

**2005-06 Community Fund Financial
Statements – follow up report on actions
taken by the Fund following the
discovery of irregular grant applications
in September 2004**

Purpose of Report

1. The Community Fund, now operating as the Big Lottery Fund, distributes funds to the voluntary and charitable sectors through a number of grant schemes. This includes the Awards for All programme, which is a lottery grants scheme aimed at local communities. Since the programme commenced in 1999 over 95,000 awards have been made for some £347 million. In 2005-06, 12,743 grants were made (for amounts between £500-£5,000) totalling £53 million of which the Fund's share was £10.3 million.
2. In September 2004, the Community Fund 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. The majority of the grant payments in which irregularities were detected were made under the Awards for All England programme, which the Community Fund administers on behalf of a consortium of lottery distributors. The various investigations are ongoing and no fraud has yet been proven.
3. I qualified my opinion and reported on the Community Fund's 2004-05 financial statements¹ on the basis that the payments made in respect of potentially fraudulent applications were not in accordance with Parliamentary intentions, noting the period of losses extended over some 5 years.
4. In the Statement on Internal Control attached to the Financial Statements for 2005-06 (page 65), the Fund have now set out their final estimate of the losses they have sustained over the period 1999-2005. They have also provided information regarding the actions taken to reduce the risk of such losses in future.
5. The purpose of my report now is to set out the reasons for my unqualified audit opinion on the Fund's financial statements for 2005-06 and to report on the progress the Fund have made in implementing the recommendations I made in my report last year. I also set out additional recommendations arising from the further work conducted during my audit of the 2005-06 financial statements. In the course of the year the NAO have provided additional guidance on good practice in tackling external fraud in grant-making² focused on the culture, media and sport sector.

¹ http://www.nao.org.uk/publications/nao_reports/05-06/communityfundreport.pdf

² http://www.nao.org.uk/guidance/DCMS_Fraud_in_Grant_Making.pdf

Unqualified Audit Opinion

6. In forming my opinion on the Community Fund's 2005-06 financial statements, 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, that they are "regular"). In doing so, I have regard to HM Treasury authorities, as well as the Fund's financial directions.
7. In order to obtain the necessary assurance I require for my audit, I have considered the control framework the Fund now has in place for assessing and monitoring applications as well as reviewing whether they have operated effectively in practice. I have also reviewed the levels of irregularity being identified by the Fund during their own compliance visits. This is supported by my own testing of a sample of grant files to verify that the relevant controls are operating in practice. I have also reviewed the levels of write-offs proposed by the Fund as shown in note 21 of their financial statements.
8. I am satisfied that, in all material respects, the income and expenditure of the Fund reported in the 2005-06 financial statements have been applied to the purposes intended by Parliament. I have therefore given an unqualified opinion on the 2005-06 Community Fund's financial statements.

Quantification of levels of potential losses

9. As reported last year, the Fund were first alerted to a number of suspicious grant applications in 2004-05 by an alert 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.
10. In my report on the 2004-05 financial statements, I reported amounts that the Fund had identified that were "at risk" of fraud. A more precise value of the losses sustained due to suspected fraud could not be given as investigations by both the Fund and the police were continuing.
11. At that time, the maximum level of losses sustained by the fund, since 1999, was thought to be £4.4m representing 0.18 per cent of total grants paid since then totalling some £2.4 bn. As the Fund explain in their Statement on Internal Control (see page 65) further work has been carried out to obtain a better understanding of the levels of fraud and other

irregularities that exist within the population of grants previously identified as being “at risk” of fraud. The results are shown in the table below.

	Category	Awards for All (£)	Main grant programmes (£)	Total Paid (£)
As reported last year	Amounts previously considered to be at risk	1,004,816	3,439,616	4,444,432
As reported now – revised classification	Amount now presumed fraudulent:	1,004,816	510,446	1,515,262
	Breach of grant conditions		1,590,265	1,590,265
	Total potential irregular payments	1,004,816	2,100,711	3,105,527
	Cases investigated and found to be regular		573,158	573,158
	Investigation limited by legitimate disposal of records.		454,272	454,272
	Investigations not yet complete		311,475	311,475
	Totals	1,004,816	3,439,616	4,444,432

12. The Fund now consider the full value of the Awards for All suspect grants to be lost and intend to write these off. The Fund are also proposing to write-off £510,446 as the likely loss sustained on their main grants programme. The Fund are still considering the actions to be taken in those cases where breaches of grant conditions have been identified. Where these are significant the grant is likely to be withdrawn and either recovery or write-off action will be taken.

Improvements to control mechanisms

13. My report on the Fund’s 2004-05 financial statements set out the actions they had already taken or were being taken to combat the risk of fraud from multiple applications. In summary these included:

- Improved data analysis tools and system alerts warning staff of suspicious applications;
- Revised checklists for staff to follow in assessing grant applications;
- Fraud awareness training;
- The transfer of the grant investigations team to a position independent of Operations and increased staffing levels in the team; and
- Confirmation of relevant information from applicant’s banks.

