

# MANAGING THE RISK OF FRAUD:

## THE ALARM STANDARD FOR RISK ADVISORS

**ALARM**  
THE NATIONAL FORUM  
FOR RISK MANAGEMENT  
IN THE PUBLIC SECTOR



# **MANAGING THE RISK OF FRAUD: THE ALARM STANDARD FOR RISK ADVISORS**



## FOREWORD

In 2002, ALARM, the National Forum for Risk Management in the Public Sector published, in conjunction with a number of partner organisations, its 'Risk Management Standard'<sup>1</sup>.

ALARM has recognised that there are a number of specific risk areas that are of national importance and which impact heavily on public sector organisations' strategic and operational planning arrangements, as well as on performance. ALARM believes that, while its current risk management standard continues to provide best practice advice on the general approach to be adopted in managing risks, there is now a need to issue formal advice and best practice guidance in relation to a number of key corporate risk areas.

ALARM members identified 'managing the risk of fraud' as an area that is of the highest importance for public sector organisations. The problems that arise in relation to the risk and occurrence of fraud, both in the public and private sectors, have been accepted as a national problem at the highest levels of government. A recent report by ACPO<sup>2</sup> estimates losses in the public sector as a result of fraud in 2005/6 to be in the region of £7.1bn. The national fraud review has now produced its final report<sup>3</sup> and this document provides significant evidence and information to highlight the problem, and to direct and influence action necessary to fight fraud, including specific comments on risk assessments in its recommendation no. 24. The introduction of new offences that clarify the legal position will further assist those involved in combating fraud.

While most organisations recognise that the risk of fraud is continually facing them, it is often practitioners in the areas of detecting, investigating, actioning and redress who are most involved in this matter. The purpose of this paper is to direct the role of the risk advisor, working in conjunction with business managers, to ensure that adequate arrangements are in place to manage the risk of fraud well in advance of any occurrence. This standard will provide best practice on the key aspects of this and will enable organisations to test that they are reaching adequate levels of compliance in relation to the management of the risk of fraud.

This review process needs to be seen as complimentary to the work undertaken through a range of other review processes by professionals in specific disciplines including those charged with governance, internal/external auditors and counter-fraud staff that will be working within their own published lines. The recent CIPFA Better Governance Forum publication 'Managing the Risk of Fraud'<sup>4</sup> is a prime example of the nature of current published guidance for other professional disciplines working in this area.

### Tracy Barnett

Director of ALARM

Chair - Counter Fraud Special Interest Group

1 AIRMIC/ALARM/IRM/ Risk Management Standard 2002

2 Association of Chief Police Officers (ACPO), 'The Nature, Extent and Economic Impact of Fraud in the UK', February 2007.

3 Government Response to the Fraud Review 'Fighting Fraud Together', 15 March 2007

4 Chartered Institute of Public Finance and Accountancy (CIPFA), 'Managing the Risk of Fraud, Actions to Counter Fraud & Corruption'

## ABOUT ALARM

ALARM is the National Forum for Risk Management in the Public Sector, a membership organisation representing over 1800 practitioners in a broad range of professional disciplines. ALARM is dedicated to the promotion of integrated risk management within and across public service organizations, including local authorities, national government departments and agencies, the police and fire services, the NHS, housing associations, charities and others in the not-for-profit sector.

Contact: admin@alarm-uk.org Telephone: (01395) 519083

**ALARM**  
THE NATIONAL FORUM  
FOR RISK MANAGEMENT  
IN THE PUBLIC SECTOR

## ACKNOWLEDGMENTS

This guide has been produced by ALARM to assist its members understanding of the threat of fraud and to enable them, as risk advisors, to assist their organisations in managing and mitigating the risks to their organisation.

ALARM drew together the following individuals to form the ALARM Counter Fraud Special Interest Group (SIG) and is grateful to them and their employing organisations for their time and assistance in preparing this document.

