

Fraud costs,  
corrupts,  
destroys.

**Huge surge  
in identity  
thefts**

**Money laundering  
is a serious and  
tangible threat**

**Lack of  
resources  
hinders  
UK fraud  
battle**

**Most British  
firms have  
been financial  
crime victims**

Fraud is growing fast. It cost £1 billion in 1985, £4 billion in 1994 and at least £13.8 billion in 2000 - £230 for every man, woman and child in Britain (figures exclusive of money laundering).

*City of London Police, 2002/ National Economic Research Associates for the Home Office, 2000*

Fraud wrecks ordinary lives by destroying jobs, savings and pensions. 16 investors took their own lives in the aftermath of the Barlow Clowes fraud.

*The Serious Fraud Office, 2002*

Fraud takes money from our pockets every day. Plastic card fraud alone cost £424.6 million in 2002 - 30% up on the year before.

*Association for Payment Clearing Services, April 2003*

Fraud leads to higher prices as business covers its losses. False motor and household claims alone cost the insurance industry and policy holders £20 million per week.

*Association of British Insurers, April 2003*

# More companies than ever affected by fraud

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**Massive fraud leads to £13 billion (yes, billion) revision in UK trade**

**Fraudsters are getting off scot-free...**

**Anti-laundering team swamped**

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Fraud causes productivity loss, cash flow problems and corporate collapses. 51% of British businesses have been victims of fraud in the last two years.

*PricewaterhouseCoopers, UK survey, July 2003*

Fraud hits public services and means more tax has to be raised than would otherwise be required. Benefit fraud alone costs £2 billion a year, £80 for every family in the land.

*Department of Work and Pensions, June 2003*

Fraud harms trust in Britain's financial services industry. The Financial Services Authority has warned that infiltration of City institutions is high on the criminal agenda.

Fraud feeds organised crime. The National Criminal Intelligence Service (NCIS) has reported that gangs now derive as much money from financial crime as from drug trafficking.

Fraud corrupts business, finance and the professions. The Home Office has estimated that money laundering accounts for 2% of Britain's GDP.

*The Cabinet Office, 2002*

“Quite simply, British business needs the government to take fraud seriously. If we didn’t have the government we would have to get together to invent it.”

Lord Sharman of Redlynch OBE, Chairman of the Government’s “Foresight” Panel on Crime Prevention

### Sounding the Alert on Fraud: The Role of The Fraud Advisory Panel

The Panel’s role is to alert the nation to the immense social and economic damage caused by fraud and help both public and private sectors to fight back. It is dedicated to a holistic approach and the long view.

The Panel works to:

Originate proposals for reform of the law and public policy on fraud (including money laundering and corruption).

Develop recommendations that will enhance the investigation and prosecution of fraud.

Advise business as a whole on fraud prevention, detection and reporting.

Assist in improving fraud-related education and training in business and the professions.

Establish a more accurate picture of the extent, causes and nature of fraud.

The FAP is an independent body of volunteers drawn from the law and accountancy, banking, insurance, commerce, regulators, law enforcement, government departments and public agencies. It is not restricted by seeing the problem from any single point of view but works to encourage a truly multi-disciplinary perspective. No other organisation has such a range and depth of knowledge, both of the problem and of the means to combat it.

# Panel as a voice in high places, kind of conscience pressing it to the FAP, I guarantee you that we

## Five Years of Achievement

Since it was formed in 1998 the Panel has succeeded in:

Creating close working links with government which have helped push fraud to the top of the legislative programme.

Developing major proposals for reforming serious fraud trials, many of them adopted in the Auld Report and the current Criminal Justice Bill.

Proposing major anti-fraud reforms in company law and corporate governance.

Highlighting the impact of fraud on small and medium sized enterprises (SMEs) and providing ground-breaking practical advice.

Improving the anti-fraud content of business and professional education and training.

Conducting new research into the extent, nature and causes of fraud.

Raising awareness of fraud and promoting prevention via conferences and seminars, and in business and professional journals.

**“This is an organisation that deserves the active support of British business. A stronger Panel means a stronger voice on fraud policy and prevention in places that matter.”**

Digby Jones, Director-General CBI

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“Economic crime is a crucial and growing concern yet in recent years I fear it has slipped off the agenda. Hard and sustained thinking and campaigning by the Fraud Advisory Panel is helping to turn the tide.”

Commissioner James Hart QPM, City of London Police

# Willing the ends but not the means?

The absence of a huge Enron-type scandal in Britain has persuaded many people that our vulnerability to fraud is much lower than America's. I wonder how carefully such people read the newspapers, let alone specialist reports. Certainly it's some years since BCCI, Barings and Maxwell but then the likes of the Brinks Mat and great train robberies aren't every day events either. The rarity of such spectacular thefts hasn't stopped 'ordinary' crime injuring millions of people and eroding the quality of our lives. In the same way fraud is less about headline incidents and more to do with a rising tide of financial crime. Individual frauds may often involve the loss of 'only' thousands or millions of pounds but they are part of a wider attack on our society that devours many billions every year.

It is true there has been a good deal of valuable anti-fraud and money laundering legislation in recent years, with more on the way; auditing and accounting regulation has proved more robust than their American counterparts; the Higgs and Smith proposals have been able to build on existing corporate governance practices rather than invent them; and we can all welcome the forthcoming introduction of microchips and PIN numbers in credit and debit cards. Unfortunately self-congratulation can blind us to facts 'on the ground'; the steep decline in police fraud squads, the current crisis in the processing of money laundering reports, the widespread lack of coherent corporate risk management, the general weakness of fraud-related education and training and the surge in identity fraud.

