

## MIDDLESBROUGH COUNCIL

### COMMITTEE REPORT

#### CORPORATE AFFAIRS AND AUDIT COMMITTEE

29 September 2016

#### Internal Audit – Annual Counter Fraud Report

#### Helen Fowler – Audit and Assurance Manager

#### PURPOSE OF REPORT

1. To update Members on the impact of fraud on the UK by summarising the main national fraud risks facing the public sector as set out in the Protecting the English Public Purse (*PEPP 2015*) report by The European Institute for Combatting Corruption And Fraud (TEICCAF).
2. To consider the potential impact of fraud on Middlesbrough Council and its residents, the existing counter fraud arrangements in place and the further action that could be taken to safeguard the Council from fraud and loss.
3. To report on the number and type of investigations undertaken by Tees Valley Audit and Assurance (TVAAS) since the previous report to this Committee on Counter Fraud activity.

#### WHAT IS FRAUD AND CORRUPTION?

4. Most organisations are at an increased risk of fraud and corruption with the fastest areas of growing risk being cyber crime and fraud caused by insiders (including acts of theft or data destruction/manipulation by employees). The latest Annual Fraud Indicator 2016 was published by Experian, PKF Littlejohn and the University of Portsmouth's Centre for Counter Fraud Studies, who have created a partnership to help consistently gauge, analyse and quantify the true scale of fraud in the UK. The total estimated fraud losses for local government amounted to £7.3bn.
5. The European Institute for Combatting Corruption and Fraud (TEICCAF) is an independent, not-for-profit organisation founded in April 2015 and is committed to working in partnership to help tackle public and voluntary sector fraud and corruption. TEICCAF was established, in part, as a response to concerns from key stakeholders about the emerging gap in counter-fraud leadership that had developed by early 2015. The organisation's aim is to work in partnership with local authorities to develop an approach that allows fraud prevention work to be accurately reported nationally, regionally and locally.

6. Fraud is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as the intentional distortion of financial statements or other records by persons internal or external to the authority, which is carried out to conceal the misappropriation of assets or otherwise for gain, or to mislead or misrepresent.
7. Corruption is defined as the offering, giving, soliciting or acceptance of an inducement or reward which may influence the action of any person; or the failure to disclose an interest in order to enjoy financial or other pecuniary gain.
8. Bribery is the receiving or offering of undue reward to persons in order to influence their behaviour contrary to ordinary standards of integrity and honesty.

## **Recent Developments in UK Counter Fraud**

9. Recent years have witnessed significant changes in the counter-fraud landscape in local government as follows:
  - The closure of the National Fraud Authority in March 2014 and the Audit Commission a year later created a significant gap in the support, advice and leadership available to councils in the fight against fraud. In July 2014, CIPFA established a new 'centre of excellence' to combat fraud. The centre is working closely with the Department for Communities and Local Government (DCLG), the Cabinet Office, the National Crime Agency (NCA) and other agencies to develop policies, tools and guidance to help public sector organisations to identify and address fraud.
  - Significant funding reductions since 2010 for councils has contributed to a near 20 per cent reduction in counter-fraud investigators in councils in the four years up till March 2014 meaning that councils have reduced capacity to take a proactive approach to fraud detection.
  - A significant change has also been the transfer of most of the benefit fraud investigators to the Single Fraud Investigation Service (SFIS), which is managed by the Department for Works and Pensions. The transition to the SFIS began in July 2014 and was due to have been completed in March 2016.
  - Longer term technological improvements in service delivery are also rapidly changing the fraud risk landscape, including the increasing adoption of digital technology. The internet has transformed the ease with which fraudsters can operate across borders.

## **National Fraud Detection**

10. Protecting the English Public Purse 2015 (PEPP 2015) reports that care should be taken when interpreting fraud detection results and states that it should not be assumed that detecting little or no fraud provides assurance that no fraud is being committed. The report states that fraud affects every council and that councils that look for fraud in the right way, will find it. The report also emphasises that whilst fraud will always be committed, prevention and deterrence strategies can reduce the harm caused.
11. PEPP 2015 points out that local authorities detected fewer frauds in 2014/15 (nearly 85,000) compared to the previous year (just over 104,000). The value of

fraud detected in 2014/15 increased over the previous year, rising from £188 million to £207 million. This is the highest annual value of detected fraud since the data collection process began in 1991. The 18.4 per cent reduction in total overall detected fraud cases is driven by the one-third reduction in detected cases of housing benefit (HB) and council tax benefit (CTB) fraud. This fall continues a trend first noted in the 2014 report on Protecting the Public Purse, with many councils starting to re-focus resources towards non-benefit frauds.

## **Key National Fraud Risk Areas**

12. Right to Buy (RTB) and No Recourse to Public Funds (NRPF) have emerged as significant areas of fraud risk for councils. Right to Buy cases more than doubled to 411 with an associated value of over £30 million. NRPF is a new sub-category of fraud and involves persons from abroad who are subject to certain immigration controls which prevent them from gaining access to specific welfare benefits or public housing. Whilst it is a relatively new fraud risk, it is already the fifth largest of the 'Other' frauds detected. Although few councils pro-actively targeted this type of fraud during 2014/15, there were still 444 cases detected with an associated value of more than £7 million.