### Members

Tracy Barnett (Chair)	London Borough of Camden
Bob Cope	Retired Chief Executive, ALARM
Derek Elliott	Audit Commission
Peter Dorrington	SAS Ltd
Steve Jackson	Zurich Municipal
Geoff Jennings	NAFN
Simon Lane	London Borough of Brent

### Additional Contributors

Joe Laidler*	Retired Asst Director Finance, LB Camden
John Baker	NHS, CFOS
Jill Abethell	NHS, CFOS
Richard Feltham	Kent Fire Brigade
Carolyn Halpin	Erimus Housing
Peter Andrews	Hampshire County Council
David Pope	DVLC
Nick Chown	Metropolitan Police

\*Note: Particular recognition to Joe Laidler for the hard work he has put into interpreting the views of the members of the SIG and formalising these into this written document.

## INTRODUCTION

The Counter Fraud Special Interest Group (SIG) was established in 2005 and has brought together colleagues from across the public sector including: local government, fire & police services, the Audit Commission and NAFN<sup>5</sup>, in addition to private sector organisations such as SAS Ltd and Zurich Municipal who have provided significant specialist input into the work of the group. The result of this work is the publication of this standard that addresses the key issues surrounding the management of the risks of fraud and how best these can be mitigated.



**“The Audit Commission believes that the risks of fraud and the damaging financial, reputational and operational consequences that can flow from fraud are such that they demand a corporate response.”**

Steve Bundred, Chief Executive,  
The Audit Commission

## WHY A STANDARD FOR MANAGING THE RISK OF FRAUD?

The recent National Fraud Review and the publication of the Fraud Act 2006 have served to focus attention on the major issues that have developed over recent years with regard to the occurrence of fraud against the public sector.

There is no doubt that instances of fraud in the public sector show an ever increasing trend, particularly in key financial/operational areas such as procurement, insurance, housing benefits and partnership areas. In addition, information and personal data held within an organisation is an area that is now at increasing risk of abuse, particularly in relation to identity fraud. The fraud review highlights the fact that financial levels of fraud against the public sector have significantly increased and provides examples of key areas where fraud has occurred. It stresses that the accurate measurement of the financial impact of fraud is a future priority.

An overriding responsibility of public sector organisations is the provision of effective and efficient services to clients and stakeholders in a manner that seeks to ensure the best possible protection of the public purse in its delivery arrangements.

The impact of fraud on a public sector organisation can have consequences that are serious and often far reaching. Fraud can directly affect the ability of the public sector to serve the most vulnerable in society. Financial and reputational loss are the obvious key risk areas but instances of fraud can also bring a range of other serious consequences including breakdown of trust, political fall-out, impact on morale and the risk of potential litigation.

It is essential that public sector organisations place the management of risk of fraud at the very top of their corporate governance arrangements. Compliance with the principles set out in this paper will ensure that organisations are adopting ‘best practice’ in their approach to this matter. In addition, there are a number of other key guidance documents that have been produced in this field, including the recent publication from the CIPFA Better Governance Forum. A number of documents for reference are listed in Appendix 1.

Public sector organisations have responsibility for the provision and control of a wide range of diverse services and the methodology of managing the risk of fraud will need to be tailored to the specifics of an individual service.

Overarching these specific services, however, is the need for organisations to have in place sound corporate governance arrangements that span and direct all areas of the organisation’s business and operational activity.

In order to manage the risk of fraud at an acceptable level, there are five key essentials of corporate governance that should be in place. These are illustrated in Diagram 1, below. These should not be seen as the only key governance requirements and organisations will need to consider local circumstances that affect their overall governance arrangements.

