



National Audit Office

DEPARTMENT FOR CULTURE, MEDIA AND SPORT

# Tackling External Fraud in Grant-Making

A GUIDE TO GOOD PRACTICE | March 2006

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**DEPARTMENT FOR CULTURE, MEDIA AND SPORT**

# Tackling External Fraud in Grant-Making

This document has been prepared by the National Audit Office as part of its Good Governance programme. Good Governance projects aim to draw on the NAO's cross-governmental experience and independent perspective to help organisations delivering public services achieve excellence in financial management, operational efficiency and quality of service.

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- Contribute to the delivery of efficiency savings, and, where possible, direct financial impacts; and
- Bring a wider perspective to the client organisation's practice by drawing on the NAO's knowledge of financial management and service delivery issues across government.

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## EXECUTIVE SUMMARY



**1** In Autumn 2004, a Lottery funds distributor discovered that it may have been subject to a fraud involving multiple applications for grants. DCMS-sponsored organisations make significant lottery and other grant awards of around £1.6 billion per annum. The purpose of this review was to identify and disseminate best practice in managing the risk of fraud in grant awards and to identify generic areas for potential improvements.<sup>1</sup> Organisations may wish to benchmark their own circumstances against the best practice identified. Internal and external fraud<sup>2</sup>, which is unrelated to the award of grants, are beyond the scope of this review.

**2** In society generally, the incidence of external fraud continues to grow and many millions of pounds of public money are lost each year through this. The losses arise from a wide range of different types of fraud: at one end of the scale are individuals who see an opportunity to make a small gain while at the other extreme a relatively small number of organised crime groups carry out systematic attacks for large sums of money. Those who commit fraud weigh up the potential gains against the risk of getting caught and there is a need to make fraud as unattractive as possible. Not acting against fraud can undermine the reputation, integrity and professionalism of the organisation and perceptions about the quality of the services it provides leading to a loss in public confidence.

**3** For this report, our findings have been categorised as issues which should be considered at the organisational level (Part 2 of the report) and issues which should be considered at the individual scheme level (Part 3).

**4** At the organisational level, we have identified the following aspects of good practice:

- the effectiveness of organisations' fraud strategies can be improved by:
  - regular review and reassessment of the fraud environment and any specific risks associated with the nature of the grant schemes in operation, in terms of the intended recipients and the purpose of funding;
  - wider dissemination of the strategy both internally and externally;

- more explicit consideration of the risk of fraud and the likely financial impact and clearer articulation of risk appetite, taking account of the reputational risk as well as the financial risk;

- best practice in counter-fraud measures should be continuously reviewed including gaining updates from relevant agencies and then shared;
- fraud awareness training should be provided more widely and updates provided where new threats are identified or counter-fraud techniques are developed;
- there is the potential for better intelligence sharing both between distributors on the sector and more widely;
- for jointly funded schemes:
  - the transparency of reporting could be made clearer by the preparation of memorandum accounts;
  - clarification and co-ordination of Accounting Officer responsibilities could be simplified, for example by the appointment of a "principal" Accounting Officer, and
- where partner organisations are used, it should be clearly stated where Accounting Officer responsibilities lie and the extent of delegation made.

**5** More widely, grant-making bodies should consider the overall impact of their grant-giving strategy. A proliferation of schemes with different rules or grant-payment mechanisms and/or partners will inevitably make the business more complex. This needs to be balanced against the objectives of the organisation and reviewed regularly. Streamlining the number of grant schemes in operation and the procedures for managing these grants could increase efficiency and reduce complexity while not sacrificing achievement of the objectives of the body concerned.

<sup>1</sup> References to other useful documents and websites are provided at the end of this guide.

<sup>2</sup> The offences generally referred to as fraud are covered by the Theft (Amendment) Act 1996. See [http://www.nao.org.uk/guidance/Tackling\\_External\\_Fraud.pdf](http://www.nao.org.uk/guidance/Tackling_External_Fraud.pdf) for more details.

**6** At the individual grant scheme level, the impact of potential fraud is influenced by a number of factors, principally:

- the intended recipients;
- the nature of the scheme;
- the purpose of the grant; and
- the scale of the award.

