



CHARITY COMMISSION  
FOR ENGLAND AND WALES

## COMPLIANCE TOOLKIT: PROTECTING CHARITIES FROM HARM

### Chapter 3: Fraud and financial crime

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# Contents

<b>A Introduction</b>	<b>2</b>
<b>B Fraud and financial crime in the charitable sector</b>	<b>6</b>
<b>C What financial crimes do trustees need to be aware of?</b>	<b>13</b>
<b>D What are the various types of fraud, and how can trustees prevent them happening?</b>	<b>17</b>
<b>E What are the Warning Signs for Fraud?</b>	<b>31</b>
<b>F What practical steps can trustees take to deal with fraud?</b>	<b>33</b>
<b>G Practical advice on dealing with money laundering</b>	<b>38</b>
<b>H Fraud action and response plan</b>	<b>40</b>
<b>J Reporting fraud and money laundering</b>	<b>45</b>
<b>K What else do trustees need to do if the charity has lost money as a result of a crime?</b>	<b>53</b>
<b>L Other connected legislation</b>	<b>54</b>
<b>M Bribery and corruption</b>	<b>55</b>

# A Introduction

## A1 What is the purpose of this Chapter?

This guidance aims to highlight some of the types of fraud and financial crime to which charities are vulnerable and provide practical advice for trustees on how to tackle it. 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. The guidance is aimed at the trustees and managers of all charities, though it will also be of interest to employees and volunteers. We recognise that smaller charities will not usually have access to the sort of resources and capabilities for managing risks that large organisations enjoy. However, trustees of small charities should use their judgement and their knowledge of their charities to develop controls and adapt procedures appropriate to the level of risk they face.

Fraud and financial crime affect all parts of the UK economy and this includes the charity sector. In a difficult economic, social and international environment, all parts of society and the UK economy are having to improve their defences against fraud and financial crime, including the prevention of money laundering and terrorist financing. With 181,000 registered charities in England and Wales, the charity sector is large, and has an annual income of £53.2 billion. During 2010, the National Fraud Authority (NFA) undertook **a survey of 10,000 registered charities** in order to produce an estimate of fraud against the charity sector. Based on the responses from more than 1,000 charities, the NFA's **Annual Fraud Indicator 2011** estimated that charities lose on average 2.4 per cent of their annual income to fraud, equating to lost charitable funds of around £1.3 billion a year for the sector as a whole.

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.

Fraud and financial crime can have a particularly damaging impact on a charity. The loss of funds may only be the beginning; forensic investigation, legal advice and recovery costs can be considerable, and in some cases may exceed the amount lost. There are also indirect consequences: the negative effect on charity trustees and staff morale may adversely influence service delivery, and the impact on the charity's reputation and resources can be irreversible. All of this can seriously threaten the security and very existence of a charity with modest resources.

Clearly, the best approach is to prevent fraud, financial crime or indeed any financial abuse happening in the first place. Charity trustees have a legal duty to take all necessary steps to protect their charity's funds and assets from misuse, and to comply with the general law on fraud and financial crime. The starting point is to make sure that the charity's governance framework includes good, robust financial controls together with effective risk assessment and due diligence. Although good systems will not necessarily prevent fraud and financial crime altogether, they will lessen its likelihood, help to maximise the chances of recovery if it does happen and minimise the opportunities for any recurrence. They will also send strong signals to criminals and those who seek to abuse a charity that they will not get away with it. 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.

**"Fraud within a small charity can instantly threaten survival. Coming so close to closure is something that we will all never forget"** Extract from case studies

Time and commitment from trustees and internal staff in dealing with the aftermath of a fraud or financial crime can be high. It can impact significantly on resources that would otherwise be channelled into direct charitable activities. A charity can limit the impact of a fraud by taking swift and immediate action, and by implementing existing procedures, policies and practices as soon as a fraud is suspected or detected to ensure further funds are not taken or are at risk. For further information, see the **Fraud Action Plan** section of this guidance.

There is tremendous diversity in the charity sector. Some charities provide services directly to beneficiaries, while others supply grant funding or operate through local partner organisations in the UK or overseas. There is the potential for abuse of a charity's finances at different stages of its operations, and the risks differ. For some charities the risks may be higher because of their fundraising activities. For some charities the risks may be higher because of the nature of their operational structures, office and branch arrangements, and for others because of their activities and end use of funds. This means that a 'one-size fits all' approach to safeguarding funds is not appropriate. Trustees of charities are best placed to assess the risks and put in place the controls that are most appropriate for their charity because they know their charity best.

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.

Charities can be victims of crime in the same way as other sectors and individuals. Financial abuse can also take place because of an abuse of trust by those connected to or involved with a charity.

Of course, charity funds may be lost and charities may become insolvent even where the trustees have acted sensibly, honestly and prudently. However, there is a difference between being unable to resolve and recover from financial pressures, and trustees and those in charge leaving a charity open to abuse through neglect and mismanagement. Although the overall responsibility for effective governance and the implementation of proper financial management rests with the trustees, for many charities the systems will often involve the charity's staff and volunteers. Trustees should identify financial risks and plan for their management. Plans should be flexible enough to respond to changes in the economic environment, and they should be periodically reviewed so as to ensure that they remain fit for purpose.

For more detailed information, see existing Commission guidance:

- **Internal Financial Controls for Charities (CC8)**
- **Trustee expenses and payments (CC11)**
- **Managing Financial Difficulties and Insolvency in Charities (CC12)**
- **Investment of Charitable Funds (CC14)**

## A2 What we mean by 'must' and 'should'

In this guidance:

- 'must' means something is a legal or regulatory requirement or duty that trustees must comply with
- 'should' means something is good practice that the commission expects trustees to follow and apply to their charity

Following the good practice specified in this guidance will help you to run your charity effectively, avoid difficulties and comply with your legal duties. Charities vary in terms of their size and activities. Consider and decide how best to apply this good practice to your charity's circumstances. The commission expects you to be able to explain and justify your approach, particularly if you decide not to follow good practice in this guidance.

## A3 Using this guidance

In answer to any anticipated questions, there are short answers and explanations in more detail. There are links to other websites, documents, further information and useful tools for charities.

## A4 Technical terms used

### **Beneficiary**

A person who is intended to receive benefit from a charity.

### **Due diligence**

Due diligence is the process and steps that need to be taken by trustees to be reasonably assured of the provenance of the funds given to the charity, confident that they know the people and organisations the charity works with and are able to identify and manage associated risks.

### **Gift Aid**

A scheme that enables tax-effective giving by individuals to charities in the United Kingdom. Any cash donations that the taxpayer makes to a charity after making a declaration are treated as being made after deduction of income tax at the basic rate, and the charity can reclaim the income tax paid on the gift from HMRC.

### **Governing document**

A legal document setting out a charity's purposes and, usually, its rules of management. Types of governing document include a trust deed, constitution, memorandum and articles of association, will, conveyance, Royal Charter, and scheme of the Charity Commission or court.

### **HM Revenue & Customs (HMRC)**

The government department which collects the majority of direct and indirect UK taxes. It is also responsible for overseeing and regulating tax concessions enjoyed by charities, including the Gift Aid scheme.

### **Identity theft**

A form of fraud or cheating in which person A pretends to be person B by assuming person B's identity. Typically, this is done in order to access resources or obtain credit and other benefits in person B's name.

### **Money laundering**

The process of turning the proceeds of crime into property or money that can be accessed legitimately without arousing suspicion. The term 'laundering' is used because criminals turn 'dirty' money into 'clean' funds which can then be integrated into the legitimate economy as though they have been acquired lawfully.

### **National Crime Agency**

The NCA is a new crime-fighting agency with national and international reach and the mandate and powers to work in partnership with other law enforcement organisations to bring the full weight of the law to bear in cutting serious and organised crime.

It has five separate commands: border policing; economic crime; organised crime; national cyber crime; and CEOP (child exploitation and on-line protection.)

### **Non Governmental Organisation (NGO)**

A not-for-profit organisation which is based on a set of social values, is independent of government and works for the benefit of other people or a class of people. NGOs may or may not also be charities.

### **Phishing**

The criminally fraudulent process of attempting to acquire sensitive information - such as usernames, passwords and credit card details - by masquerading as a trustworthy organisation in electronic communication.

**Property**

All assets, including cash, investments, land, buildings and the charity's reputation.

**Serious Incident**

A serious incident is an adverse event, whether actual or alleged, which results in or risks significant:

- loss of a charity's money or assets
- damage to a charity's property
- harm to a charity's work, beneficiaries or reputation

If a charity's income is over £25,000, the trustees must, as part of the Annual Return, sign a declaration confirming there were no serious incidents during the previous financial year that should have been reported to the Commission but were not. If incidents did occur, but weren't reported at the time, the trustees should submit these before they file their charity's Annual Return, so they can make the declaration. Until all serious incidents have been reported, the trustees will not be able to make this declaration, or complete the Annual Return, which is a statutory requirement under section 169 of the Charities Act 2011.

**Suspicious Activity Report (SAR)**

A disclosure to the National Crime Agency under either the Proceeds of Crime Act 2002 or the Terrorism Act 2000.

**Trustee**

Charity trustees are the people who are responsible for the general control and management of a charity. In some charities they may be known as directors, board members, governors or committee members.

# B Fraud and financial crime in the charitable sector

## B1 Why might charities be vulnerable to fraud and financial crime?

### Short answer

The charitable sector in England and Wales is large and carries out a diverse range of activities, with an annual income of £53.2 billion. Charities are also heavily reliant on altruism, trust and honesty. They 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.

Many charities are small or medium enterprises. Such organisations tend to rely on a small number of finance professionals, or on volunteers, to supervise the funds and assets of the charity and these arrangements may lack the scrutiny and division of duties possible in larger charities. The reliance of 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.

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### In more detail

Charities can be attractive to fraudsters and financial criminals because they:

- enjoy high levels of public trust and confidence. Appearing to be associated with a charity can give a criminal enterprise a veneer of respectability
- may believe that nobody would abuse a charity, so charity managers might not think to ensure strong financial controls
- often rely on goodwill and voluntary support in one form or another. Many people, often transient, may be involved in the charity, making it less likely that problems are identified or criminals pursued
- often depend on one or two individuals who can play a key or largely unsupervised role in running the charity, particularly in smaller charities
- form a hugely diverse sector, are involved in a wide range of activities and reach all parts of society, so patterns of financial abuse may be harder to identify and prevention methods need to be adapted to work efficiently
- may have unpredictable and unusual income and expenditure streams that can make suspicious transactions and financial trends harder to identify
- may have a global presence, sometimes in areas of conflict and/or where there is poor financial infrastructure or operate in cash intensive environments
- may have complex financial systems involving multiple donors or investments, and high levels of cash income and expenditure
- may need to use alternative money holding and transfer systems in the UK and overseas, involving conversion into and out of different currencies
- may use intermediaries through which they deliver work and pass funds
- may have branches and/or projects that are not under the direct or regular control or supervision of the charity's managers or a single regulator

- may have insufficient staff to allow for proper segregation of duties
- can be set up as sham organisations to disguise what are in reality illegal public fundraising and other activities

## B2 How might charities be vulnerable to fraud and financial crime?

### Short answer

Financial abuse may occur within a charity, carried out by someone involved in or connected to it, or the charity may be the victim of crime committed by entirely external individuals or entities.

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### In more detail

Charities can be victims of crime in the same way as other sectors and individuals and this risk can never be completely eliminated. Financial abuse of a charity can be committed by individuals outside of a charity or by other organisations. For example, fraudulent fundraising in the name of a charity or charities generally, or on behalf of defunct, bogus or non-existent charities (see External Fraud). Incidents may be isolated, or they might form part of a systematic plan over a long period of time.

However, sometimes abuse takes place by those close to or connected with the charity, which is particularly serious. Trustees are in a position of trust, and there may be other key staff in positions of trust such as a treasurer, finance director, finance manager or project manager. Charities depend on trust. The public, donors and those involved in charities depend on them to protect charity funds and assets. Sadly, sometimes people involved with charities in positions of trust with specific financial responsibilities abuse that trust.

The risk of financial crime exists at every stage of a charity's activity, from the point at which income is generated and received, through the internal management and decision making and eventually to the end use of funds. Some charities may face additional or particular risks because of the activities they undertake, but no charity can regard itself as being immune to the risk. All trustees must ensure that they are aware of the risks their charities face, assess them objectively and take appropriate and proportionate steps to manage them in the context of their particular charities and what they do.

Fraudsters and criminals are becoming increasingly sophisticated in their methods, adopting new technologies and targeting organisations' vulnerabilities. This emphasises the importance of regularly reviewing and updating financial controls and safeguards against fraud, and highlights the importance for trustees to be aware of what is going on in their charities. There is a very clear need for charities to protect themselves by adopting or reinforcing anti-fraud initiatives. The Commission has published **The Economic Downturn: 15 questions trustees need to ask**, which contains a specific section on safeguards to protect against fraud.

Charities working internationally may face an increased risk of financial abuse from fraud, or theft because of the complexity of working across borders where there may be less control or where local conditions make it hard to apply controls. Trustees of these charities may need to address particular challenges, for example relying on alternative methods for transmitting funds abroad, or trying to establish clear audit trails when working with partner agencies abroad. (See the 'Due Diligence' and 'Know Your' principles in **Chapter 2 of the toolkit**). Moving funds overseas creates extra opportunities for them to go missing because of, for example, conversion to other currencies, conversion of cash into goods and back again and, in some areas, local corruption, the absence of formal banking systems and unregulated local customs and practices. Further information on the particular issues affecting charities operating overseas can be found in our guidance on **Charities Working Internationally**.



Financial crime does not necessarily involve large amounts of money. Depending on the charity's size and the work it undertakes, fraud involving relatively small amounts can still result in significant damage. There is much that charities can and should do to be fraud-aware.

