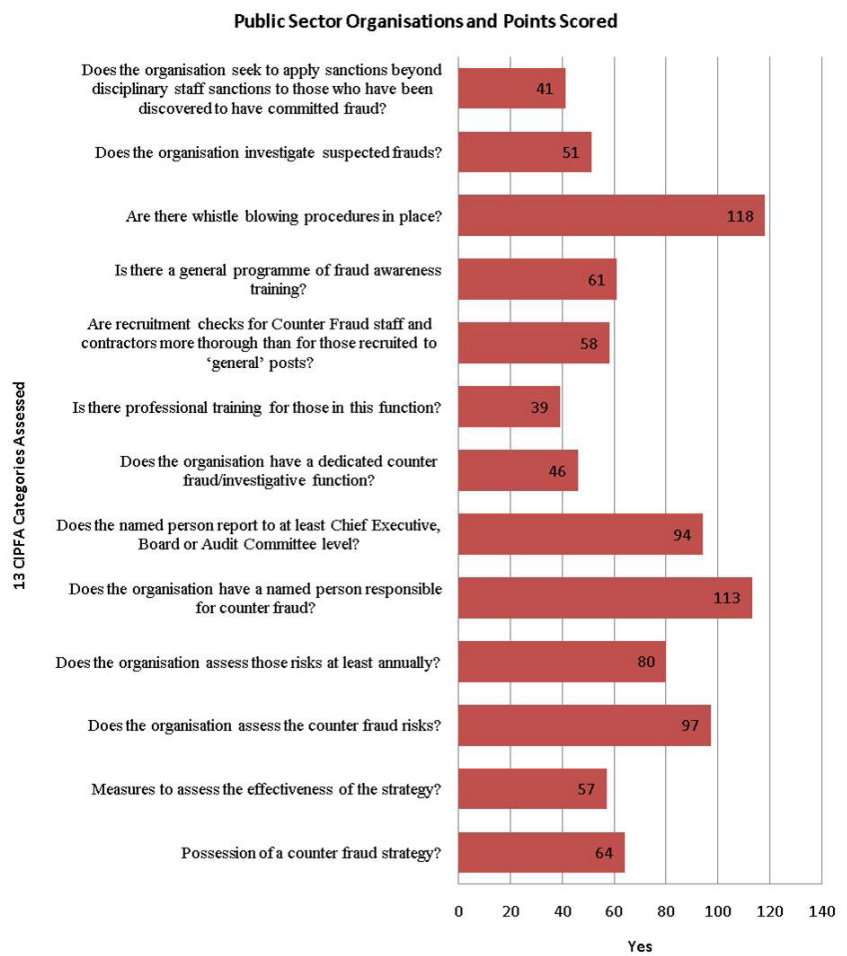


Figure 7. Number of the 135 public bodies meeting each of the 13 criteria.

For the FTSE 100 respondents the spread was much more even on the 13 criteria. The weaker points were whether there were; measures to assess the effectiveness of the strategy, the employment of a dedicated function to investigate fraud and possession of training for those in that function.

