



C I F A S

The UK's Fraud Prevention Service

# The True Cost of Insider Fraud

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Research undertaken by:



Centre for Counter  
Fraud Studies

# Foreword

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Most staff are trustworthy and, because of this, many employers take their honesty for granted. Such employers do not consider the risk of insider fraud.

While cases of fraud committed by insiders remain relatively few and far between, the risks they represent are serious. Nonetheless, most organisations do not set up staff monitoring or vetting schemes, nor participate in data sharing networks. But if they considered the true cost of an insider fraud, rather than just the amount that could be lost or stolen, would they change their approach?

CIFAS commissioned the Centre for Counter Fraud Studies at the University of Portsmouth to establish the true cost of a case of insider fraud by examining the extent and scale of the hidden costs incurred when a case of insider fraud is discovered.

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CIFAS operates a data sharing scheme that enables responsible employers to record proven cases of staff fraud in order to prevent the perpetrator moving unchallenged to a new employer to commit further fraud. An employer accesses the database in order to: check staff frauds recorded by other participating organisations. This can be done either to screen applicants or current employees; and to record data about identified staff fraud cases. Use of this system - The Staff Fraud Database - is not limited to permanent staff. It can also be used to vet contractors and agency workers, offering organisations additional protection in these high-risk areas.

The Staff Fraud Database was designed in consultation with the Information Commissioner’s Office, participating CIFAS organisations, the Confederation of British Industry (CBI), the Trades Union Congress (TUC) and the Chartered Institute of Personnel and Development and has been cited by the Financial Conduct Authority, National Fraud Authority and the Local Government Fraud Strategy as an example of best practice in preventing internal fraud. For further information, please email [staff.fraud@cifas.org.uk](mailto:staff.fraud@cifas.org.uk).

Website: [www.cifas.org.uk](http://www.cifas.org.uk)

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# 1 | Executive Summary

Putting a cost on fraud has always presented a challenge to organisations, and (in some areas) is something that has only recently begun to be addressed. Fraud committed by an insider presents its own unique challenges; largely due to the range and nature of the impacts upon an organisation and its workforce. Research carried out by the University of Portsmouth's Centre for Counter Fraud Studies (summarised here) seeks to clarify and quantify the true costs.

## Cost is not just a number

The research has identified costs that fall into three main areas:

1. The actual sum lost to the fraudster. This can be as a result of one or more frauds or thefts.
2. The associated, quantifiable, costs. These will include any penalties imposed by regulators, disciplinary processes and investigative costs, and the recruitment of a replacement.
3. The associated, unquantifiable costs. These will include the impact upon an organisation's reputation: not only in relation to the public at large (and does this affect share price?) but also to customers: e.g. how much business a customer may take elsewhere as a result, the lost productivity of remaining staff affected by the fraud and the impact upon morale.

It is therefore clear that the total cost of insider fraud far exceeds the sum lost to the fraudster, and that not all costs can be expressed numerically.

## How cost can far exceed initial loss

The University of Portsmouth's analysis of many instances of internal fraud (from the private, public and voluntary sectors) has revealed how much greater the total cost is compared with the initial loss.

- Of the cases examined, an average initial fraud loss of nearly £424,500 was identified.
- The average total sum lost (after costs were incurred), however, was just over £483,000. The net difference (after the recovery of any funds from the fraudster) averaged out at a staggering £58,696.
- The true cost of all the frauds analysed was, therefore, 14% higher than the initial amount lost to the fraudster.

Other research findings include:

- The smaller the fraud, the greater the increase in the total cost. Frauds under £25,000 incurred costs that represented an average 265% increase to the initial loss. This means that a £300 fraud loss will incur, on average, a £795 associated cost and a final bill of £1,095; while, a £10,000 fraud could cost over £36,000.
- In lower level frauds, the increased total cost in the public sector is far greater than in the private sector.
- The vast majority (61%) of costs incurred by the public sector, were associated with the sickness leave or absence taken by the person under investigation. This would mean that, for the above £300 fraud example (where the final bill for the public sector was actually £1,560) £767 of that final bill would be spent on paying sick leave or absence costs: two and a half times greater than the initial loss.
- By contrast, only 30% of the fraud cost to the private sector was due to staff absence. This demonstrates a cultural difference between sectors and points to differing challenges that they face.
- Of the intangible costs, the impact upon the morale of the fraudster's former colleagues was deemed by research participants to be the greatest threat, while the impact upon the financial strength of an organisation the least threatening.