In designing counter-fraud measures which are appropriate to the particular scheme, we identified a number of areas where approaches could be further enhanced:

- information should be provided to applicants on the organisation's policy on fraudulent claims, possibly through specific references in grant application information;
- briefing of, and contracts with, partner organisations and agents such as project monitors need to contain appropriate provisions for dealing with fraud so that all are aware of their respective roles and responsibilities for the prevention, detection and reporting of fraud;
- grant schemes should be specifically fraud-proofed, particularly against the risks of multiple applications to either the one organisation or to a number of different funders;
- counter-fraud measures should not only cover the higher risk grants but should also ensure that all grants have a chance of detailed review, although the extent of coverage of lower risk grants should be less;
- there should be a clear rationale for different counter-fraud procedures being applied to different schemes;
- where third parties are involved in the award or payment of grants, organisations should overtly assess the third party's counter-fraud measures; and
- where more than one distributor is funding the same project, assessment and monitoring procedures should be explicit and streamlined.

**7** At the scheme level, the key responsibility of management is to ensure that, once the system of control has been agreed for grant award and monitoring, controls are operated with rigour and that the organisation should seek evidence that this is the case. Internal Audit and other agencies such as a fraud investigation team have a key role in providing assurance to Accounting Officers that such systems are operating as required.

**8** In addition to being of assistance to the Department and its NDPBs, we hope that the findings of this review will help to inform the work of the cross-departmental group, chaired by HM Treasury, which has been established to consider the implications of fraud and controls over grants.



## PART ONE

# Introduction

## Background

**1.1** In Autumn 2004, a Lottery funds distributor discovered that it may have been subject to fraud involving multiple applications for grants. The funder, police and the Charity Commission initiated extensive investigations into potentially fraudulent applications by a number of community groups some of whom were also registered as charities. A number of arrests have been made by the police and the investigations continue into the nature and extent of the potential fraud. The funder has since modified its procedures so as to reduce the risk of such frauds occurring in the future and, if they do, increase the opportunities for detection. Our interim recommendations in relation to the suspected fraud should also be noted.<sup>3</sup> Where these may apply to others, we have repeated them in this report to ensure completeness.

**1.2** There are a number of DCMS-sponsored organisations who make significant grant awards each year. In 2004-05, the total value of grants awarded by major grant distributors was in the region of £1.6 billion (split approximately £200 million Grant in Aid and £1.4 billion lottery grants). The proceeds of the National Lottery support the arts, heritage, sport, charities and community and voluntary groups as well as supporting projects concerned with health, education and the environment. There are currently 14 independent distributing bodies<sup>4</sup> responsible for distributing Lottery money. These include bodies such as Sport England, Arts Council England, and the Big Lottery Fund. While the Lottery is the major source of funding our recommendations are also relevant for other grant providers.

**1.3** Lottery-funded bodies make their grant decisions independently of Government and of the Department for Culture, Media and Sport and in response to applications for funding which they receive. They also make their decisions based on the published criteria of each of their different Lottery funding programmes. Examples include:

- Awards for All. This is an easy to access Lottery grants programme set up to help small groups in local communities. In England, the programme is supported by the Arts Council England, the Big Lottery Fund, the Heritage Lottery Fund and Sport England. Similar Awards for All schemes operate in Scotland, Wales and Northern Ireland. Awards for All offers grants of between £500 and £5,000 in a simple and straightforward way;
- The Heritage Lottery Fund supports projects which preserve and enhance, or widen public access to, the national heritage. Projects can cover the land and countryside, parks, historic buildings and sites, museum collections, archives, and industrial, transport and maritime heritage. HLF programmes include the Joint Places of Worship Scheme (operated with English Heritage), the Townscape Heritage Initiative (THI) and the Public Parks initiative; and
- The Big Lottery Fund<sup>5</sup>, launched on 1 June 2004, has a range of grant programmes which include £155m for children's play; a £155m programme of support for voluntary sector infrastructure; £354m for environmental programmes, including £90m for parks; £165m for well-being programmes, and £60m for international grants; and

<sup>3</sup> Our report and more details about this matter are found attached to the 2004-05 financial statements of the Big Lottery Funds within their Annual Report. This can be found at: [http://www.biglotteryfund.org.uk/assets/annual\\_report\\_cf2005.pdf](http://www.biglotteryfund.org.uk/assets/annual_report_cf2005.pdf).

