

<b>Committee:</b>	Audit Committee
<b>Meeting Date:</b>	18 May 2016
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<b>Local Councillor/s:</b>	All
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## Audit Services – Audit Resources

### Brief summary of report

- Following a request from the Audit Committee at the meeting on 16 March 2016, this paper sets out the merits and demerits of engaging a further internal audit staff member for the purpose of fraud research and investigation.

### Action recommended

- The Committee is asked to consider the merits and demerits of engaging a further internal audit staff member for the purpose of fraud research and investigation, whilst acknowledging that responsibility for internal audit staffing levels lies ultimately with the Director of Resource Management.

### Reason for recommendation

- The Committee has a role in relation to oversight of the Council's internal audit function, and should seek to make best use of the internal audit resource within the assurance framework.

### Alternative options

- None

### Who will be affected by this decision?

- All recipients of Council services.

## Main body of report

### Fraud or Error?

6. The purpose of this paper is to consider the merits and demerits of engaging a further internal audit staff member for the purpose of fraud research and investigation.
7. Before doing so, the Committee should consider the difference between fraud and error.
8. **Fraud** is a deliberate act done by a person with the intent of obtaining money or other benefits to which they are not entitled and / or to mislead people about the truth. If caught, the individual could face criminal and / or disciplinary proceedings. Examples include falsifying records and misappropriation of cash.
9. During 2015/16, Audit Services has worked on a number of fraud investigations.
10. **Errors** (either major or minor) are made unknowingly by anyone who lacks knowledge or due to oversight on the part of the individual, which if identified, can be corrected by taking appropriate measures to prevent it from happening again.
11. Throughout 2015/16, the work of Audit Services has resulted in the recovery of a substantial amount of money, the majority of which has been as a result of error. It is important that work is done by management responsible for the areas where error has been identified, to put right control failures to prevent continued or similar failings from reoccurring. Audit Services assist management by making recommendations to improve controls. This can reduce the need for having to input audit resources into investigating such error in the future.
12. Audit work within this arena predominately falls under three categories: Reactive (usually suspected fraud); National Fraud Initiative (where potential fraud or system errors may be occurring); Proactive (looking at systems where there is a greater risk of error or fraud).
13. Management should not be reliant on Audit Services to identify fraud or error. It is the responsibility of service managers to implement effective controls, and to resource these as required.

### Audit Services

14. In accordance with the Anti-Fraud and Corruption Strategy:  
“Audit Services investigates all cases of suspected irregularity and deals with enquiries from other public sector bodies through the National Anti-Fraud Network (NAFN) and National Fraud Initiative (NFI). Audit Services liaise with management to recommend changes in procedures to prevent further losses to the County Council”.
15. It is not a primary role of an internal audit function to detect fraud. It does, however, have a role in providing an independent assurance on the effectiveness of the processes put in place by management to manage the risk of fraud. The activities of Audit Services include reviews of internal

controls within key financial systems and specific fraud and corruption tests.

16. Audit Services can do additional work, but it must not be prejudicial to this primary role. Activities carried out include:
  - a) investigating the causes of fraud;
  - b) reviewing fraud prevention controls and detection processes put in place by management;
  - c) working with directorates and making recommendations to improve those processes that are at highest risk of fraud;
  - d) advising on what, if any, legal advice should be sought if a criminal investigation is to proceed;
  - e) using internal specialist knowledge within Audit Services, or bringing in any specialist knowledge and skills that may assist in fraud investigations, or leading investigations where appropriate and requested by management;
  - f) responding to whistleblowing allegations;
  - g) considering fraud risk in every audit; and
  - h) having sufficient knowledge to identify the indicators of fraud.
17. In addition to Audit Services, there are numerous systems controls in place to deter fraud and corruption, but it is often the vigilance of employees, Councillors and the public that aids detection. In some cases frauds are discovered by chance or 'tip-off' and arrangements are in place to enable such information to be properly dealt with.