With fraud spreading like a stain through our society there can be no room for a mere box-ticking mentality. Rules, vital though they are, can never be enough. Fighting fraud demands funding, systems, vigilance and co-ordination. Are we willing the end without willing the means? Bold statements and wise laws are just so much waste paper if there isn't the will to implement them. Let me give three crucial examples:

Britain's police fraud squads are in crisis through lack of funding and specialised manpower. The number of investigators fell from 869 in 1995 to around only 600 in this year. Many frauds are going uninvestigated and some county fraud squads have closed altogether.

Companies are doing nowhere near enough to protect themselves. A recent survey by PricewaterhouseCoopers found that 46% of UK companies discovered fraud by accident compared to only 43% who did so via their internal controls. Only 26% ran anti-fraud training for management. Yet 85% were confident that their controls were adequate to deal with significant financial loss. That is complacency writ large.

None of the recent wave of reports on corporate governance (nor the Combined Code) give any prominence to fraud prevention despite it being one of the gravest risks to corporate survival.

## Chairman's Overview

The Fraud Advisory Panel has called upon government to set up an Economic Crime Commission to monitor, galvanise and counsel the public and private sectors. So far our call has gone unheeded but we are doing something to fill the gap: the Panel is an Economic Crime Commission by default, a unique independent body of volunteers combining the expertise of accountants, lawyers, law enforcement officers, business people, security and IT experts. Founded in 1998, with the continuing support of the Institute of Chartered Accountants in England & Wales (ICAEW), it works to develop new anti-fraud policies, brief Whitehall and educate business and the professions. Fighting economic crime (for our remit includes money laundering and corruption too) is too broad a task for law enforcement alone and the Panel serves as a combination of 'watchdog' and 'think tank'. When Derek Higgs said that his proposals were "about rigour...about getting away from casualness...about getting the right people working in the right way" he might have been describing the role of the FAP.

Credit for that is due in large measure to George Staple who retired from the Chair on 30th April. George was the Panel's founder Chairman who brought and kept together a very wide range of people from all disciplines to serve a common end. It is testimony to his leadership, expertise and character that in just five years the FAP has become a mature member of the fraud prevention community and its work is achieving recognition beyond the narrow boundaries of law enforcement. I speak for all Panel members in saying how pleased we are that George remains involved as a member of our Investigation, Prosecution and Law Reform Working Group.

My own background is in law enforcement, largely in the field of financial and commercial crime. I retired in April after six years as Director of the Serious Fraud Office. My immediate aim for the Panel is to establish as comprehensive a picture as possible of the impact of fraud. Studies to date, though valuable and informative, have been selective, confined only to reported fraud or certain sectors. I also want to develop the advice we give to businesses, the professions and individuals on the danger from new types of fraud and how to beat them. The Panel's educational work is absolutely vital.

FAP members are uniquely equipped and experienced and their efforts are facilitated through the financial support of a wide range of organisations. We are indebted to our sponsors and members and would like to encourage more to join and support our work. I am also most grateful for the special support that the ICAEW continues to give us. Thanks are also due to Tony Bingham, one of the Panel's founders and an invaluable counsellor and facilitator who retired as a Director in April; to Simon Pearce who has helped prepare the Annual Review; and, as always, to Helen Fay our indefatigable administrator.



Rosalind Wright CB, Chairman,  
The Fraud Advisory Panel  
September 2003



# Five policies that will make a difference

Though curbing fraud is a long-term task there are measures which will make a swift and significant contribution to reducing the damage it causes. The FAP advocates five significant changes that will make a real difference to the way fraud is tackled.

1. Give the police the resources to fight fraud. It is nothing less than a disgrace that so many frauds now go uninvestigated. It would cost around £85 million to create, and provide infrastructure for, a National Fraud Squad with 1,200 officers (costings by the Government's Inter-departmental Working Party on Improving the Response to Fraud). Such expenditure would quickly pay for itself.

2. Upgrade the Combined Code on Corporate Governance so that listed companies must report to shareholders on their anti-fraud policies and programmes or the lack thereof. Listed companies should also be required to report material

fraud involving directors, or senior management, to shareholders – who have a right to know about monies or assets stolen from them.

3. Introduce better and more focussed training for specialised judges to try fraud cases. Jury trials for serious and complex frauds demand effective trial management.

4. Bring English law up-to-date with a single offence of fraud instead of the confusing and often inadequate range of offences currently available to prosecutors.

5. Introduce compulsory corporate fraud reporting via an annual return to Companies House. Firms would declare whether they have suffered a fraud; what they believe it was worth and whether it has been reported to the police. The returns should not be declared to other agencies but would allow a better picture of commercial fraud to be built up.

**“The Bank of England warmly endorses the activities of the Fraud Advisory Panel and commends the practical advice and support it offers.”**

Mervyn King, Governor of the Bank of England

## The Fraud Advisory Panel's remit is a broad one because economic crime is a complex problem.

Research, policy development, training, education and information exchange are all essential parts of the battle. Key work areas during 2002-2003 were identity theft, money laundering, the impact of the Data Protection Act, SMEs, corporate governance and company law.

The Panel is run by a Board of Directors, chaired by Rosalind Wright, who served as Director of the Serious Fraud Office until April this year. It operates as a company limited by guarantee and every penny raised is ploughed back into its activities. The statutory Report and Accounts for 2002-2003 will be published later this year.

Most of the Panel's work is carried out by four multi-disciplinary working groups.

### Investigation, Prosecution and Law Reform

"To review the legal process and statute law as it relates to fraud and recommend changes where desirable."

