

## **Report by the Comptroller and Auditor General**

### **2004-05 Community Fund Financial Statements – discovery of irregular grant applications**

#### **Purpose of Report**

1. In their Annual Report the Community Fund, now operating under the name Big Lottery Fund, have reported that in September 2004 they first identified a number of irregularities in certain grant applications. The Fund, the police and the Charity Commission initiated extensive investigations into the potentially fraudulent applications by a number of community groups some of whom were also registered as charities. Where appropriate, the Fund also suspended payment of grant where an application had been approved but payment had not yet been made. 19 arrests have been made by the police and the investigations continue into the nature and extent of the potential fraud.
2. The Fund considers the grant payments involved to be "at risk" even though fraud has yet to be proven as irregularities with the applications (for example, the improper use of names and addresses) and supporting documentation have been found or recipients have otherwise not complied with the requirements of the Fund.
3. In addition to the grants paid that are directly part of the police investigation (accounting for approximately £1.4 million), the Fund have reviewed all grant applications and identified other cases that could be linked to the applications that gave rise to the original cause for concern or are suspect for some other reason. These are also considered by the Fund to be "at risk".
4. Subsequently the Fund have since identified that some £1.7 million of these grants have been correctly made and their best estimate of the total grants now at risk across their activities since 1999 is £4.5 million. During the same period the Fund has paid some £2.4 billion to grant applicants. Of these grants at risk, £770,000 relates to grants paid in the 2004-05 financial year, 0.3% of grants paid of some £253 million. A further £1.6 million of grants at risk funded by other lottery distributors have been disclosed separately in their accounts and notified to Parliament on 13 July 2005 in a written statement.<sup>1</sup>

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<sup>1</sup> Written ministerial statement, Hansard 13 July 2005

## Qualification of Audit Opinion

5. In forming my opinion on the Community Fund's 2004-05 accounts I am required to confirm whether, in all material respects, the income and expenditure of the Fund have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them that is, they are "regular". In doing so I have regard to Treasury authorities, as well as the Fund's financial directions. In respect of the payments made by the Fund on the basis of potentially fraudulent applications amounting to £770,000, this expenditure is not in accordance with Parliamentary intention, and my audit opinion has been qualified in this respect.
6. The purpose of my report is to explain the reasons for my qualification, note actions taken to date and make interim recommendations.

## Background

7. The Community Fund distribute lottery funds to the voluntary and charitable sector through a number of grant schemes details of which are shown in Table 1. Grant programmes include strategic, international and research programmes and cover the whole of the United Kingdom<sup>2</sup>.

**Table 1: Main grant schemes operated by the Community Fund**

<i>Programme</i>	<i>Grant payments 2004-05('000s)</i>	<i>Programme description</i>
Awards for All (A4A) £500-£5000	£13,604 (This is the Community Fund contribution to the programme)	Funding arrangements differ for each country. For example in England Awards for All is a joint programme that was set up with contributions from other lottery distributors to distribute a large number of small grants so that small, local groups can set up their own new activities or expand their work in the areas identified by the Fund. In 2004-05 some 12,000 grant payments were made.
Main programme: grants over £5,000	£203,887	Grant applications are assessed against regional priorities and can run for up to three years for current or capital projects.
Strategic grants £60k+	£18,712	This programme provides large grants to groups that operate in 2 or more regions or countries in the UK.
International Grants £500-£500k	£11,498	This programme funds projects that tackle the causes of poverty and deprivation. Supports overseas projects run by voluntary organisations based in the UK.
Research Grants	£5,728	This programme aims to fund high quality medical

<sup>2</sup> Except for Awards for All, these programmes are now closed to applications as the Big Lottery Fund prepares to launch new programmes.

		and social research led by the voluntary sector.
<b>Total</b>	<b>£253,429</b>	

8. The vast majority of grant payments for which irregularities have been detected were made under the Awards for All England programme. A small number of grant awards made under other Awards for All programmes and Community Fund programmes have subsequently also been identified as being at risk. As the average size of grant for the latter is higher the amounts "at risk" are also higher.

