An introduction to fraud risk management

Effective risk management is an essential part of good business practice. Businesses should consider the three key elements of fraud risk management – prevention, detection and response.

Introduction

Managing the risk of fraud should be a priority for all businesses, and good fraud risk management starts at the top. Executives and senior managers must lead by example and set the standards of behaviour expected of staff, suppliers and other third parties. It is not enough to simply talk the talk – senior management must also walk the walk.

Failure to adequately manage the risk of fraud may increase the chances of financial loss, reputational damage, share price volatility and unbudgeted investigation, accountancy and legal costs.

Key elements

The key elements of fraud risk management are:

- **Prevention:** Identify the main risks to your business and implement a culture, supported by policies, procedures and training, to prevent your business from becoming a victim of fraud.

- **Detection:** Implement systems and procedures to detect the early warning signs of fraud.

- **Response:** Prepare for fraud by having an up-to-date response plan.

Understanding the risk

All businesses are vulnerable to fraud. But fraud risk varies according to the nature and size of the business and the sector in which it operates. Understanding the risk profile of your organisation is one of the first steps in successfully managing fraud.

All businesses should have a risk register (or database) which specifically identifies fraud risks and which is regularly reviewed and updated. This will allow your business to identify, assess and manage the risks it

faces across all its operations. It should cover:

- The nature of the risk and who is responsible for managing it;

- The likelihood of it occurring and its potential impact; and

- The preventative controls put in place to mitigate the risk.

Prevention

Establish an ethical business culture. Develop an anti-fraud policy that clearly sets out your organisation's attitude to, and position on, fraud and the behaviour expected of staff and others (see our separate factsheet *Anti-Fraud Policy Statements* for more information). Lead by example.

Minimise the opportunities for fraud to occur within your business. Make sure that fraud features on your risk register. Review your business activities, identify the areas most at risk to fraud and introduce controls to prevent it.

Controls do not need to be complicated or expensive. Controls might include segregating finance duties, implementing authorisation thresholds, introducing IT systems access procedures, conducting reference checks on new employees (see our separate factsheet *Pre-Employment Screening* for more information), and propriety checks on new business partners, suppliers and third party service providers.

Provide a training and awareness programme relevant to your business model, utilising examples of key risk areas, the control environment and the reporting process.

Consider the need for fidelity or crime protection and/or directors' and officers' liability insurance.

Detection

Be aware of the indicators of fraud. Introduce manual procedures and IT systems to detect the early warning signs of fraud. These might include educating staff to identify common frauds and scams, introducing fraud reporting mechanisms, conducting spot audits (of stock, sales and purchase ledgers, etc) and reviewing profit and loss accounts on a regular basis.

Response

Make sure you are prepared to respond to a fraud being discovered within your business. Develop a fraud response plan that clearly sets out the investigation process (who, what, when and how), legal or ethical duties to report fraud (to your shareholders, customers, bank, insurance company and/or regulator(s)) and the action to be taken against fraudsters (see our separate factsheet *An introduction to Fraud Response Plans* for further information). Include fraud in your disaster recovery plan.

It is important to remember that there are different standards of proof that need to be met according to the type of action you wish to take against the fraudster – disciplinary, regulatory, civil or criminal.

Review procedures

Introduce review procedures to ensure that appropriate remedial action is taken to prevent any similar frauds from occurring in future.

Business practices and activities change over time. Regularly review the systems, processes and controls you have in place to manage the risk of fraud to ensure that these remain current, relevant and appropriate to the needs of your business.

Managing the risk of fraud

DO:

✔ Set the tone from the top as one of zero tolerance towards all acts of fraud and dishonesty. Ensure executives and senior management lead by example.

✔ Designate responsibility for fraud oversight to an appropriate individual with sufficient authority.

✔ Clearly set out what is acceptable behaviour and what is not, particularly in relation to conflicts of interest.

✔ Ensure that all staff and third parties (where appropriate) are fully aware of your organisation's policies on fraud and dishonesty.

✔ Make sure your risk register includes fraud. Regularly review and update it.

✔ Make fraud prevention part of your overall training strategy. This should start with your induction programme and provide staff with regular updates on an ongoing basis.

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

✔ Establish a credible mechanism for staff to report suspicions of fraud.

✔ Undertake pre-employment screening on all new employees before they start working for you.

✔ Conduct propriety checks on new business partners, suppliers and third party service providers.

✔ Prepare a fraud response plan in anticipation of a fraud being discovered or suspected.

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

DO NOT:

✗ Expect employees to understand the term 'fraud' without your defining it.

✗ Adopt generic control policies and procedures across the business. The risk of fraud is likely to vary across operations.

✗ Encourage staff to confront suspected fraudsters and/or investigate suspicions of fraud themselves. This could expose them to physical danger and lead to the destruction of evidence.

✗ 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.

Further information

See our separate fraud factsheets on *Anti-Fraud Policy Statements*, *Pre-Employment Screening* and *An Introduction to Fraud Response Plans* for more information.

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