

Fraud and irregularity update

2019/20

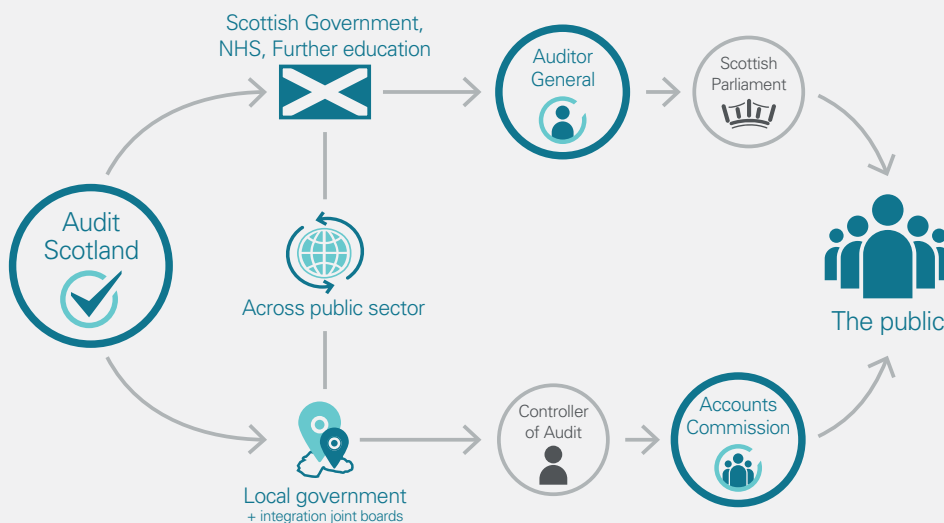
Sharing case studies to support the Scottish
public sector in the prevention of fraud



Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- **Audit Scotland** is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.
- 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.
- The **Accounts Commission** is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.



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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Summary



Key messages

- **The Covid-19 pandemic has brought significant challenges across the public sector as bodies have sought to continue to deliver services for individuals, communities and businesses during extremely difficult times. This includes additional fraud risks that will be important for public bodies to identify and manage.**
- **Weaknesses in controls have contributed to a variety of fraud and irregular activities across a range of Scottish public bodies. During 2019/20, external auditors reported nine cases of fraud and irregularity valued at almost £759,400. The value of reported fraud and irregularity remains small compared to annual Scottish public expenditure of £42.5 billion.**
- **Audit Scotland's counter-fraud hub contains useful counter-fraud information.**

Recommendations

- Public bodies should be alert to emerging fraud risks and where appropriate work with others to help alleviate these risks.
 - Public bodies should consider whether the weaknesses in internal control that facilitated each case identified in this report may also exist in their own organisations, and take the required corrective action.
 - Auditors should confirm whether internal controls at their audit clients are sufficiently strong to prevent the types of frauds and errors highlighted in this report.
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Part 1

Background

Impact of Covid-19

1. Since towards the end of 2019/20, the Covid-19 pandemic has raised significant challenges for the public sector. In such emergency situations, existing controls may be compromised and it can be difficult to put in place robust controls for new processes. The race to get assistance to those individuals, communities and businesses in need has offered opportunities for criminals and a greater risk of fraud. Good governance and sound controls are essential in such crisis situations.
2. The risks include, but are not limited to:
 - public sector staff working under extreme pressure due to significantly increased workloads in a strange new environment. This may have seen some internal controls being suspended or relaxed in order to get assistance to those in need
 - government stimulus packages to support individuals and businesses being provided quickly, again to get support to those in need. These were issued in many cases with a lower level of scrutiny and due diligence than has previously been in place for similar schemes
 - public sector staff working remotely which poses potential security risks
 - an increase in cybercrime as more public sector staff connect remotely, eg for meetings using various online video conferencing services which pose security issues
 - an increase in phishing emails and scams trying to get staff working under pressure to click on links which allow fraudsters access to public sector systems.
3. It is therefore anticipated that public bodies will see an increase in fraud and error rates going forward into 2020/21. Many public sector bodies have been working together in order to try to address these risks, through data matching and sharing information. Additional assurance activity is also planned by many public sector bodies once the Covid-19 crisis is over.
4. This report aims to share information about cases where internal control weaknesses in public bodies have led to fraud and irregularity, to help prevent similar circumstances happening again. It is based on information reported to Audit Scotland about significant frauds and other irregularities in public bodies during 2019/20. The level of fraud and irregularity reported remains small compared to Scottish public sector expenditure of £42.5 billion.¹
5. Public audit has an important role to play in helping to deter fraud. The CIPFA Code of Practice on Managing the Risk of Fraud and Corruption explains that fraud can be prevented through the implementation of appropriate and robust

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

¹ Scottish Government (December 2018), *Scottish Budget 2019-20*.

internal control measures that safeguard assets.² It follows that weaknesses in internal controls increase the risk of fraud.