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14. Since then, work to develop the control framework for the Big Lottery Fund's new programmes has continued. The key improvements include their procedures for:
- Sampling of grant files to assess the effective operation of their internal processes. This is being led within operations but by a team independent of grants officers;
 - Random visits to a sample of grant recipients in addition to those assessed as high risk.
15. The Fund have reviewed the Awards for All control framework. The revised Awards for All programme has been "re-certified" as fit for purpose by the Department for Culture, Media and Sport. From 28 April 2006, the scheme allows applicants to apply for grants up to £10,000 (up from the previous limit of £5,000).
16. The enhanced control framework is primarily based on making more effective use of the data analysis tools, more thorough checking of the identity of the applicant and enhanced fraud awareness training. Checks still concentrate however on the appraisal of grant applications rather than on monitoring and follow-up to ensure the grants had been used as intended. The key control for the latter is review of end-of-grant reports.

Progress on implementing previous NAO recommendations

17. In my report on the Fund's 2004-05 financial statements I made a number of recommendations that the Fund could be getting on with while their investigation progressed. In the following paragraphs, I provide an update of how these recommendations have been implemented by the Fund to date.

Recommendations for the Fund and progress to date:

- **More explicit consideration should be given to the risk of fraud that may exist within programmes that are intended to be easy access and the extent to which controls should be put in place to combat this.** The Fund have given us some indications on this in respect of the Awards for All programme. However, assessing the risk of fraud on a programme by programme basis needs to be further embedded as part of the Fund's evolving control framework. Without this assessment of the risk of fraud, the Fund cannot ensure that the controls in place are proportionate;
- **Any failures in internal control that are discovered must be carefully considered in case they highlight a failing that is systematic rather than a one-off failure.** The Fund have introduced system alerts in response to the fraud involving multiple applications. As part of launching the new programmes, it has re-assessed the control

framework around all its programmes. More work can still be done to make better use of existing reporting mechanisms, for example regarding disputes and visits and to ensure management are aware of key trends in this area;

- **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.** The Audit Committee now reviews an executive summary of each internal audit report, together with a summary of the recommendations made in high risk areas. The Audit Committee has requested high-level summaries of key controls in place by programme including the means by which Accounting Officer obtains assurance over regularity and this is being arranged;

Recommendations for the Department for Culture, Media and Sport (DCMS) as the 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.** The Department and relevant lottery distributors are looking at ways to streamline processes in line with my recommendation;
- **Due to inconsistencies in the way individual grant schemes are reported in the annual accounts of lottery distributors, the DCMS 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.** As stated in the Statement on Internal Control on page 67, the Fund have, as a first step, prepared an unaudited summary account for the Awards for All scheme for 2005-06. This will be subject to audit in future years.

Further development in the control framework operated by the Big Lottery Fund

18. In following up on the work of the Fund I have the following further recommendations:

On the risk of fraud:

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- The development of the control framework should be based on a more explicit consideration of the risk of fraud that is inherent within each programme. This would allow the Fund to ensure that the control framework developed is appropriate;

On monitoring:

- The levels of grants to be selected for more detailed monitoring, such as a visit, have previously been constrained by the staffing levels of the Fund. The consideration of the number of grants to be selected for visit should start with an assessment of the level of assurance the Accounting Officer requires on regularity and the degree of risk faced together with an element of random selection. It is important that the revised sampling of grant files for compliance with internal procedures and for visiting quickly become the norm and that senior management review the key findings from these programmes. Where necessary appropriate action must be taken which may be by the Fund, their partners, awardees or jointly. If awardees have real difficulty complying or are found to be deliberately not complying then the level of visits may need to be increased;
- The Fund should keep under review whether the end-of-grant report they require from applicants is providing sufficient evidence of how the grant has been spent. The end-of-grant report is also supported by a series of visits on a sample basis. And again, levels of visits should be kept under review to ensure that they are adequate protection against the perceived risk of the grant being misspent;
- Understandably, staff visiting grant applicants pay considerable attention to the progress of the project and whether the project is supporting the planned number of beneficiaries. The Fund should, however, also ensure that grant officers pay sufficient attention to reviewing and documenting evidence of spend, such as reviewing invoices, during their visits;

On working with award partners

- Further consideration needs to be given to the monitoring controls used by award partners (who assess and monitor grants on the Fund's behalf for certain programmes). Their control frameworks should incorporate the same level of defence against fraud as the Fund applies to the grants it assesses and monitors in-house;

On the information provided to management:

- At the moment the Fund collects a range of financial and qualitative data on a programme-by-programme basis but this is not regularly summarised to give an organisation-wide view to senior management. The Accounting Officer needs to

consider more explicitly levels of breaches to grant terms and conditions being identified by the routine compliance checks conducted by the Fund's staff;

- Continued attempts to defraud the organisation are being identified through their system alerts. This information should be analysed and reported to senior management and shared with Award Partners as appropriate.

19. As the Big Lottery Fund takes on the roles of the Community Fund and the New Opportunities Fund³, we have highlighted to the Fund where we believe the issues raised require further consideration. The Fund should also refer to our published guidance.

John Bourn
Comptroller and Auditor General
15 November 2006

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³ The National Lottery Act 2006 received royal assent on 11 July 2006 and is due to take effect over the coming months.