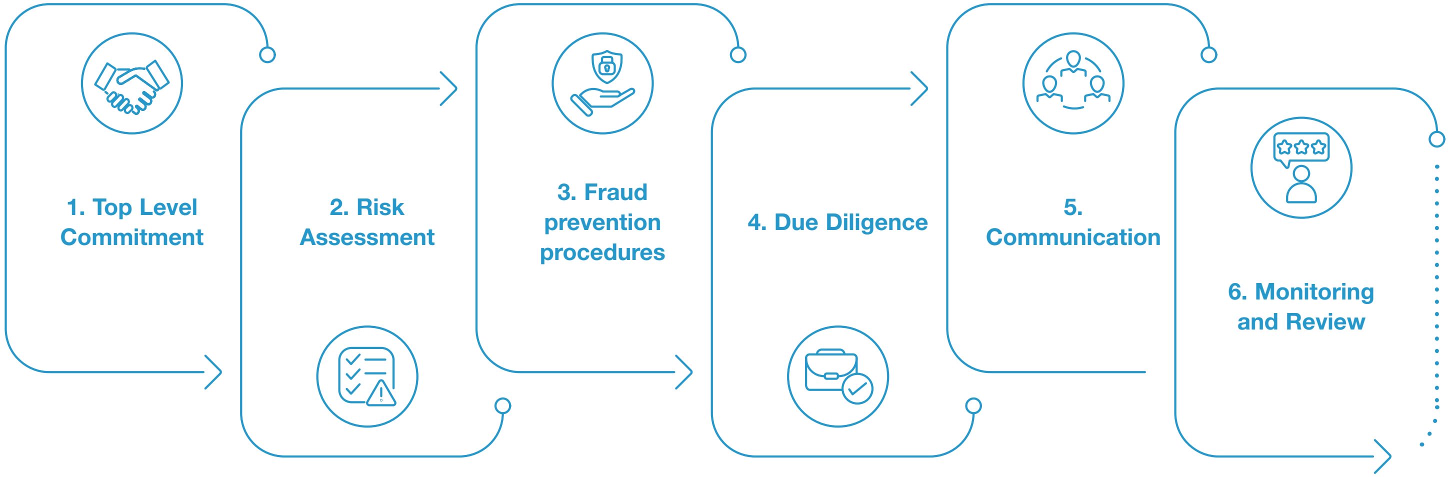
CLIFFORD CHANCE

FRAUD PREVENTION PROCEDURES – WHAT SHOULD YOU CONSIDER?

Government guidance on reasonable fraud prevention procedures is based around six key principles.



These principles are intended to be flexible, allowing for them to be adapted as necessary depending on the relevant circumstances of a particular organisation. The key component to bear in mind is the outcome. In this guide, we consider some of the questions an organisation might want to ask when determining if it is adhering to each of these six principles.

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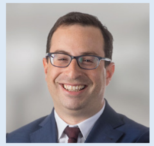

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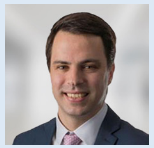

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1. Top level commitment

The Board of Directors, partners and senior management (as necessary) should be committed to preventing associated persons from committing fraud when acting on behalf of your organisation.

Effective formal statements demonstrate commitment to preventing fraud. Have you:

- Made a commitment to rejecting fraud, even if it results in short term business loss, missed opportunities or delays?
- Articulated and endorsed your codes of practices and key fraud prevention policies and procedures?
- Made clear the consequences of breaching those policies and procedures?

Ensure that there is a clear governance framework in place for fraud prevention. Do you:

- Designate responsibility for issues such as:
  - Horizon scanning for new fraud risks;
  - Developing and implementing fraud detection measures; and
  - Enabling senior managers to understand the risks and effectiveness of fraud prevention procedures?
- Ensure that your Head of Ethics and Compliance (or equivalent) has direct access to the Board or CEO?
- Keep the fraud prevention framework and its implementation under review?

Make sure your fraud prevention framework is adequately resourced. Have you made long-term commitments to:

- Allocating a reasonable and proportionate budget specifically for leadership, staffing and implementation of the fraud prevention framework?
- Sustaining anti-fraud practices when key members of staff are on leave or when they leave your organisation?

Senior managers must foster an open culture and encourage speaking up about any ethical concerns.

- Are your senior managers actively challenging arguments that seek to rationalise or minimise the effect of fraud?
- Are staff encouraged to speak up if they have concerns?

2. Risk assessment

You must assess the nature and extent of your organisation's exposure to the risk of employees, agents and other associated persons committing fraud. Ensure that this assessment is dynamic, documented and kept under regular review.

Consider identifying typologies of associated persons and the circumstances under which they could attempt fraud.

Opportunity

- Do the associated persons have the opportunity to commit fraud?
- How likely is detection of fraud?
- Do emerging technologies (such as AI) create new opportunities for fraud?
- Have any previous internal reviews or audits identified any fraud risk factors?

Motive

- Does the reward and recognition system (including commissions or bonuses) incentivise fraud?
- Do time pressures encourage staff to cut corners?
- Does the corporate culture disincentive whistleblowing when fraud is discovered?

