

Fraud and irregularity report

2017/18



 AUDIT SCOTLAND

Prepared for public bodies and appointed auditors

20 June 2018

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- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
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About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Introduction

Purpose of this report

1. This report from Audit Scotland's Professional Support provides a summary of the cases of fraud and other irregularities at public bodies reported by external auditors in respect of the financial year 2017/18.
2. Public bodies are encouraged to consider whether the weaknesses in internal control that facilitated each case may also exist in their own arrangements, and take the required corrective action. Auditors should confirm that this is the case.

Fraud is the misappropriation of assets involving deception to obtain an unjust and illegal financial advantage.

Context

3. A key objective of public audit is to deter fraud. The Code of Practice on Managing the Risk of Fraud and Corruption explains that fraud can be deterred through the implementation of appropriate and robust internal control measures that safeguard assets. It follows that weaknesses in internal control increase the risk of fraud.
4. Auditors of local government bodies and non-departmental public bodies (NDPBs) provide Professional Support with details of cases of fraud and other irregularities discovered in those bodies. The focus is on highlighting fraud caused by weaknesses in internal control.
5. Key features of the cases are disseminated to other auditors and audited bodies by inclusion in quarterly technical bulletins throughout the year. This report provides a summary of the fraud and irregularity cases reported in respect of 2017/18.
6. The cases in this report include instances where fraud is merely suspected. The cases are likely to have been investigated internally, but it is not necessary for the police to have been involved or for it to have been proven as fraud in a court of law.

This report is focussed on fraud caused by weaknesses in internal control.

Types of fraud and irregularities

7. Types of reported fraud and irregularities are typically
 - the misappropriation by employees of cash which is facilitated by weakness in internal control
 - thefts of assets by third parties facilitated by poor physical security
 - overpayments to employees (e.g. payroll or expenses) or to third parties (e.g. service providers) where internal control did not timeously detect the overpayment
 - the misuse of assets by third parties (e.g. tenancy fraud).

Bodies should consider whether the weaknesses in internal control that facilitated each case exist in their own arrangements.

Contact points

8. The contact points for this report are Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or Anne Cairns, Manager (Professional Support) - 0131 625 1926.

Part 1

Expenditure



Key messages

Expenditure frauds relate to cases where a body has incurred additional expenditure as a result of fraud, e.g. invalid supplier, fictitious invoicing, or unauthorised ordering, overpayments, invalid social care payments, purchases for personal use.

Six cases of fraud and irregularity involving expenditure have been reported and are summarised in the following paragraphs.

Invoices paid to employee

9. A council IT employee embezzled over £1 million between August 2009 and May 2016 as a result of 57 payments made into two bank accounts set up by the employee.

Key features

Routine financial year end procedures highlighted an invoice where supporting information could not be found. It was discovered that the payment for this invoice was made into an employee's bank account. This resulted in both internal and Police Scotland investigations which highlighted fundamental weaknesses in the council's internal financial control systems.

The fraud was possible as the employee worked in the council IT section and had unrestricted access to several systems which allowed him to insert false invoices into the system and alter the bank payment details of suppliers without detection.

An external accountancy firm identified additional control weaknesses within budgetary control, reconciliation procedures and IT system access.

Internal audit plan to follow up recommendations to ensure that they have been implemented effectively and to review the Bank Automated Clearance System (BACS) including user access levels.

The employee was immediately suspended and resigned from his position. The Police Scotland investigation resulted in the perpetrator pleading guilty and being sentenced to more than 5 years imprisonment.

Recovery of most of the loss has been achieved through a range of methods including recovery from the pension of the convicted individual, and proceeds from the council's fidelity insurance policy.

Weakness
Employee had unrestricted access to several systems

Weakness
Inadequate budgetary control, reconciliation procedures, and system access

Invalid funding claims (1)

10. An external service provider inappropriately claimed over £47,000 of funding from a central government body in respect of unemployed individuals who were receiving support to move towards employment. The service provider claimed payments for individuals who did not meet the eligibility criteria.

Key features

The agreement with the service provider was based on payments for successful recruitment and outcomes for unemployed individuals. An inappropriate financial claim was submitted without the necessary funding criteria having been met.

The irregularity was discovered after a whistle-blower contacted the central government body. It was facilitated by poor management of the scheme.

The body suspended payments to the provider and carried out an investigation. The service provider has dismissed staff as a result of the investigation. The funding has been recovered from the service provider.