Criminals may exploit charities by misappropriating charitable funds through fraud, theft, money laundering or diverting charitable funds from legitimate charitable work. Examples of the types of fraud and financial crime that charities may be susceptible to include:

- banking system theft and fraud
- misuse of the charity's bank account
- fraudulent credit or debit card transactions or charges
- intercepting postal donations and cheques
- failing to pass on money from public charitable collections
- stealing or 'skimming-off' money from cash collections
- fake fundraising events and requests for donations
- theft from charity shops and trading activities
- using the charity's databases or inventories for personal profit or unauthorised private commercial use
- fake grant applications
- the creation of false invoices or purchase orders
- the creation of false employees or inflated expenses, overtime or other claims
- providing services to beneficiaries who do not exist, and other forms of identity fraud

### **B3 What are trustees' legal duties and responsibilities?**

#### **Short answer**

Legal requirement: trustees' legal duties to safeguard the charity's money and assets and to act prudently mean that trustees must:

- do their best and take reasonable steps to help prevent financial abuse of the charity's funds in the first place
- make sure that proper robust financial controls and procedures suitable for their charity and its activities are in place
- ensure they act responsibly when, and in the interests of the charity, dealing with incidents of fraud and crime

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#### **In more detail**

Legal requirement: charity trustees must ensure they and their charity comply with the general law including those associated with fraud and financial crime. Charity trustees must take all necessary steps to ensure there is no misuse of charity funds or assets. This is part of their general duty of care under charity law, and of their duty to comply with the law on fraud and financial crime.

Legal requirement: if a charity is to achieve its aims then the trustees must ensure that its assets are properly used in furtherance of its objects, that its funds are spent effectively and its financial affairs are well managed. Trustees have a duty to avoid undertaking activities that may place their funds, assets or reputation at undue risk.

Charities must therefore ensure they exercise proper control over the charity's financial affairs. We also expect individuals connected with the charity to deal with concerns about financial abuse responsibly and where a crime is suspected to report this.

Failure on the part of trustees to take reasonable and proper steps to protect the charity and its assets, such as not having suitable and proper financial controls in place or not acting responsibly when dealing with incidents of financial abuse may be regarded as evidence of misconduct and/or mismanagement in the administration of the charity.

## B4 What is the Charity Commission's role?

### Short answer

The Commission does not investigate or prosecute crime. Our concerns and regulatory interest is about:

- protecting the charity's funds and assets and ensuring public trust and confidence in the charity
  - ensuring trustees comply with their legal duties and responsibilities in the management and administration of the charity
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### In more detail

Our remit does not extend to investigating or prosecuting criminal activity although we do work closely with the public and other agencies. Action taken by the Commission will usually be focused on considering whether there has been misconduct or mismanagement in the administration of the charity in how the financial abuse and illegal activity has arisen or been allowed to occur, as well as ensuring going forward the charity's funds are protected and the trustees are taking steps to recover lost funds, where it is reasonable to expect them to do so.

We will pass on information and report information to the police and law enforcement agencies through our statutory gateway where during our work and engagement with a charity we identify information which may suggest a crime has taken place.

We may need to do, or consider, one or more of the following:

- clarifying the extent to which the charity and its personnel are involved in, or responsible for any alleged incident
- whether there is an immediate need to protect the charity's funds which means we need to exercise our powers
- whether the trustees have handled any allegations and concerns properly and responsibly, particularly where they involve a trustee or someone senior with financial responsibility within the charity
- ensure trustees are taking responsibility for ensuring they have proper financial controls in place and that these are reviewed, where appropriate, after an incident and proper checks are carried out for those employed to have particular responsibility for the charity's money

The Commission's role is not to be prescriptive about the detailed range and type of financial controls that are appropriate for each charity; that is for the trustees to decide. However, as the charity regulator the Commission has a responsibility to promote public trust in charities and a role in providing guidance to trustees and setting out the minimum legal requirements that trustees must follow in order to be able to demonstrate that they have fulfilled their legal duty to protect their charities and charitable assets. In this guidance, the Commission provides practical advice about how to approach the risk of actual and suspected fraud, how to reduce its likelihood and what to do if fraud is found to have occurred.

## B5 How can trustees manage the risks from criminal financial abuse?

### Short answer

Trustees need to consider the risk of financial crime and manage those risks. More information on risk assessment and management is contained in our guidance **Charities and Risk Management: a guide for trustees (CC26)**. The role of internal control in managing identified risk should be understood and followed by all those who work in the charity whether as trustees, employees or volunteers. The nature of the internal controls put in place will vary depending upon the size and complexity of the charity and all charities should consider what is appropriate for them.

Trustees should report any incidents of financial crime and abuse that takes place in their charity to the police and the **Charity Commission**.

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### In more detail

The risk from financial fraud and abuse can never be completely ruled out. However, proper and adequate internal financial controls play an important part in managing this risk. Trustees are responsible for the effective administration of the charity and have a legal duty to safeguard charity assets. Funders, donors, supporters and beneficiaries are entitled to expect proper standards of management and financial control. If the charity falls victim to financial crime resulting from trustees not putting adequate financial controls in place, then the trustees will have failed to meet their legal duties to the charity.

When reviewing financial controls to ensure they are fit for purpose, trustees should take into account changes in the charity's structure, activities and area of operation that could affect the risks to the charity. Changes in the types of threat the charity may face also need to be considered, for example new or emerging methods of fraud, to ensure such risks are properly managed. It can be difficult to identify financial abuse as criminals may be adept at presenting their activities as legitimate and lawful. Establishing the identity and legitimacy of any organisation the charity works with can reduce such risks.

Trustees should also consider how the charity will react to different types of financial crime should they occur. There should be procedures for reporting known or suspected crime or abuse and clarity about how reports of concerns will be investigated.

Adequate training should be provided to staff and volunteers to ensure they are familiar with the charity's financial controls and know what actions to take if they suspect criminal financial abuse. Staff and volunteers should know how to report their concerns within the organisation, including concerns about the conduct of trustees or senior managers. If trustees know or suspect an individual is misusing the charity for their own purposes or misappropriating charitable funds they should take immediate and appropriate action to resolve the issue.

Charities often rely on computer systems to receive information and store financial data including the bank or credit card details of donors and financial supporters, staff and suppliers. This data is very valuable and its loss could expose the charity and others to the risk of theft, fraud, identity theft and loss. The trustees should have in place appropriate policies governing access, use and storage of electronic information ensuring compliance with Data Protection legislation. Procedures should also include the use of computers, hard drives, USB and data storage devices. The charity should consider protecting its computer systems with anti-spyware, anti-virus, firewalls and similar computer programs.

**Reporting financial abuse to the Charity Commission** - If it is known or suspected that a charity is a victim of financial crime then this should always be reported to the police and as a matter of best practice to the Charity Commission immediately under the Serious Incident Reporting regime. We have published further guidance on **Reporting Serious Incidents**.

## B6 Can trustees apply a risk based approach to their duties?

### Short answer

Legal requirement: trustees cannot apply a risk based approach as to which duties apply or they choose to comply with. The legal duties explained above apply to all trustees of all charities subject to the law of England and Wales, whatever their income, whether registered with the Commission or not and whether or not they are based, operate or work internationally.

However, what action is reasonable or proportionate to take to ensure trustees comply with these duties as regards dealing with and preventing fraud and financial crime will vary from charity to charity. Charities can apply a risk based approach to this.

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### In more detail

What an individual charity and its trustees must or should do in their charity and what is a reasonable and proportionate approach to adopt when taking action to comply with those legal duties will depend on a range of factors.

It will, for example, depend on:

- different aspects of a charity's work and the risks which arise
- how much money is involved
- whether partners and funds are overseas and what the risk of fraud and corruption is there
- whether the crime has occurred by someone within or closely connected to the charity
- how often incidents are taking place

Legal requirement: all charities must, as a minimum:

- Have some form of appropriate internal and financial controls in place to ensure that all their funds are fully accounted for and are spent in a manner that is consistent with the purpose of the charity. What those controls and measures are and what is appropriate will depend on the risks and the charity.
- Keep proper and adequate financial records for both the receipt and use of all funds together with audit trails of decisions made. Records of both domestic and international transactions must be sufficiently detailed to verify that funds have been spent properly as intended and in a manner consistent with the purpose and objectives of the organisation.

- Give careful consideration to what other practical measures they may need to consider to ensure they take reasonable steps to protect the charity's funds and the trustees meet their legal duties
- Deal responsibly with incidents when they occur, including prompt reporting to the relevant authorities and ensuring the charity's funds are secure

In all these cases, the more complex or significant the charity's activities and financial transactions, the more money or the higher the number of transactions involved, the more serious the crime or its circumstances, the more steps that are likely to be required as reasonable to ensure a trustee complies with these duties, even when balancing this with the volume and cost of administration this may involve. What is appropriate and proportionate therefore depends on the nature of the risk, its potential impact and likelihood of occurring. What is important is for trustees to be able to show that the action they have taken is reasonable in light of those risks and actions.

The existing requirements for independent examination and audit in larger charities may assist trustees, but they should not be relied on as the only way or fail safe way of ensuring no abuse takes place.

Conversely, smaller charities and those charities operating where the risk of fraud and abuse is lower, will not have to do as much to protect the charity and ensure the trustees discharge their duties. For example, smaller charities will not usually be expected to have written fraud policies and specific anti fraud measures in place. (See section **F5 Fraud policy**.)

Whatever a charity's size and circumstances, the trustees need to be able to explain what they did (or did not do) and show that this was reasonable in the particular circumstances.

More information on what a risk based approach can be found in section **C1 of Chapter 2 of the toolkit**.

## C What financial crimes do trustees need to be aware of?

The main financial crimes to be aware of are:

- Fraud and theft
- Money Laundering
- Terrorist Financing

### C1 What are 'fraud' and 'theft'?

#### Short answer

Fraud is a form of dishonesty, involving either false representation, failing to disclose information or abuse of position, undertaken in order to make a gain or cause loss to another.

Theft is dishonestly appropriating property belonging to another with the intention of permanently depriving the other of it.

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#### In more detail

Fraud is a criminal offence and has a technical definition set out in the Fraud Act 2006. In practice there are a wide variety of types of fraud that charities can experience including fraud connected with charity fundraising, income and expenditure, property and investments, charities' identities, banking fraud and others. **Section D** has more information on these many types of fraud. Fraud committed against an organisation has sometimes been portrayed as a 'victimless crime', but it can have a devastating effect upon individuals and communities. For charities, the impact of fraud can include significant loss of funds, permanent financial or reputational harm and damage to public confidence. Smaller charities with relatively low incomes may be less capable of coping with the financial and reputational impact of fraud.

There are many different types of fraud and the methods used are constantly evolving. Individuals and organisations may be targeted through emails, phone calls, letters, the internet, or other methods. An operation in which a donor is deceived or tricked into giving money is fraud. Charities themselves can be victims of fraud, but sometimes a charity, or a charity's name, can be used to commit a fraud against individuals – for example, when people are sold items supposedly for charity when the money in fact goes straight to the fraudster. During the Haiti earthquake disaster, there were instances of criminals trying to take advantage of the public's generosity through online scams designed to steal charitable donations. These took the form of fictitious appeal websites, email appeals that falsely used the name of genuine charities, or appeals from fictitious charities.

The Fraud Act 2006 reshapes previous legislation to tackle a wide range of fraudulent activity, keeping pace with rapidly developing technology. The Fraud Act came into effect on 15 January 2007, creating a new general offence of fraud and setting out three ways by which it is committed:

- fraud by false representation
- fraud by failing to disclose information
- fraud by abuse of position

It also creates new offences:

- obtaining services dishonestly with intent to avoid payment
- possessing, making and supplying articles for use in frauds
- participating in a fraudulent business carried on by a sole trader

The Theft Act 1968 covers the criminal definition of theft and associated offences such as false accounting. False accounting is described as follows:

(1) Where a person dishonestly, with a view to gain for himself or another or with intent to cause loss to another -

(a) destroys, defaces, conceals or falsifies any account or any record or document made or required for any accounting purpose; or

(b) in furnishing information for any purpose produces or makes use of any account, or any such record or document as aforesaid, which to his knowledge is or may be misleading, false or deceptive in a material particular

For charities, false accounting might involve careful manipulation of the day to day income and/or expenditure records so that the level of funds, and how they have been applied, appear to be correctly recorded but in fact are false. The charity's annual accounts might then be manipulated so as to be consistent with the false records. All this might typically be done in order to disguise fraudulent misuse of charity funds.

Where there are concerns about the abuse of charitable funds through fraud or theft, 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.

A person who is convicted of an offence involving dishonesty or deception is automatically disqualified under charity law from holding the position of a charity trustee. Further information about disqualifications and waivers of disqualification can be found in our published staff guidance **Disqualification for acting as a charity trustee (OG 41)**.

## C2 What is 'money laundering'?

### Short answer

Money laundering is a crime and is usually described as the process of turning the proceeds of crime into property or money that can be accessed legitimately without arousing suspicion. The term 'laundering' is used because criminals turn 'dirty' money into 'clean' funds which can then be integrated into the legitimate economy as though they have been acquired lawfully. Charities, like any other organisation, can be targeted as conduits for money laundering, but in practice they may have a greater vulnerability because being associated with a charity tends to give a veneer of public respectability to a non-charitable enterprise that is in reality dubious or possibly criminal.

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### In more detail

UK money laundering offences are prohibited under the following Acts:

- **Proceeds of Crime Act 2002**
- **Terrorism Act 2000**
- **Anti-Terrorist Crime and Security Act 2001**
- **Counter-Terrorism Act 2008**

Money laundering comprises three distinct stages:

1. **Placement** – movement of criminal proceeds from their source. For example, cash proceeds from crime may be paid into a bank or used to buy goods, property or assets.
2. **Layering** – undertaking transactions to conceal the origin of the money. For example, goods or other assets may be resold or funds transferred abroad.
3. **Integration** – movement of laundered money into the economy so that it looks as if the money came from legitimate sources. For example, invoices from a 'front' company may be paid using cash which originated as the proceeds of crime. Laundered cash can also be loaned to such a company.