Rationalisation

- Is your organisation's culture tolerant of fraud?
- Is fraud prevalent in your business sector?
- Do staff feel comfortable speaking up if they have concerns? Do they face retaliation?

Review a broad range of potential sources which might identify potential risks. Are you pulling information from:

- Data analytics?
- Previous audits?
- Sector specific information, best practice advice or toolkits from relevant professional or trade bodes or regulators?
- Regulatory enforcement actions?

You must ensure that your risk assessment is comprehensive.

- Does the assessment take into account fraud risks that might increase during emergency situations where there is a risk of widespread loss of life, damage to property or significant financial instability?
- Are you classifying inherent risks by both their likelihood and impact?
- Do you keep the risk assessment under review at consistent intervals (usually annually or bi-annually), and make any amendments as necessary?

3. Proportionate and risk-based procedures

Your fraud prevention procedures should be proportionate to the fraud risks you face and to the nature, scale and complexity of your organisation's activities. They should also be clear, practical, accessible, and effectively implemented and enforced.

Your fraud prevention plan should address the risks identified in your risk assessment. Is it:

- Proportionate to the risks and potential impact?
- Reasonable when taking in account the level of control and supervision your organisation is able to exercise over associated persons?

Opportunity

- Does your organisation carry out pre-employment and ongoing vetting checks?
- Do those in high-risk roles receive regular anti-fraud training?
- Are fraud risks assessed and managed throughout the procurement process?
- Does your organisation use best practices with regard to financial reporting?

Motive

- Can amendments be made to any frameworks that might encourage risk-taking?
- What can be done to prevent time pressures from encouraging staff to cut corners?
- Do you collect information on potential conflicts of interest and keep them under review?

Consequences

- Are there internal disciplinary and reporting procedures for those found committing fraud?
- Are the outcomes of fraud-related investigations communicated to associated persons?

Test your fraud prevention plan on members of your organisation who were not involved in writing it.

- Do you already use international standards to test fraud prevention controls?
- Is there any overlap with the UK Corporate Governance Code?
- Are there any residual risks once the effectiveness of fraud prevention measures has been assessed?

4. Due diligence

Your organisation should undertake proportionate and risk-based due diligence on associated persons who perform or will perform services for or on behalf of your organisation to mitigate identified fraud risks.

You may need to adapt existing due diligence procedures to ensure that they adequately tackle the risk of fraud. Do you:

- Use appropriate technology such as screening tools, internet searches and checks on trading history or professional or regulated status?
- Review relevant contracts and ensure they include appropriate obligations requiring compliance and the ability to terminate in the event of breach?
- Monitor staff and agents who may be more likely to commit fraud because of stress, targets or workload?

Relevant organisations should also conduct due diligence in relation to mergers or acquisitions: Best practices include:

- Assessing relevant criminal or regulatory charges, exposure to risk and fraud detection and prevention procedures.
- Integration of fraud prevention measures post-acquisition.

5. Communication

Your organisation should ensure that its fraud prevention policies and procedures are communicated, embedded and understood throughout your organisation. There should be clear articulation and endorsement of fraud prevention at all levels within your organisation.

It is important that all associated persons are aware of and understand the policies and procedures. Is your training:

- Proportionate to the risk faced?
- Designed to cover the nature of the offence as well as the procedures to address it?

Whistleblowing is one of the most effective ways to uncover wrongdoing. Consider:

- Are any existing whistleblowing procedures suitable for the risks identified by the risk assessment?

- Is there a culture where employees feel comfortable raising concerns?
- Are reporting channels clearly signposted and independent?
- Are concerns investigated and responded to appropriately and in a timely manner?
- Do you provide feedback and learn from issues raised by whistleblowers?

6. Monitoring and review

Your organisation should ensure that its fraud prevention policies and procedures are monitored, reviewed and improved where necessary.

This includes detecting, investigating and monitoring the effectiveness of fraud prevention procedures.

Detecting attempted fraud

- What analysis is carried out and how quickly are discrepancies flagged?
- What processes are in place for detecting unauthorised access to data?
- Are staff encouraged to speak up about fraud-related concerns?
- Is there a nominated member of staff responsible for collating and verifying management information on suspected fraud and reporting to the Board?

Investigating suspected fraud

- How is an investigation triggered?
- Who authorises investigations?
- How are investigations kept independent?
- How are the outcomes of investigations reported to the Board and communicated throughout your organisation?
- How does your organisation learn from investigations?

Monitoring prevention procedures

- Do you monitor financial controls?
- Do you collect data on attendance at and effectiveness of fraud prevention training courses?
- Do you monitor updates to procedures?
- Do you monitor updates to contractual clauses for associated persons?

Risks will change and evolve over time, and you will need to adapt fraud detection and prevention procedures in response to those changing risks. Do you:

- Seek internal feedback from staff?
- Review fraud detection analysis?
- Examine investigations or whistleblower reports and any subsequent action taken?
- Follow advice from professional organisations?
- Collate and verify management information on the effectiveness of fraud prevention measures and report to the Board?

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