6. Those looking to commit fraud are constantly looking for new and innovative ways to circumvent traditional controls or for areas where controls are weak. Changes to working practices and procedures can also increase the risk due to fraud.

Audit requirements in relation to fraud

7. International Standards of Auditing (ISAs) include certain requirements relating to the auditor's consideration of fraud. Audit Scotland's [Code of audit practice](#) sets out additional responsibilities of public sector external auditors in respect to fraud, error and irregularities. Audit Scotland has recently carried out a consultation on the next *Code of Audit Practice* and will engage further with key stakeholders in the coming months.
8. Appointed auditors in Scottish public sector bodies are required to consider the risks and the arrangements put in place by audited bodies. This will ensure that all material revenue is identified and collected, and that material payments are made correctly.
9. Auditors have provided Audit Scotland with details of cases of fraud and other irregularities discovered in their audited bodies during 2019/20. The focus in reporting cases is on highlighting fraud and irregularity caused by weaknesses in internal control and then sharing the learning from these reported cases in order to prevent similar circumstances from occurring.
10. 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.
11. Auditors should confirm whether internal controls at their audit clients are sufficiently strong to prevent the types of frauds highlighted in this report.
12. The cases in this report include instances where fraud is merely suspected. Such 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.
13. Auditors continue to engage with audited bodies in order to identify and report fraud and irregularities. The aim is to identify and share events leading to control weaknesses and losses in order to aid learning and hopefully prevent similar events occurring in other audited bodies.

Brydon Review of audit standards

14. The UK Government commissioned Sir Donald Brydon to review the quality and effectiveness of audit. His report makes a number of recommendations for the UK Government to consider, including the auditor's responsibilities around fraud.³ It is therefore possible that the auditor's role in relation to fraud may change in the coming years.
15. [Audit Scotland's counter-fraud hub](#) is available on our website and includes details of all our counter-fraud work, for example, on the National Fraud Initiative. It also includes details of work we do with partners, for example, the document on [Procurement in the public sector – how red flags can help us to stop and consider fraud](#) which was developed with Police Scotland.

² Chartered Institute of Public Finance and Accountancy (October 2014), *Code of Practice on Managing the Risk of Fraud and Corruption*.

³ Sir Donald Brydon CBE (December 2019), *Report into the independent review of the quality and effectiveness of audit*.

About this report

16. This report sets out examples of the various different categories of fraud and irregularity reported during 2019/20 and the control weaknesses which have contributed to these cases.
17. The cases included in this report are based on reviewing documents and returns.

Part 2

Examples of fraud and irregularity reported in 2019/20



Key messages

- Fraud and irregularity reported during 2019/20 falls into the following key categories:
 - three cases of fraud and irregularity involving expenditure, totalling £17,400
 - four cases of fraud involving income, totalling £123,000
 - one case involving a £19,000 payroll overpayment
 - one case of alleged embezzlement totalling £600,000.
- Control weaknesses were highlighted where fraudulent or irregular activity was identified.

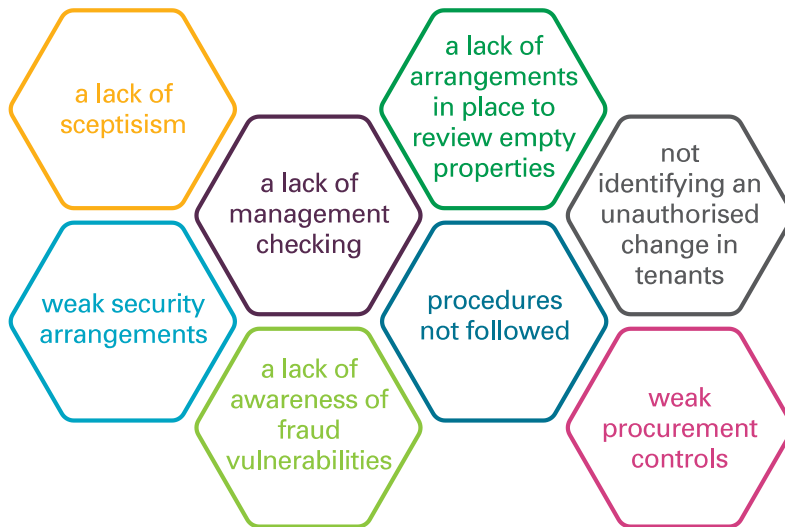
The types of fraud and irregularity identified during 2019/20