Cash is weighty, bulky and conspicuous and has no value unless it can be used successfully. Criminals launder money so they can spend it safely, avoiding suspicion and detection.

Trustees can substantially reduce the risk of their charity being used as a vehicle for money laundering by following the due diligence principles and guidance for 'Know Your Donor' set out in **Chapter 2 of the toolkit**. There is further practical advice on dealing with money laundering in **section G** of this guidance.

Under the Proceeds of Crime Act 2002 (POCA), there are three principal money laundering offences that relate to the stages mentioned above. These are: concealing, arranging and acquiring criminal property. Further detailed information can be obtained from the **National Crime Agency**, and guidance on how to report money laundering can be found at **section J5** of this Chapter.



## C3 What is terrorist financing?

### Short answer

Terrorist financing is the raising, moving, storing and using of financial resources for the purposes of terrorism. Sections 15-18 of the Terrorism Act 2000 make it an offence to:

- raise, receive or provide money or other property for the purpose of terrorism
- possess or use money for the purposes of terrorism
- become involved in an arrangement to make money, etc available for the purposes of terrorism
- facilitate the laundering of terrorist money

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### In more detail

Money underpins all terrorist activity - without it there can be no training, recruitment, facilitation or support for terrorist groups. The disruption of terrorist financing activity is a key element of the UK Government's overall fight against terrorism, involving close working across government between the intelligence and law enforcement agencies and the financial sector. Charities and voluntary organisations play an important role in ensuring that the funds they collect are not diverted to terrorist organisations.

Under sections 15-18 of the Terrorism Act 2000 a person is guilty of an offence if he 'knows', 'intends' or has 'reasonable cause to suspect' that the terrorist property may be used for the purposes of terrorism. Therefore, it is an offence for a charity to provide funds to an organisation which it suspects as being a terrorist organisation.

This affects charities and those who raise money for registered charities and charitable causes. If the person raising money, for whatever purpose, charitable or otherwise, has reasonable cause to suspect that the money may be used for terrorist purposes, he or she will be committing an offence. This could apply to trustees, the charity's fundraisers and volunteers. These offences would also include someone who makes a donation to charity or for charitable causes, whilst knowing or suspecting that it will be used for the purposes of terrorism.

In order to discharge their duties and responsibilities, trustees must take reasonable steps and implement risk-based procedures and systems to protect the charity from abuse.

For further information on the risk of terrorist financing and how to reduce it see **Chapter 1 of the toolkit - Charities and terrorism**.

Legal requirement: charity trustees, employees and volunteers are now under a positive legal duty to report their suspicions of terrorist financing offences to the police. If they do not, they may commit a criminal offence. More information on this can be found in **Module 9 of Chapter 1** of the toolkit.

The UK has introduced various new laws aimed at combating the growing threat from international terrorism. An at-a-glance summary of these laws can be found in **Counter-terrorism legislation – an overview** in Chapter 1 of the toolkit. This guidance aims to provide an outline as to how these and other laws affect the financial aspects of charity management.

## C4 What other types of financial crime are there?

There are various other types of crime related to financial abuse. The police and Crown Prosecution Service are responsible for identifying which crimes apply to a particular set of facts. However, some other crimes which exist include bribery, false accounting, fraudulent trading and intellectual property offences.

# D What are the various types of fraud, and how can trustees prevent them happening?

## Short answer

There are various frauds to which charities are potentially vulnerable. Frauds can be identified either as internal (involving only people within the charity) or external (in which at least some element of the fraud is perpetrated outside the charity).

The following sections set out some information about some common types of fraud and provide advice on how trustees might protect their charity from them.

## D1 Income-related fraud

This occurs when people within or connected to a charity attempt to divert funds for personal use or other non-charity purposes.

Examples of income-related fraud include:

- redirected resources from charity shops or trading activities
- intercepted postal donations and cheques being paid into personal accounts
- skimming money from charitable fundraising collections
- impersonating a charity and redirecting the income collected to a fraudulent or bogus body
- fraudulent Gift Aid claims
- false accounting
- claiming inappropriate expenses

### Case Study

#### Promoting fraud awareness

“Carrying out a trustee spot check on charity records and ultimately discovering that fraud had taken place was completely and utterly devastating. We knew what to do, we had a skilled board and our internal controls had detected it relatively quickly. However, the fact that it had happened at all still has a lasting negative impact on the morale of trustees, staff and volunteers as well as on the high levels of trust that had existed within our small charity.

My overwhelming advice to other small charities is to become aware that, sadly, fraud does actually happen, and to protect your charity as much as possible from the risk. Don't think it is something that can never happen within your own charity community. Fraud awareness can sometimes be a difficult subject to raise at board meetings for fear of damaging the trust and passion that are such vital components of the charity's ethos. However, the disruption and damage to trust and morale within your charity can be far greater if fraud actually does 'happen to you'. Fraud within a small charity can instantly threaten survival. Coming so close to closure is something that we will all never forget.

Fraud hurts – it really hurts. The last people you want to get hurt are your beneficiaries.”

**Trustee of charity that reported fraud to the Charity Commission in January 2010 under the Reporting Serious Incidents regime**

## Scenario

### Abuse of the Gift Aid scheme

A charity manager creates false records of charitable donations in order to claim Gift Aid repayments with the intention to transfer them to a personal account. As sole signatory and claimant, the manager fraudulently claims back income tax on each false donation.

In order to claim Gift Aid on a donation, a Gift Aid declaration must be retained (see [HMRC website](#) for full details). The declaration must contain the following information:

- the name of the charity
- the full name and home address of the donor
- the donation details
- a statement from the donor or a note that verbal confirmation was given by the donor that gift aid is to apply

Where a charity has been wrongly paid Gift Aid funds from HMRC, it will be liable to repay them. There may also be penalties and interest.

As part of each charity's financial controls, it is important that Gift Aid abuse risks are considered and appropriate safeguards put in place. Carrying out spot checks on claim forms and supporting documentation will help to confirm genuine claims and identify spurious ones. Sending letters of thanks to donors may help to discourage gift aid fraud, because there is a real risk to the fraudster that 'donors' will reply to say that they have not made donations. For genuine donors, a thank-you letter is likely to be well received and may encourage future donations.

### Prevention:

A lot of charitable work relies upon the goodwill, dedication and hard work of volunteers, staff and supporters, so it is important to maintain a culture of trust and harmony within a charity. However, trustees and managers should not assume that processes and procedures will always be carried out correctly. Trustees should remember that they are ultimately responsible and they must ensure that their charity's financial control and other systems are adequate and operating correctly so that they can satisfy themselves that funds and resources are properly collected, allocated and spent.

The Commission has published an **Internal Financial Controls for Charities Checklist**, designed to help charity trustees evaluate their charity's performance against the legal requirements and good practice recommendations set out in our guidance **Internal Financial Controls for Charities (CC8)**. Key issues covered in the checklist include:

- income received by post
- public collections
- Gift Aid
- legacies
- substantial donations
- trading
- banking and custody
- income records

## Summary of key financial controls:

**Prevent** – embed good financial controls and sound financial management as a core part of the charity’s culture:

- ensure relevant staff and volunteers are trained and understand the charity’s financial controls and their responsibilities
- segregate duties where possible. Don’t allow one person to be in charge of all aspects of the charity’s financial controls
- rotate staff responsibilities where possible

**Identify and disrupt** – be aware of risks and actively monitor and review:

- regular review of budgeting and cash flows to ascertain expected income levels, review cash received and compare to expectations
- look at comparative figures for previous periods. If there are significant variations, or no variation at all, this should be regarded as grounds for further query
- be open and transparent with donors. Trustees may discover from them that their charity has actually received more than they thought

**Act promptly and properly** to minimise damage and prevent further loss.

## D2 Expenditure fraud

Examples:

- claiming non-existent, over-inflated or inappropriate expenses or overtime
- withdrawing cash directly from the charity’s bank account for personal use using cheques which have been obtained without authorisation, or by issuing false direct debit/standing order instructions for personal gain
- misusing charity credit and debit cards or internet banking for personal expenditure
- creating false invoices, purchase orders and supplier identities in order to obtain payment from the charity for goods and services that have not been supplied
- submitting, or conspiring to submit, false applications from real or fictional individuals for grants or other charitable benefit - this may involve an employee who knows the system and how to manipulate it. In some cases individual employees may have authority to approve applications themselves
- a trustee or employee awarding a contract, or preferential terms, to a supplier in return for payments, personal discounts, commission or other benefits
- using receipts and records for a completed project to support a further application for funding from another grant-maker
- creating non-existent beneficiaries or employees for directing payments, or use of a beneficiary identity for personal benefit

## Case Study

### Forging charity cheques – lessons in robust financial controls

A charity's treasurer opens a new charity bank account for which he is the sole signatory. He uses the cheques to obtain cash, which he keeps for his personal benefit. Another trustee is concerned about the extent to which individuals have control over the charity's finances. She feels that it compromises the openness and transparency of the charity. She has become increasingly suspicious of fraud by the treasurer, and reports her suspicions to the police.

After a police investigation, the Treasurer is charged with making and using false instruments and theft. Upon learning of the theft, the Commission opens a formal inquiry and, as a precaution, freezes the new account until it is clear that there are adequate controls and safeguards in place to prevent any further loss of charity funds.

The inquiry reveals that the charity's year end accounts have not been properly completed. The Commission allows access to the frozen bank account on condition that it is operated by an increased number of signatories, and that cheques must be signed by at least two trustees.

The trustees are advised to read **Independent Examination of Charity Accounts 2007 (CC63(a))** and **Charity Reporting and Accounting: The essentials (CC15b)** in relation to the requirements for annual accounts.

This case study emphasises the importance of trustees exercising collective responsibility for their charity's finances and ensuring that there are appropriately robust controls in place, including levels of authorisation and segregation of duties. Trustees should inform the police and the Commission at an early stage if there is evidence of theft or fraud. By doing so, they fulfil their duty to act in their charity's interests. This duty also includes the requirement to review and strengthen the charity's financial control systems so as to minimise the opportunity for any recurrence of the fraud.

## Scenario

### Creating false invoices

A charity employee has full 'read and write' access to the charity's accounting system and is able to create new supplier records. The employee is responsible for making payments and maintaining the purchase ledger, and sets up a new supplier on the system including bank account details. The supplier is a genuine construction company doing work for the charity.

However, the supplier also carries out building work at the employee's home and submits an invoice for the work to the charity. There is a lack of financial control and checking by the trustees, and the employee is able to process purchase invoices for any amount and make payment. The employee enters the invoice onto the charity's purchase system and makes an online payment from the charity's bank to the supplier's account.

This could have been avoided by having suitable financial controls in place. For example:

- reducing the number of people with full access to the accounting system, and requiring a second person to approve new suppliers
- requiring additional levels of approval for transactions exceeding certain amounts
- regularly reviewing actual expenditure against budgeted expenditure and investigating any discrepancies. This will act as a deterrent against committing fraud
- for smaller charities which do not have their accounts audited externally, some level of internal audit and transaction sampling

### Prevention:

The Commission's guidance **Internal financial controls for charities (CC8)** provides information on:

- authorisation – goods and services
- authorisation – grants
- cheques
- debit/credit cards
- direct debit and BACS
- cash
- wages and salaries
- expenses
- expenditure records
- electronic banking

## Summary of key financial controls:

- Segregation of duties where possible.
- Carrying out regular bank reconciliations.
- Requiring multiple signatories for all bank account activity, including new direct debits and online banking.
- Restricting full access to all areas of the accounting system – in particular with regard to the setting up of new payees.
- Regular review of and spot checks on payroll records to ensure that they are consistent with staff movements.
- Reconciliation of supplier statements, invoices and creditor balances.
- Establishment of authority thresholds for the approval of orders and the payment of suppliers. Random checks should be carried out to ensure expenditure below key thresholds is legitimate.
- Assess whether there are any employee/trustee connections with suppliers. Any new contracts entered into with suppliers should be thoroughly assessed with regard to value for money, and trustees may wish to consider asking new suppliers to declare whether they have any business, family or other connections with charity personnel.
- Reasonable and necessary expenses may be paid to trustees and employees but there should be proper controls including a full documentary audit trail. Detailed guidance on payments to trustees can be found in publication **Trustees expenses and payments (CC11)**.

## D3 Property and investment fraud

### Examples:

- Fraudulent use of charity property - for example personal use of charity vehicles, hiring them out, siphoning off fuel, claiming for overpriced or unnecessary repairs.
- Stealing charity letterheads and personal details of trustees, staff or beneficiaries may be part of an identity theft fraud.
- Using the charity's databases or inventories for personal profit or unauthorised private or commercial use. The theft of donor details or other personal information, for example, might have implications under the Data Protection Act.
- Theft of furniture, computers, plant and other equipment. Trustees may of course allow staff to make moderate and reasonable use of charity equipment such as personal telephone calls and small quantities of stationery.
- Making grant applications on behalf of the charity with the intention to intercept the funds for personal use (see also '**D6 Fraudulent invoicing and grant applications**').
- Transferring charity funds to an organisation with which a trustee or employee is connected – for example, making an 'investment' or interest-free loan of charity funds to a company which is not in the interests of the charity and in which one of the trustees is a director.

