

D. B.

22 November 1985

MR NORGROVE

FRAUD

I wrote this paper for the Policy Unit,
but it may also be of interest to you.

David Hobson

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B/F when note on
fraud from DTI archives.

DGH
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20 November 1985

BRIAN GRIFFITHS

cc PU members

FRAUD

You asked for a paper giving some examples of fraud in commercial life. Clearly it is bound to be a selective list, and it omits such areas as Social Security frauds and corruption.

1. Basic Frauds

The classic cases usually involve setting up companies, obtaining goods on credit, selling them, and disappearing to Spain with the proceeds, leaving the creditors to wind up a company with no assets. After a while, the miscreants return from Spain and repeat the process.

Another example is payroll fraud, putting "dead men" on the payroll and drawing their salaries.

Company employees' buying of commodities on a "heads I win, tails you lose" basis is not unknown. If a profit is made, the deal was for the benefit of the company executives and does not appear in the books; if the market goes the wrong way, it goes into the books and the company picks up the tab. This has also been done by bank employees in foreign exchange transactions - easy to miss out of the books unless there is a good system, because the business is conducted on the telephone. It is not unknown in syndicated investment transactions if the beneficial ownership of the syndicate can be decided after the result of the deal is known.

2. Cash Frauds

A common type of fraud is "teeming and lading", using tomorrow's cash receipts to meet today's outgoings. This is

easy to perpetrate if the cash controls are weak and paying in money to the bank erratic and sloppy.

Another, quite common in building societies, is to cover up cash thefts by creating phoney accounts for non-existent people, forging the basic documentation. The perpetrator may use his parents' address, or some other friendly address, so that he can collect the auditors' confirmation letters, sign them in the forged name, and post them to the auditors agreeing the balance. Sometimes these frauds have gone on for years (Wakefield, Grays, Alfreton).

3. Falsifying Accounts of Business

It is not unknown for proprietors or managers of businesses to falsify accounts. There may be various reasons, such as the following:

- a. If the business is for sale, a better price can be obtained if the profit record is good. Therefore debtors and stock may be overstated and liabilities understated.
- b. In a group of companies, branch staff may be nervous as to the continuance of their jobs; therefore they falsify the monthly accounts to make it seem that their business is profitable. I have known cases where the whole management of a subsidiary has been involved in this process, successfully hoodwinking the auditors by the manufacture of false documentation. The hope in the minds of those concerned must be that they will trade their way out of trouble.
- c. Managements responsible for budgets are often anxious to seek to conform "actual" results to them; on occasion this involves falsifying the figures.

4. The Stock Exchange

The Stock Exchange has a compensation fund to ensure that clients do not lose money. The most common fraud on the Stock Exchange is probably pledging clients' securities to secure a stockbroker's overdraft. Another is passing transactions to clients at false prices, making an undisclosed "turn". The Stock Exchange has, by its compensation arrangements, managed to avoid some of the opprobrium falling on others.

5. Security Dealers and Commodity Dealers

There have been a number of cases where organisations purporting to make investments on clients' behalf have used the money for a different purpose, often including lining their own pockets. One example: Norton Warburg, which cheated pensioners of the Bank of England and Unilever. These organisations have no compensation fund, a gap which will be rectified for security dealers by the new legislation.

Regulation of the commodity markets may become a topical subject following the tin fiasco. There is no evidence of fraud there, but the supervision of the market appears to have been minimal.

6. Lloyd's

The most publicised problems at Lloyd's appear to be with certain syndicates where the underwriters or their associates are alleged to have defrauded the "names" for whom they act in a number of ways, such as:

- a. Paying themselves excessive expenses or perquisites.

- b. Creaming off the better and less risky business for themselves or their friends, by way of baby syndicates or otherwise, leaving the names to underwrite the "leftovers".
- c. Operating organisations in tax havens such as Bermuda, and milking these funds without disclosure.

It is also alleged that these organisations have been evading tax by various subterfuges. The syndicates objected to include some managed by Minets, Howdens, and Willis Faber, and considerable litigation can be expected, extending for a long time.

Alexander & Alexander, a US broker, brought an action against various directors of Howdens which was settled. They lost a lot of money because the financial position of the Howden Group, when they acquired it, was much worse than they expected.

Lloyd's complain that the Attorney General and DPP are not taking action against the miscreants, and this is likely to get further publicity when the Securities Industry legislation is introduced - particularly in view of the resignation of the Chief Executive at Lloyd's, Ian Hay Davison.