Chaired by Neil Griffiths

The Group had the satisfaction of seeing the Criminal Justice Bill substantially adopt the Auld Report's views on pre-trial procedures - which had in turn been largely based on the Working Group's recommendations to the Lord Chancellor in 1998. Advising Whitehall is a key part of the Group's work:

A response was submitted in February to the Government's proposals to amend the Money Laundering Regulations.

A response was submitted to the "Justice for All" White Paper by Jonathan Fisher QC on behalf of the Group last autumn.

The Working Group is representing the Panel in a joint project on company law reform with the Institute of Chartered Secretaries and Administrators.

The Group continues to monitor the operation of the Proceeds of Crime Act 2002 and its associated codes of practice.

Educational work continued with a major seminar on asset tracing.

The Group is currently conducting two further studies: on the effectiveness of the new money laundering regime; and on legislative and regulatory obstacles to the detection and prevention of fraud, with particular reference to the impact of the Data Protection Act 1998.

## Cybercrime

“To promote greater understanding of cybercrime and the safeguards against it.”  
Chaired by Steven Philippsohn

The Group seeks to build trust and confidence in e-commerce via the promotion of better risk management strategies. Representatives of banks, the telecommunication industry, risk management organisations and insurance companies have all accepted invitations to join during the last year. Activities have included:

A major, and widely reported, paper on identity fraud which provided policy proposals and practical advice to business and the public.

Action against credit card crime and retailer “charge-backs” (where retailers are charged if card details have been fraudulently obtained even if the transaction has been correctly authorised).

Preparation of a cybercrime awareness course for SMEs.

Development of a seminar on identity fraud to be held later this year.

## Education, Events & Training

“To identify and disseminate best practice in training and guidance in fraud prevention, detection and investigation.”  
Chaired by Martin Robinson

There are vast gaps in business and professional anti-fraud education and training. The Group works to identify and close some of them via its own programme which includes:

A special emphasis on SMEs which often lack the time and money to develop anti-fraud knowledge and systems (in collaboration with the Research, Information and Intelligence Working Group).

Liaison with academic and professional institutions on improving the anti-fraud content of their syllabuses.

Development of a standard fraud awareness presentation for business and higher education (which has been piloted twice).

Lunchtime and breakfast briefing sessions on whistle-blowing and money laundering respectively.

“...the thoughtful submissions  
of the Fraud Advisory Panel...”

Lord Justice Auld, “Review of the Criminal Courts in England and Wales”, 2002

Preparing a series of factsheets providing fraud prevention advice for managers.

Martin Robinson also represented the Panel on two National Audit Office working parties.

Future activities include a series of lunchtime and breakfast briefing sessions on corruption, ethics, the impact of the new US Sarbanes-Oxley Act and procurement fraud.

## Research, Information and Intelligence

“To investigate the nature, extent and consequences of fraud; to identify, develop and publish new sources of information and intelligence.”

Chaired by Mike Hoare MBE

The Group is as much an information-based network of anti-fraud professionals as a conventional committee. Its role is to cast light on previously neglected areas of fraud. In conjunction with Martin Robinson's team it has emphasised the threat to small and medium-sized enterprises (SMEs). Three major research projects are underway on:

Anti-fraud education, examining content, gaps and take-up.

Bribery and corruption, with particular reference to procurement fraud.

Identifying cyber fraud. This report, by Professor Paul Barnes of Nottingham Business School, will review the extensive literature on the subject and provide practical advice on preventive measures.

“The Panel's work - delivering both high is at the heart of the fight against fraud that this extends to smaller businesses knowledge and resources to recognise

George Cox, Director-General, The Institute of Directors

## Seminars and conferences

The FAP aims to ensure a cross-fertilisation of ideas, information and experiences. Over the last 12 months the Panel has staged a series of well-attended seminars for professionals working against economic crime, often in association with other organisations.

“How to keep squeaky clean” on the Money Laundering Regulations in conjunction with the FSA, the Law Society and NCIS.

“We all have whistles – but should we blow them?”, a look at whistle-blowing for the professional in conjunction with Public Concern at Work.

“Global justice to fight global crime: The European Perspective” a discussion on international mutual legal assistance in conjunction with Transparency International UK and the Law Society, chaired by Lord Lester of Herne Hill.

“International fraud and corruption and cross-border asset tracing and recovery” in conjunction with Transparency International UK.

“Is fraud a risk you can manage?” a one day conference in conjunction with the Institute of Internal Auditors, UK and Ireland addressed by the Panel’s George Staple, the Metropolitan Police and the Serious Fraud Office.

“Fraud and how to stop it” in conjunction with the ICAEW, addressed by Panel Deputy Chairman Gerry Acher and the City of London Police.

-level policy and practical advice -  
d. It is particularly pleasing to see  
which have often lacked the  
and prevent fraud.”

# Making the Panel Work

The Panel's work depends almost entirely on voluntary effort and is funded by subscription and sponsorship. As of August this year there were 107 individual members, 29 corporate members and 88 observers. Individual membership costs £50 a year and is open to those not represented by any corporate or other body. Corporate membership is £1,000 a year and provides for up to 20 individuals to join Panel activities.

## Benefits of membership

Networking and information exchange: Panel members meet experts drawn from banking, insurance, accountancy, the law, policing, academia, and the IT and security industries.

Taking part in working groups on such topics as Investigation, Prosecution and Law Reform; Research, Information and Intelligence; Education, Events and Training; and Cybercrime.

Speakers meetings: hearing expert, and often alternative, points of view.

Access to working group deliberations via the members only section of the FAP website.

Influencing public policy via the Panel's proposals to government.

Addressing business and the professions via the Panel's seminars and publications.

## Corporate members and supporters

A glance at the list of corporate members shows that the Panel is a remarkably broad based affair enjoying support from public and private sectors, business and professional bodies.

