

# Introducing a fresh approach and new medicine to tackle the constant headache of fraud and corruption (Part 1)

BY  
NIGEL KRISHNA IYER  
AND MARTINA MARMAI



Nigel Iyer has over 20 years' experience investigating and detecting fraud and corruption. A computer scientist and qualified chartered accountant Nigel soon found that his true passion lay in rooting out corruption and fraud. Nigel has written a number of films, plays and books based on his experiences, many of which are used in teaching worldwide. In addition to being one of the founder members of Hibis he is also a fellow of the University of Leicester School of Management.

Right from an early age Italian-Slovenian Martina Marmai wanted to play an active part in eradicating corruption and fraud. She continues this passion today at Hibis specializing in identifying red flags of corruption and understanding and investigating them across a wide range of countries and language-zones.

When it comes to corruption and fraud, it is logical to challenge how effective the past decade's enormous efforts in Corporate Governance, Risk Analysis and Internal Controls have been. It seems from all the media reports, surveys and statistics that the cost and impact of fraud and corruption is in fact rising, not falling. In this article we propose that the power of teamwork combined with proactive fraud detection is a way both of saving costs and building up an organisation's defences.

In connection with a speaking engagement on the subject of the early detection of fraud at a recent European Governance, Risk and Compliance conference we read in the conference brochure that the chairman of the organising committee expressed the opinion that «GRC is the cure for the migraine and progress was being made». But he also added «the fog was clearing until along came the Panama Papers and gave us another headache».

Governance Risk and Compliance (or «GRC» as it is known) may be a cure for some migraines but when it comes to fraud and corruption, we believe that a new medicine is needed. GRC is a preventative medicine, but there is only so much preventative medicine the patient can take; instead, proactive medicine is needed to be able to identify the fraud and corruption which is already there and to deal with it responsibly and efficiently thereby out-thinking the fraudsters at the earliest opportunity. Paying «lip-service» to fighting fraud and corruption by ticking off the formal GRC boxes is just not enough.

For organisations to succeed in stopping fraud and corruption, management should see its early discovery as good news rather than something to be

afraid of. We believe management need to give their unequivocal backing to all those people in the organisation who are committed to finding fraud and corruption and removing its consequential cost and waste.

The dream: Teamwork against the common enemy of fraud and corruption

In our opinion the key to the early detection and eradication of fraud and corruption is teamwork and collaboration. This collaboration should involve people such as internal auditors, a number of people in finance and accounting, senior management (of course), legal and compliance, risk management, corporate security, HR and other willing participants. There are many people in an organisation who have either a mandate or an incentive to remove unnecessary and unethical costs and waste.

Whilst corruption and fraud have become as common as the common cold and nobody likes to be cheated, there is still a perception that it is a remote risk as far as «our» organisation is concerned. It's often dismissed as «something which happens to others».

But treating fraud and corruption as a remote risk is both naïve and dangerous. Many studies (including empirical and quasi-academic ones) place the total costs



Foto: Lightspring/Shutterstock

associated with fraud and corruption (i.e. loss of money plus erosion of organisational culture plus damage to reputation) in the region of around 5% of an organisation's annual turnover. In reality fraud and corruption is much more commonplace than we would like to think, but it's supposed to be hard to spot. As a consequence it becomes a hidden cost for the organisation.

Based on our experiences one of the most important steps to counter fraud and corruption is to foster a spirit of teamwork against a common enemy and employ effective techniques which are successful in detecting fraud and corruption early.

Instead of waiting for someone else to spot the fraud and blow the whistle we have in recent months seen a number of examples where organisations were able

to actively search for, identify and address typical red flags of fraud and corruption. Here are some recent examples of things that were found and resolved early:

- Numerous suppliers which take advantage of loopholes in the routines and controls and simply charge too much for what they do
- Sharp business partners, middlemen and consultants who take advantage of the organisation's trust and behave unethically
- Customers who get excessive preferential treatment or prices
- Hidden connections between the organisation and Dirty Money Centres (the illegitimate side of tax havens)
- Bribes (sometimes cleverly disguised) which were paid as a shortcut to get business and so called «false bribes» (often just embezzlement by another name)

I solemnly swear that I have read and understood the terms and conditions

Asking people to tick boxes saying that they have read documents in the full knowledge that they will tick them blindly is not even real compliance, let alone a defence against corruption and fraud!

The release of the Panama Papers and the «tip of the iceberg» that it revealed was just one more piece of evidence demonstrating that we need to take effective action against corruption and fraud.

Teamwork across departments, raising awareness and management empowering people such as internal auditors and security officers to take a more active role to help everyone look for the early warning signs could be the cure we were looking for. - and it needs everybody to be on board.

In Part 2 (to be published in the next issue) we will describe some of the most effective techniques by which everybody (including auditors) can find fraud and corruption before it finds them.