## What this means to organisations

Irrespective of sector, the costs associated with cases of internal fraud can far exceed the actual amount initially lost. Such costs are unavoidable where internal fraud has been identified, but organisations should not regard such risks as a 'given'. On the contrary, the findings demonstrate that investment in prevention is preferable to paying out additional costs incurred as a result of internal fraud.

Comprehensive fraud prevention strategies combined with appropriate HR procedures must be the cornerstone of an organisation's work: helping to instil a zero tolerance attitude to fraud, meaning that staff have neither the motivation nor the opportunity to commit fraud from the inside. Should a case arise, however, the findings of this research demonstrate that further losses can be restricted if the organisation acts swiftly and decisively. ●

## 2 | Cost Areas

As a first step, an exercise was undertaken to identify all of the potential areas where a cost could be incurred as a result of fraud being committed by a member of staff. Such costs were then added to the initial loss in order to reach a better indication of the true cost of a case of insider fraud. These 'hidden' costs were broken down into the areas detailed in *Figure 1*.

### Fraud loss

At the centre is the fraud loss: the amount of money actually lost by the organisation from the act of fraud itself. In most cases, this is relatively easy to calculate, but it can be more complex. For example, if someone fabricates qualifications on a CV to secure a job and performs competently, does the salary paid to them constitute a loss? Equally, if someone steals customer data and sells it on to a third party, is the fraud loss equal to the funds that the third party may earn from using the data? Or in the case of the theft of intellectual property, how is this quantified?

### Costs of investigation

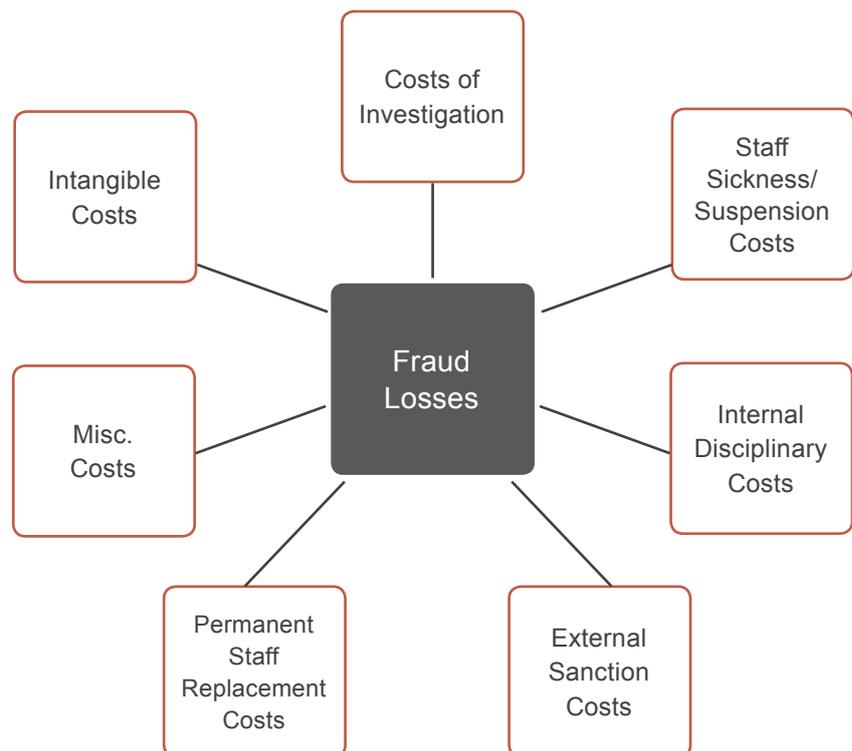
Once a member of staff is suspected of fraud, the situation needs to be investigated. This may involve a range of staff, from internal investigators to external specialists such as forensic accountants. There is clearly a cost associated with these activities, plus the possibility of other associated costs, such as travel.