**IMPACT OF IMPROVING CORPORATE GOVERNANCE ARRANGEMENTS**

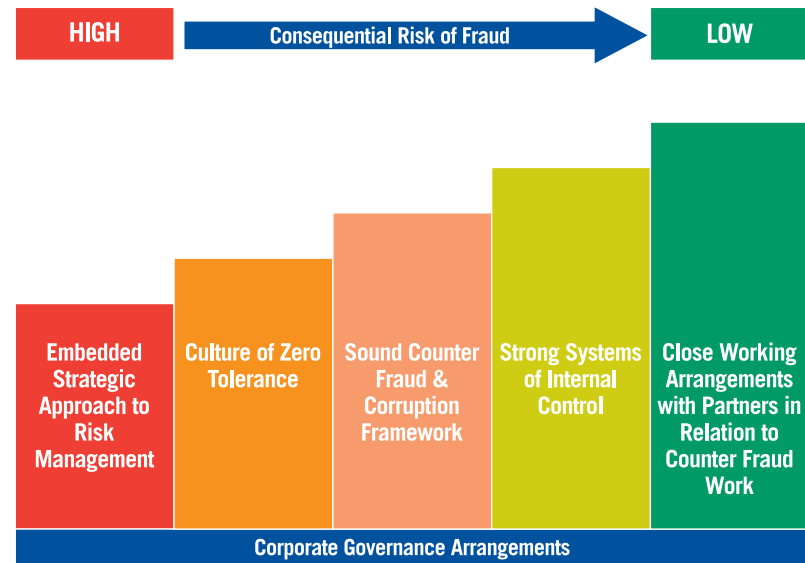


Diagram 1

Note: This diagram is not structured to suggest that any of these five strands are more important than any other or to suggest any order of implementation. It seeks to illustrate the significance of having all five aspects of governance in place to reduce the risk of fraud and the benefits this brings (i.e. risk moves from high to low).

A breakdown of the main elements that could be included in each of the strands to improve corporate governance arrangements and, in so doing, reduce the risk of fraud is provided overleaf. It should be noted these elements are not mandatory; each organisation will need to consider what is ‘best fit’ for their individual needs. Organisations will need to consider and review their arrangements against what is considered best practice. This standard and other guidance (see Appendix 1) will form key reference documents for forward-looking organisations to utilise in this review process.

### A Strategic Approach to the General Management of Risk

Key elements include: -

- A published strategic approach to managing risk that has been agreed at executive and, where relevant, political level.
- Ownership of risk at corporate management level and, where relevant, a high level corporate risk management group that is charged with implementing operational arrangements and monitoring/reporting on progress of the strategic approach.
- Adoption of an approach consistent with that set out in a recognised risk management standard (i.e. AIRMIC/ALARM/IRM, Risk Management Standard, 2002).
- A standard approach across the organisation to operational procedures for managing risk that are facilitated by competent staff.

### A Culture that is Universally Applied and Designed to Deliver 'Zero Tolerance' of Fraud

Key elements include: -

- A published Code of Corporate Governance that has been agreed at executive and, where relevant, political level, linked to the setting of high ethical standards at the top of the organisation.
- Governance arrangements that support the process, including an established Standards Committee and an independent Audit Committee.

- Published Codes of Conduct for staff and officers and training programmes to embed the requirements.
- Strong leadership (be it elected or appointed) and senior management support of those charged with managing the risk of fraud.
- Firm and effective action against those found guilty of fraud and appropriate publicity to deter potential fraudsters

### An Anti-Fraud and Corruption Framework

Key elements include: -

- A published Anti-Fraud and Corruption Strategy/Fraud Response Plan that has been agreed at executive and, where relevant, political level.
- A programme of 'fraud awareness' training that covers both elected members and all key staff.
- A widely publicised 'Whistleblowing' facility that maintains staff confidence and is provided in line with legislative requirements.
- Allocation of adequate levels of financial investment into anti-fraud work and the employment of trained professional staff to facilitate the process.
- Meeting key legislative requirements relevant to this area (i.e. Terrorism Act 2000, Proceeds of Crime Act 2000, etc.)

### Strong Systems of Internal Control

Key elements include: -

- Documented systems and procedures to support key financial and operational procedures including formal schemes of delegation, which are regularly reviewed and updated.
- A formal in-depth annual review of internal control arrangements linked to regular monitoring of key controls, which produces an annual assurance statement/statement of internal control that is considered by those in the organisation charged with responsibility for governance.
- An effective investigative function that does not solely deal with reactive issues but has developed, in liaison with internal audit, a programme of anti-fraud initiatives/projects.

