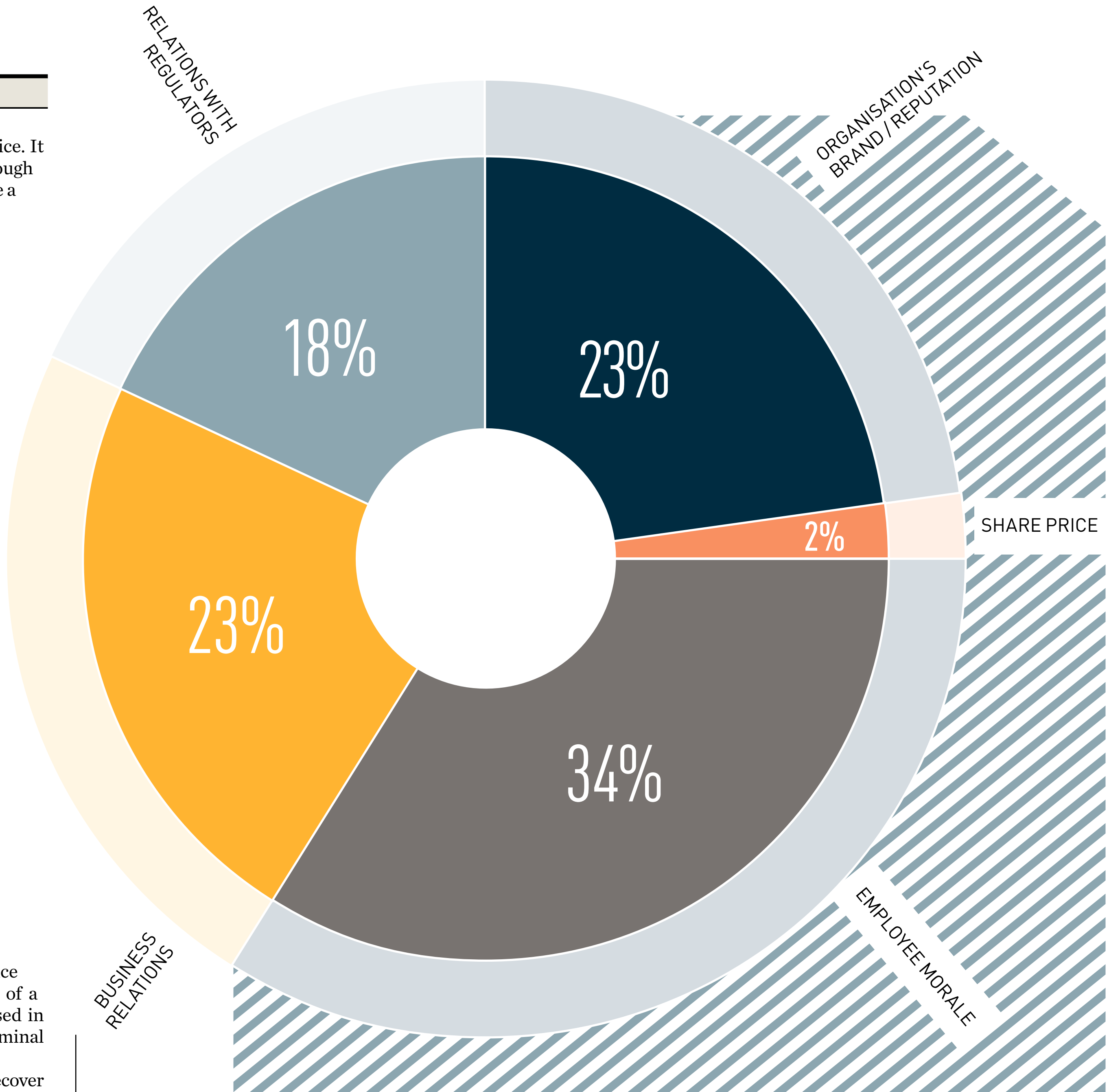
BOUNCING BACK FROM A DAMAGING SCAM

Much is at stake when a business falls foul of fraud, but speedy damage control can rescue the situation, writes **Geoff Nairn**

COLLATERAL DAMAGE EXPERIENCED BY DEFRAUDED BUSINESSES

Source: *Global Economic Crime Survey*, PwC



RECOVERING FROM FRAUD

■ However good the strategy a business has to prevent fraud, it can still occur. The consequences of a fraud are potentially devastating so rapid and decisive action is needed if the business is to recover and get back on track.

