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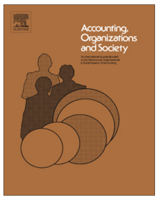

The apparatus of fraud risk

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A B S T R A C T

'Fraud risk' is ontologically different from fraud. Fraud itself is a disruptive event; fraud risk can and must be governed. This essay draws on Foucault's concept of an apparatus (*dispositif*) to explain the emergence of this difference. The analysis begins with a concrete case and explicates the history of fraud risk which flows through a specific organizational setting. First, it is claimed that fraud risk must be understood in relation to the broader historicity of risk in which risk expands its reach as an organizing practice category. Second, it is argued that the diverse elements of the fraud risk apparatus – words, laws, best practice guides, risk maps, websites, compliance officers, text books, regulatory judgments and many more – have a trajectory of formation. This trajectory begins with auditing and expands into risk management, regulation and security more generally. Fraud risk management emerges as a highly articulated, transnational web of ideas and procedures which frame the future within present organizational actions, and which intensify the responsibility of senior managers. Overall, the paper challenges the common sense idea that the present shape of fraud risk management is a functional necessity demanded by fraud events. The purpose is to display the historically contingent regime of truth for speaking about fraud, risk and responsibility in organizations. The paper suggests that this 'regime of truth' consists in a form of managerial and regulatory knowledge with a 'grammar' governing rules for talking about and acting on risky subjects and organizations. The rise of 'fraud risk' management and its prominent position within the field of corporate governance in the 21st century is emblematic of an ongoing neoliberal project of individualization and responsibilization.

Introduction

Fraud 'risk' and actual fraud are very different from one another. Indeed, they are ontologically different; one is a possibility and the other is an actuality. Instances of actual fraud have a long history and much legal and analytical attention has focused on the mind and character of the fraudster as a dangerous individual. In contrast 'Fraud risk' is a relatively recent category at the heart of a diverse network of elements – rules, ideas, roles, procedures, routines, texts – focused on risk, control systems and managerial responsibility. This paper argues that the contemporary prominence of fraud risk management is different in kind from the historical preoccupation of penal systems with retribution and blame; it is a distinctive risk framing of a future to be managed in the present. While an interest in fraud *prevention* techniques, such as segregation of duties, reaches back into the nineteenth century and beyond, it will be argued that such techniques had the insider fraudster in their sights in a very specific way. Only much later did this activity come to be part of something called 'fraud risk management'.

It is tempting to regard 'fraud risk' as somehow timeless and inherent in the nature of organizational life. Yet the converse argument will be proposed, namely that it is historically contingent on the formation of a socio-technical network of elements. Drawing on Michel Foucault, it will be argued below that this network can be understood as an apparatus (*dispositif*).

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Two broad historical developments drive the emergence of the apparatus of fraud risk. First, during the 1980s, financial auditing became self-consciously risk-based. One aspect of this development involved repeated efforts to shift responsibility for the prevention and detection of fraud from auditors to management and their systems of control. In many respects the publication of the first code of corporate governance in the early 1990s in the UK marked the completion of this process. Second, this exported responsibility for internal control connected with a wider explosion of interest in risk management from the mid-1990s onwards. Fraud became institutionalized as a distinctive responsibility- and risk-object for organizations. 'Fraud risk' became an organizing concept for an entire managerial and regulatory infrastructure.