## Prevention:

The Commission's guidance **Internal Financial Controls for Charities Checklist (CC8)** sets out financial controls for:

- fixed assets
- investments
- cash
- non-traditional
- restricted/endowment

## Summary of key financial controls:

- A list or register should be maintained of all assets, whether purchased, donated or loaned. It should show the cost (or value) of each asset and provide sufficient detail to enable them to be identified and located. For moveable items such as machinery or equipment serial numbers should be recorded, and it is usually advisable to keep photographs.
- The asset register should be inspected at regular intervals and physically checked against the assets themselves in order to ensure that they are in good repair and being put to appropriate use.
- Bank records should be reconciled with internal accounts at least monthly, and reviewed by a second person. Any discrepancies should be resolved.
- There should be a securely held list of all active bank accounts. The list should be reviewed periodically and dormant accounts should be closed.
- Payments should be subject to tiered levels of authorisation, depending on the amount. Cheques and other payment instructions should be signed by at least two individuals.
- The opening or closing of accounts should either be authorised by the whole trustee body or, if delegated, the trustees should ensure that they are informed promptly.
- Third party individuals or organisations should not be allowed to open bank accounts in the charity's name, or use the charity's bank account to receive or transfer personal money.
- There should be proper systems to approve and authorise movements between, and payments from, bank accounts.

## D4 Procurement fraud

Procurement fraud is a generic term describing fraud relating to the purchase of goods and/or the commissioning of services, as opposed to the simple theft of cash. Procurement fraud usually involves collusion between one or more members of the charity's staff and one or more outside suppliers. Examples of procurement fraud are included in this section, and the warning signs and practical advice for dealing with it are covered in sections E and F respectively.



## D5 Fraudulent fundraising in the charity's name

This usually involves misrepresenting to the public or other donors the destination of funds, or the amount going to a named charity. It can occur through:

- fundraising events and/or competitions which claim to be for charitable purposes but from which no charity in fact receives any proceeds
- cash collections either in public places or from house to house which have not been authorised by the charity and/or the relevant local authority
- collecting tins for a named charity which does not exist
- fundraisers raking off funds and handing over only a proportion of what has been collected
- professional fundraisers not being truthful to donors how much of the funds being donated will be used to pay their charges
- creating spurious email appeals or false websites, claiming that money donated through them will be given to charities which may or may not be genuine

## D6 Fraudulent invoicing and grant applications

This is likely to involve:

- making false or inflated applications to a charity to win service contracts or misapplying grant funding in breach of trust and contract
- making grant applications to a charity in respect of bogus or non-existent applicants
- setting up a false charity to obtain grant funding (and/or possibly Gift Aid relief) but with no genuine intention to provide charitable services or register with the Commission

## Case Study

Three members of a family carried out a string of frauds against grant-making charities. They began by making applications for small amounts of funding for a range of spurious projects, but once they realised that the charities' monitoring procedures were patchy and unreliable they created more elaborate, but totally bogus, projects and applied for grants of up to £60,000. The projects were so vague and nebulous that it was extremely difficult to check whether any of them had in fact been carried out.

Although some charitable work was done, enabling them to produce superficial evidence that would satisfy routine questions, the vast majority of funds were used to finance their lavish lifestyles. The project accounts could not be verified and there was little or no audit trail. Many of the expense totals were made up of unidentifiable items, unsupported by documents.

The fraudsters compounded their crimes by selling their fraud expertise to other bogus claimants. They were eventually caught when an alert grants officer noticed suspicious similarities between several different applications. Nine individuals were convicted of fraud offences and were sentenced to a total of more than 17 years imprisonment. Altogether, charities were defrauded of more than £1 million.

The investigating police officer said:

"It is important when money is obtained by way of grants for charitable purposes that the public has confidence that the money is not used dishonestly.

These individuals cynically betrayed their positions of trust by systematically stealing charitable funds raised in good faith by members of the public.

Money that should have helped those in need was used instead for their own activities. I hope that these prison sentences have sent a strong message to those intent on defrauding charities that they will be unequivocally held to account for their actions."

## D7 Identity fraud/theft

False identities may be created in order to justify fraudulent payments. Corporate Identity Fraud occurs when a bogus company is set up, or a genuine company's details are used without authorisation, to facilitate unlawful activity. For further information see the Fraud Advisory Panel's **guidance on identity fraud** and their leaflet on '**Data Security**'. Other examples of identity fraud and theft include:

- falsifying, creating or fraudulently using trustee or employee details
- provision of funds or services to non-existent beneficiaries
- using a genuine charity's name or logo in correspondence or on materials for the purpose of deception and fraudulent gain

Trustees should be vigilant against any unauthorised use of their, or their charity's, identities – for example in carrying out cash collections. If trustees believe that this is happening they should contact the Commission and the **Action Fraud reporting line**.

## Practical advice

If your charity regularly receives payments from beneficiaries for charitable services, the following suggestions could reduce the threat to your confidential client data from identity fraud:

- restrict access to account information on a 'need to know' basis, such as those responsible for processing payments
- carry out proper vetting checks on new staff, and ensure that any agency staff have been adequately checked by the agency
- ensure that your beneficiaries are clear as to what your normal business procedure is on communicating important messages to them, and that your staff follow this
- ensure that you manage your beneficiaries' personal information in line with current Data Protection guidelines - further information on this can be found on the **Information Commissioner's Office** website

## D8 Banking fraud

Although the UK banking system is regulated and generally thought of as safe, it is not immune from criminal abuse. Charities which have online banking arrangements but do not have adequate internet firewall protection may be more vulnerable to fraud on their accounts. One of the main risks involves fraudulently setting up direct debits and standing orders to transfer funds to the fraudster's own bank account. The steps that trustees can take to reduce the risk of this type of fraud are:

**Prevention** – make it clear in writing to the bank that no further direct debits should be set up without the express approval of specific named personnel. If bank account details are to be made public (for example, on appeal literature) it should be a stand alone account from which no payments can be made outside the charity.

**Detection** – ensure that regular checks are carried out on your bank statements and that they reconcile with the charity's records. Any unexplained or unusual transactions must be investigated.

**Redress** – under the direct debit guarantee scheme, wrongly paid direct debits can be reclaimed from the bank. It is then the bank's responsibility to recover this money from the person or organisation which has received it.

Go to the **BACS** website for specific advice from BACS on Direct Debit Instructions.

## D9 e-Crime

### Using charities to validate stolen or cloned credit cards

Fraudsters may use stolen or cloned credit cards to make small online donations through charity websites. Their purpose in doing this is to check whether a stolen card has been blocked or cancelled. If the 'test' donation works the card will be used for more widespread fraud.

To help prevent this, charity staff may be able to identify some of the following patterns:

- fraudsters typically donate a small, token amount, eg £1. (Note, however, that there might be a large number of relatively small donations during appeals for humanitarian disaster relief or in the approach to Christmas)
- one card may be used a number of times in succession, to check it is still unblocked
- the name of the donor may not match the cardholder's name. Some fraudsters will put random characters into mandatory name and address fields

On identifying this kind of risk it may be possible to take some preventive measures, such as:

- carrying out address checks for large donations
- checking that the CVC number (last 3 digits on the back of the card) tallies with the individual's details
- checking the internet provider address from where the donation is being attempted. Suspicious or problematic internet provider addresses can be blocked and blacklisted
- using systems such as 'Capture' which require the donor to manually input details
- reporting suspected fraudulent activity to the police and bank immediately
- having an anti-fraud email address in place so that donors can report direct to the charity any suspicious activity and possible scam emails
- ensuring that all emails sent to donors direct them to the charity's website, without using a link if possible

Fraudsters have been known to set up false charity websites, with the appearance of genuine ones, in order to obtain credit card and personal details of unwitting donors. In doing so they frequently infringe trademark, logos and UK copyright laws in addition to financial crime. The Commission advises charities to provide the following advice to donors or customers who are proposing to make donations through websites:

### **Practical advice**

Avoiding e-crime and spoof websites:

- always update your information online by using the process you have used before, or open a new browser window and type in the website address of the legitimate organisation's account maintenance page
- be wary of unfamiliar website addresses, as they may not be genuine. Only use the address that you have used before, or start at your normal homepage. Avoid unfamiliar links or pop-up screens
- always report fraudulent or suspicious emails to your Internet Service Provider (ISP). This will help to ensure that bogus websites are shut down before they can do further harm
- take note of the header address on the website. Spoof sites are more likely to have an excessively long line of characters in the header, with the business name somewhere in the string. Many secure sites have padlock symbols and other secure technology to look out for
- if you have any doubts about an email or website, make a copy of its address and send it to the legitimate business to check whether it is genuine
- if charities discover, or suspect, that they are victims of this type of scam, the Commission recommends that they contact the ISP which is hosting the spoof website and request that the site be taken down as quickly as possible

### **Phishing fraud**

'Phishing' is a type of e-crime which involves fraudsters sending emails to many, sometimes thousands, of recipients asking them to disclose sensitive or confidential information. The fraudsters are usually based overseas and may be almost impossible for the UK authorities to trace. Typically, the phishing email is made to look like a genuine email from a bank, and it may ask the recipient to confirm information such as account usernames or passwords because, it claims, there has been a security problem with the bank's computer system. In many cases the phishing email will contain a link to another website into which the recipient is asked to enter the confidential information.

Phishing scams cost fraudsters very little to set up, and they can make a profit if only a few people in every thousand actually provide information that then results in their bank accounts being emptied.

## D10 Gift Aid fraud

The Gift Aid system enables charities to reclaim the income tax that donors have paid on the amounts they donate. The most widespread type of Gift Aid fraud occurs when a claim is made to HM Revenue and Customs (HMRC) in respect of a donation that has not in fact been made. Other methods include 'carousel fraud' which involves transferring money overseas as a donation, with provisions to claim the money back shortly afterwards. Helpful measures to prevent this are covered in the 'Know Your Donor' section of Chapter 2 of the toolkit.

HMRC conducts its own checks on Gift Aid declarations, cross-checking them with appeal leaflets, membership and sponsorship forms, donor existence checks, banking records, statements and donation envelopes. If a charity conducts its own assurance checks it is much better placed to control the administration of Gift Aid claims and identify problems at an early stage.

For detailed information on keeping records in relation to Gift Aid, see **Keeping records of your gifts to charity** on the HMRC website. HMRC can also assist in the auditing and testing of charities' systems and procedures, help identify problems with claims or explain the Gift Aid process to fundraising staff or trustees.

The Finance Act 2010 introduced a new definition for tax purposes of charities and other organisations entitled to claim Gift Aid and enjoy UK charity tax reliefs. The new definition includes a requirement that to be a charity for tax purposes an organisation must satisfy the 'management condition'. For a charity to satisfy the management condition its managers must be **fit and proper persons**.

HMRC has published on its website a **basic guide for charity managers**, which includes a model '**Fit and Proper Persons**' declaration. Where charity trustees have failed to implement proper financial controls to manage the risk of fraud they may have difficulty satisfying HMRC that they are fit and proper persons.

The Finance Act 2011 introduced the tainted charity donation rules. If a donation fails all three tests set out in schedule 3 to the Finance Act 2011 then it is a tainted charity donation and tax relief is not claimable.

Trustees should also be aware that fraudsters often use more than one method to access funds improperly. So, a charity employee who is found to be operating a Gift Aid fraud may also be operating other frauds against the charity.

### **Tax Avoidance**

A number of 'tax avoidance' schemes have been disclosed to HMRC in recent years which involve charities in the arrangements. Usually these schemes involve Gift Aid or other tax reliefs, such as donations of shares to charities.

Contrary to popular belief, many tax avoidance schemes are not legal and do not successfully exploit a tax loophole. Some schemes may actually involve fraud, and in extreme cases HMRC have initiated criminal proceedings against people operating them. HMRC routinely carries out detailed investigations into tax avoidance arrangements, and if a charity participates in such a scheme it can expect to be included in any HMRC enquiry work.

Some alleged tax avoidance schemes are themselves frauds against the participants in the schemes, which can include charities. These schemes involve large upfront fees being paid to the people arranging them, who will then disappear, leaving the scheme users to tidy up any mess with HMRC.

With the introduction of the tainted charity donation rules it is important that charities are aware of the three tests to apply and alert HMRC of tainted donations and do not claim gift aid tax relief on them. Charities are potentially liable if they are a party to a tainted charity donation and were aware that the donation was a necessary part of the arrangements that were intended to afford the donor or linked person connected with the donor a financial advantage. The liability is to repay any tax relief claimed on the tainted charity donations.

The HMRC website has a '**Spotlights**' section, which provides information on what HMRC considers to be particularly inappropriate tax avoidance schemes, some of which involve charities.

## D11 Share purchase and investment fraud (boiler room fraud)

A 'boiler room' is a bogus stockbroking company, usually based overseas, which cold-calls investors and pressures them into buying worthless shares. Callers are usually well spoken and knowledgeable. They are also persistent, and might call a victim several times with offers of research, discounts on stocks in small overseas companies, or shares in a firm that is about to float.

Boiler rooms make their money in one of two ways: by simply taking money and walking away, or selling shares at vastly inflated prices and with exorbitant dealing charges. In addition, investors are sometimes encouraged to sell previously highly regarded 'blue chip' company shares, such as banks and financial institutions and to invest in green or new technology shares marketed by the boiler rooms, or even to take out loans to fund new investments. Potential investors are promised profits that never materialise.

Many victims of boiler room frauds are over the age of 50, so this guidance may be of interest to trustees of charities providing advice to and working closely with those beneficiaries. But charities themselves may also be targeted by boiler rooms seeking to persuade trustees to invest charity funds.

The National Crime Agency (NCA) has published a one-page **guidance checklist** which is intended to assist in protecting against this and other types of fraud.

Further explanation of boiler room fraud can found on the **City of London Police** website.

## D12 Mass market fraud

This covers a substantial variety of frauds which rely on letters and emails to reach large numbers of people. In some cases fraudsters pose as legitimate businesses and send what appear to be genuine letters from established companies. These can include customer account details and their current payment information. The letters instruct, say, tenants to amend existing records and send their normal payment to a different bank account, which is actually controlled by the fraudster. This account may be held with the same bank or a different one.

Any charity which has large numbers of beneficiaries who regularly and routinely make electronic payments for services to the charity may be vulnerable to this type of scam.

## D13 '419' frauds

These frauds take their name from the section of the Criminal Code of Nigeria, where they are thought to have originated. They can also be known as advance-fee frauds.