### Staff sickness/suspension costs

During an investigation, or at its conclusion, the member of staff suspected of fraud may be suspended

### Cost elements incurred by Insider Fraud

*Figure 1*



on full pay. It is not uncommon for an individual being investigated for staff fraud to take a period of paid sick leave as a result of the investigation and this too can accrue a significant cost. There are also occasions when it may be necessary to suspend on full pay the individual(s) under suspicion but who are subsequently found to be innocent. These periods of sickness and/or suspension can continue for weeks, months and even years, and may lead to the organisation hiring temporary staff to replace those off work, adding further to the costs.

### Internal disciplinary costs

In some cases, the outcome of an investigation is clear cut and the fraudster resigns immediately. In others, the fraudster will go through the staff disciplinary process, thereby incurring the costs of putting the case together and the cost of the hearing – which usually involves senior staff. It is not uncommon for these cases to be adjourned several times due to the member of staff not turning up due to sickness. The member of staff may appeal or take the case to an employment tribunal, thus adding further costs to the case. It is also not



unheard of for the fraudster to take out grievances against other members of staff, further lengthening the process.

### **External sanction costs**

In many cases, the fraud case and investigation culminates in the dismissal of the member of staff.

The difficulties of pursuing a criminal sanction, lack of available resources and the fear of reputational damage are some of the more common reasons given by organisations for not taking a case further. Some cases are referred to the police for criminal prosecution, however, and this may mean further costs: e.g. those incurred through the production of the file for criminal prosecution, meeting with officers, facilitating further investigations and attendance at court.

In rare cases, an organisation might pursue a private prosecution when there is no interest from the Crown Prosecution Service. On top of this, or separately, some organisations might also pursue a civil action, again involving similar costs for investigating staff, but incurring the additional cost of lawyers to conduct the case.

Finally, in some cases, an organisation might pursue regulatory sanctions against the fraudster through a professional body, which could again

involve additional costs. For example, in the NHS, it is common to do this and many staff found to have committed fraud are referred to the relevant professional body, such as the General Medical Council, or General Dental Council, for disciplinary action.

### **Permanent staff replacement costs**

The resignation or the termination of employment of a fraudster will in most cases require them to be replaced. Depending upon the level of seniority, this will incur further costs, both in recruitment (advertising, short-listing, interview, vetting) and training. In some senior positions, it may also be necessary to turn to recruitment consultants at further cost.

### **Miscellaneous costs**

Other costs can also arise. In some cases, the results of employing staff engaged in fraud can result in a fine by a regulator. For instance, one large service company was fined £300k by the Financial Services Authority (now Financial Conduct Authority) for poor fraud controls. In certain regulated sectors, therefore, internal fraud can expose the organisation to the risk of heavy fines. In other cases, it might be necessary to interview lots of staff as part of the investigation, possibly taking them from their duties for half a day or

more. A case might become high profile which involves media attention and, as a consequence, the organisation has to use or hire media/crisis management expertise.

### **Intangible costs**

Finally, there are costs associated with internal frauds which are very difficult, if not impossible, to measure. One of the most important is the cost associated with a damaged reputation. Internal frauds can be damaging to the image of an organisation and this can lead to loss of business, decline in share price etc. These costs are, by their very nature, difficult to quantify.

Another intangible cost is the impact on the department where the fraudster was working. The impact may lead to low morale and affect the performance of the fraudster's former colleagues, who may be shocked and hurt by the betrayal of trust, and this is difficult to measure. This in turn may lead to greater staff sickness and higher turnover, which would incur further costs for the organisation.

These intangibles are clearly additional to the initial cost of the fraud but, because of the difficulties in measuring them, they have been excluded from the analysis of costs later in this report. The report also briefly assesses the impact on staff morale and reputation according to the respondents to the survey. ●

**The difficulties of pursuing a criminal sanction, lack of available resources and the fear of reputational damage are some of the more common reasons given by organisations for not taking a case further.**

## 3 | Findings

A survey was conducted and interviews undertaken to obtain data on the real cost of fraud in 45 cases. These cases covered 18 frauds against public sector bodies, 26 against the private sector and one against the voluntary sector. The initial fraud losses, i.e. the value obtained by the fraudster, were quantified as follows:

- Total loss for the 45 cases – £19million
- Average loss per case – £424,499

These figures were distorted by a few cases where initial losses were over £1million each, however, so results have been classified according to the size of the initial fraud loss. This is summarised in *Figure 2*.