### **Awards for All**

9. The Awards for All programme is a lottery grants scheme which the Fund have aimed at local communities. Similar programmes are operated by the Community Fund for each of England, Wales, Scotland and Northern Ireland although the funding arrangements differ for each country. The published aims of Awards for All are to:

- **Extend access and participation** by encouraging more people to become actively involved in local groups and projects, and by supporting activities that aim to be open and accessible to everyone who wishes to take part;
- **Increase skill and creativity** by supporting activities which help to develop people and organisations, encourage talent and raise standards, and
- **Improve the quality of life** by supporting local projects that improve people's opportunities, welfare, environment or local facilities, for example through voluntary action, self-help projects, local projects or events.

10. The Community Fund administer the Awards for All programme on behalf of a consortium of lottery distributors. Funding for the England programme is also provided by the New Opportunities Fund, the Heritage Lottery Fund, Sport England, the Millennium Commission (from 1999 to 2000 only) and Arts Council England. The Accounting Officers share responsibility for the programme and each funder contributes an agreed percentage to a "joint pot". While the day-to-day running of the scheme is the responsibility of the Community Fund's Programme Director, important decisions about the scheme require the approval of each Accounting Officer including for example whether to write-off particular payments which can inevitably lead to delay.

11. Awards for All provides grants from £500 to £5,000 and has grown rapidly. Since the programme commenced in 1999 over 83,000 awards have been made for some £294 million. In 2004-05 some 12,000 grants were made totalling £46 million of which the Fund's share was £13.6 million.

12. The grant funding paid under the Awards for All scheme is not reported within a single set of financial statements unlike for other grant schemes. Instead grants paid are reported within the accounts of each of the funders. While there may be good reasons for a grant scheme to be funded from a variety of sources, for example to assist a particular group, a single reporting framework would assist in clarity in accounting for the funds spent. In some cases this is done already. For example, Sport England produce a separate memorandum account for their Spaces for Sports and Arts.

### **The level of potential losses**

13. The Fund was first alerted to suspicious applications by a vigilant member of staff. Following the identification of the initial cases of suspected fraud involving multiple applications, the Fund conducted a data-mining exercise on its grants database system to identify all possible grant awards and payments related to the original cases. From this exercise the Fund have identified grants where fraud may be present. Some of these cases are subject to police investigation while others have been identified simply because they share similar characteristics. In order to ascertain whether these grants were used for the purpose intended, the Fund would need to visit the grant recipient to establish their legitimacy. The Fund hold the view that for a number of cases especially where the amount of grant is less than £5,000 that this may not be practical or represent the best use of their resources. In some cases a visit is not currently possible because of the continuing police investigation. Nevertheless where they consider appropriate the Fund have engaged in a programme of follow-up visits which is continuing.

14. In the course of the investigation, a number of other suspect grants have also been identified in the main grants programme of the Community Fund. The number of grants at risk is small, but as these grants are much larger than Awards for All grants, a larger amount is at risk. These grants are all being investigated and some have already been cleared from the investigation. The remainder will continue to be considered "at risk" until the Fund's investigations are complete.

15. Table 2 gives details of those grants over which the Accounting Officer has insufficient evidence over the regularity of these payments broken down by year and between Awards for All and other grant programmes. The total value represents the maximum extent of the potential loss. Over the same period the losses amount to 0.18 per cent of grants paid.

**Table Two: Estimate of possible losses by year and grant scheme against total grants paid**

<b>Scheme:</b>	<b>Awards for All</b>		<b>Other Grant Programmes</b>		<b>Total</b>		<b>Total grants paid</b>	
<b>Year Ending</b>	<b>No of grants</b>	<b>Amounts paid (£)</b>	<b>No of grants</b>	<b>Amounts paid (£)</b>	<b>No of grants</b>	<b>Amounts paid (£)</b>	<b>No of grants</b>	<b>Amounts paid (£)</b>
Prior to 31 March 2000	32	82,016	10	608,287	42	690,303	28,029	789,605,805
31/3/2001	37	123,082	4	357,026	41	480,108	15,725	380,280,143
31/3/2002	73	220,986	9	506,905	82	727,891	14,715	362,235,025
31/3/2003	114	177,320	8	625,254	122	802,574	15,378	328,575,065
31/3/2004	211	236,615	10	737,350	221	973,965	13,939	290,977,233
31/3/2005	139	164,797	7	604,794	146	769,591	11,261	253,428,869
<b>Total</b>	<b>606</b>	<b>1,004,816</b>	<b>48</b>	<b>3,439,616</b>	<b>654</b>	<b>4,444,432</b>	<b>99,047</b>	<b>2,405,102,140</b>

Note:

(1) Potential losses totalling £1.6 million sustained by other distributors under the A4A scheme have been disclosed separately in their accounts.