### Partnership Working Arrangements

Key elements include: -

- Managing the risk of fraud is included within the partnership risk management consideration between the organisation and its key strategic and delivery partners.
- Agreements with suppliers, contractors and consultants delivering services to the organisation that are structured to incorporate and agree joint approaches to tackling potential fraud risks.
- Established liaison and operational working agreements and the sharing of intelligence with other relevant organisations including police, insurers and other specialists in the areas of fraud avoidance and investigations.

## UTILISING STANDARD RISK MANAGEMENT TECHNIQUES

In considering the methods that should be employed in managing the risk of fraud, it is essential that organisations utilise the same principles that are adopted in managing other key business risks.



This will be a two-stage process for individual business areas/services provided by the organisation: -

- Stage 1** A risk review of the overall corporate governance arrangements in place that impact on all areas of the organisation's activity and how these link to the business area/service - information on this matter, documented earlier in this standard, should be utilised.

**Stage 2** A systematic review of the individual business area/activity at an operational level - information on this is provided in the remainder of this standard.

Note: These reviews should be seen as complementary to each other.

Reviews in relation to potential fraud risks (as for other business risks) should be carried out in a formal manner utilising the general guidance contained in the published AIRMIC/ALARM/IRM Risk Management Standard 2002, as well as other relevant professional guidance.

Priorities will include: -

- Identifying the key risk areas
- Considering the impact of potential frauds
- Assessing the scale/likelihood of the risk of fraud occurring
- Identifying/evaluating the adequacy of existing controls
- Implementation of revised controls/action planning for the future

These matters are considered in detail below.

It needs to be highlighted at this stage that the role of the public sector risk advisor is crucial to adequately managing the risk of fraud. Risk advisors stand in a pivotal position in relation to the provision of best practice and advice on this issue, both to those charged with governance (including audit and counter fraud professionals) and to senior/service managers of the organisation, and liaison/joint working will be required to achieve best results.

## IDENTIFY THE KEY RISK AREAS

It is essential that the organisation is able to undertake an overall review of all its operational areas in order to identify those that are most susceptible to the risk of fraud occurring.

A key element of this process is for managers to understand that there are certain essentials that are necessary for a fraud to be perpetrated: -

The human element is an essential consideration and this can arise in a number of ways through: -

- Employees
- Third party claimants
- Customers applying for and utilising services from the organisation
- Partnership and voluntary bodies working with the organisation
- External contractors/consultants working for the organisation
- Collusion through any combination of these

There must be assets that can be acquired or converted into cash through the perpetration of a fraud that creates a loss to the organisation and these will include cash, property, equipment, and the highly important emerging area of information theft, etc.

There must be an element of opportunity that fraudsters can take advantage of; these include weak systems, poor internal control, inadequate separation of duties, lack of management supervision, etc.

Note: There will always be an element of intent and dishonesty on behalf of the individuals to carry out a fraud.

With the above in mind, managers of operational areas must be required to undertake a formal review process of their local areas of activity to identify those areas that are most vulnerable to fraud.

There are a range of indicators and factors that can be utilised in this review process, including: -

- Nature, security and value of the assets held within the operational area and within the services it provides
- Quality, reliability and adequacy of the staffing arrangements including the recruitment processes in the operational area
- Performance, attitude and lifestyles of those staff undertaking key duties
- Adequacy of documented systems and local control procedures
- Adequacy of defined schemes of delegation
- Extent of the separation of duties utilised within the operational area
- Evidence of previous frauds occurring within the area and utilisation of statistical information
- Quality and extent of the internal and external review process
- Adequacy of risk management arrangements to reduce exposure to insurance claims, etc.
- Benchmarking/information sharing

Performing such a risk review will enable the organisation to identify and action those areas that are considered most vulnerable and to place responsibility with nominated officers.