### **Reactive Fraud**

18. Reactive work is classified as the need for Audit Services to undertake investigative work as a result of whistleblowing, management concerns or issues identified through the course of operational audit work. The most common type is via management concerns.
19. The size and complexity of the County Council means that some irregularities are inevitable. In accordance with the Anti-Fraud and Corruption Strategy, officers are responsible for immediately notifying the Head of Audit Services of any circumstances suggesting the possibility of an irregularity which affect the County Council's assets or interest.
20. Without prejudice to any action required of Directors under any disciplinary codes, procedures or regulations, the Head of Audit Services shall, in consultation with the Head of Legal Services and the appropriate Director, determine what action to take, including any preliminary audit investigation or referral to the Police.
21. The 117 days spent on investigations during 2015/16 covered a wide range of irregularity types. Time spent in 2015/16 was greater than in 2014/15 (82 days), but less than in 2013/14 (138 days).
22. Due to the unknown, it is not possible to determine how many days are needed on reactive work. As such, the total days allocated from audit resources to fraud-related work is done on the basis that when reactive work is not required, then proactive work can be carried out (including NFI analysis).

23. In an attempt to cut the time spent by Audit Services on reactive work, a new system has recently been introduced which assesses each alleged irregularity. This rates the source of the allegation, the effectiveness of the evidence, and carries out a public interest test. Lower rated allegations are transferred back to the relevant directorate, with guidance, for them to investigate and report back to Audit Services.

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

24. The NFI is an exercise that matches electronic data held within and between public and private sector bodies to prevent and detect fraud, and correct error. All mandatory participants, including the Council, must provide data for matching with other local government organisations. The NFI exercise provides a good indication of whether Council systems are operating effectively.
25. The NFI exercise takes place every two years. As such, the input required by Audit Services on investigating NFI output is greater every other year. The next data extraction will be completed in October 2016, with the results due in February 2017. The only work required by Audit Services on NFI during 2016 (April to December) will be on co-ordinating the gathering of the information required.
26. When the results are published in February 2017, Audit Services will lead on investigating the output throughout 2017. The level of resource required at this time will depend on the results which are split between higher risk matches (i.e. those which are recommended for full individual investigation) and lower risk matches (where a sample investigation approach is adopted).
27. Resource levels do not allow all NFI matches to be investigated. For the last exercise, there were over 10,000 higher risk matches. Of those investigated, in excess of £570k was recouped for the County Council. The majority of this related to residential care payments for deceased customers (£478k) and duplicate payments (£70k). It is important to highlight that no referrals to the Police were made in relation to these payments; the monies were recovered from the suppliers concerned.
28. Work undertaken by Audit Services to assist services in the improvements of controls and systems should reduce the number of future NFI matches.
29. **It is important for Committee members to be aware that the majority of savings come through the biennial NFI exercise** and that greater audit resource is required every two years to analyse and review the NFI output.

### **Proactive Fraud and Error**

30. Proactive work can be split into two categories; non-audit and audit. Non-audit proactive fraud work is predominately time spent on fraud communications, policy reviews, the completion of fraud returns and participation in fraud groups with other authorities. Direct audit proactive fraud and error work relates to testing carried out on systems where there is a greater risk of fraud or error (examples in 2015/16 include responding to alerts from the National Anti-Fraud Network (NAFN), expenses claims, duplicate invoices, data matching against Companies House data, and the blue badge exercise carried out in December 2015).

- 31. Audit interrogation software is utilised across a range of proactive audits. This can lower the cost of analysis, add more quality to the work of Audit Services, and meets the professional requirements regarding fraud and internal controls. This software can read, display, analyse, manipulate, sample or extract from data files from almost any source.
- 32. Proactive fraud work often leads to the identification of error / control failures and not specifically fraud. Proactive work on duplicate invoices (separate to NFI work), for example, has, as a result of a breakdown in controls, resulted in the recovery of over £15k for the Authority and has raised awareness which should make officers more vigilant moving forwards.
- 33. **Accordingly, it is vitally important that management takes action to rectify any control failings so as to prevent fraud and / or error from occurring in the future, and which, in-turn, can reduce the need for audit resources to be directed to fraud related work.**
- 34. Whilst there are tangible identifiable savings from proactive audit work to date, the future total long-term savings for the Authority cannot be quantified.

**2016/17 Internal Audit Coverage**

- 35. The Head of Audit Services, as part of his responsibilities, must set out the minimum level of audit coverage and audit resources needed to give a sound, evidence based annual audit opinion. The chargeable internal audit days available to the County Council for 2016/17 has been split as follows:

Audit Type	Days	%
Operational Audit	802	58%
Advice and Consultancy	48	3%
Assurance	250	18%
Fraud	213	15%
Management Activity	85	6%
<b>Total</b>	<b>1,398</b>	

- 36. In the opinion of the Head of Audit Services, this split enables a sound, evidence based annual audit opinion to be provided. If there are threats to achieving the planned split (examples would include staff absence and an increase in the need to carry out more reactive fraud work than planned), then the Head of Audit Services will advise the Director of Resource Management and the Audit Committee at that time, including the consequences for the level of assurance that can be provided.