The Accountants' Joint Disciplinary Scheme

AVIVA Plc

Association of British Insurers

Association of Chartered Certified Accountants

Association of Certified Fraud Examiners

The Bank of England

BDO Stoy Hayward

Bentley Jennison

Bishop International Ltd

Cadbury Schweppes Plc

Capcon Ltd

Chantrey Vellacott DFK

Chartered Institute of Management Accountants

Control Risks Group

Deloitte & Touche

Denton Wilde Sapte

Gallaher Group Plc

Grant Thornton

HBOS Plc

The Institute of Chartered Accountants in England & Wales

The Institute of Chartered Accountants of Scotland

Institute of Internal Auditors, UK and Ireland

The Law Society of England & Wales

Legal & General Group Plc

MCL Software Ltd

PricewaterhouseCoopers

Prudential Plc

Royal & SunAlliance

Royal Mail

Nine organisations also provided the Panel with financial support during 2002-2003:

Barclays Bank

Boots Company Plc

Canary Wharf Group Plc

HSBC Holdings Plc

The Institute of Chartered Accountants in England and Wales

Lloyds TSB Bank Plc

Nationwide Building Society

Royal & Sun Alliance Plc

Zurich Financial Services (UKISA) Ltd

The Corporation of London has also generously hosted major events for the Panel at both the Mansion House and the Guildhall, the former with the kind permission of the Lord Mayor of London.

The Board is deeply grateful to all those individuals and organisations whose generous support has made the Panel's work possible.

## Paying for the Panel

There were wry smiles at the FAP Board when "The Times" diary joked about it "joining the twentieth century" by opening a website. Yet the truth was that shortage of funds had caused long delays. And there are other Panel activities that are currently shelved for lack of funds - research, publications, conferences as well as an additional member of staff to support such initiatives. For instance, a professional research project and report on procurement fraud will cost up to £15,000. More support is urgently needed. For further details please contact the Panel at [info@fraudadvisorypanel.org](mailto:info@fraudadvisorypanel.org) or telephone 020 7920 8721.

## New website

The Panel's website [www.fraudadvisorypanel.org](http://www.fraudadvisorypanel.org) was launched in August 2002 thanks to sponsorship from Royal & SunAlliance which paid for website design and construction and contributes to the cost of a professional webmaster. The site contains information about the Panel, its role, objectives and achievements; most publications; notice of Panel and useful third party events; updates on the activities of each of the various working groups; links to other relevant websites; membership criteria and application forms. A Members Section opened in July and has just gone 'password only'.

**"The FAP isn't part of government or law enforcement and doesn't have a commercial agenda. That's why business sees it as an impartial source of information and advice."**

Mike Bluestone, Panel member

## The Board



### **Rosalind Wright CB**

Chairman since 30th April 2003; Director of the Serious Fraud Office 1997-2003; General Counsel and Executive Director in charge of the Investor Protection Policy and Legal Division at the Securities and Futures Authority 1987-97; Head of the Director of Public Prosecution's Fraud Investigation Group for the City of London and Metropolitan Police areas 1983-1987; Independent Member of the Strategic Board of the Office of Fair Trading; Independent Member of the Department of Trade and Industry's Legal Services Board; Vice Chairman, Jewish Association for Business Ethics; former Chairman of the Association to Combat Fraud in Europe (ACFE); Bencher of the Middle Temple; a member of the Bar Council.



### **Gerry Acher CBE LVO FCA**

Deputy-Chairman; Head of the Partnership in Policing Agenda as Vice-Chairman of London First with the Metropolitan Police Service; Chairman, DTI Foresight Panel working party on crime and business; member of the Board of KPMG and Senior Partner of its London office until 31st December 2001; founder Chairman of the Audit Faculty of the Institute of Chartered Accountants in England and Wales 1996-2001 and an ICAEW Council Member for that period; Non Executive Director of BPB plc and Camelot Group plc.



### **Felicity Banks MSc FCA**

Head of Business Law at the Institute of Chartered Accountants in England and Wales; represents the ICAEW on economic crime issues, including money laundering, general business law and regulated financial services; represents the accounting profession on HM Treasury's Money Laundering Advisory Committee.



### **Ruth Eisenberg BSc FCA**

Director, Special Projects at the Institute of Chartered Accountants in England & Wales.



### **Neil Griffiths**

Chairman, Investigations, Prosecutions and Law Reform Working Group; solicitor; a partner in the Insolvency Group at Denton Wilde Sapte; Vice-Chairman of the Creditors Rights Committee of the International Bar Association.





**Mike Hoare MBE**

Chairman, Research, Information and Intelligence Working Group; Hon. Chairman of the Risk and Security Management Forum having been Chairman from 1990-2002; formerly a Metropolitan Police Commander and Director of the Investigation Department of the Post Office.



**George Staple CB QC**

Chairman 1998-30th April 2003; Consultant to, and former partner of, Clifford Chance; Director of the Serious Fraud Office 1992-97; a Chairman of the disciplinary tribunals of the Securities Association and the Securities and Futures Authority 1987-91; former DTI Companies Act Inspector; Member, Senior Salaries Review Body; Chairman of the Review Board for Government Contracts.



**Steven Philippsohn**

Chairman of the Cybercrime Working Group; solicitor; founder and Senior Partner, Philippsohn Crawfords Berwald; Co-Editor of the UK Manual of the Association of Certified Fraud Examiners; member of the editorial boards of “E-Commerce Law & Policy” and “Inside Fraud Bulletin.”