"We often find companies that have been the victim of fraud don't act quickly enough," says Howard Cooper, associate managing director of investigations at Kroll, a specialist in risk consultancy.

When a fraud is discovered, the obvious next step for many would be to call the police. However, business owners must temper this emotional desire to punish the fraudster with the need to act in the best interests of the business. That means concentrating on getting the money back, which is not the main focus of the police.

In many cases, the police may decide not to pursue a criminal prosecution against the fraudster. What often happens is that, after a few weeks weighing the available evidence and the likelihood of a conviction, the police tell the business they are going to drop the case.

In frustration, the business may consider a civil prosecution. But by this time, of course, the chance of recovering the missing funds through the civil courts is much less than it was when the fraud was discovered.

"Speed is absolutely essential to the effectiveness of civil action as you need to lock down evidence and freeze assets. Once you have frozen assets, you have a war chest," says Jeremy Cole, co-head of investigations at City law firm Hogan Lovells.

His firm has been involved in several landmark fraud cases, including that of the Bank of Credit & Commerce International, the private banking empire, which regulators shut down in 1991.

Hogan Lovells has also, embarrassingly, been on the receiving end of a high-profile insider fraud. In 2012, former partner Christopher Grierson was jailed for three years after pleading guilty to defrauding his firm of £1.27 million with fictitious expenses claims.

Fraud experts say businesses should always consider reporting a suspected fraud to the police. It shows the business takes a tough line on fraud, which can have a powerful deterrent effect if the crime was committed by an insider.

"Businesses need to make examples of employees who have defrauded, but most are too embarrassed and prefer to cover it up," says John Smart, head of fraud investigation at EY, the accountancy firm.

But criminal prosecutions for fraud are often lengthy and only a minority of frauds reported to the police may receive their active attention.

By contrast, the civil recovery route maximises the opportunities of restitution without relying on the outcome of a criminal prosecution. In addition, evidence obtained during the course of a civil investigation can be used in subsequent or parallel criminal investigations.

There are various ways to recover defrauded money through the civil courts – direct claims against perpetrators, freezing orders, injunctions and insolvency proceedings. In the latter case, a liquidator or official receiver is appointed by the court to take immediate control of the assets of the company or individual responsible for the fraud. Other possibilities include private prosecutions and mediation.

Irrespective of the legal route chosen, going to court can be both exhausting and frustrating. That is particularly true for smaller businesses, which may feel the time tied up in court appearances and meetings could be better spent keeping the business afloat.

The financial cost of mounting a fraud case should not be underestimated either and it can create pressure to accept early settlement to avoid running up lawyers' bills.

Financial redress is clearly a priority for businesses that have been defrauded, but a fraud has other repercussions that extend beyond the profit and loss account.

The morale of employees may be affected, and customers, suppliers and investors may be understandably wary of the company. "It's not just the money you lose, but your reputation as well," says Mr Smart.

While it's tempting to keep quiet about a fraud, particularly if it involves high-level employees, the best strategy is to come clean and explain the measures the business is taking to restore its tarnished reputation.

Next Fifteen Communications, the UK-listed PR group, found itself in this situation last year when it admitted that it had been embezzled by a trusted employee. Around $3 million was stolen by a senior member of its finance team in a US subsidiary.

Practising what it preaches, Next Fifteen was upfront about telling investors, customers and suppliers what had happened, and what it was doing to make sure it would not happen again. A comprehensive review of the cash management function was undertaken and the company said it would set up dedicated internal audit teams. Unfortunately, the company has since issued a profit warning and admitted to fresh "audit issues".