



AUDIT & GOVERNANCE COMMITTEE
2 December 2013

**Half-year summary of Internal Audit irregularity
investigations and anti fraud measures
April – September 2013**

SUMMARY AND PURPOSE

1. The purpose of this report is to inform members of the Audit and Governance Committee about irregularity investigations and anti-fraud measures undertaken by Internal Audit in the first half of this financial year from 1 April to 30 September 2013.
2. Audit reports following irregularity investigations typically help to provide independent evidence to support a management case against an employee under formal disciplinary procedures, or to help tighten control in areas where weaknesses are identified. Irregularity audit reports are not subject to the same distribution as general audit reports due to their confidential nature. This arrangement is formalised within the Reporting and Escalation Policy, agreed by this committee.
3. Due to the confidential aspects of such investigations, and given that some are ongoing in terms of investigation and/or forthcoming disciplinary hearings, this work is reported in a summarised and thematic fashion to committee rather than on a detailed case-by-case basis.

RECOMMENDATIONS

4. The committee is asked to note the contents of this report.

BACKGROUND

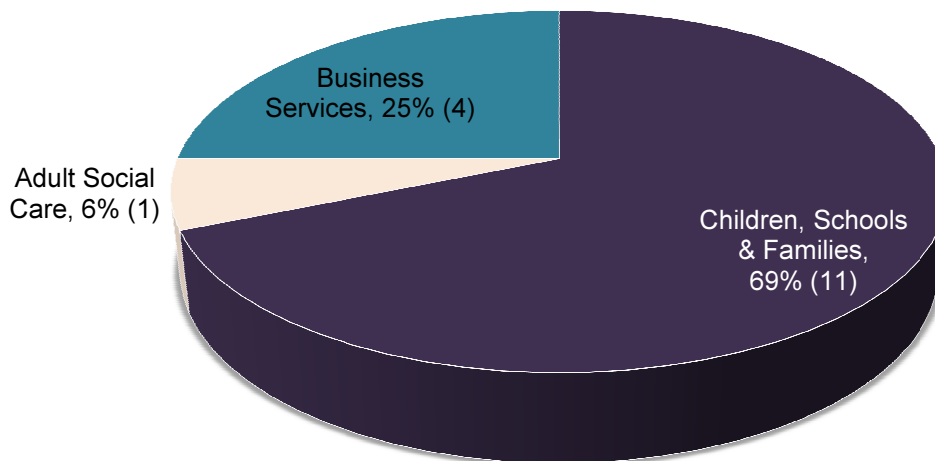
5. The council's Financial Regulations require all matters involving, or thought to involve, corruption or financial irregularity in the exercise of the functions of Surrey County Council to be notified to the Chief Internal Auditor. Internal Audit will in turn pursue such investigations as appropriate. To allow for an adequate resource to investigate alleged fraud and financial irregularity the annual Internal Audit Plan for 2013/14 carries within it a contingency budget for 'Irregularity and Special Investigation Work' of 345 days.
6. This contingency covers work to investigate 'irregularities' (actual or alleged financial impropriety, corruption, and other similar matters) as well as time for Fraud Prevention work, assisting with the Audit Commission's National Fraud Initiative (NFI), reviewing the national Fighting Fraud Locally strategy and using data analytics to test for specific fraud scenarios. This proactive work is considered in more detail in paragraph 27.

7. Special ad hoc reviews are also charged against this contingency if commissioned in-year by members or senior managers and not originally in the agreed annual plan. Examples of such reviews in the first half of 2013/14 include an investigation into the purchase of land by the council; scrutiny of the TUPE transfer arrangements of council maintained school staff to academies; and analysis of external publicity communications expenditure. While often linked to concerns raised by management these reviews may also arise during the course of planned audit work.
8. In the six months since April 2013, 16 investigations commenced excluding ad hoc special reviews. Four of these cases arose due to whistle blowing allegations; 11 were brought to the attention of Internal Audit by management; and one arose as a result of a data match from the NFI exercise.
9. Of the 16 investigations undertaken, six cases have been investigated as possible fraud or theft; three concerned breaches of the Code of Conduct; three involved non-compliance with Procurement Standing Orders; and four were cases of poor control.
10. These 16 investigations are shown diagrammatically in Figures 1 and 2 (below) to identify the Directorates in which the review fell and the broad type of investigation undertaken. Numbers of investigations in each area are shown in parenthesis. A total of 51 days has been used to investigate these cases since April 2013.