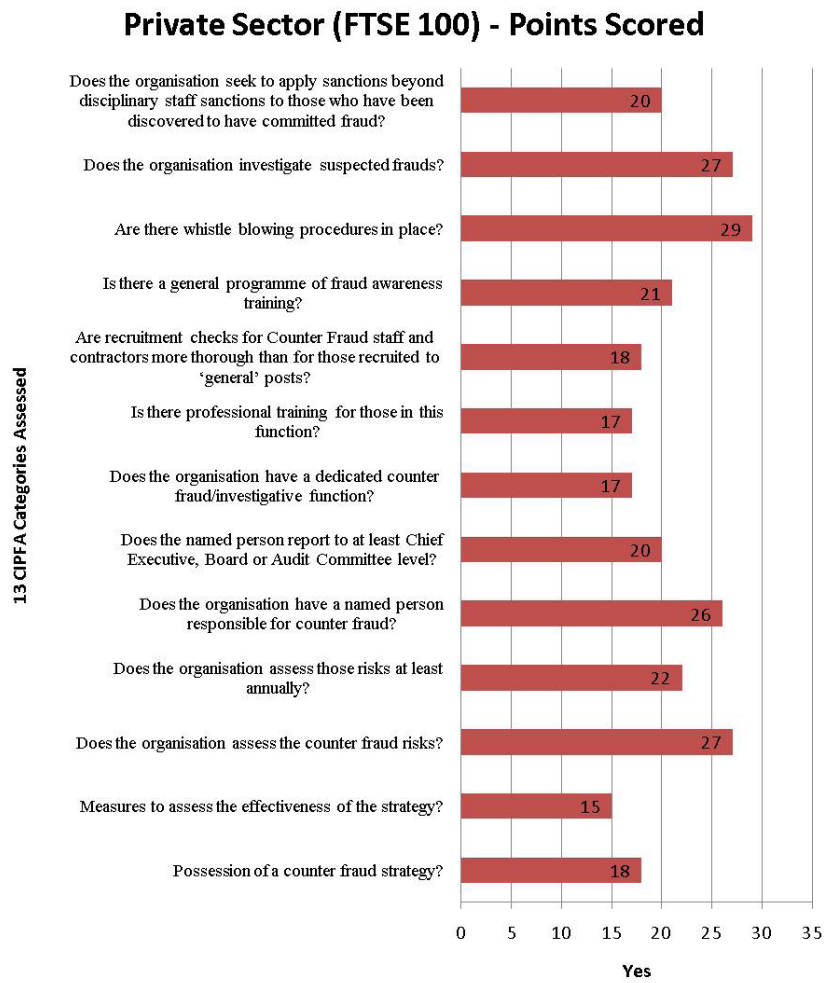


Figure 8. Number of the 32 FTSE 100 organisations meeting each of the 13 criteria.

It would now seem appropriate to pick out some of the more salient gaps. Having a counter fraud strategy is very important, but is even more important to assess the effectiveness of it, as many bodies may just have it 'filed'. The pie charts reveal the number of organisations that regularly assess their strategy.

Public Sector : Assessing Effectiveness of Counter Fraud Strategy ?

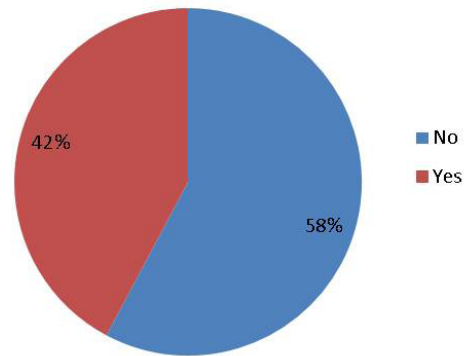


Figure 9. Percentage of public bodies assessing the effectiveness of their counter fraud strategy.

Private Sector (FTSE 100) : Assessing Effectiveness of Counter Fraud Strategy ?

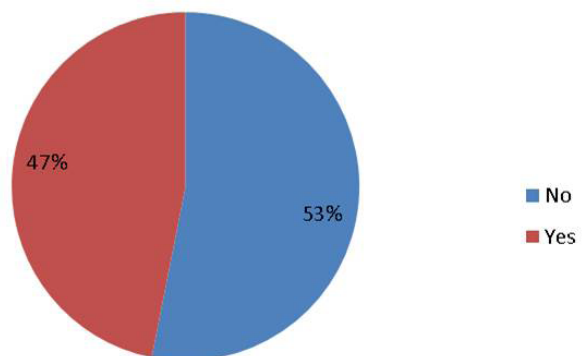


Figure 10. Percentage of FTSE 100 companies assessing the effectiveness of their counter fraud strategy.

It is also important to regularly assess the risks of fraud to an organisation on a regular basis of at least yearly or better. As figures 11 and 12 show, in the public sector 41 per cent did not do so, where as for the FTSE 100 respondents just under a third did not do so. Given the size of FTSE 100 companies this is a much more worrying finding.

Public Sector : Annual Risk Assessment

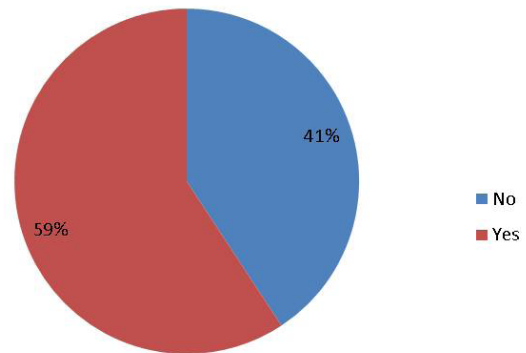


Figure 11. Percentage of public bodies undertaking annual, or more frequent, assessments of fraud risks.

