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This special report is one of a series produced for faculty members. In each report we give a review of a topic within finance and management, offering both analysis of the relevant theory and a review of the practical application of appropriate management techniques.

If you have any comments or suggestions for future topics, please contact robert.russell@icaew.com

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This report is provided free to members of the Finance and Management Faculty.

FOREWORD

FINANCIAL FRAUD

fraud: /frɔːd/, noun

- wrongful or criminal deception intended to result in financial or personal gain: he was convicted of fraud [count noun]: prosecutions for social security frauds;
- [count noun] a person or thing intended to deceive others, typically by unjustifiably claiming or being credited with accomplishments or qualities: mediums exposed as tricksters and frauds.

(extract from *Oxford Dictionaries*)

We have some marvellous euphemisms in English to describe cheating, many of which make what is essentially fraudulent activity sound less harmful than it really might be. Synonyms for fraud include chicanery, craft, deceit, double-dealing, hoax, humbug, scam, sharp practice and trickery. Euphemisms nicely cover some uncomfortable truths, but their use when describing fraud perhaps reveals an attitude of tolerance towards what is often seen as a 'victimless' crime.

The term 'fraud' itself, however, covers all forms of deception, from petty crime on an individual basis (deliberate misstatements on staff expenses) to systematic deception and theft of billions (eg, Bernard Madoff was imprisoned in 2009 for the theft of around \$18bn from investment clients), so it is not surprising that the level of fraud perpetrated in the UK is estimated at some £73bn a year, according to the National Fraud Authority.

Arguably the biggest question about fraud for organisations is determining what to classify as error and what to consider to be fraud. The materiality level within your organisations for fraud may assist in this, but it is subjective.

The classification of a loss as either an error or fraud will have potentially huge impacts on the individuals involved, especially bearing in mind that the profile of a fraudster is of someone who has no criminal record (see David Luijck's article 'Fraud - the causes and catalysts in business worldwide' on page 04).

In catering, management routinely used to build in 'shrinkage' in stock as this level of loss was classified as an overhead. I am sure that many of us will remember the warehouse mentality from our training days, where losses through breakages, spills and spoiling were tolerated and accounted for in pricing by management. It was only when these levels rose above the 'acceptable' level that action would be taken. Attitudes may have changed since then, but the issues still remain. We are all affected by fraud.

Another big issue for organisations to face is that of dealing with any identified fraud. The choice between dealing with identified fraud internally or bringing in the police is not one to be taken lightly and may well have tremendous repercussions for those involved. This may be driven by an organisation's level of materiality and questions surrounding the feasibility and costs of recovering the amount involved. The reputational damage caused to those associated with fraud can be devastating.

We hope that you enjoy reading this special report.



Robert Russell

These reports are produced quarterly and are sent to members of the Finance and Management Faculty. You can join the faculty at icaew.com/fmjoin or by telephoning 01908 248 250. Cost for one year is from £85.



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