### The actual cost of Internal Fraud

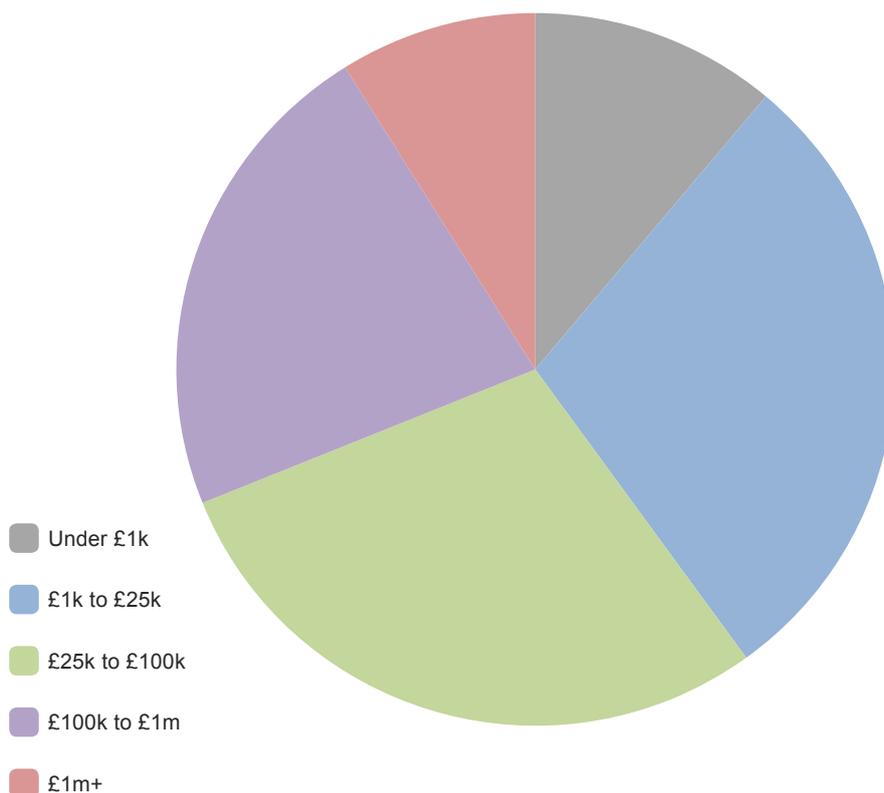
The total cost of the fraud can be considered to be the initial fraud loss, plus the cost of dealing with the fraud, but minus any money recovered. When these are factored in, the resulting total costs are significantly higher than the initial loss. These figures can be seen by comparing *Tables 1* and *2*.

What this demonstrates, in the starkest possible terms, is that the *actual* cost of the internal frauds (*Table 2*) far exceeds the original losses (*Table 1*).

From these two sets of figures, the *average actual/net cost of dealing with the fraud* can be calculated – that is the total cost of the fraud minus any recoveries. This average/net cost can be seen in *Table 3*.

### Classification of cases according to initial loss value

*Figure 2*



### Average\* initial fraud loss by sector and comparable fraud size

*Table 1*

	All	Public	Private	Voluntary
Under £25k Frauds	£8,524	£4,723	£10,967	£10,700
Under £100k Frauds	£24,572	£21,568	£27,040	-
Under £1m Frauds	£88,166	£83,156	£94,271	-
<b>All Frauds</b>	<b>£424,499</b>	<b>£374,166</b>	<b>£475,260</b>	<b>£10,700</b>

\* All average figures are mean average calculations and are rounded to the nearest £1



