

## **The Fall-out from the Credit-Crisis – Fighting Fraud**

### **The Scale of the Problem**

This decade has seen an unprecedented rise in the number of investigations conducted by all bodies in relation to fraud. The rise is not just because there are more people in the world; there is an increase in percentage terms. In part this is because there is relatively more fraud but it is also because governments and regulators are facing increasing pressure to be seen to promote the economic well being and reputation of their markets.

### **Fraud details**

A recent UN report estimates the loss of just one type of fraud at 1.5 trillion dollars a year world wide<sup>1</sup>. Insurance fraud as a whole costs the UK economy around £14–20 billion a year in 2006<sup>2</sup>. Whilst according to the KPMG Profile of a Fraudster Survey 2007:

“Misappropriation of money was revealed as the most common type of fraud. In 83 percent of profiles the fraudsters acted nationally and not internationally. 91 percent of perpetrators did not stop at one single fraudulent transaction but rather performed multiple fraudulent transactions; every third perpetrator acted more than 50 times. A total loss of 1 million EUR and more per fraudster and profile was caused by every second fraudster in Europe, by almost every third perpetrator in South Africa and by every fourth offender in India and the Middle East. In 24 percent of profiles the timeframe for perpetrating fraudulent acts was less than 1 year. In 67 percent of profiles fraudsters acted within a timeframe between 1 year and 5 years until they were exposed or stopped their fraudulent activities. This result generates questions concerning the effectiveness and the quality of existing internal controls: why were they not able to discover or stop fraudulent acts within the recurring standard controls in more than two thirds of all profiles?

All sectors are almost equally affected by white-collar crime, except for the chemicals, pharmaceuticals & biotech sector, which appear to be less impaired. In Europe in half of the profiles the turnover of the companies that suffered damage, was less than 50 million EUR. While in South Africa it was 63 percent. In India and the Middle East the companies with a turnover of less than 50 million EUR and between 50 and 500 million accounted for 34 percent each.”

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<sup>1</sup><http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20190295~menuPK:34457~pagePK:34370~piPK:34424~theSitePK:4607.00.html> (accessed 21/10/08);

<sup>2</sup> Association of British Insurers Survey 2006

There are also an increasing number of bodies and specialists involved in investigations. They each have an explanation for the increasing number and types of investigation:

*In the financial sector* - the adoption of the Financial Action Task Force principles with their emphasis on customer due diligence and the investigation of suspicious transaction reports.

*Accountants* – point to the Sarbanes Oxley legislation and the introduction of Standard Accounting Statement 99 “Considerations of Fraud in a Financial Statements Audit” which requires auditors to investigate and report on fraud.

*Corporates* – point to increased regulatory activism and international cooperation. One international law firm puts it this way:

“Three trends that have significantly affected risk for large companies over the past ten years are:

- The degree to which regulators not only have increased powers but cooperate with each other in the application of those powers to a particular company or practice which is of concern – i.e. globalisation of the regulatory regime
- The increasing use of severe sanctions, particularly of a criminal or quasi criminal nature to control corporate behaviour; and
- The changing ethical environment and the expectation of stake- holders as to corporate behaviour and as to what represents acceptable levels of governance in entities that are of increasing power and impact on all aspects of economic and social life”

(Lomas,P. and Kramer, Daniel J.(2008) *Corporate Internal Investigations*. Oxford University Press)

Fraud is pervasive and increasing and it often comes to light in a credit crunch.

Studies of the psychology of the fraudster have failed to provide a simple recipe for fighting fraud. Accountant firm KPMG have conducted many surveys:

“The results paint an interesting and instructive picture of “the typical fraudster.” In eighty-nine percent of the profiles, the fraudsters committed fraudulent acts against their own employers. In twenty percent of these profiles, an external perpetrator was involved. Interestingly, the tenure of employment does not have a positive influence – rather the contrary: more than fifty percent of offenders have been with their company for more than six years. In sixty-eight percent of profiles fraudsters acted independently. In only five percent of profiles more than five people were involved. In ninety-one percent of profiles perpetrators were not content with one fraudulent act, but acted multiple times – often over a period of several years.

Lone operators represent the greatest white collar crime risk for companies. The survey results indicate that two thirds of all primary internal perpetrators are members of the top management. This finding highlights a significant risk,

based on the concept of trust, as company executives are privy to highly confidential information and have the potential to cause the most harm to the organization.”

### **Towards a strategy to counter fraud**

In 2005 the UK Attorney General set up a team to answer three questions:

- What is the scale of the problem
- What is the appropriate role of Government in dealing with fraud
- How could resources be spent to maximise value for money across the system

As part of the development of an effective deterrence the review highlighted the importance of professional investigation so that the fraudster’s expectation would be that he would both be investigated and discovered.

