CHARITY COMMISSION
FOR ENGLAND AND WALES

COMPLIANCE TOOLKIT: PROTECTING CHARITIES FROM HARM

# Chapter 3: Fraud and financial crime - summary

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Fraud and other financial crimes affect all parts of the UK economy and this includes the charity sector. In its **Annual Fraud Indicator 2011**, the National Fraud Authority (NFA) estimated that fraud alone now costs the UK £38.4 billion a year. Although the true nature and extent of fraud in the charity sector is not known, targeted measurement by the NFA of fraud against charities has revealed annual losses of around £1.3 billion or 2.4% of annual charity income. The NFA concluded that there is significant potential for fraud in the charitable sector.

Charities can be attractive to fraudsters and financial criminals for a number of reasons. With over 181,000 registered charities in England and Wales, the charity sector is large, with an annual income of £53.2 billion, and carries out a very diverse range of activities. Charities are also heavily reliant on altruism, trust and honesty. Charities enjoy high levels of public trust and confidence, so appearing to be associated with a charity can give a criminal enterprise a veneer of respectability. The reliance of many charities on cash-based fund raising may make the sector attractive to both opportunist and organised fraudsters. And the ethos of charities, built on voluntarism and pursuit of a common and shared goal, may create a degree of trust amongst individuals and staff which allow the unscrupulous to operate with less suspicion.

The impact of fraud and financial crime on a charity, particularly on smaller charities, can be significant, going beyond financial loss and the impact on the financing of a charity's planned activities. These crimes cause distress to trustees, staff and volunteers. They may bring adverse publicity to the charity and damage the good reputation the charity has with its donors, beneficiaries and the public as well as that of the charity sector more generally. It is therefore important that trustees deal responsibly and properly with incidents of fraud and financial crime and take reasonable steps to reduce the risk of such events happening again.

Sound financial management is an increasingly important factor in determining people's trust and confidence in charities, as the results of the Commission's last **Public Trust and Confidence Survey** show. So it is vital for charities to reassure the public that the money they donate to charity is used properly and goes to the causes for which it is intended. Sound financial controls and financial management are an essential defence for charities against fraud and financial crime. They should be a core part of a charity's culture, and practised to the same degree of excellence as a charity's activities.

## What are trustees' duties and responsibilities?

Trustees have a legal duty and responsibility under charity law to protect the funds and other property of their charity so that it can be applied for its intended beneficiaries. They must also comply with the general law (and overseas law where applicable) including in relation to the prevention of fraud, money laundering and terrorist financing.

Fraud will flourish in an environment of weak governance and poor financial management. So this means that the protection of charity funds begins with having robust financial control systems within a framework of strong and effective governance.

## What is the purpose of this Chapter?

This Chapter aims to highlight some of the types of fraud and financial crime to which charities are vulnerable and provide some practical advice for trustees on how to tackle it. The charity sector is very diverse, and sometimes highly specialised; not every charity will experience every type of fraud or crime mentioned. However, if trustees have an awareness of fraud and financial crime risks they will be better equipped to recognise them. This guidance will also help trustees to devise and implement measures to manage the risks.

## Who should read this guidance?

The guidance is aimed principally at the trustees and managers of all charities, although it will also be of interest to employees and volunteers. No charity can be guaranteed immunity from fraud and financial crime. However, recognising the warning signs and using common sense and care to apply good financial controls, together with effective risk assessment and due diligence, will help reduce the likelihood of incidents occurring. It will help to maximise the chances of recovery if incidents do happen and minimise the opportunities for any recurrence.

We recognise that smaller charities will not usually have access to the financial infrastructure resources and capabilities that large organisations enjoy, such as an internal audit team or forensic accountancy skills. Trustees of small charities should use their judgement and their knowledge of their charities to adapt procedures according to the level of risk to their charity, taking into account the cost and burden involved.