## CONSIDERING THE IMPACT OF A POTENTIAL FRAUD

The possible impact in relation to any fraud arising within an organisation will vary with regard to the nature of the organisation and the type of service it provides. Within the public sector, the nature of many of the personal services provided and the fact that the public purse funds most of the operational activity means that any type of reported fraud can have a major impact in a wide variety of areas including, for example: -

- The overall reputation of the organisation
- Potential financial loss
- Loss of confidence in the organisation
- Possible need to divert financial resources from other key services
- Affect on staff morale and productivity
- Potential increase in insurance costs
- Need to utilise resources in investigative work
- Potential loss of political office
- Disruption caused by criminal investigations

Note: These and other matters need to be given full consideration when assessing the impact of a fraud occurring.

Following the identification of key risk areas and after assessing the potential impact of a fraud occurring in these areas, it is essential that the business manager in conjunction with the risk advisor and other advisors (e.g. auditors and counter fraud professionals) ensure that top management and those charged with governance are made aware of this information. This will enable a corporate response to be organised and monitored in relation to potential areas of risk.

In addition, there need to be well established lines of communication between risk advisors and internal auditors/counter fraud officers regarding key risk areas, in order that the necessary exchange of information can be undertaken to facilitate joint working in this area.

## ASSESSING THE SCALE / LIKELIHOOD OF FRAUD

Utilising standard risk management techniques and scoring arrangements adopted within the organisation, the operational manager needs to work in close co-operation with the organisation's risk advisor and other advisors (e.g. auditors and counter fraud professionals) to assess the possible scales and likelihood of fraud as well as the counter fraud arrangements in place. This analysis will consider: -

- The overall nature of the organisation's corporate governance arrangements
- The local control arrangements that emanate from the overall corporate governance arrangements
- Specific controls that have been established at local service levels to deal with particular local arrangements
- The impact of a potential fraud both on the organisation corporately and in relation to the specific operational area
- Monitoring and review of national/local trends in relation to new and emerging frauds and considering the potential impact on the organisation

Risk advisors and business managers must ensure that liaison and exchange of information between internal auditors/counter fraud staff is an essential element of this assessment process.

## IDENTIFYING THE ADEQUACY OF EXISTING CONTROLS

A detailed evaluation of existing controls is a fundamental element of the review process in assessing an organisation's ability to adequately manage the risk of fraud. The identification and evaluation of controls will need to recognise that a realistic approach needs to be adopted; an element of proportionality will need to be used when considering the extent and cost of suggested improvements to control measures.

Where previous frauds have been detected, it is essential that consideration is given to rectifying specific control weaknesses highlighted in respect of these cases.

The risk review necessitates a two-stage process: -

### Stage 1

It is expected that all organisations will include on their corporate risk register an item relating to the risk of fraud being perpetrated. A high level review will be necessary of key controls that are established at a strategic/organisational level to deal with this risk.

Key controls expected at this level will include as a minimum: -

- Adoption of best practice and an embedded approach to the organisations general arrangements for managing risk
- Policy statements and published strategies on the matter including the existence of an Anti-Fraud/Corruption Strategy
- The existence of an independent audit/governance committee/panel with defined responsibility for monitoring the organisation's internal control arrangements

- An adequately resourced internal audit and/or counter fraud function that meets its published review plan
- The adequacy of overall internal control arrangements evidenced by annual assurance reviews and formally reported to those charged with governance
- Codes of Conduct relative to staff including agency, consultancy, contracting staff, etc. and elected representatives (if relevant)
- Whistleblowing arrangements that are independently structured and widely published
- Fraud awareness training of managers and staff

Risk advisors should also make reference to Appendix 1, which lists other best practice sources, and professional guidance that can be utilised to assist the risk review process.

### Stage 2

Business/service heads, with necessary advice and guidance from risk advisors, will have identified those areas where there is risk of fraud occurring. The risk register for the operational area will include the risk of fraud and local control arrangements will need to be reviewed and identified.