**Tony Bingham FCA**

Director 1998-3rd April 2003; Partner at PricewaterhouseCoopers; originator of the “Taking Fraud Seriously” initiative which resulted in the foundation of the Panel; Chairman of the Technical Auditing Committee of the Institute of Chartered Accountants in England and Wales; Board member of Transparency International UK; member of working parties of the Auditing Practices Board and the Federation Europeens Experts Comptables.



**Martin Robinson FCIS, FIIA**

Chairman, Education, Events and Training Working Group; Independent consultant; Training Development Adviser to the Institute of Internal Auditors, UK and Ireland; Audit Adviser to the Institute of Chartered Secretaries and Administrators; former Head of Risk Training, Lloyds TSB Bank Plc.

# Identity fraud - a new threat

Relatively rare a decade ago, identity fraud – the theft and criminal exploitation of individual and business IDs – has now become a major scourge. Examination highlights five vital truths also common to other types of economic crime:

It is large scale. A Cabinet Office report stated in 2002 that identity fraud costs the British economy an incredible £1.3 billion per year. The total number of cases (including impersonation) rose from 20,000 in 1999, to 53,000 in 2001 and reached 74,000 in 2002 (figures from CIFAS – The UK's Fraud Prevention Service). Some fraudsters have even hijacked the identities of banks.

It hits ordinary people and small firms as well as big institutions. The Home Office has reported that it takes an average of 300 hours for victims of identity fraud to set the record straight.

It is increasingly organised. NCIS believes that identity fraud underpins much serious and organised crime.

It thrives by exploiting gaps in the law and business procedures as well as low levels of personal awareness. Scotland Yard's Assistant Commissioner in charge of crime operations said recently that "It is now comparatively easy to assume the identity of another person and live in the UK without fear of exposure."

It will grow at a frightening rate without co-ordinated action by government, police and business.

The Panel's July 2003 report, "Identity theft: Do you know the signs?" set out recommendations for action:

Urgent clarification or amendment of the Data Protection Act 1998. Uncertainty about the scope of the law is hindering attempts to reduce identity fraud via data-sharing on known criminals and suspected persons.

Procedures for issuing birth certificates must be tightened up. CIFAS has reported that 9,000 identity frauds in 2002 involved the use of a dead person's identification details compared to 5,000 in 2001.

A central register of stolen identities and documentation should be established.

The issuing of driving licences and passports should be recorded and data shared between the passport and the driving licence agencies.

# Battling in the dark

## Why no proper figures on fraud?

Why are there no official and authoritative statistics on fraud in the United Kingdom? And how can either police or government direct scarce resources intelligently without them? Their absence allows the problem of economic crime to be politically marginalized. The Panel first highlighted this statistical black hole in 2000. That autumn the Home Office published “The Economic Cost of Fraud” by National Economic Research Associates (NERA). Valuable though it undoubtedly was the report was based on information that often dated from the middle of the previous decade. It has not been updated.

NERA not only sought to calculate known direct losses, it also allocated costs to investigations, court proceedings and preventive measures and estimated the extra tax revenue required to offset the cost of frauds on public funds. The estimated total economic cost of fraud was up to £13.8 billion in 2000. £10.3 billion of which was the result of actual fraud, the remainder the result of consequential expenditures (figures exclude money laundering). NERA believed these figures were likely to be underestimates; it regarded the insurance industry’s 1999 calculation that fraud costing the country £16 billion a year as “not outside the bounds of plausibility, especially when the potential scale of undiscovered fraud is taken into account”.

It is worth noting by way of international comparison that the US Association of Certified Fraud Examiners surveyed America’s Chief Financial Officers in 2002 and discovered fraud losses of \$9 per employee a day – 6% of corporate revenues. Private research proved necessary because the Federal Government, like our own, has failed to measure the economic effects of fraud and abuse.

The importance of obtaining a reliable picture of fraud was underlined in July 2003 when the Office of National Statistics reported that “missing trader fraud” (where a firm imports goods from the EU and then disappears without paying any VAT) had masked trade worth more than £20 billion- 2% of GDP - over the past four years. Britain’s current account deficit with the rest of the world for 2002 rose from £10 billion to more than £20 billion as a result and growth figures will also be affected.

## Fraud and the nation

The Panel plans to undertake its own research into the cost of fraud but the ideal solution lies with government. Three options suggest themselves:

Creating a new version of the British Crime Survey dedicated to reporting crime against business. The BCS is regarded as the most reliable indicator of the true level of crime and of public attitudes toward it. The results play an important role in shaping public policy. The Home Office is considering a Business Crime Survey for England and Wales but it is essential that this be designed to elicit a reliable picture of both the extent and cost of fraud.

Compulsory corporate reporting. The least burdensome form of this would be to oblige companies to make an annual return to Companies House declaring whether they have suffered a fraud; what they believe the fraud was worth; what action they took, including reports to the police and recovery via civil action. The returns should not be declared to other agencies but a much better picture of commercial fraud would be built up.

A biennial review of existing information along the lines of the NERA report. This is the least satisfactory option because so many available sources are out-of-date or difficult to compare.

An interim arrangement would be to require individual police forces to estimate the value (rather than the numerical incidence) of the various crimes which constitute fraud and to do so on a mutually consistent basis. "Fraud" as such is not counted by the police as a reportable crime so its designation as a single criminal offence would allow a more accurate estimate of the scale of the problem.

# Give us the tools: law, regulation and the courts

Organised criminality is now a significant and growing threat to law and order, one rooted in, and profiting from, fraud and its close relation, money laundering. Gangs and terrorist groups need to introduce the proceeds of their crimes, including trafficking in drugs, people and weapons into the legitimate financial system. The Home Office has estimated that money laundering accounts for a staggering 2% of Britain's GDP, at least £20 billion a year. Dirty money drives out clean and there is a danger that as large amounts of criminal money infiltrates legitimate business it will also bring corruption, threats of violence and blackmail in its wake.