Charities (as well as other organisations and individuals) are contacted by letter or email with an invitation to assist the sender in recovering a large amount of money, usually, but not exclusively, from a bank account originating in Africa. The recipient is promised a large share of the money recovered. There is no money, of course; the aim of the scam is simply to obtain the charity's bank account details or letterheads that can be used for fraudulent activities, or to obtain money from the charity under the pretence that it is needed to assist in the process of recovery.

A variation on the scam is a message informing the recipient that he or she has been identified as having an entitlement to a large sum of money, but will have to pay handling or administration costs before the money can be remitted – this is the 'advance fee'. Not only does this invariably result in the loss of any money sent, but the fraudster is able to obtain bank account information through the cheque or bank transfer.

This activity is on the increase and it is evident that charities remain a prime target. Our current advice is that any such approaches should be ignored completely and that the recipient should make no contact with the sender.

## E What are the Warning Signs for Fraud?

### Short answer

There is no definitive list of what to look out for. However, we have set out below some questions that may help trustees and their charities.

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### In more detail

This section poses some questions that may help trustees and managers to recognise the early signs of fraud. It is important to bear in mind that a 'yes' answer to any question – or even more than one – should not be regarded as an indication that fraud is taking place. Rather, it should prompt trustees to consider whether their charity's financial control systems and procedures are adequate, and to revise them where appropriate. A high number of 'yes' answers, or repeated occurrences of a small number, should be investigated appropriately, in the context of the charity's size, activities and financial structure. Trustees should use their judgement and their knowledge of their charity to determine the appropriate extent and depth of investigation.

### E1 Accounting and transactions

- Are there unusual discrepancies in accounting records and unexplained items on reconciliations?
- Are many financial documents - such as invoices, credit notes, delivery notes, orders etc - photocopies rather than originals? This might indicate counterfeit documents created to support bogus account entries
- Do alterations or deletions frequently appear on documents? Again, this might be evidence that documents have been falsified to support bogus account entries
- Have any documents or account books gone missing?
- Are there high numbers of cancelled cheques?
- Are common names unexpectedly appearing as payees?
- Are there any duplicated payments or cheques?
- Do transactions take place at unusual times with irregular frequency, unusual or 'round' amounts, or to unknown recipients?
- Are suppliers regularly submitting invoices electronically and are these in non-PDF format that can be altered?
- Are there any unexplained variances from agreed budgets or forecasts? Have audits highlighted any inconsistencies or irregularities?
- Are unrestricted reserves being spent without proper prior authorisation?
- Have restricted funds been used for general purposes?
- Is there an asset register or inventory, and does it match up with equipment physically on hand?
- Are payments made to individuals or companies with family or business connections to a trustee, and perhaps authorised by that trustee? This might indicate collusion
- Is there any indication that income is being under-reported or expenditure being over-reported?



- Is there any misdescription of purchase and expense items in the accounting system?
- Can cash withdrawals be supported by documents and a full audit trail from approval to expenditure?
- Have any blank cheques been pre-signed?

## **E2 Changes in behaviour of trustees or staff who handle the accounts**

- Are vague responses being given to reasonable and legitimate queries and/or are those queries being left unexplained, or taking a long time to resolve?
- Is there any reluctance by a volunteer, member of staff or trustee involved in handling finances to accept assistance? Does a single member of staff or trustee have control of a financial process from start to finish with no segregation of duties?
- Is any member of finance staff working unsociable hours or working from home without reason? Are there any noticeable changes in behaviour or work patterns, such as a reluctance to take holidays or over-protectiveness of work?
- Has the format of financial information presented to the trustee board or senior managers suddenly changed or become more complicated or difficult to understand?
- Are there inconsistent, vague or implausible responses to questions about the accounts or accounting records?
- Do trustees and members of finance staff always comply with financial policies and procedures?

None of the above warning signs are necessarily indicative of financial abuse on their own, but if one of them is happening frequently or several in combination, further scrutiny may be warranted.

## F What practical steps can trustees take to deal with fraud?

### Short answer

All charities are vulnerable to fraud and financial crime and those that have weak internal financial controls are likely to be at even greater risk. Trustees need to consider applying, depending on the size of their charity and the complexity of its operations and administration, an appropriate set of financial controls and, for many charities, put in place a suitable range of anti-fraud measures to protect their charity's funds. The larger and more complex a charity's operations and administration, the more likely it is the trustees will need to implement a broad set of anti-fraud measures.

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### In more detail

Trustees may find some of the following anti-fraud measures are appropriate to use or adapt for their charities. Such measures will not be necessary or relevant for all charities but trustees should use their judgement and their knowledge of their charities to decide which ones are appropriate and proportionate for the context of their charity. Any anti-fraud measures adopted should be flexible enough to cope with change and regularly reviewed to ensure that they cover all risk areas and remain generally fit for purpose.

### F1 Anti-fraud measures:

This list of measures ranges from those (at the top) which all charities should implement through to those (at the bottom) which are probably necessary and proportionate only for larger charities. The larger the charity, the more complex its operations and financial transactions or higher the risks of fraud or other financial abuse, the more trustees will be expected to do to ensure they protect the charity and meet their legal duties and responsibilities. Trustees should use their judgement and knowledge to decide how far down the list it is appropriate for their charity to go. Remember to review these measures at regular intervals, and especially when the charity expands or changes its activities.

- implementing robust financial controls and governance measures - relevant staff should be made aware of the controls and measures in place
- ensuring there are clear procedures for reporting fraud to the police and to the Commission
- ensuring basic records of all income and expenditure are kept and receipts, invoices and supporting documents are kept
- increasing awareness amongst trustees, staff and volunteers of the fraud risks within their charity
- checking that financial controls are not being overridden, by-passed or ignored, whether by trustees, staff or volunteers - override arrangements such as pre-signing blank cheques can significantly compromise financial controls
- restricting and closely monitoring access to sensitive information
- using tiered authority and signature levels for payments, where possible
- regularly reconciling bank statements and other accounts, carrying out spot-checks on books and records
- periodically auditing processes and procedures
- setting out clearly defined roles for trustees and staff -these should include segregation of duties and delegation of financial responsibilities with appropriate report-back procedures

- recording all instances of suspected and confirmed instances of fraud, which will help your charity spot emerging patterns, identify areas of risk, measure losses and build an evidence base if fraud is confirmed as having occurred - a fraud recording 'tool' is available (the file is a template spreadsheet, which can be customised to fit the needs of your charity)
- clearly communicating fraud policies and procedures to all staff, volunteers and trustees through team meetings and as part of an induction programme for new people - training will be needed to keep up to date with new risks and changes in the law
- appointing or designating staff, at appropriately senior levels, to have special responsibility for fraud prevention policies
- introducing a whistle-blowing policy and including fraud as one of the key threats on the charity's risk register
- controlling access to buildings, assets and systems using secure or unique logins and passwords
- introducing an anti-money laundering policy
- aligning Human Resource policies and procedures with fraud and financial crime issues
- developing a fraud risk assessment process that takes into account the types of fraud to which the charity is most exposed, having regard to its structure and activities
- having a clear response plan in case fraud occurs - it should outline how investigations will be conducted and by whom, the people and organisations that need to be notified, and the process for handling internal and external communications

## F2 Implementing robust financial controls

Legal requirement: trustees must ensure that their charity has financial and banking procedures in place which are appropriate to their charity and its activities and are fit for purpose. They must also monitor the application of those procedures so as to ensure they remain fit for purpose, and ensure that they obtain and understand financial reports upon which they base their management decisions. Not doing this may be regarded as failing to exercise the reasonable care expected of trustees.

Internal financial controls are essential checks and procedures that help charity trustees to:

- meet their legal duties to safeguard the charity's assets
- administer the charity's finances and assets in a way that identifies and manages risk
- ensure the quality of financial reporting, by keeping adequate accounting records and preparing timely and relevant financial information

The operation of a system of effective financial controls should be a priority for charities at all times, but it becomes even more important during periods of financial difficulty for the charity, or for the economy in general. An effective framework provides trustees, charity employees and volunteers with the boundaries within which they should operate and also gives beneficiaries and the public confidence that their charity is operating effectively.

Trustees should ensure that any staff and volunteers working for the charity understand how its financial controls are to be properly implemented. For larger charities subject to an external audit, the correct operation of internal controls is something about which the auditor will need to gain assurance in order to produce an opinion on the accounts. Some audits simply acknowledge paper trails rather than verifying actual transactions. In these cases, the risk of financial crime or fraudulent activity being missed is greater.

Trustees are individually accountable for the performance of their duties and must collectively make decisions about internal financial controls. In some charities, trustees may be able to delegate some aspects of financial management to one or more trustees or employees, but they remain collectively responsible and should ensure that the delegated tasks are properly carried out. This will involve setting out a clear description of the work to be done and arrangements for regular and adequate report-back. Trustees should ensure that the decisions they make about financial controls and delegation are fully recorded.

All charity trustees are required by law to keep accounting records sufficient to show and explain all of its transactions. Smaller charities, as a minimum, should maintain simple income and expenditure records supported by invoices, receipts and bank statements. Larger charities with more complex activities and structures will need to have accounting systems that are appropriate for their purpose.

Every charity needs to operate a bank account of a kind that best meets its individual needs. For some charities this will mean having more than one account, and possibly accounts in more than one country. As a matter of general principle cash transactions should be kept to the absolute minimum, but all transactions, whether through the bank or in cash, must be properly authorised and authenticated with appropriate supporting documentation.

For detailed information on implementing internal financial controls, management of cash, income, purchase payments, assets and investments, see the Commission's guidance **Internal Financial Controls for Charities (CC8)**, which includes a self-checklist.

By defining, implementing, and reviewing a charity's controls, the risk of fraud and financial crime is reduced. However, trustees and managers should be alert to new risks and ensure that their charity's financial controls remain fit for purpose.

### F3 Human resources and recruitment

For those charities that have staff or volunteers, effective fraud prevention starts with robust HR policies and procedures. For smaller charities this might mean nothing more than checking references for new staff and ensuring that they are aware of the financial controls in place. For larger charities with more staff and greater levels of income and expenditure, a more comprehensive recruitment and selection process will be appropriate. Introducing measures to inform decisions made on recruitment and staffing issues will help to limit exposure to fraud and financial crime. The following measures may be helpful when reinforcing HR procedures:

- a self-declaration form for staff to confirm that they do not have an unspent conviction for fraud, theft or other relevant offence (as a minimum for smaller charities)
- performing a credit check or screening on employees and volunteers who are handling finances or dealing with cash - prospective and existing employees or volunteers must be informed they will be subject to screening and have signed a consent form and data protection statement
- checking the references of previous employers when recruiting
- setting out the charity's policies and procedures covering anti-money laundering, fraud and reporting requirements (including whistleblowing) as part of a staff and trustee handbook
- assessing staff and trustee awareness of charity policies and procedures as part of the performance appraisal and review process

## F4 Financial control policies and their implementation:

It is crucial that financial control procedures are understood and used by trustees, staff and volunteers, and that they reflect what happens in practice in the charity. Developing a culture in which respect for internal controls as an integral part of the charity's operation is important. Regular communication with staff on financial control policy and procedures will help to embed an organisational culture that focuses on effectively addressing risk and safeguarding the charity. Staff, volunteers and operational partners should be made aware of charity policies and procedures as part of their induction and training processes.

The larger and more complex the charity the more likely it is that it will need to have a documented financial control policy, whereas smaller charities may rely on their practice and procedure being generally known. Either way, it is important that a charity's policies and procedures are understood and applied. Amongst the key points to be covered by policies are: who has authority to commit expenditure, and how much; how cash is handled and accounted for; and who is responsible for maintaining the day to day records and producing periodic financial reports.

Policies and procedures introduced to safeguard against fraud and financial crime should be subject to regular reviews, as they can only continue to be effective if they take into account changing internal and external factors which may impact upon the charity. Where appropriate, trustees should ensure that staff receive adequate refresher training when systems are changed or updated. **Section H** of this Chapter includes practical advice on what trustees can do in response to fraud.

## F5 Fraud policy

Not every charity will need to have a fraud policy. However, the larger the charity or complex its operations the more likely that this will be sensible and/or necessary. If trustees decide it is appropriate to develop and implement a fraud policy for their charity, this can usefully outline the charity's attitude to fraud and set out responsibilities for its prevention and detection. These may include:

- setting out what fraud and theft means within the context of the charity
- how the charity expects to deter fraud and how it will react to different types of potential fraud
- key responsibilities of senior staff and trustees in preventing and detecting fraud and in co-operating with any investigations
- details of any whistleblowing plan, including those to whom charity representatives can report concerns and suspicions confidentially
- the procedures for reporting to the police and Charity Commission suspected incidents of fraud and theft
- how to respond to allegations of fraud, as part of a Fraud Response Plan
- how the charity assesses its exposure to fraud risk, including details of its fraud recording system, an estimate of how much has been lost as result of fraud in the past, and an opinion of how much could be at risk

## F6 Developing anti-fraud measures

Management meetings, at which trustees and staff can share experiences and ideas, are a useful way to encourage the development of good anti-fraud procedures and decision-making. Preparation for and conduct of meetings might include:

- circulating financial reports and related papers in advance to trustees and managers so they have time to consider and, if necessary, check the financial information
- ensuring that all decisions on financial controls and policies are accurately minuted
- allowing sufficient time to discuss finance reports and related decisions on financial controls
- providing training for new and existing trustees on how to understand the charity's accounts and financial reports
- carrying out regular budget comparisons with previous years for benchmarking purposes
- producing statutory accounts as soon as possible after the financial year-end, as this could highlight any deviations in income and expenditure - an early analysis may highlight any unusual and potentially fraudulent activity
- encouraging open discussion and questioning - if something doesn't look or seem right to the trustees then it should be properly investigated

## F7 Whistle-blowing policy

A whistle-blowing policy should set out the procedures to be followed where there are concerns about fraud or financial crime. These policies are often wider than just about fraud or financial crime. The policy would normally include:

- confirmation that the charity actively encourages its staff and volunteers to report concerns and suspicions about fraud or financial crime in the charity, and it will take them seriously
- a statement on confidentiality/ anonymity and support
- advice for staff and volunteers on when to speak to a line manager or other senior staff
- details of how to report concerns (eg about a trustee) to the charity's senior staff or trustee body

# G Practical advice on dealing with money laundering

## G1 How can charities reduce the risk of money laundering?

### Short answer

Internal financial controls are essential checks and procedures that help to safeguard against money laundering. It can be hard for a charity to detect that it is the innocent victim of money laundering, so an initial assessment of the type of money laundering risks that might affect the charity's activities, and what this would mean to the charity's finances and reputation, should help to determine the level of anti-money laundering procedures that is appropriate.