Private Sector (FTSE 100): Annual Risk Assessment

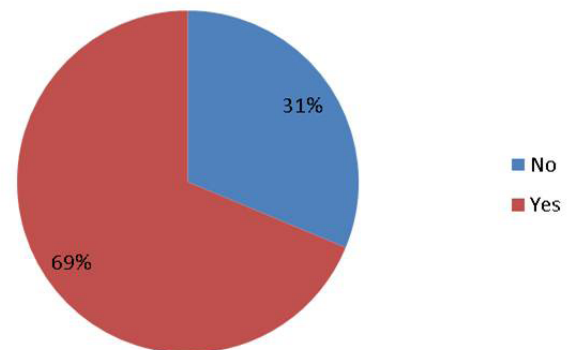


Figure 12. Percentage of FTSE 100 companies undertaking annual, or more frequent, assessments of fraud risks.

Figures 13 and 14 show whether the named person reports to at least the Chief Executive, Board or Audit Committee. This shows that in both sectors around a third does not have this arrangement in place. Given the public sector includes some of the smaller bodies this is concerning as one would expect a smaller hierarchy to enable this to happen. It is also a concern that a significant minority of the larger FTSE 100 companies do not have appropriate reporting structure in place.

Public Sector : Reporting Structure

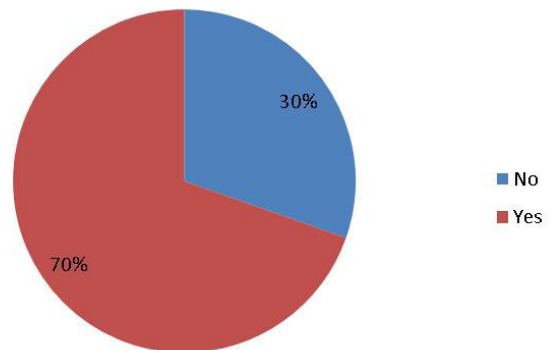


Figure 13. Percentage of public bodies whose named counter fraud person reports direct to at least Chief Executive, Board or Audit Committee level.

Private Sector (FTSE 100): Reporting Structure

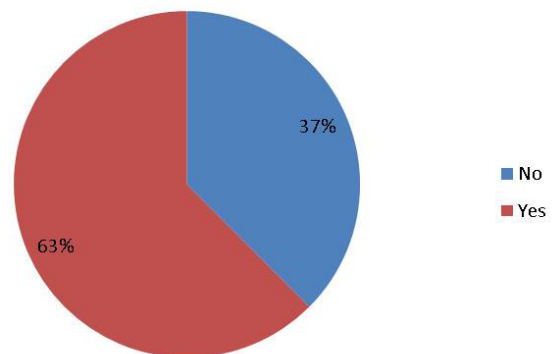


Figure 14. Percentage of FTSE 100 whose named counter fraud person reports direct to at least Chief Executive, Board or Audit Committee level.

Developing an anti-fraud culture is also a very important part of a counter fraud strategy and part of achieving that is the use of fraud awareness training for general staff. Here again about a third of the FTSE 100 companies did not do this, which is a concern given their size. For public bodies over half did not, which is also a major concern.

Public Sector : General Fraud Awareness Training

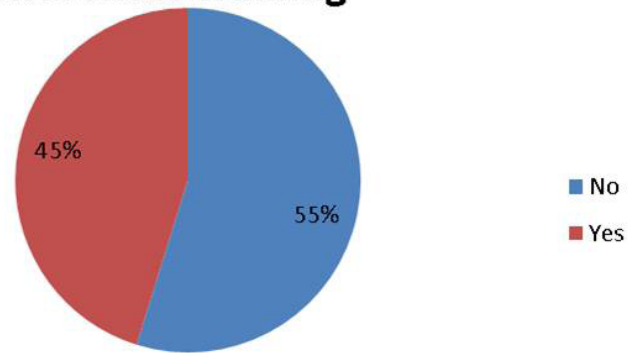


Figure 15. Percentage of public sector bodies that undertake general counter fraud awareness training.

Private Sector (FTSE 100) : General Fraud Awareness Training

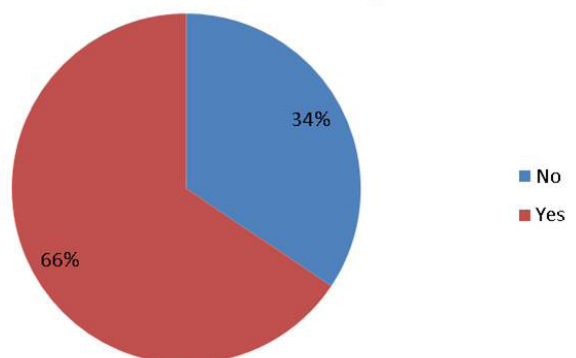


Figure 16. Percentage of FTSE 100 companies that undertake general counter fraud awareness training.

