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# The Effectiveness of Anti-Fraud Management Systems – Condensed Version



## Introductory Note

This is a condensed version of a working paper by the AuditFactory. In the full version, we use a broad foundation as the basis for an impact analysis of an anti-fraud management system and make some initial observations about its potential effectiveness.

The full version is intended for organizations that have a concrete interest in the establishment or further development of anti-fraud management systems.

As part of our response to a project enquiry, we will be pleased to provide a copy of the full version of this working paper on request. Please refer to the contact address at the end of this document.

## Condensed Version

The AuditFactory puts a great deal of resources into analyzing the effectiveness of anti-fraud management (AFM) systems in order to present to organizations well thought out proposals for servicable, efficient and highly effective systems. This is the AuditFactory's response to the fact that this subject has up to now been insufficiently considered, and to the uncertainty about the effectiveness of anti-fraud management systems and the actual degree of fraud protection that they provide.

The AuditFactory has produced a comprehensive working paper that gives an overview of an anti-fraud management system, broken down into core processes and associated activities. There follows an excursus on the subject of effectiveness and the logic of impact. The latter is examined for the most important areas of an anti-fraud management system, and analyses are given of the potential effectiveness of individual components. This serves as the basis for practical recommendations for organizations that are interested in introducing a targeted, highly effective anti-fraud management system or who wish to evaluate or supplement an existing system.

The goal of an anti-fraud management system within an organization is to prevent, detect and investigate fraudulent activity. Hence prevention, detection, investigation have become the three core processes. Ideally, these should exist in a state of interaction, develop synergies and complement one another. Through the continual feedback of information, the system is able to continually learn from itself and improve itself.

An organization would be well advised to familiarize itself in some depth with anti-fraud management systems as a whole, and, on the basis of a fraud risk assessment, develop an appropriate system for their own organizational structure. This system needs to harmonize with individual activities that target potential sources of fraud. An expensive and unfocused scattergun approach that may well be trying to combat non-existent risks or be ignoring identified risks should be avoided.

The three core processes can be composed of various different individual activities. The following are just some examples:

### Prevention:

- A code of conduct.
- Internal and external rules and regulations with specifications for the systematic execution of processes, e.g. procurement regulations.
- Integrity test for potential employees to look for certain personality traits.
- Preventative checks, e.g. auditing potential suppliers.
- Rules governing working practices, e.g. the dual control principle.

**Detection:**

- Whistle-blowing systems detect internal and external indications of fraudulent activity and follow up on them.
- Compliance auditing is aimed at identifying infringements of internal and external rules.
- Internal audit provides independent and objective audit and consultation services with the aim of improving business processes.
- Special audits are carried out as and when indications of fraudulent activity are detected.
- Fraud due diligence auditing examines structural and procedural organization in order to identify incidences of fraud and fraud risks.

**Investigation:**

- Crisis management is the well-defined and systematic manner in which crisis situations that occur as a result of fraudulent activity are handled.
- Special audits not only contribute to the detection of fraud but also to the examination of the causes and course of fraudulent acts.
- Sanctions can be of an internal or external nature and range, for example, from termination of employment to criminal prosecution.
- Ex-post analysis is used to analyze and document fraudulent acts after they have been identified and investigated.

The AuditFactory sets great value in paying close attention to the effectiveness of anti-fraud management systems. The term effectiveness is very often used too lightly. It is not always appreciated that there is usually a medium to long term time delay between implementing a targeted activity and it taking effect.

Effectiveness means that an activity has brought about a change. This may be a change in behavior or a change in a process. In order to be able to generate an effect, the logic of impact of an anti-fraud management system must be thoroughly thought through and planned. Then it must be ensured that the system is properly implemented. An important element in the evaluation of effectiveness is that the core processes and the system as a whole be given measurable and achievable goals. An example of such a target could be: "Any fraudulent act resulting in losses exceeding €20,000 should be detected without significant delay".