(2) "Other grant programmes" can include grants payable over several years. Numbers of grants are shown against the year in which their first payments were made.

## Existing control mechanisms

### Awards for All

16. The programme and the systems of control set up to support applications, assessment and monitoring were designed by the Community Fund to provide easy access for applicants. Their key objectives were to place the minimum possible burden on grant applicants consistent with protecting the public money involved and ensure the Community Fund could pay out grants to successful applicants as quickly as possible. This approach was taken with the knowledge of the other funders and the sponsoring Department to encourage a wide cross-section of the voluntary and community sector, such as small community self-help groups, to apply for grant funding. Many of the successful grant applicants had not previously obtained grant funding and their size could mean that they possessed only rudimentary systems of monitoring and reporting.

17. Grants are available from £500 up to £5,000 and the Fund have an objective to pay grants to successful applicants within 6 weeks of their application. The grant application form was simplified as far as possible and had to be signed by the applicant, one other

individual and by one referee. If the application for funding fell within the Fund's criteria and the form was otherwise correctly completed (including the signing of an undertaking that the funds would be used as stated) then funding was provided. The key obligation on grant recipients was to use the funds in the way they stated in their application and then report on the outcomes.

18. The Fund established a range of controls to give assurance that grants would be used as intended. At the assessment stage these included:
- identification of high risk grants, by applying criteria such as the previous experience and degree of organisation of the applicant;
  - documentary evidence (for example bank statements, budget plans) being required to support the application, and
  - random allocation of grant applications to awards officers to reduce the opportunities for collusion.
19. Further controls were applied after the grant was paid including sample checking of:
- grant recipients being asked for receipts for some purchases;
  - referees being asked for reports on project progress, and
  - grant recipients being subject to a visit to gain assurance both about the particular grant and the control framework.

The proportion of grants sampled in these ways was higher for those identified as high risk, with some controls being applied to all high-risk grants.

20. A key control to provide the Accounting Officer with assurance over the regularity of the grant payments made was to obtain an "end of grant" report from the recipient of their activity and the use they have made of their grant. This is not subject to audit or other independent scrutiny but should have been authenticated, for example, by trustees if the beneficiary was a charity.

### **Other grant programmes**

21. Other grant programmes are funded exclusively by the Community Fund. For these programmes funds are paid over in instalments and dependent on the provision of information supporting the need for continued payment. This gives the Community Fund the ability to withhold later grant payments if submission of an annual report or other requirement is not met. This is the key control by which the Community Fund tracks how the recipient is spending their grant.

22. Other controls include:

- a progress report is required every year and at the end of the project;
- all high risk grants and a significant proportion of other projects are visited during the management stage as well as all second grants to organisations that were not visited for the first grant (in 2004-05 there were around 1,650 visits to grant applicants and recipients), and
- invoices for all capital items over £10,000 and vehicles are requested.

### **Inadequacies in the control system**

23. On Awards for All, where the vast majority of multiple applications were received, the risk of multiple application fraud had been identified but management believed that any frauds were more likely to be one-off instances and took the decision that controls were sufficient in view of the need to keep the administration requirements for such low-value grants to a minimum. Targeting of the Fund from large-scale criminal activity had not been identified as a threat.
24. The suspected frauds were not detected earlier because the Fund's systems did not include adequate checks to identify instances where more than one application was being received from the same applicant. This resulted in multiple applications remaining undetected. In addition, the control system in place meant that the Accounting Officer did not have sufficient prima facie evidence to confirm that grants to a significant number of related cases were regular in order for them to be excluded from the amount identified to be "at risk".
25. In 2003, the Fund's internal audit team conducted a review of the controls in place around the Awards for All programme and did identify the risk of receiving multiple applications but it was considered slight and acceptable in the context of the scheme. The summary internal audit report and associated recommendations that no immediate action was required was brought to the attention of the Audit Committee. The particular risk of multiple applications was not specifically mentioned as the risk was felt by management and internal audit to be low. The recommendation for a further review was adopted by management and this was being planned at the time the suspected fraud was discovered.
26. Key evidence to give assurance that grants have been spent properly is a report from the grant recipient. However grant recipients did not always provide this information despite continued requests from the Fund. The Fund had little leverage to exert pressure on uncooperative grant applicants as they had already received their grant. The Fund could prevent further applications for grants from non-compliant recipients but otherwise would normally judge that the grant purposes had been achieved. While this was seen as an

internal administrative matter staff might not have appreciated that without such evidence the Accounting Officer had no assurance on the regularity of the Fund's expenditure.