SUMMARY OF IRREGULARITIES BETWEEN APRIL AND SEPTEMBER 2013

11. Figure 1 illustrates the proportion of all recorded irregularities across the different Directorates of Surrey County Council.

Figure 1: Summary of investigated irregularities by Directorate, April - September 2013



12. The distribution of investigations across the various Directorates is broadly in line with expectations. The higher proportion of investigations in front-line services reflects the fact that these services typically have more risks associated with access to cash and assets over numerous sites than back-office departments.

13. Figure 2 shows by broad categorisation how the 16 cases of irregularity are defined by typology. In some cases more than one type of irregularity might have been alleged or investigated within one case (for example, both breaching the Council's Procurement Standing Orders and theft of Council assets). Figure 2 therefore shows the primary reason for investigation and more detail is provided on specific cases later in this report.

Figure 2: Summary of irregularities by typology, April - September 2013

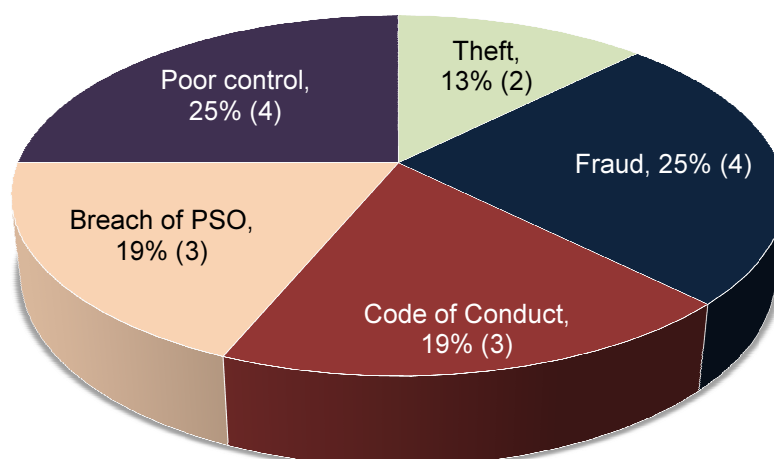


Table 1: Definitions of typologies defining the irregularities investigated 2013/14 to date

Type	Definition
Theft	The theft of assets (most frequently cash) from council property or from clients under the council's care.
Fraud	Attempts to obtain money by deception, including submission of incorrect travel allowance claims and/or through false accounting.
Code of Conduct	Failure (or alleged failure) to comply with council policies (Code of Conduct, Procurement Standing Orders etc) in respect of declaration of a second employment, pecuniary interests, completing contractual obligations or managerial responsibilities, or declaring appropriately possible material conflicts of interest.
Breach of PSOs	Failure by staff or contractors to comply with the Council's Procurement Standing Orders.
Poor Control	Examples where local or corporate arrangements fail to stop inappropriate payments being made or fail to ensure compliance with council policy.

14. To give a better indication of the type of work conducted by Internal Audit in the first half of the financial year the following paragraphs summarise examples of specific investigations (appropriately anonymised). Internal Audit work in this area not only protects the Council's assets and reputation; it acts as a visible deterrent in preventing other irregular activity across the organisation.

Theft

Misappropriation of funds from a school shop

15. The implementation of a new till system in a school shop revealed discrepancies between shop takings and income banked. It was apparent that this shortfall in banking was in excess of £30k and had been going on for some time. The school bursar contacted Internal Audit for advice.
16. Following review of the records, which included fake invoices, Internal Audit concluded that, given the criminal nature of the case, referral to the police was the most appropriate course of action. While there has been no further involvement from Internal Audit an update from the school is being obtained.