**Average\* total fraud loss: initial fraud loss plus costs of dealing with it minus any recoveries**

Table 2

	All	Public	Private	Voluntary
Under £25k Frauds	£31,088	£24,563	£35,903	£28,621
Under £100k Frauds	£53,203	£65,559	£47,344	-
Under £1m Frauds	£127,899	£130,542	£130,285	-
<b>All Frauds</b>	<b>£483,196</b>	<b>£414,337</b>	<b>£548,321</b>	<b>£28,621</b>

\* All average figures are mean average calculations

**Average\* actual cost of dealing with fraud (minus recoveries)**

Table 3

	All	Public	Private
Under £25k Frauds	£22,564	£19,840	£24,936
Under £100k Frauds	£28,631	£43,991	£20,304
Under £1m Frauds	£39,733	£47,386	£36,014
<b>All Frauds</b>	<b>£58,696</b>	<b>£40,171</b>	<b>£73,061</b>

\* All average figures are mean average calculations

**The true cost of internal fraud: expressed as a percentage increase on the initial loss (minus recoveries)**

Table 4

	All	Public	Private
Under £25k Frauds	265%	420%	227%
Under £100k Frauds	117%	204%	75%
Under £1m Frauds	45%	57%	38%
<b>All Frauds</b>	<b>14%</b>	<b>11%</b>	<b>15%</b>

\* All average figures are mean average calculations and are rounded to the nearest £1

**Understanding the true costs**

The cost of actually dealing with the fraud can be calculated as a percentage of the initial loss, to be added to that initial loss (minus any recoveries). The increases seen in Table 4 reflect the true cost of internal fraud.

The percentage increases shown diminish as the initial fraud loss increases, as many of the costs of dealing with the fraud will be common across all cases of staff fraud, irrespective of the actual fraud loss. The likes of investigation costs, for example, may not necessarily correlate to the size of the fraud loss. It could be that a fraud of a relatively low value involves a long, complicated investigation, while a high value fraud actually is less complicated and relatively quick (and therefore cheaper) to investigate.

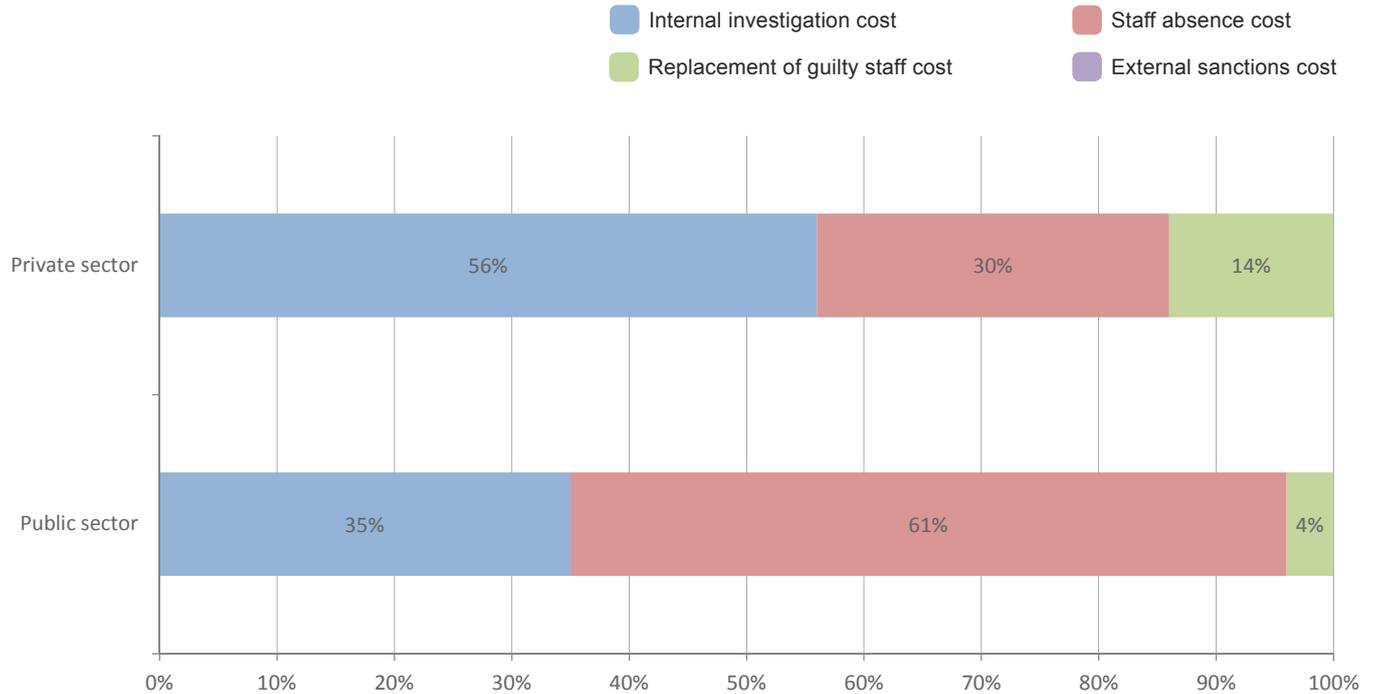
Using the percentages in Table 4, this means that a fraud with an initial loss of £300 will, on average, result in a final cost to the employer of £1,095. This average conceals a differential between sectors. If the fraud occurs in the public sector, the cost will be £1,560, compared with £981 in the private sector.