## Legislative progress

The Government is to be congratulated on understanding this danger and for introducing a raft of anti-fraud and economic crime measures since 1998. Improved financial services regulation and extensive new money laundering rules have together given Britain one of the strongest legislative armouries in the world. The Proceeds of Crime Act 2002 (PoCA), which came into force this year, illustrates the benefits of the new approach. It extends the confiscation regime to all serious crimes, making seizure the norm rather than the exception. It enables the freezing of suspects' assets from the start of a criminal investigation and a confiscation order may then be made following any conviction in the Crown or Magistrates' Court. A Crown Court must decide at the start of confiscation proceedings if the offender has a "criminal lifestyle" – defined by certain trigger offences such as drug dealing, or a certain pattern of acquisitive offences – in which case all assets accumulated over six years can be confiscated. PoCA also targets those not convicted of an offence but who can be shown to have benefited from criminal conduct. Enforcement procedures are provided. The Taskforce set up to pursue outstanding confiscation orders netted £2.7 million in criminal assets between December 2000 and last March alone. A target has been set to recover £60 million in 2004-2005.

## Fraud and the nation

Further measures are on the way:

The new Criminal Justice Bill addresses long standing issues, proposing an alternative, judge-only, form of trial for complex and lengthy fraud cases; a wholesale reform of the laws of evidence and hearsay; and codification of the criminal law.

The introduction of the British version of the latest EU regulations later this year will radically reshape the law on money laundering. An “objective test” has been introduced whereby a Suspicious Transaction Report (STR) must be made not only when a firm actually knows of, or suspects, laundering but also when there are reasonable grounds for that knowledge or suspicion.

A draft Corruption Bill, which includes provisions against procurement fraud, has been the subject of a report by a Joint Committee of Lords and Commons. Its recommendations are now being considered by the Home Office.

The Crime (International Co-operation) Bill will strike at international fraudsters by facilitating cross-border evidence gathering.

The Panel welcomes these proposals but also believes that care must be taken to ensure that this great tide of law does not create practical problems for those who must enforce it (see below).

## Better management of trials in serious fraud cases

Jury trials have proved their worth and should clearly be retained for almost every category of serious crime. Yet ironically, it is the very presence of the jury that results in lengthy fraud trials, which sometimes last as long as a year. Lengthy and repetitious explanations, cross-examination and speeches are introduced to ‘help’ jurors. Paper is only replaced by simple screened images and graphics in a very few cases. Evidence is all too plentiful and investigators scoop it all up, fearful that some vital piece of the jigsaw might be missed. The result is huge, unwieldy cases which, to be understood by a jury, must be chopped into manageable parts. In the Guinness case, severance by subject matter resulted in orders for three separate trials which, had they run their full length, would have spanned two or more years. And the prosecution is only allowed one ‘bite of the cherry’. The second Maxwell case was stopped when the judge ruled that some of the issues at stake had been central to the first in which the defendants had been acquitted.

There are immediate and obvious advantages of trial without a jury; a judge alone, or with assessors, could read the documentation in advance of the trial and limit cross-examination and speeches. Not least he would give a reasoned judgment at the conclusion of the proceedings describing how the verdict was arrived at. But this proposal, embodied in the present Criminal Justice Bill, does not meet with universal enthusiasm and may not be enacted. In any event, better trial management is essential:

Specialised judges must have thorough and professional training in trial management techniques.

Counsel must be discouraged from indulging in lengthy and repetitious cross examinations and speeches.

More intense efforts must be made before the trial starts to bring prosecution and defence to agreement on undisputed issues which need not be brought before the court.

More robust and consistent efforts must be made to improve the way evidence is presented, particularly via greater use of visual presentations.

## A single offence of fraud

The Panel endorses the Law Commission's recommendation for a single offence of fraud to replace the complex variety of offences which confuse juries, but on which the prosecuting authorities must currently rely. The mechanics of fraud are relatively unimportant. The real issue is whether there has been deception with the dishonest intention of obtaining advantage, avoiding an obligation or causing loss to a third party. General offences of fraud are used successfully in many jurisdictions, including a number which have also signed up to the European Convention on Human Rights.

## Plea bargaining

Lord Justice Auld recommended the introduction, via a judicial sentencing guideline, of sentencing discounts, so structured that the earlier a guilty plea is entered the higher the discount that would apply. A judge would be formally entitled to indicate the maximum sentence in the event of a plea of guilty at particular stages of the proceedings, together with the possible sentence on conviction. The Panel supports Lord Auld's proposals, a form of which has a long and successful history in the United States. 'Plea bargaining' would shorten fraud trials while ensuring a higher conviction rate.

### Too much law, too few resources? The draft Money Laundering Regulations

The Panel's sole goal is to reduce the impact of fraud. But this does not mean blanket approval of every law and rule intended to suppress it. Idealistic lawmaking can sometimes create as many problems as it solves if it fails to consider the practicalities of implementation. The Panel has highlighted the problems caused by the Data Protection Act 1998 which sometimes inhibits investigators from gathering information on fraud suspects. Now the new draft Money Laundering Regulations risk swamping NCIS, the already struggling assessor of Suspicious Transaction Reports (STRs).

Accountants, insolvency practitioners, estate agents, legal and tax advisers, transporters of funds, dealers in precious metals and casino operators must inform NCIS of *any* criminal offence that they suspect may have been committed by their clients, their client's staff and/or customers. Indeed they risk imprisonment if they fail to do so. Law enforcement officers have expressed concern at the lack of a *de minimis* provision; Britain is the only EU member that has chosen to do without one. The Home Office did not wish to set a monetary limit to STRs on the grounds that some serious crime involves repeated small transactions. But other approaches are possible, for instance designating specific crimes that must be reported.