The final criterion that we pick out from the 13 criteria is that of pursuing sanctions beyond merely disciplinary action. As part of a broader counter fraud strategy it is important to adequately punish fraudsters. For many organisations the general policy is to just 'quietly' dismiss the person. As figures 17 and 18 show, only 30 per cent of the public bodies and 63 per cent of the FTSE 100 companies would pursue sanctions beyond disciplinary action. This shows many are missing out on a major part of a counter fraud strategy - that of sending the message that a fraudster might not only lose their job, but may also face civil and criminal actions.

Public Sector : Sanctions Beyond Disciplinary

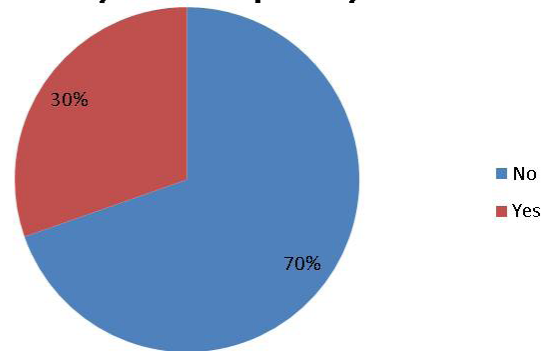


Figure 17. Percentage of public sector organisations who pursue sanctions beyond disciplinary action.

Private Sector (FTSE 100) : Sanctions Beyond Disciplinary

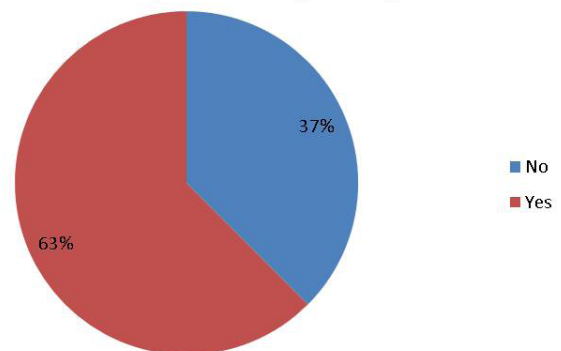


Figure 18. Percentage of FTSE 100 companies who pursue sanctions beyond disciplinary action.

Conclusion

This Report considers the effectiveness of counter fraud arrangements in public sector organisations with budgets totalling more than a quarter of public expenditure and private companies generating over a quarter of the UK's GDP. The results give the first ever comparative and economy wide view of the situation.

There is serious cause for concern. The Report, based on data from 2005 - 2007, shows that in the case of public bodies only 6 per cent of total expenditure was at risk, compared to 55 per cent in the case of FTSE 100 companies. **This means that in the two years before the recession FTSE 100 companies with a turnover of almost £180 billion were not properly protected against fraud – a shocking statistic.**

The Report also shows that while larger public sector organisations have improved counter fraud arrangements, many smaller public sector bodies did not have adequate arrangements in place to counter fraud.

Over recent years there has been a general trend to develop and provide comparative, UK-wide information about different functions. Such information allows considered judgements to be made about prioritising improvements. The good work of the Government's new National Fraud Authority will quicken this trend, but more needs to be done.

The concerns which have emerged clearly justify a further in-depth analysis of the position as it is now. The recommendation is that this should be completed as quickly as possible.

About the Report sponsor

The Right Honourable Frank Field M.P.

Campaigning against poverty and low pay

From 1969-79, Frank Field worked as Director of the Child Poverty Action Group, during which time it became one of the premier pressure groups in the country.

In 1974 he also became Director of the Low Pay Unit until 1980. The Unit was established to make sure wages councils properly protected the rights of workers in certain industries. It was the first to campaign for a national minimum wage, along with Rodney Bickerstaffe, the former general secretary of the National Union of Public Employees, now Unison; a goal that was eventually achieved in 1998.

Parliamentary experience

In 1979, he was elected Member of Parliament for Birkenhead and has since displayed a unique attachment to his constituency. During the 1980s he led the campaign to make the Labour Party electable, which not only involved the very public countering of Trotskyites in Birkenhead, but also the development of policies which appealed beyond the ghettos. To this end, he led the transformation of the debate on welfare from one that believed in a process of pure altruism, to one which had a more sane view of human nature.

Between 1980 and 1981 he served as Shadow Education and Social Security spokesman under the leadership of Michael Foot. In 1990 he took up the chairmanship of the Social Security Select Committee and continued in this role up to 1997. From 1997-1998 he accepted the position of Minister for Welfare Reform in Tony Blair's first cabinet. Since then, he has served as a member of the Public Accounts Committee between 2002 and 2005.