This key finding demonstrates clearly that a case of internal fraud can cost many times more than the initial loss. Undoubtedly, this shows that the consequences of internal fraud are far more serious than the original sum lost to the fraudster and underlines the importance to organisations of taking pre-emptive measures to prevent it rather than simply 'brush it under the carpet'.



### Distribution of costs where the initial fraud loss was less than £100k

Figure 3



### Cultural differences expressed through cost

This distribution of where the costs of dealing with insider fraud are incurred can be seen in *Figure 3*. This shows that the main cost within the private sector relates to the cost of investigating the fraud and any costs associated with a prosecution. Within the public sector, however, the main cost results from the amount paid to the employee while he or she is absent for the duration of the investigation. This points to a cultural difference between the public and private sectors (specifically with relation to how an identified fraudster is dealt with), that represents and demonstrates a challenge: not only to the public sector (in terms of how to stop someone

taking protracted periods of sick leave in order to avoid disciplinary processes) but to all sectors. Moreover, is it the culture of certain organisations or business sectors to turn a blind eye to some actions that are incompatible with a zero tolerance attitude towards fraud and corruption? ●

## 4 | Intangible Costs

Some of the costs of a case of insider fraud are very hard, if not impossible, to calculate with any degree of accuracy or confidence. How does one place a value on the lost productivity of staff whose morale has been adversely affected by a colleague being dismissed for fraud, for example?

In an effort to gauge the relative impact of these intangible costs, survey respondents and interviewees were asked to rate the impact of the fraud on seven issues, on a scale of 1 to 5: where 1 was no impact and 5 was a very significant negative impact. The results can be seen in *Table 5*.

This shows that respondents considered that the impact on the morale of other colleagues was the most harmful of the intangible costs.

The impact on the financial strength of the organisation scored relatively low, as most of the frauds (individually) were not of sufficient value to do too much damage to the bottom line. This is not to say, however, that the compound effect of multiple frauds would not start to create a bigger impact.

What it does highlight, however, is that even those who are involved in countering – or dealing with – cases of internal fraud do not necessarily appreciate the true cost associated with it. While the size of the initial fraud might not be considered to be damaging to the bottom line, the findings presented in Section 3 demonstrate that the average net cost of fraud far exceeds the sum initially lost. This ‘low score’ for the financial impact upon an organisation may,

therefore, need some reassessment. If respondents were asked to rate the impact upon the financial strength of an organisation after reading the findings presented here, it is likely that the impact would have been rated as far more serious.

