

Report for Information

Report To: Audit Committee - 3 June 2010

Subject: Internal Audit Annual Fraud Report 2009/10

Report of: City Treasurer / Head of Internal Audit and Risk Management

Summary

Like any organisation of significant size and complexity Manchester City Council is inherently vulnerable to risks of fraud and corruption. In response to these risks the Council has a range of mitigating controls including the Fraud Investigation Group within Revenues and Benefits, enforcement officers in other services and dedicated anti-fraud and corruption resources within Internal Audit

This report provides a summary on the outcome of proactive and reactive anti-fraud and investigation work during 2009/10, with a particular focus on the work delivered by Internal Audit. It outlines some of the areas of emerging fraud risk and the Council's strategic and operational arrangements for managing these risks.

Recommendations

Members are requested to consider the Internal Audit Annual Fraud Report for 2009/10.

Wards Affected:

None

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Background documents (available for public inspection):

Internal Audit Plan 2009/10

1. Introduction

- 1.1. As a major employer, continually seeking to change and transform how it delivers services and that is engaged in a range of partnerships and activities the Council is inherently vulnerable to acts of fraud and corruption committed both from within and outside the Council. Nationally, fraud is recognised as a growing area of risk, particularly in the current economic climate, and the Council is not immune to these increased levels of risk.
- 1.2. This is the first Internal Audit annual fraud report. The purpose of the report is to provide a summary on the outcome of proactive and reactive work undertaken during 2009/10 to investigate referrals of fraud and other potential irregularities. It sets out the context for fraud risks in the Council and how the Council responds to these risks. It provides a summary of the work delivered by Internal Audit in the year and areas identified for further development during 2010/11.

2. Key issues and drivers

- 2.1. A recent report by the National Fraud Authority (NFA) calculated the annual cost of fraud in the United Kingdom to be £30 billion with 58 percent of fraud occurring in the public sector at a cost of £17 billion.
- 2.2. In the current economic climate there is a perceived increased risk of fraud due to a tightening of available credit and borrowing. In local government, budgetary pressures and the emphasis on efficiency savings are also considered to be factors that increase the likelihood of fraud. In response central government has established the NFA to coordinate a national strategy aimed at fraud prevention and detection. There is also increased focus on the collection of fraud statistics across the public sector, most recently by the Audit Commission, to help identify and respond to emerging areas of fraud risk.
- 2.3. Fraud can be perceived as a soft touch and a victimless crime but this is not the case. Fraud costs money and impacts adversely on the ability of the Council to deliver essential services and keep Council Tax as low as possible.
- 2.4. To safeguard public funds and ensure these funds are used for their intended purpose the Council has a zero tolerance approach supported by a strong policy statement and commitment to tackling fraud and corruption. This is backed up by various policies, procedures and codes linked to the Anti-Fraud and Corruption Strategy. This is to help ensure that the people of Manchester and stakeholders can have complete confidence that the affairs of the Council are conducted in accordance with the highest standards of probity and accountability and that Members and officers demonstrate the highest standards of honesty and integrity.

3. Structure and roles

- 3.1. Internal Audit acts on behalf of the City Treasurer in ensuring the Council has appropriate arrangements to deter, detect and investigate fraud. This role includes the following:
 - Driving the continual development of a framework of anti-fraud policies and procedures

- Raising awareness of fraud risks and developing mechanisms to maximise the opportunities for fraud risk reporting.
 - Responding to whistleblowing allegations, referrals and other concerns including those received under the Council's Money Laundering Policy
 - Investigation of reports of financial or other irregularity
 - Liaising with Greater Manchester Police to support criminal prosecutions
 - Delivering a programme of proactive anti-fraud reviews
 - Providing advice and support to managers across the Council and within schools in their own investigation of irregularities
 - Providing advice and recommendations to managers on appropriate controls to help prevent and detect fraud and corruption.
 - Monitoring anti-fraud activity across the Council
- 3.2. In discharging this wide range of roles Internal Audit has a Lead Auditor for anti-fraud. This post was created in 2009/10 to support the Council in further developing its strategic and coordinated approach to combating fraud. This officer is supported by auditors and investigators within the Internal Audit Section and across the team there are three officers qualified in the CIPFA Certificate in Investigative Practice.
- 3.3. The Council's approach to fraud risk management extends beyond Internal Audit. These include the Fraud Investigation Group in the Revenues and Benefits Unit which deal with Housing Benefit and claimant fraud, the Blue Badge Enforcement Team, Trading Standards and Corporate Personnel. All of these teams have a vital role to play in the deterrence, detection and investigation of fraud. For example the Fraud Investigation Group report regularly to the Resources and Governance Overview and Scrutiny Committee and in 2009/10 they investigated over 1,100 cases of alleged claimant fraud that resulted in nearly 50 criminal convictions and the recovery of over £1m of housing and Council Tax benefit overpayments.
- 3.4. In 2009/10 Internal Audit spent 340 days on proactive and reactive anti-fraud and corruption work compared to a budget of 255 days. The majority of this was spent on investigations. In recognition of the need to ensure robust arrangements to deter, identify and investigate fraud risks over 500 days have been allocated to anti-fraud work within the 2010/11 Internal Audit Plan for 2010/11.