The AuditFactory has developed a theoretical impact model of an anti-fraud management system. This has been carefully analyzed in order to derive recommendations for its practical use. The logic of impact shows that for all three core processes the essential prerequisites needed for the system and its components to produce the desired effect in practice are satisfied. Using the example of the establishment of a code of conduct as a frequently recommended activity in the core process of prevention, there follows a brief look at the logic of impact:

In order for this instrument to produce a change in attitude or behavior, the following requirements must be fulfilled: The code must use language that is appropriate for the target group, it must be regularly and comprehensively communicated to the target group and it is advisable that a commitment to the code is obtained from the target group. It is then crucial that the target group reads the code of conduct and takes it seriously. The logic of impact will be interrupted right from the start if the code is not understandable for the target group or if it is not sufficiently communicated. Additionally, disregard of the code by certain groups, such as management, impedes its effectiveness. In cases where the aforementioned is not observed, a code of conduct as an instrument will be completely without effect, simply writing one will achieve absolutely nothing. The extent to which this instrument actually produces changes in behavior is, as in many other areas, only measurable through a proper evaluation.

In the core process of detection via whistle-blowing systems, in order to ensure a coherent logic of impact and produce an impact through the use of the system, the following prerequisites must be

met: Ombudspersons must be appointed or the existence of any internet-based communication systems that have been set up must be sufficiently publicized, both internally and externally. The use of whistle-blowing systems should be encouraged by assuring confidentiality and anonymity for informants. It is important that the plausibility of information received be immediately verified. This requires qualified contact personnel.

The protection of informants against reprisals, by means of specific internal rules for example, remains of crucial importance in encouraging use of the system. This instrument, too, will have absolutely no effect if from the beginning its existence has been insufficiently communicated.

In a similar way to the above examples, the AuditFactory carefully examines the logic of impact of each individual activity within the core processes. This makes it possible for us to help organizations setting up an anti-fraud management system by providing them with support in the development of a system that is well thought through, specifically tailored and easy to understand. Any prerequisites that will be absolutely essential in order to achieve the intended goals are clearly laid out at the beginning so that they can be kept in focus throughout the planning phase.

The main causes of fraud (and the fact that it often continues undiscovered for years) are: a small chance that it will be detected or reported, inadequate controls and a lack of condemnation of fraudulent activity. Bearing this in mind, the AuditFactory recommends that increasing the probability of detection be the main area of concentration. This will not only reduce the number of incidences of fraud, but also their duration. In practice, this means attaching the greatest importance to whistle-blowing systems. But that alone is not enough to detect the entire spectrum of fraudulent activity. For this reason, a mix of all three core processes is highly advisable.

This leads to the development of synergies that increase both the efficiency and the effectiveness of the system. For example, the concrete prospect of sanctions also acts as a deterrent, which, provided the penalties are sufficiently publicized, means that the core processes of investigation and prevention overlap here.

Ex-post analysis is considered by the AuditFactory to be part of the core process of investigation. But it also produces information that can be used during the regular updating of the fraud risk evaluation. This feedback of information about the causes and the

course of fraudulent acts means that the anti-fraud management system can be further developed to become ever more efficient. The prerequisites for this, however, are that the necessary qualified personnel is available and that ex-post analysis recommendations do actually get implemented. Only then can the effect of the entire system begin to influence all business processes in the direction of a continual process of improvement.

One considerable drawback attached to some frequently recommended preventative measures is uncertainty about their effectiveness. Take codes of conduct for example: They consist solely of recommendations that attempt to bring about the desired behavior, but they do not place any barriers in the way of fraudulent activity, and their effect is difficult to measure.

In the area of prevention, preference should therefore be given to activities that make fraudulent activity more difficult, such as the introduction of rules for working practices and application of the dual control principle. Preventative instruments such as internal rules remain very important as it is through these that desired behavior is defined, and deviations from that behavior provide the basis for being able to detect and evaluate fraudulent activity.

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The impact model developed by the AuditFactory clearly reveals that there is a limiting factor for almost every activity in all three core processes: They require sufficient and appropriately qualified personnel to be made available in a timely manner at various points both internally and externally. Corresponding internal provision for this needs to be made in advance; it will not be enough to wait until a fraudulent act has been detected. If these prerequisites are not fulfilled, then even the best planned system will be ineffective.

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