FRAUD FACTS

Fraud Advisory Panel

Issue 14 November 2011 INFORMATION FOR ORGANISATIONS

An introduction to fraud indicators

Prevention and early detection of internal fraud are always preferable to intervention after the event. Once a fraud has become firmly established or entrenched within an organisation, the financial, legal, reputational or regulatory ramifications will be considerably more severe. One very effective method of prevention is the pro-active identification of fraud indicators.

What are fraud indicators?

Within an organisation, internal fraud can be perpetrated by any employee, from the most junior to the most senior. Where fraud is perpetrated from outside the organisation, it can be with the assistance of an employee or 'insider'.

There are a number of recognised warning signs or 'red flags' which *may* indicate that an employee is engaged in a fraudulent activity. These indicators can be a powerful part of risk assessment when combined with other relevant information.

Why are they important?

Internal frauds are a big issue for organisations and are usually triggered by one of four situations:

- **Opportunistic crime:** employees commit fraud for their own benefit. This may be entirely opportunistic or carefully planned. There are likely to be a number of possible motives.
- **Lack of a corporate ethic:** in some organisations low-level fraud, such as the inflation of expenses claims, may appear to be condoned by both employer and employee.
- **The recruited criminal:** some individuals seek employment (often in the financial sector) with the deliberate intention of defrauding their employer or gathering intellectual property.
- **Employee intimidation:** organised crime groups are increasingly involved in the intimidation of staff to directly participate in frauds or to provide information on customer accounts or internal procedures in order to assist other attempts. A common threat is the harming of family and friends. Employees who have succumbed to an approach from a third party, provided information and accepted a fee in return often feel they have been 'bought for life'.

Fraud indicators should help to identify these triggers, which should then be addressed as part of a robust anti-fraud strategy.

'Red flag' indicators

There are a number of warning signs that can indicate that there may be a problem within your business. These should not be taken alone as evidence that fraud is occurring within the organisation; there may be other legitimate explanations for the occurrence of these indicators.

Fraud indicators are inherently interrelated. However, for ease of reference they have been grouped together below under umbrella themes. This list is not exhaustive.

Behavioural

- Employees who consistently work longer hours than their colleagues for no apparent reason.
- Employees who are reluctant to take holidays and/or time off.
- Employees who are excessively secretive in relation to their work.
- Employees known by others to be under duress for personal reasons.
- Employees with a sudden change of lifestyle and/or social circle.
- Employees under apparent stress without identifiable pressure.
- Employees who are aggressive or defensive when challenged and/or controlling of certain colleagues.
- Employees who are subject to complaints and/or tend to break the rules.
- Employees who delay providing information or who provide different answers to different people.
- Employees who ask to defer internal audits or inspections to 'properly prepare'.
- Employees with new and unusual relationships with other individuals or departments within the organisation.
- Employees who request significant detail about proposed internal audit scopes or inspections.
- Excessively high or low staff turnover and/or new employees resigning quickly.

Financial

- Cash-only transactions.
- Poorly reconciled cash expenses or customer accounts.
- Rising costs with no explanation or that are not commensurate with an increase in revenue.
- Large volume of refunds to customers.
- Unusually large inventories.
- Unusual transactions or inter-account transfers (even for small amounts).
- Remuneration disproportionately linked to activities such as sales.
- Employees known by others to be under external financial pressure.
- Employees who appear to make a greater than normal number of mistakes, especially where these lead to financial loss through cash or account transactions.

- Employees with unexplained sources of wealth.
- Employees with competing or undeclared external business interests.
- Employees who submit inconsistent and/or unreasonable expense claims.
- Employees at the highest level of performance (eg sales) where there might be a concern that they are achieving this through suspect activity.

Procedural

- Employees making procedural or computer-system enquiries inconsistent or not related to their normal duties.
- New employees with knowledge of industry procedures but no such experience disclosed on their CV.
- Prospective employees who are reluctant to provide full background information or who provide inaccurate or inconsistent information.
- Key managers with too much hands-on control.
- Insufficient oversight/audit applied.
- An unusual number of customer complaints.
- Customers or suppliers insisting on dealing with just one individual.
- Managers who avoid using the purchasing department.
- Tendering to one supplier only or to the same suppliers.
- Lack of transparency.
- Poor engagement with corporate governance philosophy.
- Too much delegation by senior managers without proper review procedures.

Indicators of fraud checklist

DO:

✔ Understand the 'red flags'. Consider how they may apply to your organisation. Be vigilant.

✔ Use 'red flags' in conjunction with broader risk management.

✔ Take account of changes in business activities and/or control procedures that may open up new potential fraud risks.

✔ Involve staff in identifying and discussing fraud risks and how to prevent fraud from occurring within your organisation.

✔ Educate all staff and raise awareness of fraud indicators.

✔ Implement systems and processes to detect the early warning signs of fraud.

✔ Establish a credible mechanism for staff to report suspicions of fraud. Encourage an open culture where the reporting of genuine suspicions is acceptable.

✔ Be alert to possible collusion between staff and third parties.

✔ Ensure regular monitoring of compliance with fraud prevention and detection policies, processes and controls.

✔ Have a fraud response plan which outlines the policies and procedures to follow in the event of a fraud being discovered or suspected. This should clearly define roles and responsibilities.

DO NOT:

✗ Ignore 'red flags'. Certain industries and/or activities are exposed to specific fraud risks. Ensure that any risks specific to the business are adequately addressed.

✗ Act too swiftly. They are only indicators of potential fraudulent activity – not proof.

✗ Overlook petty or frivolous reporting by employees.

Further information

See our separate Fraud Fact Sheet *An introduction to Fraud Prevention* for more information.

Fraud Advisory Panel
www.fraudadvisorypanel.org

CIFAS
www.cifas.org.uk

Public Concern at Work
www.pcaw.co.uk

The Fraud Advisory Panel gratefully acknowledges the contribution of the Financial Crime Prevention Team at International Compliance Training (ICT) in the preparation of this Fraud Facts.

Fraud Advisory Panel, Chartered Accountants' Hall, Moorgate Place, London EC2R 6EA.
Tel: 020 7920 8721, Fax: 020 7920 8545, Email: info@fraudadvisorypanel.org.
Company Limited by Guarantee Registered in England and Wales No. 04327390
Registered Charity No. 1108863

Distributed by