4. Reactive fraud cases

- 4.1. During 2009/10 Internal Audit received formal notification of 68 reported cases of suspected fraud, theft or irregularity. 22 of these were handled under the Council's Whistleblowing procedure and referrals included concerns raised directly by managers and members of the public. Internal Audit led investigations, supported managers and advised investigating officers in all of these.
- 4.2. One of the challenges in handling these cases is the wide and varied nature of the referrals received and determining how best to investigate. Types of referrals included suspected cases of fraud, staff behaviour and conduct issues,

matters relating to external organisations for which the Council provides funding, issues of licensing, data loss, procurement irregularities and sickness fraud.

- 4.3. It is important to acknowledge that investigations are conducted independently and without prejudice. This is reflected in a number of cases where investigations have resulted in the exoneration of individuals against whom allegations have been made. This is an essential part of the process as officers and Members need to be assured that whilst fraud and corruption allegations will be thoroughly investigated these investigations are designed as much to protect staff from unfounded allegations as they are to identify and address wrongdoing.
- 4.4. The key areas of focus and examples of cases investigated in the year included the following

Theft

- 4.5. 2009/10 has seen a rise in the number of reported thefts of cash or assets from schools or Council premises. There have been a number of thefts of computer equipment from schools, in one case of over 100 laptops. In this particular case the police were involved and are continuing to investigate.
- 4.6. There have been several incidents involving thefts of cash from safes located in schools or Council offices, in one example of up to £5,000. Where possible, disciplinary action has been taken but thefts have highlighted some examples of poor controls over cash handling and access to safes. The outcome of this has been that the Internal Audit plan for 2010/11 includes a proactive review of safes and security in schools to ensure that appropriate controls are in place to manage these risks.
- 4.7. A driver employed by the Council was found to have stolen fuel valued at up to £38,000 from depots over a period of time. The driver resigned and the matter has been reported to the police for further consideration and recovery of funds.

Chequebooks

- 4.8. There have been several frauds involving the interception, alteration or use of counterfeit school cheques for sums up to £25,000. These have generally been perpetrated externally, and while controls operated by the bank have prevented significant losses it does highlight the potential vulnerability of schools to this type of fraud. The positive pay processes and controls within the Council's systems prevent this type of fraud with main payment systems but does not apply within schools so we are continuing to work with them, as well as colleagues in finance and the banks, to help minimise the risk of this type of fraud.

Procurement and payments

- 4.9. Given the volume and value of payments made by the Council each year it is not unsurprising that errors and attempted thefts do occur. There were a number of these in the year including the following.

- 4.10. A creditor payment of £68,000 was misdirected and paid to the wrong person because of the cumulative effect of a number of errors. The outcome of our investigation was the recovery of the funds, pursuit of a criminal prosecution and a series of recommendations to address the risks of similar issues in the future.
- 4.11. Payments for care services continued to be made to the bank account of a service user following his death and resulted in an overpayment of £68,000. The circumstances into the overpayment and steps to recover the funds are being investigated by management.
- 4.12. Four BACS payments totalling £1m were identified as being paid incorrectly to one of the Council's bank account. These misdirected payments did not result in a financial loss to the Council but investigations were undertaken to establish whether this was a system error, mistake or deliberate attempt to divert funds. Whilst there is no evidence of potential fraud this cannot be completely discounted as there remains a system control weakness that is the subject of ongoing work between ICT, the system supplier and Internal Audit.
- 4.13. The Council has been targeted by bogus recruitment and advertising companies submitting false invoices dating back to 2006. The individual behind one of these companies was already being investigated by Merseyside Police and has we have provided statements that have contributed to a charge of conspiracy to commit fraud.
- 4.14. We also investigated allegations in respect of contracts and contractors. These did not identify fraud issues but areas of non-compliance with expected procedures and financial regulations that were addressed in each case. The wider contract fraud risk will be considered further as part of revenue and capital contract compliance testing in the 2010/11 audit plan.