Change makes sense when NCIS is struggling to cope with the present volume of reporting. In July the Home Office published a report by KPMG which revealed the present counter-productive state of play:

There were 63,000 STRs in 2002, up from 30,000 the year before, with 100,000 expected in 2003.

There is a backlog of 58,000 unprocessed reports from financial institutions.

Intelligence derived from such reports is taking an average of 181 days to reach law enforcement agencies.

Information providers, NCIS and law enforcement agencies are not geared up to make the system work as it should:

Many STRs are prepared and presented in unsatisfactory ways yet little feedback is given to disclosers to help them improve the quality of their reports.

Law enforcement bodies often fail to provide adequate guidance to NCIS on the kind of information they need.

Law enforcement agencies tend to devote inadequate resources to handling the intelligence NCIS sends them.

How could the system cope with the tidal wave of STRs that would be generated by the proposed Money Laundering Regulations?

The Government has set up a task force to overhaul the existing system. The Panel believes that ministers should go further, creating a *de minimis* provision in the Regulations, providing new resources for NCIS and issuing firm guidance on the generation and utilisation of STRs by both the regulated sectors and law enforcement.



# Close to breakdown? Policing fraud

Good laws are not enough to deter economic crime. Without an adequate supply of skilled investigators the law is impotent. And that is increasingly the situation in some parts of the country as fraudsters rob without fear of the police. Given the pressure on chief constables the principal responsibility must lie with government.

The number of officers tasked to fraud squads is in steep decline and has been since the mid-1990s. There were 869 mainstream fraud investigators in 1995 and around 600 today, each of whom is liable to be, and often is, called away to other duties. On a good day in summer 2003 there are, perhaps, 400 officers available (the figures were released by the Attorney-General in June 2002 and have been updated by the City of London Police). Last year saw only seven police forces operating with more than 15 investigators. Some county forces have closed their fraud squads altogether and others have only a handful of officers. There are also strategic deficiencies. The Serious Fraud Office (SFO) is only equipped to handle 80 to 100 cases a year, all of which are worth at least £1 million, while NCIS has no resources available to collect or analyse criminal intelligence on major commercial (as distinct from public sector) fraud.

The Attorney-General, Lord Goldsmith, acknowledged last year that “large amounts of fraud are going uninvestigated” and the new SFO Director Robert Wardle has concurred. Mr Wardle points out that most forces do not even operate a filter to determine which frauds must receive police attention (for instance, according to the number or vulnerability of victims, or impact on the economy). Indeed some fraudsters deliberately operate in places where they know the police response to be weak.

The crisis touches London as well as the regions. The Metropolitan Police’s Fraud Squad has been merged into a Specialist Crime Directorate and fraud investigations suffer from repeated diversion of officers to other urgent tasks. The situation is aggravated by London’s general shortage of detectives as well as a specific shortfall in officers with a background in financial investigations. Some local stations feel compelled to turn away significant complaints of fraud because of their lack of specialist manpower. So difficult is the Met’s position that consideration is being given to recruiting accountants as special constables and tasking them to fraud enquiries.

Even the work of the Serious Fraud Office is being adversely effected. An average of four police officers were made available for every case in 1997; this fell to two officers per case in 1999 and to one officer in 2003. Mr Wardle has said that “the SFO was established on the basis that it would investigate in conjunction with the police, and if their resources are not available... cases at the very least take longer to investigate and, on occasions, cannot be investigated at all”. Though an impressive 40% real-terms rise in the SFO’s budget will occur from 2003-2005 much of this will go to dealing with new cartel offences created by the Enterprise Act 2002.

Part of the problem is that fraud does not figure in the Home Office’s list of police priorities, nor are individual forces required to devise anti-fraud strategies. Detective Chief Superintendent Ken Farrow, Head of the City of London’s Fraud Squad has pointed out that “Consequently there is little or no incentive for local police chiefs to commit already stretched personnel to combating economic crime. The situation is compounded by dwindling numbers of qualified fraud investigators, as experienced officers retire and are not replaced.”

## Reform frustrated

Last year’s Panel Annual Review reported the recommendations of the Government’s Interdepartmental Working Party on Improving the Response to Fraud which sat during 2000-2002 and included senior representatives from the police, departments of state and the FSA. Ministers accepted its recommendations in principle. They included:

1. A study of the feasibility and cost of a national police fraud squad.
2. Increasing the SFO’s civilian investigative and casework resources.
3. Better training for police fraud officers and financial investigators.
4. New guidelines on which type of fraud cases would be accepted by the police, what criteria would be applied and which force would take the lead when cases crossed police boundaries.
5. Revised criteria allowing police forces to provide consistent estimates of the cost of reported fraud.
6. A “thematic inspection” throughout England and Wales by HM Inspectorate of Constabulary into the way fraud investigations are carried out.

Progress has been poor. A national fraud squad was rejected as too costly. City of London Police and the SFO are instead examining a possible joint approach where the City's Fraud Squad would act as a "lead force" for major investigations in the capital and the South-East of England. This, though a welcome step, would go nowhere near addressing the nation-wide problem. The other working party recommendations, (increased SFO resourcing aside) are on hold pending a decision on the "lead force" proposal.

Yet the Interdepartmental Working Party concluded that the cost of expanding the police's drive against fraud would be relatively small. It estimated that £85 million would pay for a National Fraud Squad of 1,200 officers sited in five well-equipped regional centres. It would cost even less to distribute the same number of officers to county forces – though this is very much a second-best option since investigators would inevitably be detached to work on other categories of crime. The proposed City of London police/SFO scheme will cost under £5 million. These figures do not take into account the economic benefits of improved deterrence, recovery of stolen funds and confiscation of criminal assets.