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### In more detail

There have not been any proven instances of money laundering involving a charity. However, it could happen and it is therefore important that trustees take reasonable steps to prevent the charity being used for money laundering purposes and know what to do if they have any suspicions. This kind of abuse usually involves the receipt of funds which are then paid out, perhaps in different amounts, to different people and in different forms and currencies. To help prevent money laundering, charities should assess the levels of risk to which they are exposed and adopt appropriate anti-money laundering procedures. These might include:

- due diligence checks on the donor, in accordance with the **'know your' principles** in Chapter 2 of the toolkit, taking into account factors such as size of donation, source of funds and donor's location
- further verification checks when the donor is considered higher risk
- ensuring that staff know how to recognise the warning signs of possible money laundering
- robust methods for recording and documenting donations and grants
- protocols for monitoring the effectiveness of the money laundering procedures

In order for the controls to be effective, all relevant staff will need to be adequately trained on the charity's policy on accepting donations and loans. Trustees must ensure that robust methods for recording and documenting donations and grants are in place, and that there are procedures for monitoring the effectiveness of the money laundering controls. Decisions to refuse or accept donations should be recorded in writing. This will be important to show that trustees have acted responsibly, have given due consideration to any risks and can demonstrate the integrity of the decision-making process. If there is any reasonable doubt or suspicion about the source of funds coming into the charity trustees should consider whether to refuse it and inform the relevant authority.

Some donors may seek to attach conditions to their donations. Whilst charities are free to accept gifts in these circumstances, they should consider whether the condition is compatible with the purposes of the charity as well as their current priorities and planned activities. Donations subject to unusual conditions or unsolicited offers of loans to charities *may* be intended to facilitate money laundering or financial crime. For further guidance, see the **'Know Your Donor'** section in Chapter 2 of the toolkit and the Commission's publication **Charities and Fundraising (CC20)**.

These risk-based measures should be documented and can form part of the charity's general policy on accepting and refusing donations. They can be a constructive part of general risk assessment procedures required under the **Statement of Recommended Practice (SoRP) 2005**.

## G2 What are the warning signs for money laundering?

### Short answer

There is no definite list of common signs. However, some examples are set out below.

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### In more detail

The following situations should be considered critically as possible indications of money laundering, especially if more than one of them occurs or they occur regularly.

- large unexpected donations from unknown individuals, organisations or other sources new to the trustees
- donations conditional upon particular individuals or organisations, who are unfamiliar to the charity, being engaged to carry out work
- money being offered as a loan to the charity for a period of time after which it is to be returned or sent elsewhere. Typically, the charity is allowed to retain the interest earned or some other small sum in return for agreeing to take part in the arrangement
- similar 'loan' arrangements in which money is received by the charity in a foreign currency but is to be returned to the donor in sterling
- unexpected or unexplained requests for the repayment of all or part of a donation
- requests for assistance in recovering large sums of money where the charity is offered a percentage of the amount recovered. The charity might be asked to provide its bank account details or permit the donor to use its name or letterheads on the pretext that it is a necessary part of the recovery process
- unsolicited offers of short term loans of large cash amounts, repayable by cheque or bank transfer, perhaps in a different currency
- being asked to allow transactions to pass through the charity's bank account
- offers of goods or services which seem very expensive, unusual or carry high administration and other charges

## G3 What is a Risk-based approach?

Adopt a risk-based approach to limit potential for money laundering:

- **Identify risks** – weigh up money laundering risks; their scale and possible impact on your charity
- **Reduce risks** – apply the preventive measures set out above
- **Monitor risks** – collect data, re-assess risks, modify and introduce new systems, criteria and procedures to meet increased or different risks
- **Keep records** – write down your charity's policies and procedures, and regularly review and update them

For information on terrorist financing and reducing the risks of it occurring, see **Chapter 1 of the toolkit – Charities and terrorism**.



# H Fraud action and response plan

## H1 Why should a charity have a fraud action and response plan?

### Short answer

If trustees and staff are aware of what to do if a fraud occurs or is suspected, they have a much better chance of reducing any potential negative impact. A fraud action and response plan can help with this and can also act as a deterrent to fraud in the first place. For very small charities, such a plan may not be necessary. For others, a fraud action and response plan can be a relatively simple set of procedures; trustees of larger charities with a wider range of activities or more complex operations are likely to need a plan and for it to be more comprehensive.

As well as the obvious financial impact of fraud it is important not to underestimate the emotional impact of being a victim. If a charity has an action plan in place, which addresses both aspects, trustees and staff will be in a much better position to deal with the full impact and consequences of fraud.

### Case Study

#### Responding to fraud quickly

“A substantial part of our fraud took place over an eight week period between two board meetings. If it had continued at the same rate for another eight weeks before the trustees detected and dealt with the breach in financial procedures, the charity would not now be here. Still, the devastation for this small charity has been immense.

There remains a profound sense of shock that over twenty years’ work and a national reputation came so close to being wiped out within such a short time-scale.”

**From a trustee of charity that reported fraud to the Commission in January 2010 under the RSI regime**

### Case Study

#### Recovering from fraud

“The initial reaction is confused, to say the least. All ‘normal’ activity seems to stop, as you try and discover just how much money has been stolen, how the fraud was perpetrated, and the extent of it.

We were very fortunate in having Board members who knew exactly what to do, but even then it can be a struggle to keep a united front and take unanimous decisions in how the fraud is dealt with and ensuring your charity survives.”

**CEO of a charity that was a victim of fraud in 2009**

## In more detail

A Fraud Action Plan often begins with a statement, making it clear that the charity will not tolerate fraud, abuse or indeed other financial abuse of the charity. It might also contain the following:

## H2 What is covered by the plan?

- An explanation of the types of financial activity that the Plan is intended to cover
- The charity's Fraud Management Policy, which may also be contained within the trustees' annual report
- A statement of the sanctions that will be applied if trustees, employees or volunteers take part in fraudulent activities. These may include dismissal, prosecution and civil action to recover assets and funds

## H3 Roles and responsibilities

- Setting out clear roles and responsibilities for trustees and staff and provide training.
- The provision of training in fraud recognition. For smaller charities, appropriate training is likely to be simple and straightforward.
- Identifying additional resources and external assistance that might be needed, such as legal advice and/or HR expertise.

## H4 Gathering evidence, and Fraud Recording Tool

- First, contacting the police and seeking their advice on whether they intend to investigate. If so, the charity might need to defer its own internal investigation.
- Setting out a framework for the conduct of any internal investigations.
- Considering (with legal advice where necessary) the timetable and framework for carrying out witness interviews.
- Keeping an open mind, bearing in mind that any incorrect accusations could be disastrous for the charity and have a serious impact on the individual(s).
- Obtaining professional advice from the charity's auditor or independent examiner as to whether an audit or specific review should be carried out immediately.
- Where necessary, obtaining copy cheques and bank statements from the bank, checking for evidence of fraud or mismanagement (such as forged signatures or failure to comply with mandate) and reconciling payments with invoices etc.
- Packing-up any computerised accounting information and preserving emails or data that may be needed as evidence. Seek legal advice before accessing the computer of an individual suspected of fraud because it might compromise any action the charity decides to take.
- Maintaining a simple system for recording suspected or confirmed instances of fraud. This will help a charity to identify areas of risk, spot emerging patterns, and build an evidence base if fraud is confirmed as having occurred. A **fraud recording 'tool'** is available. The file is a template spreadsheet, which can be customised to fit the needs of your charity

## H5 Human Resources Procedures

Charities employing several staff will usually have some form of policy and procedures covering employees' terms and conditions and various aspects of human resource management. Investigations involving staff suspected of committing fraud will need to give consideration to the following relevant aspects of such policies and procedures:

- they need to cover the terms of investigatory interview with witnesses - legal advice may be needed about interviewing, employment law, the Human Rights Act and the Data Protection Act
- if a trustee is suspected of committing the fraud, the charity's governing document should be checked for any rules or procedures in relation to possible suspension or removal
- if the fraud appears to involve a member of staff, consideration must be given to employee status, contractual rights and staff disciplinary processes

## H6 Security

- if the investigation results in the suspension or departure of a trustee or member of staff, steps should be taken to make sure that he or she can no longer access office systems - any password to which he or she had access should be changed, and any charity credit or debit cards or security passes in his possession should be cancelled
- any other property in the possession of a departing member of staff or trustee (such as cars, computers, official stationery or other items) should be recovered as quickly as possible
- review the adequacy of internal financial and security controls to determine whether any immediate changes are needed to prevent further loss

## H7 Reporting

- Keeping the trustee body informed about the investigation, and debriefing staff appropriately. Everybody within the charity will be affected to some extent and will want to know what's happening. The extent and depth of information that can be released will naturally depend upon the circumstances and nature of the fraud.
- It may be difficult for an internal investigation to decide whether there is evidence of crime rather than procedural irregularity, but trustees will need to consider the findings of the investigation and the weight of evidence. Based on this, they will have to decide whether to report a possible fraud to the police and the Commission, if they have not already done so. The trustees may have to do this in order to complete the charity's annual return, which requires them to declare that they have **reported any serious incidents** to the Commission. Consideration should also be given to informing the charity's auditor and any other relevant regulatory body.

## H8 Communications strategy

- Setting out lines of communication with other trustees and possibly convening an emergency board meeting, ensuring that a record of decision-making is kept. Trustees will need to consider the likelihood of matters becoming public and the impact that will have on the charity, but also bear in mind the importance of maintaining neutrality before the outcome of any court case(s)

- Setting out a strategy and designating responsibility for managing and communicating information in a way that complies with the law (for example, in relation to confidentiality and data protection), and protects the charity's reputation. Consider nominating single points of contact for dealing with relevant bodies, the press etc, and ensure that individual trustees and members of staff do not speak publicly about matters
- Drawing up a timetable for communicating with other stakeholders, such as donors and patrons
- Consider whether to issue a general statement to donors, funders and patrons, perhaps in the charity's accounts. A risk assessment is a good starting point in determining whether a public statement is in the best interests of the charity. Any statement may have a bearing on a police investigation, so it is important that legal advice is sought first. However, by being open, transparent and accountable, and showing that robust action has been taken, any negative impact on the charity's reputation may be significantly reduced following an occurrence of fraud.

## H9 Assessment and recovery

- Depending on the extent of loss and the complexity of the charity's finances, carrying out a full financial impact assessment to determine whether the charity is solvent and remains able to meet its service delivery commitments. Assessing the proportion of restricted and unrestricted funds and ascertaining whether it is possible and/or necessary to release restricted funds
- Where appropriate, in consultation with the charity's auditor or independent examiner, decide how any financial losses will be accounted for in the charity's annual accounts
- Judging whether the charity needs to apply for an immediate funding grant or begin additional fundraising activity
- Having taken any relevant employment law advice, deciding whether it is necessary to redeploy staff and/or recruit new staff to replace those who have left as a result of the fraud investigation
- Carrying out a comprehensive review of financial controls and procedures, including immediate action, where appropriate, to prevent any recurrence of the fraud
- Review and update HR procedures, including the staff handbook and other governance manuals. Ensure that any system weaknesses are remedied
- Consider whether it is realistic and cost effective to begin action to recover any losses. It is likely that trustees will need to take legal advice before reaching a decision. Litigation can be expensive, uncertain and lengthy, and in some cases will not be the best option for the charity.

## H10 Evaluating and acting on the lessons learned

Trustees may be able to introduce better policies following an instance of fraud, and ask themselves important questions to improve the charity's internal financial procedures. Useful questions may include:

- Have the internal financial controls been reviewed and updated as a result of what happened?
- Have recruitment processes and other HR procedures been reviewed and updated as a result of what happened? A periodic review of these policies and procedures should be ongoing.
- Have trustee role descriptions, handbooks and general governance procedures been reviewed and updated as a result of what happened?
- Is any disciplinary action appropriate in relation to breaches of controls by remaining staff?

- If any trustee or member of staff has overridden a financial control which contributed to the fraud has this been appropriately addressed by the trustee body? Are the trustees confident that it cannot happen again?
- Are trustees satisfied that any improved control and security procedures have been implemented throughout the charity, including branches?
- Is there a programme of periodic system reviews, and is it being complied with? Trustees should not wait until a fraud occurs before checking the integrity and suitability of their charity's policies and internal control systems.

## Case Study

### Lessons learned following fraud

"The first 6 months following the fraud were the most difficult in the charity's history. We all wanted to resign and hand the charity over to a new board. However, some positives are beginning to emerge. The charity has now undergone something of a long overdue 'MOT' that we had never acknowledged needed doing. Not only have we dealt with all the actions that were immediately necessary following the fraud, but the whole incident opened our eyes to take a fresh look at just about **everything** about the charity. We have started to make additional changes in many other ways and have taken care to document the processes we have been through to ensure all lessons learned are passed on to future board successors. This renewal process is still ongoing.

The charity is now moving forwards with a fresh energy, revised strategic direction and a much sharper focus. I can honestly say that despite the negative impact that a fraud potentially has on a charity and its reputation, our stakeholders can rightly and deservedly have an even greater confidence in the charity following our thorough internal overhaul.