**On the 19th January 2017, Nigel Iyer and Veronica Morino will be holding a course for IIA Norge and NKRF about how to find corruption and fraud early and effectively called «Oppdag korrupsjon, svindel og misligheter - raskt og tidlig!» See <http://iia.no/aktiviteter/oppdag-korrupsjon-svindel-og-misligheter-raskt-og-tidlig/>.**

- «Creative numbers fraud» when sales figures are artificially inflated or costs are suppressed
- Conflicts of interest where people on both the inside and the outside have their «fingers in many pies».





In every case where fraud and corruption was discovered early by a team approach, management felt they were prepared and was able to take immediate remedial action, first to stop any further unnecessary costs and waste, and then to find the most effective solution to resolve the matter and strengthen the robustness of the organisation for the future.

Amongst the most important additional benefits of teamwork in the early detection and resolution of and corruption were:

- The avoidance of internal squabbling over «who needs to take the blame for not finding it earlier?»
- People across the organisation feel confident to raise what they see as red flags, potential problems and cost saving opportunities because they know that this is what is expected of them (i.e. early discovery is good news)
- The creation of a new positive spirit in the organisation and a realisation that the days of «waiting for whistle-blowers» or only reacting to discoveries in the media were soon going to be over!

The example case in the box on this page, whilst in many ways an extreme case, illustrates important behavioural responses which are not as uncommon as we may at first think. It is understandable for management, at least at first, to be sceptical to any form of early detection of fraud and corruption. In their mind fraud and corruption does not happen to them, or they derive comfort from the fact that since nothing has been discovered so far then nothing will be uncovered in the future. A natural fear is that the process of looking could be disruptive and that in the event of a discovery the end result will be a painful investigation and possibly even a media scandal. We believe that all these fears can be dealt with and none of them have to be true. It is important however to address these fears in advance. Finding fraud and corruption early requires a solid business case (a financial «value proposition» to use another phrase), one which everybody supports and buys into.

Taking the next step and tuning up the organisation to be even more effective in

## A CASE IN POINT: WHY AND HOW TEAMWORK AND FINDING FRAUD EARLY IS GOOD NEWS FOR EVERYBODY - EXCEPT OF COURSE THE FRAUDSTERS!

A few months ago we assisted the internal audit department of a large Nordic company with a pilot review to look for red flags of fraud. It was a small project but among many of the examples and red flags identified one particular supplier stood out. At first glance, the invoices issued by this supplier looked fine: not a single detail was missing, from the unit price to the firm's logo, addresses, and contact details. This was a supplier from whom they had been sourcing large quantities of raw materials for over 10 years. Up to then there was no apparent reason to complain.

Yet a closer review of the invoices showed that something rather "odd" seemed to be going on. The supplier stated that they were the offshore branch of a company registered in a Dirty Money Centre (or DMC), and they requested payment in a different currency to an account in a slightly different name in yet another DMC. This on its own was not enough to convince the management that maybe something was wrong. Management repeated the argument that they had been using this supplier for many years, and no one had pointed out anything wrong before, they were getting the products at a good price and that they placed reliance on "compliance checks" that had been carried out. They referred to the supplier's almost flawless and detailed website which included a 10 page code of ethics, a whistle-blower line and a statement that the company's management would welcome and not discriminate against whistle-blowers. Despite this the internal auditor trusted the analysis and his intuition and he was politely persistent. In order to get management's attention further evidence was needed; evidence that the company's website was only recently registered, the principal place of business was a law office employing four people with a permanent answerphone, and that no information could be found about the current true management and owners of the company whilst there was evidence that the former management had been the defendants in some serious criminal cases. Now management's interest was aroused and they gave their full backing to the internal auditor to proceed to examine a little further. To cut a long story short, it was proven that this particular supplier was central to a complex scheme of shell companies controlled by a particular and well known organized crime group who had been working in this way for a relatively long period of time.

Management were quick now to appreciate that despite apparent cost-savings, the future risks to continue to buy from this supplier were too big to take. At the same time any further investigation or legal action against an organized crime group would likely be long and drawn-out, probably futile, and even counter-productive. A board decision was taken to politely sever the business relationship with this supplier. At the same time action was taken across the company to learn the lessons and put in place processes and training to prevent a similar situation arising in the future. Management and the board also commended the internal audit department for its proactive and timely action.

eliminating the cost of fraud and corruption.

Whilst we believe that «Governance, Risk and Compliance» is not the ideal medicine for finding fraud and corruption early, we are by no means arguing for a complete dismissal of all organisational, regulatory and compliance measures; on

the contrary, it is clear that complex organisations do need guidelines to establish their own controls. These must, however, be accompanied by proactive efforts to detect on-going fraud and corruption. A new internal regulation or a tick in a box is quite simply not enough.