<sup>4</sup> Currently these are: Sport England; Sport Scotland; the Sports Council for Wales; the Sports Council for Northern Ireland; UK Sport; Arts Council England; Arts Council of Wales; Arts Council of Northern Ireland; Scottish Arts Council; Scottish Screen; the UK Film Council; the Millennium Commission; the Heritage Lottery Fund and the Big Lottery Fund.

<sup>5</sup> The Big Lottery Fund is a UK-wide distributor. The programmes illustrated operate in England with similar programmes in Scotland, Wales and Northern Ireland.

- Sport England provides grants through the national governing bodies of some 32 key sports and other partners. Grants are focussed on local sport, encouraging participation and the infrastructure of clubs, coaches and volunteers.

## Scope

**1.3** Our aim has not been to give formal assurance about the organisational level responses to the threat of fraud or about the adequacy of procedures in each of the grant schemes; nor does the report seek to identify all possible risks that may exist in relation to external fraud in these organisations. Rather, our purpose in carrying out this particular review was to identify and disseminate within the sector best practice in managing the risk of fraud in grant awards and to identify generic areas where further improvement to procedures could be considered.

**1.4** Our review has covered counter-fraud measures at the organisational level, including external fraud strategies, as well as the procedures for awarding and monitoring grants. Across the sector, and within individual organisations, there are a large number of grant schemes in operation. Our additional work focussed on a sample of these schemes.

**1.5** Internal fraud, and other types of external fraud which are unrelated to the award of grants, are beyond the scope of this review and have not been considered here.

## Approach

**1.6** As part of our routine audit coverage, we examine a sample of grant awards in each of the distributors (and other grant providers) and carry out a review of the organisations' control environments to the extent necessary to ensure that the financial statements are free from material fraud or error. Consistent with our routine procedures, our additional work has consisted of a combination of interviews with key staff and file review as well as consideration of reports prepared by the organisations' internal auditors.

**1.7** Control procedures have been assessed against a range of key procedural and control criteria in relation to external grant fraud. These criteria have been drawn, inter alia, from those outlined in the joint NAO and Treasury publication, "Good Practice in Tackling External Fraud"<sup>6</sup>, and are those which we consider to be of particular relevance to grant-awarding bodies within the DCMS-sponsored sector.

**1.8** This report summarises our findings, presented in two sections: Section 2 addresses the understanding and assessment of, and response to, the risk of external fraud at the organisational level; Section 3 covers the prevention and detection of external fraud at the grant scheme level.

**1.9** We understand that a cross-departmental group, chaired by HM Treasury, has been established to consider the implications of fraud and controls over small grants. The group includes representatives from the Department for Culture, Media and Sport and grant providers from across government. We have made a number of observations and recommendations and hope that these will contribute to the debate, and be of assistance to the Department and its NDPBs in determining ways to further improve procedures and controls that mitigate the risk of external fraud to grant-awarding bodies.

<sup>6</sup> [http://www.nao.org.uk/guidance/Tackling\\_External\\_Fraud.pdf](http://www.nao.org.uk/guidance/Tackling_External_Fraud.pdf). This publication includes a wide range of useful further references.

## PART TWO

# Understanding and managing the risks of external fraud at the organisational level

**2.1** In the context of this report, the key risk is that of people or organisations claiming grants to which they are not entitled. This risk ranges from unsophisticated, opportunistic attempts to defraud, to more systematic attacks by organised criminals. Whilst the amounts involved in fraudulent claims may individually be small or the numbers of sophisticated attacks may be low, the resultant losses to public funds have the potential to be significant.