Of course we wish that the fraud had never happened. Perversely, the fact that it did at this point in the life history of this charity, has enabled this organisation to move forwards in a far stronger and healthier condition than previously. Not only has this charity survived fraud, but it now has every hope of thriving much better in the future".

**Trustee of a charity that experienced fraud in 2009.**

# J Reporting fraud and money laundering

## J1 When should a report be made to the police?

### Short answer

If trustees suspect a crime has been committed or the charity's money or help is being used for illegal purposes, they must report their concerns and the suspicious activities to the police and appropriate authorities as soon as possible and ensure they obtain a crime reference number.

Legal requirement: charity trustees, employees and volunteers are also under a specific positive legal duty to report their suspicions of terrorist financing offences to the police. If they do not, they may commit a criminal offence.

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### In more detail

A charity's responsibility is not to investigate or determine criminality. However, if a charity suspects a crime has been committed, it needs to report the concerns and suspicious activities to the appropriate authorities, including the police.

Legal requirement: in some cases trustees must report criminal activity affecting the charity. The more serious the crime and impact on the charity and its funds, the more difficult it is to see how trustees could otherwise discharge their duties to act in the best interests of the charity and their duty of care to protect the charity, its assets and beneficiaries.

The National Fraud Authority, police and other agencies involved with fraud have set up a national reporting centre – Action Fraud - specifically dealing with fraud and fraud related crime. (**J3 Reporting Crime to the National Fraud Reporting Centre** )

The specific positive legal duty on trustees to report suspicions of terrorist financing offences to the police is in UK counter terrorism legislation. The **Counter-Terrorism Act 2008** amended a section of the Terrorism Act 2000 which creates a positive legal duty under section 19 of the **Terrorism Act 2000** to disclose information about certain possible terrorist offences to the police.

Legal requirement: the duty is to disclose to the police a suspicion or belief that someone has committed an offence under sections 15 to 18 of the Terrorism Act 2000 (which are offences connected with terrorist financing). The duty applies if the suspicion comes to his/her attention in the course of a trade, profession, business or employment. This duty applies to office-holders (such as trustees of a charity), individuals on a formal work experience programme or training (for example an intern) as well as volunteers. It is therefore important that charity trustees know about this. Where a 'belief or suspicion' arises in 'the course of a trade, profession, business or employment', a person will commit a criminal offence if he/she does not disclose this to the police as soon as possible. See further C3 Terrorist Financing and **Chapter 1** of the toolkit on terrorist financing.

There are also specific reporting requirements regarding money laundering (see **J6**).

## J2 When should trustees report to the Commission?

### Short answer

The Commission requires charities to report serious incidents. A serious incident is an adverse event, whether actual or alleged, which results in or risks significant:

- loss of a charity's money or assets
- damage to a charity's property
- harm to a charity's work, beneficiaries or reputation

The most common, but not the only, type of incidents are frauds, thefts, significant financial losses, criminal breaches, cyber attacks such as phishing, terrorism or extremism allegations, and safeguarding issues.

If a serious incident takes place, the trustees need to report to the Commission what happened using the email [RSI@charitycommission.gsi.gov.uk](mailto:RSI@charitycommission.gsi.gov.uk) and explain how they are dealing with it. This is the case even if they've already reported the incident to the police, donors or another regulator.

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### In more detail

Legal requirement: As a matter of good practice, all charities, regardless of size or income, should report serious incidents to the Commission promptly. If a charity's income is over £25,000, the trustees must, as part of the Annual Return, sign a declaration confirming there were no serious incidents during the previous financial year that should have been reported to the Commission but were not. If incidents did occur, but weren't reported at the time, the trustees should submit these before they file their charity's Annual Return, so they can make the declaration. Until all serious incidents have been reported, trustees will not be able to make this declaration, or complete the Annual Return, which is a statutory requirement under section 169 of the Charities Act 2011. Be aware also that it's an offence under section 60 of the Charities Act 2011 to provide false or misleading information to the Commission.

If trustees fail to report a serious incident that subsequently comes to light, the Commission may consider this to be mismanagement, for example, where the trustees have failed to manage the risks properly and breached their legal duties. This could prompt regulatory action, particularly if further abuse or damage has arisen following the initial incident.

### What to report

Trustees should report incidents of fraud to **Action Fraud**, ensuring they get a crime reference number and making clear that they're representing a charity.

Trustees should report theft (or suspected theft) to the police and obtain a crime reference number. If they've already reported a serious incident to the police or another regulator, they should still make a report direct to the Commission, as its regulatory interest is different from that of other agencies.

There is no minimum loss figure that should be reported - trustees need to decide whether incidents are serious enough to report, in the context of their charity and its income, taking account of the actual harm and potential risks posed. However, the higher the value of the loss, the more serious the incident is likely to be, indicating it should be reported. Other factors that are likely to indicate seriousness include:

- where the person accused of taking the funds/ assets is involved in the charity, particularly if he/she holds a senior position or has responsibility for financial management, such as the CEO or Treasurer on the board of trustees
- where the person accused is involved with other charities
- numerous incidents have taken place that appear connected

- a single incident has been committed over a long period of time
- a number of separate incidents have occurred over a short period
- the funds lost/at risk are from a public appeal, collection or grant
- if there's public interest, such as significant media reporting
- where the charity has taken serious action against an individual, such as disciplinary procedures or suspension

Be aware that 'low value' incidents can pose serious risks - these may be a sign that individuals are trying to avoid detection. Repeated or frequent incidents can be symptomatic of weak financial controls and poor governance, leaving a charity more vulnerable to fraud or theft. Therefore, if there have been repeated incidents of low value fraud or theft in a charity, the Commission would expect trustees to report this.

Trustees should also inform the Commission of any actual or suspected criminal activity within or involving the charity as soon as possible after the incident. Trustees must do so where an individual may have committed an offence that calls into question their suitability to be involved in or connected to a charity, whether as a trustee, member of staff or volunteer. Where there is evidence or reasonable grounds to believe that criminality has taken place, and the trustees have failed to report this to the police, then the Commission has a duty to do so.

More detailed **guidance** is available.



### J3 Reporting crime to the National Fraud reporting centre

The **National Fraud Authority (NFA)** is an executive agency of the Attorney General's Office. It works to bring together the efforts of a large number of counter-fraud bodies across the private, public and voluntary sectors, who are involved in gathering intelligence and taking action against fraudsters intent on stealing our money and our identities.

The NFA works with and through these bodies, identifying commonly agreed priority target areas and forming alliances to deliver an effective response to fraud. This helps to remove barriers to effective information sharing and counter-fraud action, and find new ways of approaching the issues around fraud.

The NFA works closely with the **National Fraud Intelligence Bureau (NFIB)**. The NFIB employs analysts from both law enforcement and private sector backgrounds to sift through raw intelligence, searching for distinct patterns of fraudulent activity and behaviour. Once a trend has been spotted, such as identifying a persistent offender, an intelligence report will be dispatched to the relevant police forces to be used in their investigation.

Members of the public, including charities and their trustees, are able to provide the NFIB with information about fraud by using the newly developed national fraud reporting centre - Action Fraud.

**Action Fraud** is run by the NFA and is the central point of contact for information about fraud and how to report it. You can call 0300 123 2040 and talk to a fraud specialist who will provide help and advice. Action Fraud also has an **online fraud reporting** service which is available 24 hours a day, and their website includes a comprehensive **A to Z of fraud types**, providing information about how these frauds operate and how to report them.

### J4 Other ways to report fraud

To report credit/debit card or bank account fraud, trustees should make contact with the relevant bank or card issuing company. Credit card companies and banks are responsible for verifying the crime, and reporting it to the police. Other areas of bank-related fraud can be reported as follows:

- Phishing emails **reports@banksafeonline.org.uk**
- Paypal fraud **spoof@paypal.co.uk**
- Ebay fraud **spoof@ebay.co.uk**
- **City of London Fraud Desk**

The Fraud Desk is a telephone-based service to take initial action concerning any fraud within the jurisdiction of the 'square mile' (ie post codes EC1 - EC4). They respond to all initial allegations of fraud, liaise with other forces and agencies, provide technical assistance to 'in-force' requests for advice and offer fraud prevention advice.

Telephone: 020 7601 6999

Fax: 020 7601 6938

Email: **frauddesk@cityoflondon.police.uk**

- Anonymous reports of criminal activity can also be made to the Crimestoppers freephone number - 0800 555 111.

## J5 As the victim of a crime, what help is available to our charity?

### Short answer

It is estimated that more than half of all fraud victims do not report fraud. The stigma and embarrassment of falling victim to fraud can make people feel they are to blame and deter them from reporting it, especially if the amount involved is relatively small. It may also be that fraud victims are unsure about who they should inform, or they believe that only very large frauds will be of any interest to the authorities. However, help is available.

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### In more detail

Fraudsters rely on victims' silence in order to operate. One of the biggest threats to a fraudster is people knowing about the types of fraud being committed and taking steps – even basic, straightforward steps - to prevent it happening to them.

**Action Fraud** helps victims of fraud in a number of ways. As well as providing a central point of contact for reporting fraud callers are given the option of a referral to Victim Support, a national charity that helps those affected by crime by offering free and confidential emotional support and practical help.

The **Fraud Advisory Panel** is a registered charity which raises awareness of fraud and financial crime and how to protect against it. The Panel publishes a range of practical Fraud Facts for businesses on how to reduce the risk of fraud. Many are suitable for charities, and are available to download from their website.

## J6 What do trustees need to know about reporting money laundering?

### Short answer

Legal requirement: if you discover that potential money laundering offences are taking place in connection with your charity, you must report it to the police immediately. You must also report it to the Commission. Detailed information can be found in **Reporting Serious Incidents – guidance for trustees** .

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### In more detail

The Proceeds of Crime Act 2002 (POCA) expanded, reformed and consolidated the UK's criminal money laundering offences. Banks, solicitors and others involved in the financial sector have a duty to report cash transactions of certain types. Most of the offences under POCA apply to all individuals and businesses in the UK, but some apply only to those doing business in the 'regulated sector'. Part 7 of POCA establishes two distinct regimes for the handling of suspicions about criminal funds. The first requires institutions in the regulated sector to disclose as Suspicious Activity Reports (SARs) any suspicions that arise concerning criminal property. The second provides all individuals and businesses - not just those in the financial sector - with a defence against money laundering charges if they seek consent to the doing of the act which would prompt such charges.

‘Consent’ means the consent of a police officer, customs officer or an officer of the National Crime Agency (NCA) to proceed with a prohibited act (section 335 of POCA). When seeking consent it is important to identify as clearly as possible:

- the suspected benefit from criminal conduct (the ‘criminal property’), including where possible the amount of benefit
- the reason(s) for suspecting that property is criminal property
- the proposed prohibited act(s) the reporter seeks to undertake involving the criminal property
- the other party or parties involved in dealing with the criminal property including their dates of birth and addresses where appropriate (such information should be held routinely by reporters in the regulated sector in order to comply with the requirements of the Money Laundering Regulations 2003)

Trustees are in the same position as members of the public in relation to seeking consent under POCA to report an act which may be money laundering, and are encouraged to submit the request for consent and report suspicions as soon as there is any knowledge or suspicion of such an offence. It should be done immediately if consent is required, and always at the earliest opportunity as consent cannot be given retrospectively.

If a charity wants to request consent to a transaction then NCA’s preferred method for reporting suspicious activity is by using the **NCA Suspicious Activity Report Form**. The NCA prefers this form to be submitted electronically (see below) but hardcopy versions (including Limited Intelligence Value Reports) can be found on the **NCA** website or obtained directly from the NCA. After completion they can then be posted directly to the NCA. Hardcopy consent requests should be faxed to 0207 238 8286.

For detailed information on SARs and individual reporting requirements under POCA, please consult the **NCA website**.

For further information on reporting suspicions of terrorist financing, see **Chapter 1** of the toolkit – Charities and terrorism.

## J7 What are the reporting obligations on a charity’s auditor or independent examiner?

### Short answer

Auditors and independent examiners are under legal duties to report certain serious incidents to the Commission.

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### In more detail

The Commission’s **Guidance for auditors and independent examiners** clearly explains the legal duty of auditors and independent examiners to report matters of ‘material significance’ to the Commission. This guidance mirrors that contained in Appendix 5 of **Practice Note 11: The Audit of Charities in the United Kingdom**, published by the Auditing Practices Board in March 2011.

The Commission will always consider the following to be of material significance and hence reportable:

- matters suggesting dishonesty or fraud involving a significant loss of, or a major risk to, charitable funds or assets
- failure(s) of internal controls, including failure(s) in charity governance, that resulted in a significant loss or misappropriation of charitable funds, or which leads to significant charitable funds being put at major risk

- matters leading to the knowledge or suspicion that the charity or charitable funds have been used for money laundering or such funds are the proceeds of serious organised crime or that the charity is a conduit for criminal activity
- matters leading to the belief or suspicion that the charity, its trustees, employees or assets have been involved in or used to support terrorism or proscribed organisations in the UK or outside of the UK
- evidence suggesting that in the way the charity carries out its work relating to the care and welfare of beneficiaries, the charity's beneficiaries have been or were put at significant risk of abuse or mistreatment
- significant or recurring breach(es) of either a legislative requirement or of the charity's trusts
- a deliberate or significant breach of an order or direction made by a charity regulator under statutory powers including suspending a charity trustee, prohibiting a particular transaction or activity or granting consent on particular terms involving significant charitable assets or liabilities
- the notification on ceasing to hold office or resigning from office, of those matters reported to the charity's trustees

These matters are considered central to the integrity of a charity and as such will require evaluation and where appropriate investigation by the Commission as charity regulator. During 2009-2010 reports made to the Commission by auditors and independent examiners included:

- the charity's governing document being breached in respect of trustee remuneration
- the trustees of a charity enjoying the benefit of cars and expenses which had not been reported as taxable benefit
- a charity's financial reports being qualified for not having disclosed all remuneration paid to the executive directors
- a general lack of control over the charity's expenditure, and specifically in respect of cheques cashed with no explanation as to the purpose or use of the funds
- remuneration being paid to the charity's trustees and partners without being subject to PAYE and NI deductions
- a charity's finances being under the control of one trustee

As regards money laundering, the Auditing Practices Board's **Practice Note 12 (Revised)** focuses on the impact of the UK anti-money laundering legislation for auditors' and accountants' responsibilities when auditing and reporting on financial statements.