General local controls expected at operational level will include as a minimum: -

- Adequate segregation of duties between key control areas
- Staff resources that are sufficient to provide adequate control and are organised in a structured manner

- Published local schemes of delegation identifying levels of responsibility and authority
- Regular reconciliations of budgets that are subject to independent review
- IT security arrangements (including security systems and codes of conduct for IT usage)
- Asset control register (cash, fixed assets), inventories, asset marking, etc.
- Documented procedures that are subject to regular review
- Maintenance of adequate records of risk assessment procedures

## IMPLEMENTATION OF REVISED CONTROLS / ACTION PLANNING

The result of implementing the above review process using a standard risk management approach should result in the identification of any areas where control is considered to be in need of improvement.

It is recommended that a formal list of control improvements be developed in each of the key operational areas considered where the risk is deemed to be above a defined level. Any improvements to control considered necessary should be developed into an action plan, with responsible officers allocated and timescales identified. This action plan would be expected to form the basis of a review document that can be utilised to monitor and evaluate the implementation of revised controls and provide information that the expected improvement in control has been achieved. The importance of ongoing monitoring and review is considered an

essential element of an organisation's approach to managing its business risks, including fraud, and senior management must ensure that this process is implemented and recorded.

Finally, risk advisors/business managers cannot deal with the risk of fraud in isolation. The management of the risk of fraud is a key aspect of corporate governance and it is essential that a range of other officers and agencies are involved and kept aware of developments in key risk areas. This should include the organisation's responsible financial officer (e.g. 'Section 151' Officer for local government), internal audit, counter fraud officers, the 'Monitoring Officer' and the organisation's external auditor, as appropriate.

## LIST OF GUIDANCE & BEST PRACTICE DOCUMENTS

Title of Document	Produced by	Further Information
A Risk Management Standard 2002	AIRMIC / ALARM / IRM	<a href="http://www.alarm-uk.org">www.alarm-uk.org</a>
Managing the Risk of Fraud	CIPFA Better Governance Forum	Greg Marks Tel. 020 8667 1144 Fax. 020 8667 8058 <a href="http://www.ipf.com">www.ipf.com</a>
Fighting Fraud Together 'The Government Response to the Fraud Review' March 2007	HM Treasury	Lesley Frost Treasury Solicitors 1 Kemble St, London WC2B 4TS Tel. 020 7210 4752 Fax. 020 7210 2955 <a href="http://www.attorneygeneral.gov.uk">www.attorneygeneral.gov.uk</a>
Tackling Staff Fraud & Dishonesty: Managing & Mitigating the Risks	Chartered Institute of Personnel & Development	<a href="http://www.cipd.co.uk">www.cipd.co.uk</a>
The Financial Challenge to Crime & Terrorism (February 2007)	HM Treasury	<a href="http://www.hm-treasury.gov.uk">www.hm-treasury.gov.uk</a>

Title of Document	Produced by	Further Information
Forensic Fraud Barometer Report November 2006	KPMG	<a href="http://www.kpmg.com">www.kpmg.com</a>
Fraud Risk Management	KPMG	<a href="http://www.kpmg.com">www.kpmg.com</a>
Corporate Governance in Local Government	CIPFA / SOLACE	<a href="http://www.cipfa.org.uk">www.cipfa.org.uk</a>
Firms' High Level Management of Fraud Risk	FSA	<a href="http://www.fsa.gov.uk/pubs/other/fraud_risk.pdf">www.fsa.gov.uk/pubs/other/ fraud_risk.pdf</a>
Best Practice Fraud Guide	Zurich Municipal	<a href="http://www.zurich.co.uk/Municipal/ToolsAndTips/InformationLibrary/fraud.htm">www.zurich.co.uk/ Municipal/ToolsAndTips/ InformationLibrary/ fraud.htm</a>

**ALARM**  
THE NATIONAL FORUM  
FOR RISK MANAGEMENT  
IN THE PUBLIC SECTOR



Ladysmith House  
High Street  
Sidmouth  
Devon EX10 8LN

t: 01395 519083

f: 01395 517990

e: [admin@alarm-uk.org](mailto:admin@alarm-uk.org)

[www.alarm-uk.org](http://www.alarm-uk.org)