Other commitments

Outside of Parliament, he is equally busy and committed. In 1999 he helped set up the Pension Reform Group which he chairs. The group has acted as an important independent think tank for the cause of a long-term, investment led reform to the pension system. Between 2001 and 2007 he chaired the Church Conservation Trust helping develop the trust from being one primarily concerned with conserving the best architectural gems of the Church to one which tries to open up such places for alternative use. Since 2005, he has been chairman of the Cathedral Fabrics Commission for England which is the planning authority for English cathedrals. In 2007 he took on the chairmanship of the 2011 Trust which has been established to celebrate the 400th anniversary of the Authorised Version (King James Version) of the Bible.

About the Report authors

Jim Gee is Director of Counter Fraud Services at MacIntyre Hudson LLP and Chair of the Centre for Counter Fraud Studies

Jim Gee is one of the leading counter fraud specialists in the UK. His accomplishments include leading the team which cleaned up London Borough of Lambeth in the mid to late 1990s; advising Right Honourable Frank Field M.P. during his periods as Chair of the House of Commons Social Security Select Committee and Minister for Welfare Reform; and being Director-General of the European Healthcare Fraud and Corruption Network between 2004 and 2006.

He was also a senior advisor to the Attorney-General concerning the Government's Fraud Review which has started to professionalise this country's approach to fraud. Gee's work in the NHS reduced fraud-related losses by up to 60 per cent, delivering financial benefits to the tune of more than £800 million and achieving a 12:1 return on the costs of the work.

Mark Button is a Reader at University of Portsmouth and Director of the Centre for Counter Fraud Studies

Mark Button is a Reader in Criminology and Associate Head Curriculum at the Institute of Criminal Justice Studies, University of Portsmouth. He has also recently founded the Centre for Counter Fraud Studies of which he is Director.

He has written extensively on counter fraud and private policing issues, publishing many articles, chapters and completing four books with one forthcoming: *Private Security* (published by Perpetuity Press and co-authored with the Rt. Hon. Bruce George MP), *Private Policing* (published by Willan), *Security Officers and Policing* (Published by Ashgate), *Doing Security* (Published by Palgrave), and *Understanding Fraud: Issues in White Collar Crime* (to be published by Palgrave in early 2010 and co-authored). He is also a Director of the Security Institute, and Chairs its Academic Board, and a member of the editorial advisory board of 'Security Journal'.

Mark founded the BSc (Hons) in Risk and Security Management, the BSc (Hons) in Counter Fraud and Criminal Justice Studies and the MSc in Counter Fraud and Counter Corruption Studies at Portsmouth University and is Head of Secretariat of the Counter Fraud Professional Accreditation Board (CFPAB). Before joining the University of Portsmouth he worked as a Research Assistant to the Rt. Hon. Bruce George MP specialising in policing, security and home affairs issues.

He completed his undergraduate studies at the University of Exeter, his Masters at the University of Warwick and his Doctorate at the London School of Economics. Mark is currently working on a research project funded by the National Fraud Strategic Authority and ACPO looking at victims of fraud.

Kwabena Frimpong, Research Associate at the Centre for Counter Fraud Studies

Kwabena has an interest in the professionalisation of counter fraud specialists. He was educated at Portsmouth University with a BSc (Hons) in business administration, Masters in Information Systems, CertHE in Risk and Security Management and a PGCert in Research Methods.

About MacIntyre Hudson LLP

Established in 1880, we are a growing and successful mid tier UK independent accountancy firm working with entrepreneurial businesses, groups and multinationals with operations in the UK.

We provide a comprehensive range of services and specialist advice, including audit and assurance, tax planning and compliance for both corporate and individual clients, payroll and VAT, corporate recovery, business strategy and outsourcing. Other parts of the MacIntyre Hudson Group provide specialist advice on corporate finance and professional training.

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The Centre for Counter Fraud Studies

The University of Portsmouth's Centre for Counter Fraud Studies (CCFS) was founded in June 2009 and is one of the specialist research centres in the University's Institute of Criminal Justice Studies. It was founded to establish better understanding of fraud and how to combat it through rigorous research. The Institute of Criminal Justice Studies is home to researchers from a wide cross-section of disciplines and provides a clear focus for research, knowledge transfer and educational provision to the counter fraud community. The Centre for Counter Fraud Studies makes its independent research findings available to support those working in counter fraud by providing the latest and best information on the effectiveness of counter fraud strategies.

www.port.ac.uk/departments/academic/icjs/CentreforCounterFraudStudies/



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