13. Other key national fraud risk areas, as noted by PEPP 2015, are as follows:

- Procurement fraud - although detected cases decreased by 32.3 per cent, the associated detected value of those cases increased by 47.1 per cent.
- Insurance fraud – although detected fraud continues to rise, this is possibly due to local authorities giving insurance fraud more attention as opposed to an increase in the amount of insurance fraud being committed.
- Economic and third sector fraud - cases increased by 183 per cent, with values increasing by over 220 per cent. This type of fraud involves the false payment of grants, loans or any financial support to any private individual or company, charity, or non-governmental organisation. It includes grants paid to landlords for property regeneration; donations to local sports clubs; and loans or grants made to a charity.
- Business rate fraud - cases have more than doubled, although the total value detected has dropped slightly. Fluctuations in value are to be expected, given some individual business rate frauds have been worth over £1 million. In part, the increase in cases may have resulted from greater national attention given to this risk in recent years.
- Other risk areas include housing tenancy, housing benefits, payroll, council tax discount, blue badges, pensions, abuse of position, and social care payments.

All of the above fraud risks and their potential risk to Middlesbrough Council have been included in the Council's Fraud and Loss Risk Self Assessment which is updated and monitored by Internal Audit (TVAAS).

## **The Main Issues facing Councils when Tackling Fraud**

14. The 2015 fraud survey asked councils to identify the top three issues in tackling fraud. Two thirds of councils stated that the single most important factor is the lack

of sufficient counter fraud resource (this was also the main issue in 2014). Better data sharing and effective fraud risk management were the next top two issues.

### **Counter Fraud Arrangements in Place at Middlesbrough Council**

15. Middlesbrough Council has the following counter fraud arrangements in place:

- Whistleblowing Policy.
- Anti Fraud, Bribery and Corruption Policy.
- Anti Money Laundering Policy.
- Information on the standards expected of employees including general conduct, disclosure of information, undertaking private paid work, private unpaid work, the interest of employees in contracts, writing of books, political neutrality etc. Specific reference to the Social Media Policy and the Gifts and Hospitality Policy.
- Procedures for declaring gifts, hospitality and interests.
- Internal audit reviews of the control environment.
- Ensuring that the annual audit plan includes time to focus on the significant fraud risks facing the Council.
- Internal audit plan which includes contingency allocation for investigating alleged fraudulent activity.
- Annual fraud and loss risk self assessment.
- Benefit fraud investigations carried out by the Single Fraud Investigation Service;
- National Fraud Initiative (NFI) data matching exercise;
- Communications with other local authorities and bodies e.g. TVAAS circulate fraud alerts to other regional internal audit teams and notify National Action Against Fraud Network (NAFN) where appropriate.
- Allocated responsibility for fraud to one audit and assurance officer to develop as a specialism.
- Monitoring the number of recommendations being made relating to anti fraud controls to identify trends in both control weaknesses and in service areas. Audit work carried out in 2015/16 resulted in 18 audit recommendations aimed at improving anti fraud controls (2014/15 – 30; 2013/14: 52).
- As TVAAS provides audit services to both Middlesbrough and Redcar and Cleveland Borough Councils, it has been possible to share intelligence regarding possible risk areas.

### **How significant a problem is fraud to Middlesbrough Council and what is being done to minimise losses?**

16. The investigation of housing benefit and tax credit fraud is carried out by the Department of Work and Pensions (DWP) following the introduction of the Single Fraud Investigation Service (SFIS). The DWP now conducts single welfare benefit fraud investigations to one set of policies and procedures.

17. During the financial year 2015/16, TVAAS has not been made aware of any incidences of internal fraud but has issued fraud alerts in response to potential

external threats (cyber attempts at fraud are becoming increasingly common). A number of other potential fraud risks have been examined and fraud alerts circulated accordingly.

18. During 2015/16, the Council detected no incidences of council tax discount fraud but, like many local authorities, this is attributable to the fact that council tax discount abuse is not treated as a fraud with incorrect status being corrected at the point of identification. During 2015/16, 19 blue badges were retained (41 - 2014/15) and 5 have been retained during 2016/17 to date.
19. When notified, TVAAS investigate suspected internal fraudulent activity and also review anti fraud controls whilst carrying out audits across the Council. The best way to reduce fraud losses is to prevent the opportunity in the first place by ensuring that the Council has an effective governance and control environment in place. The annual programme of work carried out by TVAAS assists in providing this assurance both on the material financial systems but also in relation to other high fraud risk areas within the Council.