Weakness

Poor monitoring of external service provider

Invalid funding claims (2)

11. An advisor within a body in receipt of council funding submitted claims for £11,000 of funding using invalid evidence.

Key features

Internal audit carried out an investigation following receipt of information from a third party which suggested that an adviser who was an employee of a consortium delivering a project falsified claim evidence.

The falsified evidence consisted of forwarded emails regarding client activities, which the adviser could edit. Documents which were intended to evidence eligibility of benefits and identification were also tampered with.

The internal audit investigation prevented the council paying out on the ineligible claims. The adviser resigned during the subsequent disciplinary process.

Controls have been tightened and emails alone are not allowed as evidence. Training has also been given to consortium supervisors on detecting tampered documents.

Weakness

Acceptance of inadequate standard of evidence to support payments

Change of bank details

12. Two separate third parties defrauded two councils of £175,000 and £25,000 by re-directing payments intended for a legitimate supplier. In each case, the fraudster sent an email from an email account purporting to be from one of the council's suppliers requesting a change in bank details. Payments were then made to the new bank account.

Key features (1)

The council was notified of a change of bank details by email from a supplier. The council followed its procedures in this regard and requested confirmation details by email. The relevant information was duly received appearing to be from an individual known to the council. The change was actioned and a payment made.

The genuine supplier subsequently contacted the council looking for the payment which the council thought it had already made. It was identified that the supplier's email account had been hacked.

While the council followed its agreed procedures in this regard, it was not its practice to telephone the supplier to confirm details. The council has reviewed its procedures in respect of requests to change bank details and they now include a requirement to make a telephone call to suppliers.

Around £55,000 is expected to be recovered from the bank.

Weakness

Changes in supplier details not confirmed by telephone

Key features (2)

Emails from a perpetrator purporting to be a legitimate contractor were sent to the council's technical services department requesting a change to bank account details. The revised bank details were then communicated onwards to the accounts payable section.

The fraud was identified after a further communication was received from the same email address. This e-mail was reviewed by a senior officer who was concerned about the wording and poor use of English. The senior officer telephoned the contractor from the contact details held on the council system and informed them that their e-mail account may have been hacked or compromised.

Internal audit carried out an investigation. Telephone records for the accounts payable section identified that a call had been made to a clerical assistant in technical services and it was concluded that the accounts payable member of staff had most likely called technical services to confirm the bank details rather than directly with the contractor.

The fraud was possible as the accounts payable clerk did not have a full knowledge of the procedures to follow. In addition, there was a lack of follow up and review which should have happened at the authorisation stage of the process.

Payments totalling £21,000 were subsequently recovered through the BACS process.

Purchase of goods for personal gain

13. A street lighting technician ordered goods and materials worth £15,500 which he subsequently sold for personal gain.

Key features

The officer either placed orders for cabling material by creating a requisition on the purchasing system or placed the order first by phone, then requisitioned these through the purchasing system retrospectively. In either case, he would collect the material from the supplier without a requisition having been approved. In addition, some purchases were made 'in store' using a purchasing card. The officer subsequently sold the materials for personal gain.

The fraud was possible as control checks on these purchases were ineffective and did not identify, initially, that they were of a specific type of material that the officer would not have required as part of his normal duties. Issues with the purchasing IT system also meant that orders could be placed without approval.

The fraud was identified when a supervisor identified that a delivery note was missing at the point of 'signing off' procurement system orders. Copies of delivery notes were subsequently obtained from the supplier, identifying the officer who had placed the orders.

Controls are now in place within the purchasing system to ensure the any orders for goods follow the correct route for purchase authorisation. Internal audit is reviewing the service area concerned and is also assisting with periodic reviews of compliance with purchasing card controls.

The matter has been reported to Police Scotland, and the individual has been charged. The individual also went through an internal disciplinary process and was dismissed.

Weakness
No control
checks or
approval
required for
orders

Part 2

Income



Key messages

Income frauds relate to cases where a body's income has been misappropriated, e.g. cash takings being re-directed, invalid discounts claimed.

Four cases of fraud involving income have been reported and are summarised in the following paragraphs.

School funds

14. An administrative assistant in a school misappropriated £6,000 by failing to bank school fund income.

Key features

The fraud was identified during an internal audit investigation following a theft from the school safe. The administrative assistant denied any involvement in the theft, but admitted failing to bank school fund income.