Another impact that scored relatively low was the impact on the reputation of the organisation in the outside world. This was likely to be due to many of the lower value frauds not having made it into the public domain or, where they had, the publicity may not have been as negative if the impression given was that the frauds had been dealt with effectively by the organisation. The rise of social media in recent years presents a challenge to organisations, however, as any perceived failing in dealing with a case of fraud can quickly be magnified as consumers voice their discontent. ●

### Estimated impact of fraud on intangible issues

*Table 5*

Impact (1= no impact, 5= severe impact)	Average score	Number of responses
The morale of the colleagues of the fraudster	4.00	31
The performance of the colleagues of the fraudster while the case was continuing	3.00	30
Relationships with clients	2.48	27
The reputation of the department within the organisation	3.29	31
The reputation of the department's management	3.45	31
The reputation of the organisation in the outside world	2.14	28
The financial strength of the organisation	1.59	27

## 5 | Conclusions and recommendations

Clearly, the key finding from this work is that internal fraud costs far more than might originally have been thought, and therefore investment in appropriate prevention and monitoring cannot be considered purely on the basis of the sum initially taken by the fraudster. The whole range of associated costs must be taken into account in order to establish the true impact of the fraud – and this may increase the overall sum considerably compared with the initial loss.

The report has identified where the most substantial costs lie in both the private and public sectors, and there are recommendations that relate to reducing them. It is important to note that many of these costs are unavoidable, however. Once an organisation detects a staff fraud there are processes that they need to go through and there are rights the employee can exercise and defend. Some of these procedures can be made more efficient and reduced, but most cannot be avoided.

In this context, it is also important to note that doing nothing is *not* a cheaper option. If a member of staff commits fraud, but faces no sanction, this will have other financial implications. It will give the green light to other staff to engage in fraud and ultimately will increase the costs of fraud to the organisation.

Crime is said to be likely where there is an opportunity, a motivated offender and the lack of a capable guardian (Felson M (2002) *Crime and Everyday Life: Insights and Implications for Society*). Doing nothing creates the lack of a capable guardian, making further fraud more likely.

Tackling staff fraud requires investment in prevention, but the detection and investigation of it should not be neglected. No employer, however careful, can completely rule out the potential for an internal fraud (and the costs associated with it). Nonetheless, they can help to reduce the risk to a minimum by investing in prevention and, if the worst should happen and a fraud is perpetrated by an insider, by tackling it effectively. In this respect, organisations can learn from others as to the most efficient way to deal with it.

Recommendation 1  
**A comprehensive staff fraud prevention strategy should be a priority for any organisation.**

Given the high costs of dealing with a staff fraud, and that the prospects for the return of money are not always good, the priority for any organisation should be to avoid it in the first place and do all that is possible to prevent staff fraud. A comprehensive staff fraud prevention strategy should involve measures to prevent those who represent a higher risk from entering an organisation and minimising the opportunities for fraud for those already working.

Recommendation 2  
**HR procedures must be a part of the fraud prevention strategy**

One important aspect of some internal frauds was that recruitment processes involved no criminal record or character checks for applicants. Although such checks can be time-consuming, far more can be lost to fraud if someone is recruited with a background that represents a risk to the financial and reputational wellbeing of an organisation. Ensuring that the HR checks of an organisation form a part of the counter fraud strategy is essential, therefore, to any organisation.

Recommendation 3  
**Organisations should consider policies/processes that enable faster termination of employment for staff who have committed fraud.**

A further significant cost is staff suspension or sickness leave taken by the member of staff suspected of fraud, particularly for some public sector bodies. While ensuring that employment rights are not disregarded, organisations must examine existing policies that might enable a fraudster simply to exploit sick leave policies in order to avoid facing the consequences of their actions, thus prolonging processes and increasing costs. Speedy resolution helps to minimise impacts on organisations following any initial 'loss' identified.

Recommendation 4  
**Organisations must react to weaknesses quickly and decisively.**

Greater importance must be given, within organisations, to actions taken as a result of cases of fraud which have come to light. If a case of fraud has been analysed and the weaknesses that were exploited identified, then quick and decisive measures must be implemented in order to counter the systemic or endemic 'causes'. This will include measures such as changing procedures where internal fraud had flourished, and giving publicity to the effectiveness of the organisation in catching such fraudsters, e.g. in initial training of new staff.

Recommendation 5  
**Organisations must consider how their response is perceived.**

Not only is taking decisive action of utmost importance, but an organisation must consider how its actions are perceived both internally and externally. Giving publicity to new counter fraud measures, increasing training for new and existing staff, and publicising the steps taken against fraudsters help to send a clear message that fraud is not tolerated.

For further information, please email

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