Thefts from service users

- 4.15. We have been involved in supporting a number of investigations into the management of finances for vulnerable service users in the Directorate for Adults. There have been some significant thefts including one old case valued at over £100,000. Work is ongoing in a number of other cases but the outcome of this investigation has been the conviction of a former member of staff who was sentenced to 15 months imprisonment. Another case is due at Crown Court in 2010. Following these investigations we are able to confirm that the service made fundamental changes to processes and procedures to provide greater control over staff with responsibility in this area. This has proven to be a significant area of inherent fraud risk and Internal Audit will continue to provide assurance over the robust operation of these procedures and the audit plan includes both audit and proactive fraud work in this area for 2010/11.

Computer Misuse

- 4.16. We have received reports on the sharing of usernames and passwords by staff. These reports did not identify any deliberate attempt to misuse data or act fraudulently but management have taken positive actions to ensure the risks of reoccurrence have been addressed.

Financial Irregularities

- 4.17. We have been involved in the delivery of a number of audit investigations into services where financial irregularities have been identified. In these cases we have worked with management to deliver comprehensive reviews of financial management arrangements resulting in the reporting of recommendations for improvement. This is an area of added value where the outcome of initial investigations has been sustained support to management to ensure that the risks of financial loss are addressed and appropriate actions are taken to improve financial management arrangements.
- 4.18. Several cases reported to us during 2009/10 are still under investigation and will result in disciplinary action and possible criminal action.

5. Proactive Anti-fraud work

- 5.1. In addition to the reactive investigation work Internal Audit developed new areas of activity around fraud prevention and detection in the year. This work was supported by the effective use of new data interrogation and analysis software in data matching and data mining exercises. This software is now used by Internal Audit and the Fraud Investigation group and provides the Council with the tools to analyse data to identify potential unusual or potentially fraudulent transactions for further investigation.
- 5.2. Pilot proactive fraud detection reviews have been undertaken and have proven successful in identifying fraud risks as well as system and compliance issues. The three pilot reviews undertaken in the year were as follows:
- 5.3. Duplicate payments: Work led by Internal Audit detected duplicate creditor payments of £80,000 to be recovered. The work highlighted the potential risks around duplicate payments and further preventative and detective work is planned for 2010/11. We are also discussing with the Head of Financial Management how such checks could be integrated into her own business assurance processes.
- 5.4. Staff expenses: Focussed on staff business travel and subsistence claims. We are pleased to be able to report that we did not identify any fraudulent transactions but identified areas of non compliance that have been reported to management for further action.
- 5.5. Purchase cards: As with staff expenses, our transactional testing identified no fraud but identified areas where improved recording and reporting would help to further minimise potential risks.
- 5.6. The success of these exercises has been encouraging. A fraud risk assessment has been developed and has been used to inform areas of further focus in 2010/11. Alongside this Internal Audit is developing a fraud risk register that will be used as a dynamic document to inform pro-active fraud and internal audit work.

6. National Fraud Initiative 2008/09

- 6.1. Internal Audit coordinates the Council's involvement in the National Fraud Initiative (NFI). NFI is the Audit Commission's biennial data matching exercise designed to detect fraudulent and erroneous transactions across the public services. The core of this work is to help deter and detect housing benefit fraud, occupational pension fraud and tenancy fraud but also uses data matching techniques to identify potential fraud in areas including housing rents, right to buy, blue badges, insurance claims and payments to creditors.
- 6.2. The overall exercise produced a number of cases requiring investigations of varying complexity, some of which might be considered fraudulent. Internal Audit worked together with other relevant service areas to actively manage the matches. To date £230,000 of savings has been attributed to this work, a significant proportion of which relates to Housing benefit fraud work undertaken by colleagues in the Fraud Investigation Group. Work is continuing in this area, with preparation for the 2009-10 NFI exercise planned for later in the year.