**POCA** and the **Money Laundering Regulations 2007** do not extend the scope of the audit required, but auditors and accountants are within the regulated sector and are required to report where:

- they know or suspect, or have reasonable grounds to know or suspect, that another person is engaged in money laundering
- they can identify the other person or the whereabouts of any of the laundered property or that they believe, or it is reasonable to expect them to believe, that information that they have obtained will or may assist in identifying that other person or the whereabouts of the laundered property
- the information has come to the auditors in the course of their regulated business

According to POCA, failure by an auditor to report 'knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering in relation to the proceeds of any crime' is a criminal offence. This requirement is not just related to matters considered relevant to financial statements, but also of crimes that have potential impact on financial statements.

Auditors and accountants report to their Money Laundering Reporting Officer (MLRO), or in the case of sole practitioners, to NCA. The auditor is not required to report where:

- they do not have the information to identify the money launderer and the whereabouts of any of the laundered property, or
- they do not believe, and it is unreasonable to expect the auditor to believe, that any information held will or may assist in identifying the money launderer or the whereabouts of any of the laundered property.

The duties to report on overseas money laundering are complex, as they rely on knowledge of both overseas and UK law. In practice, auditors may choose to report all overseas money laundering activity to their MLRO. Further information can be found in **Practice Note 12** and The Consultative Committee of Accountancy Bodies' **Anti-Money Laundering Guidance for the Accountancy Sector**.

## **K What else do trustees need to do if the charity has lost money as a result of a crime?**

### **Short answer**

The duty of trustees to protect their charity's funds extends to taking reasonable and proportionate action to recover funds that have been lost. The pluses and minuses of legal action are set out more fully below, but in every case where there has been financial loss due to crime the matter should be reported to the police. This may affect the charity's chances of recovering losses through an insurance policy.

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### **In more detail**

The starting point is that trustees have a duty, whenever possible, to recover charity funds that have been misappropriated. This does not mean every charity must take legal action to recover stolen funds. Sometimes the criminal case will include steps to seek to recover the proceeds of crime.

In other cases, however, taking civil or other action is something for trustees to be aware of and consider. If this is a real possibility, trustees will then need to consider whether there is a reasonable prospect of success in pursuing an action through the courts, so as to justify the outlay on legal costs. It will not always be cost effective to pursue a loss, and trustees should always take legal advice before deciding to embark on litigation. When considering whether to pursue the recovery of the charity's assets, trustees must ensure that the decisions they take are reasonable and in the best interests of the charity.

## L Other connected legislation

The information contained in this module is aimed at charity trustees, and the intention is to help safeguard against the kind of fraud and financial crime to which charities might be most vulnerable. There is a broad range of legislation relating to fraud and financial crime, much of which might be relevant to different kinds of charity activity. For example, POCA applies to individuals, regardless of whether they are charity representatives. Much of the following legislation (such as the Companies Act 2006, for example), may be especially relevant to incorporated charities:

**HMRC Legislation** – this is extensive and sometimes complex. Trustees will need to consider taking professional tax advice.

Forgery and Counterfeiting Act 1981 – provision for forged and false documents

Company Directors Disqualification Act 1986 – procedures for company directors to be disqualified in certain cases of misconduct.

Insolvency Act 1986 – consolidating enactments relating to company insolvency and winding up

Copyright, Designs and Patents Act 1988 – covers making, dealing with or using illicit recordings, publications etc

Computer Misuse Act 1990 – provision for securing computer material against unauthorised access

Social Security Administration Act 1992 – consolidating enactments relating to the administration of social security benefits

Value Added Tax Act 1994 – consolidating enactments relating to value added tax, including certain enactments relating to VAT tribunals

Social Security Act 1998 – provision for appeals under enactments relating to social security, child support, vaccine damage payments and war pensions

Financial Services and Markets Act 2000 – provision for creating the false or misleading impression as to markets, prices or value of any relevant investments

Finance Act 2000 – provisions for Excise Duties, Value Added Tax, Income Tax, Corporation Tax, and Capital Gains Tax

Enterprise Act 2002 – provision for the functions of the Office of Fair Trading, the Competition Appeal Tribunal and the Competition Service; to make provision about mergers and market structures and conduct.

Criminal Justice Act 2003 – provision for criminal justice (including the powers and duties of the police) and about dealing with offenders; to amend the law relating to jury service

Identity Cards Act 2006 – provision for a national scheme of registration of individuals and for the issue of cards capable of being used for identifying registered individuals.

Companies Act 2006 – reforming company law and restating the greater part of the enactments relating to companies

# M Bribery and corruption

This guidance sets out the Commission's position on bribery and provides guidance to trustees.

The Bribery Act 2010 came into force in July 2011. The Ministry of Justice has issued a **Quick Start Guide** to the Act generally, together with more detailed guidance on section 6 – **bribery of a foreign official** - and section 7 – **failure of a commercial organisation to prevent bribery**. The Director of the Serious Fraud Office (SFO) and the Director of Public Prosecutions (DPP) have issued **Joint Prosecution Guidance** which sets out their approach to prosecutorial decision-making in respect of offences under the Act. Bond, the UK membership body for NGOs working in international development, has published **Anti-Bribery Principles and Guidelines for NGOs**.

The Commission expects trustees to comply with the law on bribery and to implement good practice in accordance with their duty to protect the property and reputations of their charities.

Our guidance also refers to facilitation payments, which can be a particular concern to charities operating internationally.

## M1 What is bribery and how does it affect charities?

### Short answer:

Bribery means offering, promising or giving someone a financial or other advantage to encourage them to perform their functions or activities improperly, and includes where it is known or believed that the acceptance of the advantage in itself constitutes improper performance. It also means asking for or agreeing to accept a bribe.

The Bribery Act 2010, updating previous law, creates four criminal offences:

- bribing another person
- accepting a bribe
- bribing a foreign official
- (for commercial organisations) failing to prevent bribery

The Ministry of Justice (MOJ) guidance confirms that the Act generally applies to charities.

If a bribe were to be paid to a known member of a proscribed organisation or to a designated individual, such payments may be offences under counter-terrorism legislation – for general guidance on this legislation see chapter 1 **Charities and terrorism**.

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### In more detail:

Legal requirement: the Act applies to individuals and 'commercial organisations' (which, according to the MOJ's guidance, can include charitable companies carrying on a not-for-profit business). The Commission recommends that all charities adopt a risk-based approach, putting in place policies and procedures to comply with the Act. If trustees are unsure how the Act applies to their charity, we advise them to seek clarification from the MOJ and/or take legal advice.

Charities may encounter corruption wherever they operate. However, in some areas of activity and in some parts of the world, bribery can be found to be more deeply embedded in cultures, and charity officials might be tempted to adopt and conform to prevailing custom or local standards and values.



However, as a matter of general principle and to comply with the trustees' legal duties, trustees should avoid any situation where there is an expectation of a gift or payment in return for an advantage of any kind.

There are real risks for charities if they are for any reason associated with bribery. The potential damage to reputation may be severe and could result in loss of confidence and support from donors and the wider public. A charity accused, or convicted, of bribery offences may find that this could jeopardise future funding and contracts, and compromise its credibility and reputation. Charities must be clear that they will not tolerate bribery and corruption and will benefit from having a reputation for operating in an open and transparent way.

## M2 Can charities make facilitation payments?

### Short answer:

Small bribes paid to speed up a service are sometimes called facilitation payments. Some charities work in areas where such payments are the norm in the local culture, often where charitable need is extreme. The MOJ guidance confirms that, notwithstanding the small amounts usually involved, they are still bribery payments. Therefore, they are an unacceptable use of charity funds.

Some charities work in areas where there are serious difficulties with security and safe access and that payments are sometimes demanded under duress. The DPP/SFO and MOJ Guidance recognises that there may be exceptional situations where it is necessary to make facilitation payments to ensure the safety of charity personnel.

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### In more detail:

Facilitation payments could trigger a number of offences under the Bribery Act - section 1 (bribing another person), section 6 (bribery of foreign public officials) or section 7 (failure of commercial organisations to prevent bribery). Trustees have a duty of care to their charity and must not act illegally in its administration. If a charity intends to work in an area in which it is known that bribery takes place the trustees should undertake a risk assessment as outlined below and in the MOJ guidance and establish a policy and procedures to manage the risks.

The Government recognises that there are circumstances in which individuals are left with no alternative but to make payments in order to protect against loss of life, limb or liberty. The MOJ guidance advises that the common law defence of duress is very likely to be available in such circumstances.

**However, there is no general exemption in respect of facilitation payments.** They were illegal under the previous legislation and remain so under the Bribery Act. A prosecution will usually take place unless the prosecutor is satisfied that there are public interest factors against prosecution which outweigh those in favour.

The joint prosecution guidance outlines factors which prosecutors would consider:

### Factors tending in favour of prosecution:

- Large or repeated payments
- Premeditation: the payments are planned as a standard part of business
- Evidence of active corruption of an official
- Failing to follow the charity's bribery policy and procedures

### **Factors tending against prosecution:**

- A small one-off payment
- Self reporting the facilitation payment and remedial action
- Following the charity's bribery policy and procedures
- Payment demanded in circumstances making the payer vulnerable

## **M3 What steps can a charity take to prevent bribery?**

### **Short answer:**

The MOJ guidance sets out six principles to inform an organisation's anti-bribery policies and procedures. Charity trustees will need to use their judgement and their knowledge of their charities' activities, and of the country they are operating in, to decide upon appropriate anti-bribery procedures which are proportionate to the risks faced by the charity.

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### **In more detail:**

The MOJ's six principles are as follows. They are explained in more detail in the MOJ guidance:

#### Principle 1 – Proportionate procedures

An organisation's procedures to prevent bribery by persons associated with it are proportionate to the bribery risks it faces and to the nature, scale and complexity of its activities. They are also clear, practical, accessible, effectively implemented and enforced.

#### Principle 2 – Top-level commitment

The top-level management of an organisation (for charities, this means its trustees and senior managers) are committed to preventing bribery by persons associated with it. They foster a culture within the organisation in which bribery is never acceptable.

#### Principle 3 – Risk assessment

The organisation assesses the nature and extent of its exposure to potential external and internal risks of bribery on its behalf by persons associated with it. The assessment is periodic, informed and documented.

#### Principle 4 – Due diligence

The organisation applies due diligence procedures, taking a proportionate and risk based approach, in respect of persons who perform or will perform services for or on behalf of the organisation, in order to mitigate identified bribery risks.

#### Principle 5 – Communication (including training)

The organisation seeks to ensure that its bribery prevention policies and procedures are embedded and understood throughout the organisation through internal and external communication, including training, that is proportionate to the risks it faces.

#### Principle 6 – Monitoring and review

The organisation monitors and reviews procedures designed to prevent bribery by persons associated with it and makes improvements where necessary.

These principles should be applied to every aspect of how a charity operates and also when engaging with partners.

## **Partners**

Charities may not always have the infrastructure to carry out and oversee their work and activities. They might therefore appoint a representative or enter into an operational relationship with a partner organisation; this may involve the partner recruiting staff locally.

**Chapter 2** of this toolkit provides guidance for trustees on the 'Know Your Partner' principle and the appropriate due diligence checks when selecting and working with partners. **Tool 8** sets out some key issues to think about, and these include issues with potential relevance to the risk of bribery and corruption. Amongst the key issues that trustees should consider are:

- whether the partner organisation's aims and values are compatible with those of the charity
- whether there are likely to be any language, communication or cultural issues, and how they can be dealt with
- whether the partner's financial controls are adequate and reliable, and whether the charity will be able to inspect them
- how closely the partner's senior staff monitor its more junior staff
- whether there are any special external risk factors in the area of operation. For example, what is the political, economic and social environment? Is there any instability, unrest or conflict?

## **Methods of service delivery**

Trustees should undertake a risk assessment so that they can devise and implement procedures to minimise the risk of bribery. Trustees may wish to consider:

- has the charity contacted the country's UK representative (embassy or High Commission) to find out whether risks can be identified and managed from the outset?
- can the charity deliver goods or services in other ways, avoiding areas where bribery is a high risk?
- has the charity chosen a suitable operational partner, and carried out adequate due diligence?
- are there other NGOs already operating in the area, possibly with established infrastructures and better distribution networks, with which the charity can cooperate?

## **Internal policies and procedures**

A charity can best demonstrate its stance on bribery and corruption through the clarity and robustness of its policies and procedures, which should include risk assessment and management of situations which have the potential to involve bribery or corruption. These policies and procedures should be periodically monitored and reviewed as part of the charity's risk management and internal control practice.

There should be clear guidance to trustees, staff and volunteers on business entertainment, gifts and hospitality. Charities risk losing support if there is a perception amongst the public (justified or not) that charity funds are being applied lavishly or wastefully. Similarly, trustees need to remember that accepting hospitality beyond the reasonable minimum, even if it costs the charity nothing, can give an impression of an inappropriate culture of extravagance, or inappropriate influence.

Here are some top tips for trustees to consider and adapt according to the context of their charity:

- have written policy, practice and procedures in place in line with MoJ principles
- lead from the top of the organisation, and by example, to embed policy and good practice
- have a clear code of conduct and guidelines for its implementation
- ensure awareness raising and training for staff
- promote a culture of openness and transparency
- put in place an effective monitoring and review regime - penalties for breaches can be severe
- implement robust incident handling procedures with senior management involvement - this also sends a strong message to staff about expected standards
- carry out short and sharp risk assessments - always record decisions in case of challenge and the need to withstand scrutiny