## Fraud risk strategies should be in place and should be widely publicised internally and externally

**2.2** With a clear understanding of the fraud risk faced, an organisation can take a strategic and systematic approach to its management of the risk, at both the organisational and operational level. This means that the risk of fraud can be managed in the same way as any other business risk. A strategic approach can help organisations develop a range of well targeted, proportionate measures, which are cost effective. In all of the organisations reviewed, fraud risk strategies are in place.

**2.3** These strategies should be:

- subject to regular review; and
- reflect not only the external environment in general but also an assessment of the organisation's particular exposure to fraud.

The impact on risk of the nature of individual schemes is discussed in further detail in Section 3 of this report but it is important that the organisational response to risk takes full account of the overall impact of the various grant schemes in operation.

**2.4** Streamlining and rationalising the number of schemes may assist in fraud reduction. At appropriate intervals, grant-making bodies should consider the overall impact of their grant-giving strategy. There has been a general trend that, in responding to new opportunities for more effective funding or shifts in the priorities for funding, new schemes have been introduced to supplement existing schemes. This proliferation of schemes with different rules or grant-payment mechanisms and/or partners has inevitably made business more complex and this needs to be balanced against the continuing objectives of the organisation. Arts Council England recently carried out a major rationalisation of their grant schemes and simplification of their grants programme. The use of the similar delivery models for differently labelled programmes could simplify the assessment of the risk of fraud and allow for more consistency in prevention and detection controls as well as improving efficiency.<sup>7</sup> It also means that staff administering the schemes do not need to have knowledge of a wide number of very different schemes which have evolved over time and which may be subject to very different terms and procedures.

**2.5** A formal fraud risk management strategy can be useful in communicating to staff what is expected of them and can assist in engendering a "fraud-aware" culture. Moreover, the publication of a fraud policy externally makes the public aware that an organisation has a well thought out approach to tackling external fraud and this, in itself, can act as a deterrent to the more opportunistic fraudster. Organisational fraud risk strategies were not always available on the intranets of those organisations reviewed or on external application websites.

<sup>7</sup> The Big Lottery Fund, for example, have a large number of different grant programmes which use a more limited range of five delivery models.

## The types of fraud risk faced need to be fully understood and articulated

**2.6** For the lottery scheme where the vast majority of multiple applications were found, the risk of multiple application fraud had been identified but management believed that any frauds were more likely to be one-off instances. They therefore took the decision that existing controls were sufficient in view of the need to keep the administration requirements for such low value grants to a minimum. Targeting of the distributor's grant schemes by large-scale criminal activity had not been identified as a significant threat.

**2.7** There have been a number of developments over recent years which have increased the ease with which fraudulent claims can be made and therefore have altered fundamentally the viability of smaller scale frauds. Key amongst these changes are the increasing availability at low cost of difficult to trace mobile phones and internet addresses. Provided individual amounts are also low, the banking controls designed primarily to prevent money laundering may not act as an effective control against these low value frauds.

## A full assessment of the scale of the fraud threat should always be carried out

**2.8** Although the organisations we reviewed indicated that they may revise their assessments of the fraud threat faced following the reported fraud, we found that explicit consideration of the scale of the threat faced was limited. The changes in communication technology described above mean, for example, that the scale of the fraud threat may have fundamentally changed and it was not always clear that this had been reflected in an update of the risk assessment.

**2.9** The joint NAO and HM Treasury guide, "Good practice in tackling external fraud", states that '... assessing the scale of loss from fraud is an important first step in developing a strategy for tackling external fraud'. An estimate highlights the scope for potential savings from fraud prevention which can then help to determine the relative priority that should be given to tackling fraud in the context of all the other calls on an organisation's resources.

## The risk appetite for fraud should be clearly articulated

**2.10** There is a clear understanding that the level of fraud response needs to be proportionate to the risk of fraud and the impact this will have on the organisation. Having established the risk of fraud, it is then necessary to consider what would constitute an appropriate response. A major obstacle to developing a fraud response is the absence of a clear assessment of what might constitute an acceptable level of the risk of fraud. From a purely financial perspective, a decision about the level of acceptable risk would be determined based on the balance between the scale of potential loss and the cost of preventative and detective controls.