7. Developing an anti-fraud culture

- 7.1. The Council has a zero tolerance approach to dealing with fraud and corruption and this commitment is positively and publicly endorsed by Members and the Senior Management Team.
- 7.2. Internal Audit work to promote the anti-fraud culture across the Council has included a review and update of the Council's Anti-Fraud and Corruption Policy and Procedure, the Whistleblowing Policy and Anti-Money Laundering and Proceeds of Crime Policy. These policies establish the arrangements for reporting and investigating suspected cases of fraud.
- 7.3. A dedicated anti-fraud and corruption page on the intranet has brought together various Council policies, procedures and codes relating to anti-fraud. This has helped further clarify how to report concerns to Internal Audit and the Fraud Investigation Group. This site will be developed further in 2010/11 to help raise levels of awareness amongst staff of fraud issues and highlight areas of anti-fraud activity, risks and success stories. The outcome of this, the engagement of directorates throughout the year and presentations to officer groups has been positive with increased awareness of managers reflected in earlier reporting of allegations and suspicions to Internal Audit.
- 7.4. The Chartered Institute of Public Finance and Accountancy (CIPFA) Redbook publication is a standard of good practice for managing fraud and corruption. Our assessment of the Council's arrangements against these best practice standards and benchmarking with AGMA colleagues demonstrated a good level of compliance as well as some areas for improvement that are reflected in the key priorities for 2010/11.

8. Fraud Monitoring and Reporting

- 8.1. One area where there is an opportunity to develop arrangements is fraud monitoring and reporting. Given the number of different services involved in fraud detection and investigation work across the Council and wide range of

potential fraud, corruption, disciplinary and conduct issues that are investigated there is scope to develop greater consistency, clarity and completeness of reporting. This will include the development of this report for next year to determine how the activities of other services involved in fraud detection can be best consolidated and provide Members with a complete picture of anti-fraud arrangements across the Council.

- 8.2. Internal Audit have taken responsibility for monitoring and reporting the outcome of suspected cases of fraud and corruption and the Head of Internal Audit and Risk Management now provide regular briefings to the Executive Member for Finance and Human Resources, the Chair of the Audit Committee and the City Treasurer that include fraud risks. This is in addition to reporting by the Head of Revenues and Benefits on claimant fraud.
- 8.3. In 2009/10 the Audit Commission introduced a fraud and corruption survey following the publication of their 'Protecting the Public Purse' report. This requested information relating to categories of fraud and corruption and was to be used to assist the Commission and National Fraud Authority (NFA) in developing their understanding of national fraud risks. Internal Audit completed the survey on behalf of the Council but this process demonstrated the need to develop the Council's corporate arrangements for capturing, recording and reporting cases of fraud. This is a key priority for 2010/11 as the coordination of anti-fraud intelligence and activity should help to ensure that resources across the Council are targeted appropriately, efficiently and effectively. Manchester was one of only 62% of Council's who submitted a response to this survey and the Audit Commission has elected to exercise its powers under section 48 of the Audit Commission Act 1998 to require all Councils to submit an updated response by the end of June 2010.

9. Key priorities 2010/11

- 9.1. 2009/10 has seen higher than anticipated levels of referrals and fraud investigations in a number of thematic areas including theft, payments and financial irregularity. The need to respond quickly and comprehensively to allegations of fraud and corruption has impacted on the ability to deliver as much development and proactive anti-fraud work as had been anticipated at the start of the year. This demand on resources is reflected in the 537 days of auditor and manager time for reactive and proactive fraud work in the 2010/11 Internal Audit Plan.
- 9.2. Despite this volume of referrals good progress has been made. This has been acknowledged by the external auditor whose recent Use of Resources submission to the Audit Commission stated that "arrangements for anti-fraud and corruption and promotion of good conduct have been further strengthened through investment in a dedicated post within internal audit. There is evidence of pro-active fraud work during the year in a number of areas to support the Council's Counter Fraud and Corruption plan". The refresh of policies and procedures, development of intranet resources, benchmarking and risk assessments have all contributed to improved anti-fraud awareness and arrangements. Losses have been averted and in many cases recovered with improved engagement and support from the police.

9.3. Nonetheless there are further opportunities for development that we have identified as service priorities for 2010/11 that include the following:

- Supporting the Council to improve levels of awareness of fraud risks amongst managers, staff and partners.
- Further improvements to the effective communication of Council policy, procedures and codes relating to anti-fraud
- Finalisation of fraud risk assessments and a fraud risk register to focus resources on potential vulnerabilities
- Building on the strong links with the police over case handling and arrest
- Continuation of a strong proactive anti-fraud programme to deter, prevent and detect potential fraudulent activity
- Working with colleagues, particular in personnel and the Fraud Investigation Group to help clarify roles and responsibilities, share expertise and maximise the efficiency and effectiveness of anti-fraud activity across the Council.
- Maintaining intelligence and oversight of fraud cases and outcomes to support decision making.

10. Conclusions

10.1. Members are asked to note the 2009/10 Internal Audit Annual Fraud Report.