Fraud

Whistle blowing about a Business Manager

17. Another example highlighting the role of the police in investigating criminal activities is the case of a school Business Manager whose misconduct was identified after a newly appointed Headteacher reviewed financial processes. Concerns raised included misuse of the school purchasing card, falsified overtime claims, and possible bid-rigging with a building contractor.
18. The initial investigation was temporarily ceased in December 2012 after sufficient evidence was found to refer the case to Surrey Police. In July 2013, however, the internal investigation recommenced alongside the criminal proceedings. Internal Audit contributed to the disciplinary case, which culminated in the dismissal of the Business Manager on the grounds of gross misconduct. Criminal hearings are still pending and a court case is scheduled for December.

Code of Conduct

Officer role as a company director

19. NFI reports revealed a matching address for an officer and a company in receipt of payments from the council. Internal Audit determined that the officer and his partner were directors of the company from which the council had purchased in excess of £70k of services. Despite this, the officer failed to declare any pecuniary interest. On one occasion where the company's services were procured, the officer was placed in the position of direct line manager of his partner, in breach of the Code of Conduct.
20. In addition, the officer secured new employment with another council while on sick leave from Surrey County Council before failing to serve his notice period. As a result of this investigation, the officer's leaving date was brought forward, the final month's salary recalled, and a note placed on file indicating that disciplinary action would have commenced had he remained in the council's employment.

Breach of Procurement Standing Orders

Payments for cleaning services

21. Internal Audit was asked to comment on the propriety of purchasing services from an employee-owned cleaning company. Operating as a sole trader, an informal arrangement with management enabled contracting of small cleaning jobs without any formal tender. Over the course of several years, however, the cumulative payments to the company approached £500k, the value at which Cabinet approval is required.

22. This case demonstrates how the lack of any strategic overview created a situation in which senior managers commissioning cleaning services were inadvertently in breach of the council's Procurement Standing Orders. Internal Audit has requested the vendor is blocked and an appropriate market tender undertaken for these services.

Poor control

Use of staff personal money for client care services

23. Internal Audit investigated an instance of officers in Children's Services using their own personal money to pay for clients' care services and then claiming reimbursement. While there was no indication that this practice was widespread, there was evidence of expenses being reimbursed through direct billing to vendor accounts.
24. Guidance offered multiple alternative routes by which staff may reclaim expenses and there was no explanation for this divergence from normal practice. These local arrangements created an unprofessional relationship between officers and clients and Internal Audit recommended that the service use only agreed methods for reimbursement of expenses.

Direct receipt of sales income by an officer

25. A manager at a youth centre requested the assistance of Internal Audit following the discovery of paperwork that suggested income from DVD sales had been paid directly to a Youth Worker. The DVDs were recordings of stage productions by the youth centre, made available for sale to participants and their parents.
26. The Youth Worker confirmed that all income relating to these sales was made payable directly to her, including by cheque. It appeared, however, that the Youth Worker had acted under the instruction of former management. Although there were no complete records of the total income, there was insufficient evidence to suggest fraudulent behaviour. Internal Audit concluded that poor judgement by former management had created this unusual scenario but a subsequent change in management and cessation of production filming eliminated the risk of this reoccurring.

PROACTIVE FRAUD PREVENTION AND AWARENESS WORK

27. Internal Audit has made continued progress in embedding an anti-fraud culture within the organisation through specific proactive fraud prevention and awareness work.

National Fraud Initiative

28. In July 2013, the Government announced its intention to transfer responsibility for NFI to the Cabinet Office in 2015 following the closure of the Audit Commission.
29. The biennial NFI exercise matches key data sets such as payroll and pensions, vendors, and care data across the public sector to identify fraud and error. The data is matched with records including other public sector payrolls, housing, immigration, and deceased person records.