### **The National Fraud Initiative (NFI)**

20. The NFI is a data matching exercise, via a secure website, that compares information held by and between approximately 1,300 organisations including councils, the Police, hospitals and almost 100 private companies. The purpose of the exercise is to identify potentially fraudulent claims, errors and overpayments. Each of these organisations submits various data sets relating to those services where it is anticipated that fraud and error is most likely to occur, for example, housing benefits, council tax (single person discounts), payroll, insurance claimants, private supported care home residents, licenses (taxi, personal alcohol) electoral roll, trade creditors payments, transport passes and permits (blue badge, residents parking permits and concessionary travel passes). Data has to be submitted according to specified timescales.
21. Once the data has been submitted, the matching process is undertaken and it is this process that results in 'matches'. The 'matches' relevant to each public body are passed back to the organisation for further investigation to either clear the 'match' i.e. confirm that the match is acceptable or take action in response to a potential fraud or error. One example of a 'match' could be a person in receipt of pension but who, according to other data, is deceased. This 'match' would require further investigation by the organisation paying the pension. In the UK, the NFI exercise has produced significant results, identifying £1.17 billion of fraud, overpayment and error since it started in 1996.
22. The data matching results for the Council from the 2014/15 NFI initiative resulted in 76 reports which identified 8182 matches with 2568 matches 'recommended' for investigation, within a variety of service areas. In total, 2285 matches have been processed resulting in the identification of 6 errors and 2 frauds (payroll and housing benefit claimant matches). A total of £100,994 of benefit was overpaid of which £61,779 is being recovered either from the claimant or the landlord (official errors accounted for most of the remaining unrecovered amount – not all error

identified is classed as claimant error and so may not all be recoverable). No frauds were identified within the remaining data set areas.

23. The 2015-16 data matching exercise is less comprehensive than the biennial exercise. Data sets were input and reports produced in December 2015 for Council Tax (single occupiers) and Electoral Register (rising 18s). These reports only match the council records to each other and are not matched to other bodies.
24. Council and TVAAS officers are currently working on the production of the datasets for the 2016-17 NFI exercise.

### **Further action to be taken to fight fraud**

25. Having a strong anti fraud and corruption culture underpins any Council's objectives by ensuring that resources are appropriately used. It is the responsibility of all staff to prevent fraud but the work of both the Single Fraud Investigation Service and TVAAS helps to identify fraud risks and areas where anti fraud controls need to be strengthened. In order to tackle fraud, the Council should embrace the national guidance set out in the Fighting Fraud Locally Strategy 2016-2019 which is based on three key principles: Acknowledge, Prevent and Pursue and assess their counter fraud performance against six key themes of culture, capability, capacity, competence, communication and collaboration.
26. PEPP 2015 included a checklist (**Appendix 1**) to be completed by an organisation as a self assessment of its counter fraud arrangements. A high level review of this checklist and other counter fraud work has identified the following areas where additional action could be taken to strengthen the Council's counter fraud environment is as follows:
  - 2016/17 audit and assurance plan to include specific counter fraud reviews on insurance, council tax discount, anti bribery and business rates. A corporate fraud management audit is also due to be undertaken.
  - TVAAS Counter Fraud Audit and Assurance Officer to continue to work in conjunction with service managers across key fraud risk areas in order to ensure strong control frameworks are in place.
  - Continue to review the counter fraud controls in relation to the emerging fraud risks such as No Recourse to Public Funds (NRPF).
  - Complete fraud detection benchmark analysis tool.
  - Request allocation of Anti-Fraud champion role to an elected councillor.
  - Carrying out a survey across the Council to establish the current level of awareness of existing counter fraud and whistleblowing arrangements;
  - Publicising cases of fraud that have resulted in prosecution (subject to legal and Data Protection considerations);
  - Exploring joint ways of working, for example with other local authorities, housing associations etc. in order to tackle high risk areas of fraud outlined in PEPP2015 e.g. No Recourse to Public Funds.

### **FINANCIAL CONSIDERATIONS**

27. The total estimated fraud losses for UK local government amounted to £7.3bn. Each pound lost to fraud represents a loss to the public purse and reduces the ability of local government bodies to provide services to people who need them. The prevention and detection of fraud is therefore crucial to all councils. Each pound lost to fraud represents a loss to the public purse and reduces the ability of local government bodies to provide services to people who need them. Fraud is never a victimless crime.

## **FINANCIAL, LEGAL AND WARD IMPLICATIONS**

28. The financial implications of fraud and the measures required to mitigate the risks are highlighted throughout this report. There are no specific ward implications arising from the Fraud Report.

## **RECOMMENDATIONS**

29. Members are requested to note and comment upon the report and highlight any concerns or areas where additional resource should be given to fraud prevention.

## **REASONS**

30. In the current economic climate, most organisations are at an increasing risk of fraud, bribery and corruption. The European Institute for Combatting Corruption and Fraud (TEICCAF) has recommended that local authorities should assess and review their own counter fraud arrangements and should understand the fraud risks they face. The main fraud risks highlighted relate to procurement, housing tenancy, housing benefit, payroll, council tax discount, blue badges, grants, pensions, insurance, business rates, disabled parking concessions, social care payments, abuse of position, non-recourse to public funds and right to buy housing. Fraud can diminish public trust and confidence in local authorities. A strong anti fraud, bribery and corruption culture underpins the Council's strategic objective of being an effective and efficient Council by ensuring that resources are appropriately used.

## **BACKGROUND PAPERS**

31. No background papers other than published works were used in writing this report.

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