7. Banks

Allegations of fraud have been and are being made in the JMB affair - mainly, it appears, in connection with what seems to be a most imprudent level of lending. Was it corrupt or merely inefficient? What is the margin between acceptable hospitality and corruption?

Banks belong to a scheme to protect small depositors against failure, but this does not cover the Bank of England's possible losses.

There is also some smell emanating from Henry Ansbacher, which lost money following making an investment in the USA.

There have been a number of banking failures over the past 10 years, including London & County, Cornhill Consolidated, First National Finance, and Slater Walker. Common to these have been greedy and naughty directors lining their own pockets and borrowing short and lending long.

8. Three Personal Experiences

The next three cases illustrate the problems of dealing with fraud cases in practice.

British Printing

The Chairman, Wilfred Harvey, was in the habit of drawing large sums of money from the company. At the end of the year his account was substantially in debit, and the commission on the group's profits to which he was entitled was insufficient to regularise his account. The main way by which he was put into credit was for the company to buy a new subsidiary, backdated to the end of the financial year, ostensibly from a vendor but actually from Wilfred Harvey himself. He had acquired the shares for much less than the company paid him for them, the company's purchases being supported by stockbrokers' contract notes supplied by a crooked stockbroker.

One of the transactions was published in the auditors' report on the company, indicating that the Chairman had made a profit of over £250,000 on the transaction. This was front-page news in a number of newspapers. Prior to this,

details of the transaction, together with supporting documents, had been supplied to the Director of Public Prosecutions.

The resulting investigation was carried out by a single Detective Inspector, and after 2 years Harvey was arrested. Due to high blood pressure, he was released. Later, summonses were issued on other charges, but he produced medical evidence to the effect that he was prone to high blood pressure which might come on if, as might be expected, he was irritated by what was said in court! So he was unable to appear in court, and eventually the matter was dropped.

No charges were brought against others concerned in the frauds - the Company Secretary and the stockbroker, who produced false backdated statements. It was felt that their evidence was needed to convict Harvey.

MC

A fraud investigation was made into a contracting company which had issued a prospectus and then failed. Profits had been "manufactured" by inflation of stocks and work in progress on contracts, and by failing to provide adequately for reinstatement of sites.

A single Detective Sergeant was assigned to this work. It was evident, after he had been on the job for 6 months, that he really did not understand how the fraud had been carried out and what he should investigate.

After a while, the investigation was dropped, and no prosecutions resulted.

London & County Securities

The Inspectors in this case - Andrew Leggatt QC (now Mr Justice Leggatt) and myself - reported on a number of matters where fraud was alleged, in particular a transaction involving the theft of some £5 million.

Before the report was prepared, I suggested to the DTI that the investigation by the Authorities might take at least 2 years after the Inspectors' Report was prepared, based on my experience in the British Printing case. I was told that they would endeavour to bring prosecutions within 6 months. But again it took 2 years, and by the time the trials were held, perhaps another 2 years had passed.

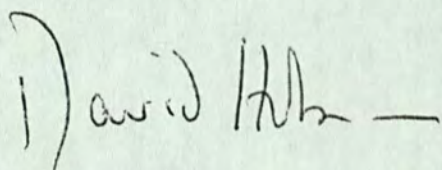
One can argue that the greatest unfairness is the time these matters overhang the defendants. The main defendant, Caplan, remains in the USA as extradition proceedings failed.

9. What should be done?

- a. I believe the main skill needed in investigating and proving complicated fraud cases is to find a limited number of specimen frauds and to break them down into simple explanations as to what happened. This is both a good discipline and necessary to present a good case in court.
- b. It is necessary to put sufficient personnel into the investigation with proper direction, so that charges can be brought within a reasonable time, and supported by evidence and witness statements.
- c. I have little experience of attending criminal trials, but sat on a murder trial jury as foreman once. What struck me was the apparent lack of preparation by

prosecuting counsel. I do not believe this experience unique. They need to settle in their own minds what they need to prove, and concentrate on what is relevant to this.

- d. Whether or not the Roskill Committee recommends trial by a judge, or judge and assessors, on the grounds that fraud cases are too complicated for a jury to understand, skill in picking the essentials in the case, and seeing the wood for the trees, will still be invaluable.
- e. Improved extradition arrangements to cover Spain - where many alleged criminals reside - are needed.
- f. There is open criticism of the Attorney General and DPP in Whitehall and outside. No results have been seen from the Chancellor's Fraud Investigation Group (FIG) initiative. The situation encourages fraud, and is dangerous to the Government's reputation.



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