30. A total of 17,600 data matches were identified at Surrey County Council, detailed across 35 reports of which Internal Audit has completely reviewed 27 to date. Previous NFI exercises have identified illegal workers, duplicate payments and pensions still in payment after death. Findings in the current exercise have been limited but this provides assurance that the processes and procedures in place are minimising losses through fraud and error. Findings include:
- No issues of fraud or error for Care or Insurance data;
 - An overpayment of £250 in respect of a deceased pensioner;
 - Two duplicate payments to vendors totalling £2,000; and
 - Secondary employment of one officer contributing to resignation.

Fighting Fraud Locally

31. The National Fraud Authority launched the Local Government Strategy “Fighting Fraud Locally” in April 2012. A report to this committee in October 2012 recognised a number of key components already in place to support an effective counter fraud culture but also identified several areas for improvement.
32. Work has been undertaken to address these areas for improvement, which includes:
- Updating the Strategy Against Fraud and Corruption, approved by Cabinet in February 2013;
 - Refreshing the Fraud Awareness e-learning package and publicising the new strategy and e-learning on S-net and posters from May to July. While there was a measured increase in the number of views of the associated web pages, only 39 new individuals completed the e-learning. Consideration is currently being given to ways to improve this take-up.
 - Incorporating an assessment of the council’s fraud and corruption risks during preparation of the Internal Audit Plan 2013/14. This includes an allocation of days for anti-fraud and data interrogation, detailed further in paragraph 33; and
 - Working with Human Resources and Organisation Development to review the ‘fraud-proofing’ of policies, ability to risk assess the level of recruitment vetting required, and assessment of the whistle blowing policy against the BSI Code of Practice.

Data interrogation

33. While still in development, the anti-fraud data interrogation technique is based on a fraud scenario model. Systems are reviewed and unusual activities analysed for traits or patterns of behaviour consistent with a fraud scenario. Examples of some of the tests undertaken since April 2013 are detailed below.

Changes to own records by payroll officers

34. Management in Payroll identified a ‘test’ additional payment made to a payroll officer’s pay. Internal Audit determined that the level of SAP access required by payroll officers was such that amendments were possible without any separation of duties. Consequently payroll officers were able to amend their own payroll records. Internal Audit tested all adjustments to pay for payroll staff to ensure no other transactions had been processed and management are currently addressing SAP access levels.

Uplift of net pay using gross pay deductions

35. Internal Audit discovered that a feature in SAP that allows one-off deductions to pay may be manipulated so that, rather than gross pay being reduced, it is actually inflated. This is due to an automatic calculation used by SAP. This potential fraud scenario is currently under further investigation.

Assumed vendor fraud

36. The history of a vendor may indicate fraudulent activity. For example, a vendor that has been dormant and which suddenly has a change of bank details followed by payment of numerous low value invoices may indicate fraud. This fraud would be due to an employee amending the details of the vendor and diverting payments to an account under their control. Analysis identified three vendors with these traits but ultimately there was no evidence of assumed vendor fraud.

Single Person Discount

37. The Audit Commission estimates 4% of Single Person Discount (SPD) claims for council tax are fraudulent, representing a potential loss of income of £3m to Surrey County Council. In light of the fact that borough and district councils, responsible for the billing and collection of council tax, retain on average only 10% of the council tax collected (76% going to the county, 14% to the police), these councils have only limited incentive to invest in recovery of fraudulent SPD claims.
38. The Investment Panel approved an 'invest to save' project in December 2012 and, following a procurement exercise, a contract was signed with Capita in August 2013 on a payment by results basis.
39. Internal Audit is acting as a contract manager for the exercise, which is already underway. Data has been matched for all authorities and letters are being sent to claimants where results suggest they may not be sole occupants. The outcome from the exercise will be reported in the annual report to committee.

IMPLICATIONS

Financial and value for money

40. Public money is safeguarded through Internal Audit investigation of fraud and irregularities, ensuring that perpetrators are appropriately dealt with and recommendations to improve internal control made where necessary.

Equalities

41. There are no known equalities implications in this report.

Risk management

42. Combating fraud will contribute to better internal control and value for money.

WHAT HAPPENS NEXT

43. No specific action is required.

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Sources/background papers: Final irregularity reports, Committee reports, Galileo database

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