- 18.** The types of reported fraud and irregularity communicated by audit teams to Audit Scotland in 2019/20 include:
- expenditure fraud and irregularity, where an organisation has incurred additional expenditure because of fraud
 - income fraud and irregularity, resulting in a loss of income for the organisation
 - payroll overpayments
 - alleged embezzlement of funds.
- 19.** A review of fraudulent and irregular activity highlights common control weaknesses which have contributed to the fraudulent and irregular activity reported by external auditors ([Exhibit 1, page 9](#)).

This report focuses on fraud caused by weaknesses in internal control

Exhibit 1

Common control weaknesses



Source: Audit Scotland

Expenditure

20. Expenditure frauds relate to cases where a body has incurred additional expenditure because of fraud. This may be due to invalid suppliers, fictitious invoicing, or the redirection of payments intended for legitimate suppliers.

Invalid supplier

21. A third party defrauded £6,400 from a central government body by requesting a fraudulent payment.

Key features

An email was received by the finance team purporting to be from the chief executive, requesting that an urgent payment be made to a new supplier. The finance team responded and made the payment.

It was subsequently identified that the email was fraudulent.

Staff training, awareness sessions and other communications have highlighted the risks of cybercrime. Three further similar emails have since been received but were not actioned.

The matter has been reported to Police Scotland.

Weakness in internal control

The fraud was possible as the finance team did not spot signs that the email was not genuine. There was a lack of:

- detailed challenge of the email address and content on this occasion
- scepticism applied to the request for transfer of funds.

Weakness: a lack of scepticism applied to a fund transfer request

Source: Auditor returns to Audit Scotland

Change of bank details

22. A third party defrauded over £5,000 from a council by redirecting salary payments.

Key features

The payroll team received an email purporting to be from a senior officer of the council, advising of a change of bank account details. The payroll records were amended, and a salary payment was made.

It was not identified as fraud until the officer contacted the payroll team to query why they had not been paid.

Payroll staff have been reminded of the proper verification procedure for changes to employee bank account details. They have also received refresher training on how to spot fraudulent emails. The case is being investigated by Police Scotland.

Weakness in internal control

The fraud was possible as the procedures in place to check the validity of bank detail changes had not been followed.

Source: Auditor returns to Audit Scotland

Weakness: procedures to verify the validity of changes to bank details were not followed

Misuse of a mobile telephone

23. A social care customer misused a council mobile phone resulting in a cost of almost £6,000 to the council.

Key features

The council had placed a mobile phone in a locked box at a customer's home for use by support workers. The customer managed to access the phone and used it to make calls to premium services over the period of a month.

The fraud was identified when the council received a telephone bill.

The case has been reported to Police Scotland and the customer charged with using a phone when not permitted.

Weakness in internal control

The fraud was possible as the telephone did not have a PIN authorisation code to prevent unauthorised access.

Source: Auditor returns to Audit Scotland

Weakness: a lack of security arrangements on phones

Income

24. Income frauds relate to cases where a body's income has been misappropriated, eg cash takings being redirected, or invalid refunds being processed.

Council tax income

25. Three separate council tax payers defrauded over £30,000 of council tax.

Key features

The perpetrators failed to declare that in two cases, their properties were unoccupied long term; and in the third case that the ownership had changed. In all three cases, the perpetrators consequently avoided paying the double council tax for which they were liable.

Two of the frauds were identified after neighbours contacted the council to complain about the poor state of repair of the properties. Subsequent investigations by the council identified that:

- a company purchased the first house in 2012. A visit to the property confirmed it was clearly uninhabited.
- the other house had been in receipt of a second home discount since 2013. However, investigations of utility supplies and a visit identified that the property was clearly not a second home.

In the third case, the fraud was identified after a housing association approached the council for information on the property. Investigations identified that the property had previously been subject to an empty property exemption due to the previous occupant being deceased. However, a relative of the deceased failed to notify the council that they had inherited the property in 2016.

Council tax bills have been raised based on the double council tax charge. The debt has been passed to sheriff officers for collection in two cases and the council tax payer has paid the debt in the third case.