### Time Allocated to Fraud and Error

37. The actual time spent on fraud and error related work during 2015/16, was 321 days. This includes the time of a secondment from Finance and a bought-in resource from Business Development:-

Type	Days	Audit Services Staff	Non Audit Services Staff
Reactive (investigations)	117	113	4
NFI	52	26	26
Proactive (non-audit)	46	46	0
Proactive (audit)	106	73	33
<b>Total</b>	<b>321</b>	<b>258</b>	<b>63</b>

38. During 2015/16, there were 1,514 chargeable internal audit days, based on resources of 8.03 fte (excluding the seconded and bought-in staff). The amount of time spent by Audit Services staff on fraud-related work (258 days) is equivalent to 17% of chargeable days.
39. For 2016/17, resources for Audit Services are 7.53 fte. Of the 1,398 chargeable internal audit days available to the County Council in 2016/17, 213 days (15.2%) have been allocated to fraud-related work. Based on a reduced level of reactive work (albeit unknown) due to the new rating system to be introduced, and 2016/17 being a year when less NFI work is required, then an indicative split, before any consideration of seconding or buying-in resources, would be as follows:-

Type	Days
Reactive	90
NFI	15
Proactive	108
<b>Total</b>	<b>213</b>

### Budget Position

40. Upon recruitment to an Audit Leader vacancy (interviews are being held in May 2016), it is anticipated that the salary budget for Audit Services will be allocated. If appointed at the top of the scale, the cost of an Audit Leader (£41k, with on-costs) would exceed the total salary budget for Audit Services. This would be managed through anticipated income levels for non-County Council work done.

### Cabinet Member for Finance & S151 Officer

41. The Council continues to have to make significant savings with the target for 2016-18 being £81m and then at least another £50m in 2018-20. This is due to continuing very large grant reductions and additional cost pressures.

42. Faced with this challenge it is difficult for any activity of the Council to avoid contributing to the savings targets no matter how important they are deemed to be. However it is fair to say that Internal Audit has had a degree of protection against the recent “deep savings” Resource Management (RM) has had to make and that will continue to be the case. Nevertheless increasing resources on a permanent basis whilst the Council continues to shrink is not something we could advocate.
43. The service performs well and adopts a risk based approach to allocating its resources. It has an effective approach to fraud both in pursuing investigations and working through data matches thrown up by the National Fraud Initiative (NFI). It is recognised that the NFI work could benefit from some additional resource on a one off basis at the time of the data exercise and therefore using a small withdrawal from the RM Service Reserve would address this issue.

### **Action to Take**

44. More resources could be allocated to fraud-related work, or indeed other internal audit coverage. However, the Council’s expectation of propriety and accountability is that Councillors and staff at all levels have a duty in ensuring adherence to legal requirements, rules, procedures and practices. Whilst it is not a primary role of Audit Services to detect fraud or error, it does, however, have a role in providing an independent assurance on the effectiveness of the processes put in place by management to manage the risk of fraud. A need has already been identified, through completion of the CIPFA Fraud Tool (which assists public sector organisations in measuring their counter-fraud arrangements) to further promote fraud awareness throughout the Council; in particular with regard to responsibilities and the assessment of fraud risk within directorates.
45. It is vitally important that directorates do not become reliant on Audit Services. If Audit Services continues to allocate resources into fraud and error work rather than educating officers, then responsibility will not improve which, in turn, could mean the need for more reactive work. **Therefore, the Head of Audit Services will be attending all Directorate Management Team meetings to raise awareness and responsibilities.** When directorates are facing significant savings challenges, they should be taking their own action to reduce the risk of unnecessary expenditure through duplicate or erroneous payments, as well as fraud.
46. The need for reactive fraud work will be closely monitored by the Head of Audit Services. **Any impact on other audit coverage, including proactive audit work will be reported immediately to the Director of Resource Management and Chairman of the Audit Committee.**
47. **Should a need for additional resource be identified, solutions will be sought, for example, the offering of a secondment opportunity, depending on the resources available.**
48. **In respect of the 2016/17 NFI exercise, an assessment will be carried out by the Head of Audit Services to determine the level of audit resources required to review the output, when it is published in February 2017.**

**Sources of Further Information**

No other documents have been relied upon to a material extent in preparing this report.