The fraud was possible due to reconciliations and spot checks of accounts and cash balances not being carried out

Regular spot checks and bank reconciliations signed off by the head teacher have been introduced. A report has been made to the Procurator Fiscal.

Weakness

No bank reconciliations or spot checks carried out

Non- domestic rates income

15. A company defrauded over £18,600 in business rates relief through the submission of fictitious lease agreements and applications for small business bonus relief.

Key features

A professional rating practitioner advised the company to report to the council that three of the four industrial units it rented had been sub-let to other companies. The liability for business rates was then transferred to the names of the different companies. This entitled all the businesses to receive a small business relief, reducing the rates liability to nil.

The fraud was identified when a member of the business rates team became suspicious and referred the case to the council fraud team. Subsequent enquiries established that all leases were fictitious.

The fraud was possible due to council officers failing to identify inconsistencies in documentation. For example, an examination of

- the lease agreements would have identified substantial errors such as the leases being dated prior to the company leasing the premises
- publicly available records would have revealed that the company registration number on the lease did not relate to the named companies and the people named as directors were not recorded as such with Companies House.

Employees involved with the administration of business rates have been made aware of the weaknesses identified and a fraud awareness session relating to business rates is being developed for these employees. Recovery action will be instigated to recover the full business rates liability from the company. The rating practitioner was sentenced to a four-year prison term.

Weakness
Inadequate
examination of
supporting
evidence

Council tax evasion (1)

16. A principal teacher evaded a council tax liability of £6,300.

Key features

A council tax exemption of 100% was in place at a property in relation to the previous occupier who died in May 2012. The teacher failed to notify the council that they occupied the property from that date.

The council tax evasion went undetected as limited visits were carried out on exempt properties.

The evasion was eventually identified after a visit by internal audit to properties with council tax exemptions in place identified that the teacher's residency. Further investigations identified his date of entry.

Debt recovery procedures are now being carried out and a recommendation for a sanction has been passed to the teacher's head of service.

Weakness

Inadequate visits of properties exempt from council tax.

Council tax evasion (2)

17. A local resident evaded a council tax liability of £16,400 by claiming an exemption he was not entitled to.

Key features

A landlord applied for a false exemption by claiming that a tenant, who was exempt because he was a member of a visiting armed force, resided at the address until 2017.

The fraud was identified when a Team Leader became suspicious regarding the existence of the tenant. Enquiries indicated the exemption should have ended in 2005, and that the landlord had occupied the property over that period. The perpetrator had provided paperwork which was believed to be falsified to support the fraud.

The fraud was possible due to a lack of review of exemption status once granted. Council tax exemptions are now being reviewed.

A repayment agreement has been reached with the resident.

Weakness

No review of council tax exemption status.

Part 3

Theft



Key messages

Thefts of assets by third parties can be considered fraud if they are facilitated by poor security arrangements, e.g. theft of equipment or stores.

One cases of fraud involving theft has been reported and is summarised in the following paragraphs.

Theft of mobile phones

19. Mobile telephones valued at £5,400 were stolen from a council store.

Key features

The council ordered mobile phones which were placed into a council secure store on receipt. The project that the phones were ordered for did not go ahead and therefore they remained in storage. Fourteen months later, it was discovered that the phones were no longer in storage and were presumed stolen.

The theft was possible due to

- the code for the door entry system to the store being widely known by employees
- fire exits being left open
- the phones not being recorded on the council asset tagging system upon receipt.

Following an internal audit review, an action plan has been put in place to improve controls including periodic changes to door entry codes, ensuring fire doors remain closed, regular physical checks of stock and recording and tagging assets when received.

Weaknesses

No control over door entry codes, no physical checks on stock, and poor security.

Part 4

Misuse of assets



Key messages

A common misuse of assets relates to tenancy fraud, e.g. the use of social housing by people who have no rights to occupy the accommodation, or individuals falsely claiming to reside at the property.

Several cases of tenancy fraud have been reported and are summarised in the following paragraphs.

Tenancy fraud

20. Individuals in a number of council areas have obtained an unfair advantage by falsely claiming to reside in social housing.

Common key features

Several cases have been reported where individuals

- failed to notify the council that they were no longer living in the property.
- sub-let the property without proper authority.
- claimed housing benefit in respect of a property they were not residing in.

The frauds are generally facilitated by an inadequate level of property visits to confirm residency. They are often not identified until an allegation is received that the tenant is not residing in the property stated on the housing application.

The councils concerned have recovered the properties.

Weakness
Inadequate visits
to properties

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