Weakness in internal control

The frauds were possible as the councils did not have adequate arrangements in place to review long-term empty properties or second homes.

Source: Auditor returns to Audit Scotland

Weakness: a lack of arrangements in place to review long-term empty properties

Housing rent

26. A former tenant defrauded a council of an estimated £93,000.

Key features

The genuine tenant moved out of the property but did not advise the council. A family member then moved in.

The fraud was not identified until a housing officer reported their suspicion that the tenant had moved out of the property. Investigations identified that the original tenant had moved out three years before.

The property was recovered and reallocated.

The council is using this case in training for housing officers to raise awareness and enable other issues to be identified and addressed more quickly in future.

The £93,000 cost is an estimated cost used nationally for tenancy fraud.

Weakness in internal control

The fraud was possible as the council did not identify an unauthorised change in tenants.

Source: Auditor returns to Audit Scotland auditor

Weakness: the council did not identify an unauthorised change in tenants

Payroll

27. Payroll frauds relate to cases where an organisation's payroll has been misappropriated, eg employees working elsewhere while claiming to be unfit.

Redundancy payment

28. A council paid out a redundancy payment to a former employee that was overstated by £19,000.

Key features

An error was made when the incorrect figure was input to the payroll system, and the incorrect payment was made.

The error was not identified immediately after payment was made despite the former employee querying the value. It was eventually identified almost a year later by internal audit during routine monitoring of payroll.

A process is now in place to ensure that two members of staff are involved in the payment of any employee redundancies. One team member processes the payment and a second more senior team member checks and authorises the payment.

The former employee is repaying the overpayment.

Weakness in internal control

The overpayment was possible as there were no controls in place to ensure the correct figure was input to the payroll system.

Source: Auditor returns to Audit Scotland

Weakness: a lack of controls in place to ensure the correct figure was input to the payroll system

Embezzlement

29. Embezzlement of funds is where a perpetrator takes money or equipment that is in their care or that belongs to an organization they work for.

IT equipment

30. A member of staff in a college is alleged to have stolen IT equipment. The present value of IT equipment which cannot be accounted for is estimated to be £600,000 (exclusive of VAT).

Key features

IT equipment, including laptops and mobile phones, appears to have been purchased and subsequently removed from the college by a member of staff.

The college's internal auditor conducted a forensic review of the incident concluding that the arrangements for the prevention and detection of fraud and other irregularities require improvement. The external auditor is undertaking a review of the finance and IT function within the college.

Certain updates have now been made to the college's financial regulations and Fraud Prevention Policy.

The employee was dismissed. The case was reported to Police Scotland and the employee has been charged.

The college is pursuing both the recovery of the missing IT equipment, and recovery of the potential losses.

Source: Auditor returns to Audit Scotland

Weaknesses: a lack of adequate controls around procurement

Appendix

Audit methodology

Audit Scotland's *Code of audit practice* sets out additional responsibilities of public sector external auditors in respect to fraud, error and irregularities. The Code states that:

“Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

International Standards on Auditing (ISAs) include certain requirements relating to the auditor's consideration of fraud. The nature of public sector organisations means that there are specific fraud risks that are relevant to a public sector audit which should be considered when applying ISA 240. These include taxation receipts, welfare benefits, grants and other claims made by individuals and organisations on the public purse.

Appointed auditors should consider the risks and the arrangements put in place by audited bodies to ensure that all material revenue is identified and collected and that material payments are made correctly.

Audit work would include reviewing, concluding and reporting on areas such as whether the body has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.

Appointed auditors are required to report information on cases of fraud and irregularities in accordance with guidance from Audit Scotland. Appointed auditors should also review information about frauds disseminated by Audit Scotland and consider whether any action is required in relation to their own audit appointments.”

This report is informed by information provided by external auditors during 2019/20 in their fraud and irregularity returns to Audit Scotland.

External auditors are required to report frauds (or suspected frauds) where they are caused or facilitated by weaknesses in internal controls at public bodies.

Frauds and irregularities are considered significant where the value of the loss is over £5,000 or where it is of significant due to the nature of the activity.

Auditors of local authorities are not required to report cases of fraud perpetrated by claimants, for example, housing benefit claimants, unless the fraud was facilitated by the collusion of local authority staff or otherwise by weaknesses in internal control.


The cases included in this report 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.

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This report is available in PDF and RTF formats, along with a podcast summary at:

www.audit-scotland.gov.uk 

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: info@audit-scotland.gov.uk 
www.audit-scotland.gov.uk 

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