Other useful immediate, and low cost steps, would be to offer short-term contracts to recently retired officers with anti-fraud skills and to introduce a more flexible approach to the rotation of senior investigators out of fraud squads.

# Ticking Boxes?

## Corporate governance and financial reporting

### A culture of complacency

British corporate reporting and governance have come under close scrutiny in the wake of Enron and other US business scandals. A series of government commissioned or inspired reports have recommended expanding the role of non-executive directors (NEDs) and enhancing their independence (the Higgs Report); enhancing the role and responsibilities of audit committees (Smith); tightening audit and accountancy regulation (the Co-ordinating Group on Audit and Accounting); and changing the structure of accountancy regulation (Swift).

The Panel welcomes the proposed reforms but notes a missed opportunity. Neither Higgs nor Smith paid much explicit attention to fraud and the revised Combined Code on Corporate Governance gives insufficient prominence to the need for companies to guard against it. America's new Sarbanes-Oxley Act on corporate governance requires the two most senior company officers to personally certify the veracity of their accounts, on pain of a large fine or several years in prison. The Panel is not recommending similar British legislation but the comparison illustrates another, more urgent, response to corporate fraud.

Fraud kills companies as well as robbing them. Its impacts include broken bank covenants, cash flow crises and share price decline when bad results are declared, regardless of whether the original fraud was reported to the police. Yet a recent PricewaterhouseCoopers survey revealed that 46% of UK firms interviewed discovered fraud by accident, compared to only 43% who did so via their risk management systems. The survey also found that only 68% of companies had an anti-fraud code of conduct; only 59% used pre-employment screening; only 59% had a whistle-blowing policy; and only 26% provided managers with anti-fraud training. The same survey showed 85% of British firms as "confident" or "very confident" in their controls.

Too few firms have risk reviews which pay serious attention to fraud. Many others focus disproportionately on misappropriation by low-level employees. This is a potentially disastrous mistake when most serious frauds tend to involve management or even executive directors. Boards should avoid emulating the British intelligence services of the 1940s and '50s whose senior officers refused to believe that traitors could be found amongst their own ranks.

Fraud management should be designed into corporate systems. This requires clear policies and implementation programmes; it means allocating specific, and sufficiently senior, staff to manage and monitor; it demands comprehensive risk evaluation and the matching of controls to identifiable risks. Support is needed via good management information, a staff fraud awareness programme, recruitment screening, a whistle-blowing policy and a response plan. Fraud prevention should be part of corporate culture, endorsed by high-level example, inculcated by education and training and involve review by external auditors. It must also be placed firmly on the Board agenda.

## Incorporating fraud prevention into corporate governance

The Panel's submission to Higgs argued that non-executive directors should have an explicit role, on behalf of the whole Board, in assessing whether fraud risks have been properly identified, and whether adequate preventive measures are in place. This means that:

Non-executives must be satisfied that the company has clear and properly communicated anti-fraud policies.

All directors (and NEDs in particular) must be assured that the company has conducted a proper risk assessment and installed adequate risk management and internal control procedures.

Non-executives must be satisfied that fraud warnings will be reported to managers untainted by suspicion; that NEDs will receive reports of material problems; and that appropriate actions will be taken.

All non-executives must undergo appropriate training and the entire Board must submit to the procedures it imposes on employees.

Listed companies should be required to report material matters involving director or senior management malpractice to the shareholders. A more open approach should be seen as enhancing a company's reputation rather than diminishing it.

The Panel would also like to see the Combined Code on Corporate Governance upgraded so that listed companies must report to shareholders on their anti-fraud policies and programmes or the lack thereof. Shareholders have a right to know about monies or assets that have been stolen from them.

### Back to basics in auditing

The current Chairman of the ICAEW's Audit and Assurance Faculty has said that: "Audit is all about integrity, independence and judgement...[it] is not and never can be a commodity." A significant step in reasserting the authority of these vital principles was taken when the American auditing profession introduced a new standard (SAS99) last year on the auditing of fraud risk. This maintains the auditors' existing legal and professional responsibility but seeks to improve auditor performance so that:

Greater emphasis is placed on auditors adopting an appropriate mindset of professional scepticism.

Auditors give a more thorough and thoughtful assessment of fraud risks.

They provide a closer study of assessed risks.

Specific procedures are introduced in response to the ever-present risk of management override.

This US stance has now been taken as the starting point for updating international auditing standard ISA240. Britain, in common with other members of the EU, has pledged to adopt international auditing and accounting standards by 2005.

The ICAEW's Audit and Assurance Faculty intends to publish guidance for its members later this year which will encourage a move towards the US model in anticipation of the international standard taking effect. It is likely that the guidance will stress the need for Britain's auditing profession to take a more assertive attitude toward fraud risk.

The Panel welcomes action to reassert intelligent professional judgement over an exclusively rule-based approach. It believes that the former is far more likely to produce a frame of mind conducive to the detection and deterrence of fraud.

Auditors must also guard against so-called "aggressive earnings management" (AEM) which artificially improves corporate results by exploiting generally accepted accounting policies and treatments and distorting a true view of a firm's financial position and prospects. Regulators increasingly view AEM as "fraudulent behaviour" regardless of technical compliance with reporting standards. This is clearly a vital issue for auditors too.

Offenders are being offered a chance to clean the skeletons out of their cupboards via the adoption in the last year of UK Financial Reporting Standard FRS 18, which requires companies to adopt the 'most appropriate' accounting policies rather than merely adequate ones.

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