**2.11** For public sector grant distributors, the decision is more complex. Firstly, there is a tension between the burden placed on applicants by the framework of controls to prevent and detect fraud and the drive for increased accessibility of grants, particularly in the context of the move by a number of distributors towards making a large number of smaller scale awards. And secondly, the lower value of awards heightens concerns about the possibility of the cost of controls exceeding the potential loss through fraudulent claims.

**2.12** In addition to cost/benefit considerations, it is also important to consider the potential impact of fraud on the reputation of the distributing organisation, and of the National Lottery if this is the original source of the funding. Public expectations and perceptions, and the reaction to fraud in the public sector, place particular demands on public sector distributors. There have been a number of high profile cases where the media have focussed critically on relatively small scale awards and the fact that these form only a very small part of total annual grants is not seen as relevant to the extent of criticism being levelled at the distributors. Such exposure could also increase the risk if the organisation is perceived to be an easy target for fraudsters.

**2.13** It is clearly not practical or possible to design systems which will guarantee that all fraud will be prevented or detected. It is therefore important that the distributors' fraud strategies specifically address their risk appetite on individual schemes. This assessment should be informed not only by financial considerations but should also include an assessment of the impact of the control framework on accessibility and the impact of fraud on the organisation's reputation.

## Best practice in fraud risk management should be continuously reviewed

**2.14** Whilst we are aware of recent action that has been taken as a result of the reported fraud in the organisation concerned, we found that most organisations tended to be reactive. Organisations may therefore not be keeping up to date with best practice, leading to anti-fraud approaches that are less pre-emptive and preventative than they might otherwise be.

**2.15** At the organisational level therefore management needs to ensure that it receives relevant and regular updates from, for example, the police and other anti-crime agencies on emerging fraud risks and that appropriate responses to these are considered. Bulletins could then be issued to increase staff awareness. DCMS, as the sponsor department, could enlist the Treasury working group noted above to assist with the co-ordination of this and this group could also assist in the development of “heads of agreement” between the various agencies which would promote the sharing of intelligence.

## Fraud awareness training should be provided more widely to staff

**2.16** Regular and specific fraud training is highly desirable for a number of reasons. General fraud awareness training helps to create and reinforce a culture of fraud awareness throughout an organisation. For those staff directly involved in more risk-prone activities, training should focus on an understanding of the nature of the risks and the expected impact of, and the importance of, the controls in place to mitigate those risks. This training needs to be provided regularly to allow any changes in the risk environment to be promptly communicated to staff as well as to allow the dissemination of latest techniques in prevention and detection.

**2.17** Although some of the organisations we reviewed have expressed an intention to increase levels of fraud awareness training, we found that fraud training had sometimes been limited to general induction training.

## Knowledge sharing between distributors may assist in the prevention and detection of fraud

**2.18** The standard Financial Memorandum issued by DCMS to its sponsored bodies states that ‘all cases of attempted, suspected or proven fraud, irrespective of the amount involved, must be reported by the [body] to the Department as soon as it discovered so that any lessons can be quickly shared’. Preliminary findings from the reported fraud investigation suggest that several schemes, within both the public and private sectors, were targeted and, as part of the investigation, knowledge was shared to assist in determining the full extent of the frauds.

**2.19** There are a number of legal constraints arising from data protection legislation which limit the extent of data-matching and information-sharing which is permissible. However, there may be greater potential for sharing information, for example through specific conditions being attached to the awards of grants. Liaison with the Data Protection Registrar/Information Commissioner may be necessary. It may be that the sponsoring Department could lead on this on behalf of the sector.

## Assignment of responsibility and accountability needs to be clear

**2.20** A number of jointly-funded lottery schemes are in operation across the Culture, Media and Sport sector. Whilst joint funding in areas of common interest to distributors and the Department can clearly lead to improved effectiveness in funding, there is a risk of a lack of clarity in governance arrangements. For example, in the case of the Awards for All scheme, although the scheme was administered by the Community Fund, there were technically five Accounting Officers who each individually were accountable for this expenditure.