### **Investigations need to be better planned**

The recent KPMG survey on cross-border investigations, conducted during late 2006 and early 2007, brought responses from 103 senior business executives in 21 countries throughout North America, South America, Europe, Asia, Australia, and Africa with responsibility for cross-border investigations within multinational businesses<sup>1</sup>.

The headline findings of the survey make interesting reading. 92 percent of respondents said they expect the number of international investigations to increase or at least remain constant in the coming year, yet 56 percent said they have not implemented comprehensive investigation procedures or protocols. Notably, 60 percent of executives acknowledged that planning an investigation remains essential to its success.

### **The Experience of the Serious Fraud Office**

The SFO was established in 1988 against the background of failed serious fraud prosecutions by Customs & Excise and the deregulation of the Financial Services market. The SFO was the product of a review by a senior Judge Lord Roskill. Among his 112 recommendations was the establishment of an agency which would be responsible both for the investigation and prosecution of serious and complex fraud and which would bring together legal, financial and police investigators.

In general all investigations, and in particular criminal investigations, face common problems:

- Who should conduct investigations
- How should you organise investigations
- How do you resolve the issues arising in collecting information
- How do you manage large volumes of information
- How do you better analyse information

- How can you present complex information simply to decision makers

In this brief presentation I want to make a few observations on planning investigations which is just one area in which the SFO has made progress by adopting project management methodologies and better investigator training.

### **Better Organisation and Conduct of Investigations**

What I have to say may not strike you as rocket science and you may think it is just good practice but if you succeed in doing this consistently then you are better than most.

One of the first questions you have to address though is:

#### **Who will conduct the investigation and who should lead:**

There are now a bewildering number of different types of investigation and organisations involved.

Typically individuals and firms from any of the following disciplines could be involved:

- In house investigators
- Lawyers
- Accountants
- Private Investigators
- Computer Specialists
- Forensic scientists and medical experts
- Engineers

Additionally the investigation may have as its object a number of different (and sometimes conflicting goals), for example:

- To protect reputations
- To discover what has gone on
- To determine responsibility
- To prevent loss
- To punish the guilty

Not all those conducting investigations are equally suited or experienced

- to achieve the different objectives
- to organise or coordinate a multi national or multi disciplinary team
- to deal with the complexity of the political, economic or legal context.

So assuming you are going to have to look to external advisers you have to decide who should lead and who should be on the team. Will you leave it to the externals to choose or should you give them a steer?

Fraud investigations in the financial sector whether with a view to prosecution or simply recovery of the proceeds are particularly problematic because the investigation will have to draw upon legal and regulatory expertise as well as financial and investigatory expertise. Most likely you will have a multi- disciplinary team with all the tensions this creates.

For some investigations it is important to appoint a respected and experienced figure – a former Judge or a senior Advocate. In other cases it may be more appropriate to appoint Accountants. I do not think it so important that one adopts the “law firm always leads” approach which is common on the Continent or the United States but if litigation is contemplated this is often the best course.

In making your choice it is important to seek the advice of those you know you can trust and to appoint the most appropriate discipline to lead. If there is someone whom you have worked well with and trust you should not necessarily ditch that person just because someone comes along claiming to be the biggest or the best in a particular field. You are looking for the right combination of:

- Availability
- Expertise
- Connections with appropriate persons and bodies
- Quality of service
- Integrity and trustworthiness

If you are seeking to staff your own investigations you will have a different set of problems to do with recruitment, selection and training and it will be your staff that have the problems which the external team face.

In relation to training there is both a surprising little amount and a large volume. In many places reliance is still placed on the native abilities of the investigators and their reputation. Often investigators will state that they learned their craft on the job without formal training or education. A lawyer will have had an extensive education with a range of practical skills training encompassing interviewing as well as practical knowledge. Many private investigators and even some forensic accountants will have learned on assignment, often mentored by someone who also learned on the job. Everywhere however, there are moves to professionalise investigators and investigations. The UK Police began a Police Improvement Programme in 2004-2007 which encompasses a wide range of investigative techniques. In 2001 there were moves to regulate the Private Investigators with the advent of the Private Security Industry Act. In the SFO, for our recent recruits, we now have an extensive Fraud Investigators Accreditation scheme which encompasses Investigative Interview techniques<sup>3</sup>.

So whether you are investigating locally or working with externals nationally or internationally you need to:

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<sup>3</sup> E.g. the PEACE Method

- Have a plan
- Be clear on your objectives and who will achieve it
- Have a central point of control and operations
- Have a methodology for organising the investigation and managing the politics of the process
- Determine when and how you want reports on progress.

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This paper reflects the personal views of its author and not those of any organisation.  
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