'Fraud' itself is an elusive category and exists as a term within popular discourse. It may be understood generally as non-violent crime involving theft of assets directly or indirectly via a variety of means of deception, such as 'false accounting' (a criminal offence, Jones, 2011). Yet, although UK law has recently tried to be more precise about the various sources and means of committing fraud (Taylor, 2011, chapter 3), it has no statutory definition. Sometimes categorized as 'white collar' crime (e.g. Geis & Stotland, 1980), fraud is also a focus for a great deal of criminal law and criminological research (Levi, 1987) and has come to be subsumed within the more general notion of 'financial crime' encompassing moneylaundering. These different nuances and associations make fraud itself a slippery concept for analytical and legal purposes despite its long history. Specific fraud 'cases' continue to give it life and recent financial history provides no shortage of them, from Maxwell to Madoff; from Barings to UBS, and many more in between (Kindleberger, 2000, chapter 5; Clarke, Dean, & Oliver, 1997; Punch, 1996). Each case has led to reflection, investigation and pressures for reform. A focus has invariably been on the apparently deviant individuals in question; the character of the dangerous fraudster continues to fascinate a celebrity-oriented public. Yet equally, there has been a growing understanding that organizations and their economic environments are often both the context and potential means for the enactment of fraud, providing not only opportunity but also motive (Ermann & Lundman, 1996; Greve, Palmer, & Pozner, 2010). The emergence of 'fraud risk' management reflects the growth of institutional attention to these organizational conditions of fraud.

The arguments which follow address the historically contingent elements of fraud risk discourse as they emerged to shape the boundaries of thought, practice and responsibility attribution (Hopwood, 1987, pp. 230–231). Specifically, 'fraud risk' is positioned as an object in a wider system of rules for talking about, acting on and governing organizations in the name of risk. Rather than being a matter of common sense or functional necessity, the rise of 'fraud risk' management and its position in relation to corporate governance is emblematic of a distinctive liberal project of individualization and responsibilization (Rose & Miller, 1992). Yet, the main subjects of this process are not the fraudsters themselves but senior managerial actors, namely corporate directors as individuals and boards as their collective manifestation. How and why this new common sense of fraud risk management came about will be addressed in what follows.

The argument begins from a specific organizational context in order to ground the methodological orientation of the paper and to display some of the micro-manifestations of the macro-level apparatus of fraud risk. The work of Foucault is a particularly attractive resource in this regard, enabling analysis across what some have called the micro/macro-split (Silverman, 1985, p. 88). This is followed by an account of the historical conditions of possibility of fraud risk in terms of a generalized expansion of risk framing, beginning with the calculative 'insurantial imagination' in the nineteenth century and culminating in the mid-1990s with an explosion of less calculative but even more expandable forms of risk management. This analysis of the historicity of risk provides the 'archaeological' moment of the argument (Hacking, 1986) by laying out the background conditions of possibility for the emergence of 'fraud risk' discourse, first within external auditing, then within internal control and risk management and finally as a feature of regulation supported by advisory services.

Overall, it is argued that 'Fraud risk' is embedded in an extensive socio-technical apparatus (Hilgartner, 1992) involving regulators, consultants, compliance officers and many other actors, including material instruments such as fraud risk questionnaires and other diagnostic devices. The analysis goes on to suggest how security issues have also been re-coded within risk management frames, with a consequent securitization of fraud risk which continues to develop. At the heart of the apparatus of fraud risk is body of disciplinary knowledge in Foucault's sense which is not science yet which mimics the orderliness of science. The final section of the paper explicates the structure of this disciplinary knowledge as a 'grammar' characterized by four problem–solution clusters or diagnostic tropes. These clusters, which are defined by their respective deviant subjects (employees, leaders, organizations and outsiders), have their own specific histories of emergence, but they are also contemporaneous and intermingled, thereby contributing to the density of the apparatus.

The ambition of the analysis as a whole is to move from a specific micro-setting to an understanding of the system of thought which flows through it and which constitutes the practice of fraud risk management. While there is rich variation and agency to be observed at the case level (Lounsbury, 2008), this variation can also be understood as variety within a larger system of thinking or logic whose elements are made manifest in the analysis which follows. Indeed, even though there seem to be clear and obviously functional business interests in preventing costly fraud (FSA, 2006a), the analysis of the apparatus of fraud risk casts light on the deeper presumptions, assumptions and regularities which shape and channel the articulation of such interests.

Practices and method

The analysis begins with a specific case. The author has been a high level part-time participant at a large financial