27. At the same time supporting controls have not been sufficiently robust. Key issues are that:

- controls were designed on the assumption that applicants were fundamentally honest. Application forms and other documentary evidence including end of grant reports contained false information. In some cases the supporting documentation that was requested to substantiate the regularity of applications (e.g. bank statements and budget plans) could have been reviewed more thoroughly which might have revealed suspect applications more quickly. Bank statements, for example, which were used to confirm bank account details could also have been used to query details of large cash withdrawals;
- the requirement for easy access to the Awards for All programme meant that the controls used were intended to support quick turnaround of applications and the need for reduced bureaucracy for relatively small grants. Potentially there was a conflict between payment of grant quickly and the more thorough checks required if a grant was assessed as high risk (with the greater likelihood of a visit for example). There could therefore be a perverse incentive not to operate the controls as intended, and
- audit findings, which identified cases to management where there appeared to be control failings in administrative procedures, were not seen as potentially damaging to the whole system of control but regarded as one-off instances which resulted in reminders to staff to apply controls procedures properly.

### **Action taken in response to the identification of possible fraud and control weaknesses**

28. The Fund has reviewed its grant making systems and has put a number of additional controls in place to combat the identified risk of multiple application fraud. Action taken includes:

- improved data analysis tools and flags to alert staff to suspicious applications. These alert staff to suspicious applications, which are then investigated. The Fund believes that these tools are an effective control, which provide a high probability of detecting any further attempts at fraud similar to that suspected;
- mandatory revised checklists for all staff to follow in assessing grant applications;
- fraud awareness training;
- the transfer of the Grant investigations team to a position independent of grant operations and an increase in size from 2 to 8 staff, and



- confirmation of relevant information from applicants' banks.
29. A cross-departmental group to consider the implications of fraud and controls over small grants has also been established. Membership includes the Department for Culture, Media and Sport and the Big Lottery Fund and the group is led by Treasury.
30. The Big Lottery Fund are in the process of reviewing their grant-making systems prior to launching their new programmes. Once the new programmes have been developed, they intend to use their internal auditors to conduct a review of the effectiveness of their systems in preventing and detecting fraud.
31. With regard to the files that are being investigated by the Community Fund in connection with the fraud, the Fund is making an assessment on a case-by-case basis of whether the grant should be withdrawn. Recovery of amounts already paid out will take place where there are assets to recover.

### **Interim recommendations**

32. The full lessons to be learned can only be publicised once the police and legal processes have been completed. However in the interim, the National Audit Office has drawn on their experience of good practice in other grant schemes and recommends that:
- more explicit consideration should be given to the risk of fraud that may exist within programmes intended to be easy to access and the extent to which controls should be put in place to combat this. There needs to be a common understanding that there is a trade-off between ease of access and the level of control that can be exercised. Controls should be reviewed to target the key data and assurances (including on regularity) required by the Accounting Officer to carry out their duties. I welcome the establishment of a cross-departmental group by Treasury to look at this issue;
  - any failures in internal control that are discovered must be carefully considered in case they highlight a failing that could be systemic rather than one-off failure;
  - the Audit Committee should review the process for bringing risks identified by internal audit to their attention and ensure that summarisation of Internal Audit reports does not lead to significant audit findings being excluded from their overview. In all cases, full audit reports need to be available to Audit Committee members who need to be content that the summaries produced are accurate and meet their needs.
- Looking beyond this to wider issues, in their role as sponsor department:
- the Department for Culture, Media and Sport should consider whether accountability for joint grant programmes could be given greater clarity. For example the Department should appoint a lead Accounting Officer for significant grant schemes

who can take all decisions relating to the scheme rather than as in the case of Awards for All where accountability is still shared, and

- because there is inconsistency in the way individual grant programmes are reported in the annual accounts of lottery distributors, the Department for Culture Media and Sport should consider with the Distributors whether all similar joint programmes could be reported separately rather than, as for Awards for All, each distributor reporting their share of grants paid.

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**2 December 2005**

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