## What does the guidance contain?

The guidance sets out the main types of financial crime and fraud, illustrating some with actual case examples and scenarios. Fraud which takes place entirely within the charity and involves only the charity's managers and employees is referred to as 'internal fraud', while that which involves some element of collusion or conspiracy with an individual outside the charity is referred to as 'external fraud'.

The guidance highlights some warning signs of fraud, money laundering and other financial misconduct. No single 'warning sign' – or even more than one - can be taken as conclusive evidence of fraud. Trustees will need to assess and act on what they see in the context of their charity's activities and financial situation, as well as in their internal financial monitoring and reporting and audit recommendations.

We provide a broad range of practical advice about how to deal with actual and suspected fraud, including anti-fraud measures that can be taken to prevent its recurrence. The guidance also shows trustees how to carry out an effective fraud action and response plan. We give practical advice for putting in place policies and procedures, appropriate to the size of the charity and its activities, so that all trustees, staff and volunteers are aware of the parts they have to play in protecting their charity from fraud and financial crime. Policies and procedures need to be reviewed regularly so that they remain relevant and effective.

We give advice about how to report fraud and to whom, and signpost to organisations that can provide practical support to victims of fraud. Fraud is a criminal offence and must be reported to the police. Trustees also need to report to the Commission any actual or suspected serious incidents of fraud, theft, other financial crimes or other significant loss to the charity as part of the serious incident reporting regime. There is no minimum figure that should or must be reported. Trustees need to decide whether these incidents are serious or significant enough to report to us in the context of their charity and the circumstances of the incident, taking account of the actual harm and potential risks to the charity posed by the incident.

Where there are concerns about the abuse of charitable funds through fraud, theft or other financial crime, the role of the Commission is to ensure that trustees are meeting their legal obligations and duties to protect charity funds and property, and so that public trust and confidence in the charitable sector is protected. The investigation of fraud and theft is, like other criminal activity, the responsibility of the police and law enforcement agencies who take the lead in cases where there are suspicions that offences may have been committed in charities. The Commission works in partnership with the police and other agencies, and our role is to investigate any regulatory concerns that arise in connection with such cases. This includes considering whether matters arising in those separate investigations may indicate misconduct or mismanagement in the administration of the charity and/or raise issues about the suitability of trustees which are regulatory issues for the Commission.

We also signpost to some of the main legislation relating to fraud and financial crime, although we cannot say specifically which sections of individual legislation will be relevant. This is because of the many different forms that charities take and the diversity in charities' activities and their financial complexity.

## Top Ten Tips for Trustees

- Review your financial controls at appropriate intervals and do so critically, keeping them up to date. Just because you have not been a victim of fraud, do not assume that it will never happen.
- Segregate duties – do not allow one or two people to be in charge of and unchecked for all aspects of your charity's financial controls.
- Make sure all of the separate parts of the financial records agree with each other. Always ask for and keep receipts. Reconciling bank statements with invoices, receipts, purchase and payment authorisations will often help to identify fraud at an early stage, and may discourage potential fraudsters.
- Never weaken your financial security for the sake of short cutting or time saving. For example, do not pre-sign blank cheques, even if a second signature is required. Doing so reduces your cheque security by 50% - or, to put it another way, doubles the risk!
- Keep a list or register of valuable fixed assets and key charity property, and periodically inspect them.
- Ensure that electronic or online banking arrangements are secure and are protected with dual-level authorisation.
- When recruiting staff – especially those who handle the charity's finances - make appropriate background checks and take up references.
- If your charity makes grants to beneficiaries or other organisations, carry out appropriate due diligence checks on applicants. See the '**know your beneficiaries**' guidance in Chapter 2 of the toolkit.
- Ensure as trustees you receive and consider regular reporting information about the charity's finances. If you are a trustee or manager, make sure that you understand the financial summaries and reports that are presented to you, and if you do not, ASK for an explanation that you CAN understand.
- If you suspect or become aware of fraud, make sure that you know what to do and who to inform. Make sure it is part of the culture of your charity. Prompt and appropriate action will help to protect your charity and limit any financial damage.