**2.21** There are some examples of greater clarity of governance and accountability, most notably the reporting arrangements for the Spaces for Sport and the Arts and the Active England schemes. Separate memorandum accounts are prepared for each of these schemes. These accounts are presented within the statutory accounts of the principal administrator of the joint schemes, in this case, Sport England. This type of arrangement has a number of benefits, for example:

- the total scale of the scheme is visible both in terms of the various sources of funding and the total expenditure;
- expenditure is reported only once in each of the distributors' accounts, as funding from other distributors is not shown as income in the lead distributor's accounts; and
- the activities of the scheme are subject to a higher level of audit scrutiny than would otherwise be the case.

**2.22** However, while responsibility for preparation of a memorandum account leads to clarity of reporting, of itself it does not lessen the burden on the co-funding Accounting Officers. Governance, co-ordination and cohesion could be strengthened by the appointment of a "principal" Accounting Officer for the Scheme. Whilst other Accounting Officers would retain ultimate responsibility for the use of their funds, this arrangement would clarify the particular responsibilities of the organisation which is administering the scheme and should also help to streamline the processes for obtaining appropriate assurances for each of the organisations involved in the jointly-funded scheme.

**2.23** The use of partners within different models of grant-making means that for some grants the monies pass through several intermediaries before the grant is received. The responsibilities of the Distributor Accounting Officer for regularity and the safeguarding of public assets needs to be clearly defined so that each party can show they have discharged their responsibilities effectively.

## Recommendations

**2.24** We recommend that:

- the effectiveness of organisations' fraud strategies could be improved by:
  - regular review and reassessment of the fraud environment and any specific risks associated with the nature of the grant schemes in operation, in terms of the intended recipients and the purpose of funding (paragraph 2.3 to 2.4);
  - wider dissemination of the strategy both internally and externally (paragraph 2.5); and
  - more explicit consideration of the risk of fraud and the likely financial impact and clearer articulation of risk appetite, taking account of the reputational risk as well as the financial risk (paragraph 2.6 to 2.13);
- more widely, a regular review of grant programmes and their continued fit with the organisation's objectives should be performed to check whether there is a case for streamlining the number of schemes in operation and the procedures for managing these;
- best practice in counter-fraud measures should be continuously reviewed (paragraphs 2.14 to 2.15) including gaining updates from relevant agencies and sharing of best practice;
- fraud awareness training should be provided more widely and updates provided where new threats are identified or counter-fraud techniques are developed (paragraph 2.16 to 2.17);
- there is the potential for better intelligence-sharing both between distributors on the sector and more widely (paragraph 2.18 to 2.19);
- for jointly funded schemes the transparency of reporting could be clearer and Accounting Officer responsibilities could be simplified, for example by requiring the preparation of memorandum accounts for significant jointly-funded schemes and by the appointment of a "principal" Accounting Officer (paragraph 2.20 to 2.22), and
- where partner organisations are used, it should be clearly stated where Accounting Officer responsibilities lie and the extent of delegation made (paragraph 2.23).

## PART THREE

# Understanding and managing the risks of external fraud at the grant scheme level

## Factors affecting the potential for fraud

**3.1** Individual grant schemes and individual awards are vulnerable to fraud to differing degrees. There are a number of factors which will influence the nature and extent of controls which are appropriate to the grant award. The main factors relevant to the sector are detailed below.

**3.2 The type of grant recipient:** Where the award is to, for example, an NDPB (such as a national museum) for a major capital project, the risk of fraudulent claims may be relatively low. Where grants are to individuals or less well-established groups, the risk can be significantly higher. In the case of an NDPB, the distributor will have a large amount of contextual knowledge about the applicant. However, in the case of individuals, the only knowledge may well be the grant application. In addition, an NDPB can be expected to have a strong set of internal controls in place and a sound knowledge of propriety in the use of public money. This is unlikely to be the case for private individuals.

**3.3 The nature of the scheme:** Linked with the above, a number of schemes deliberately target less “sophisticated” applicants. These groups are less likely to have the resources or skills necessary to provide the sort of assurances which could be expected from more commercially aware applicants. Furthermore, the imposition of complex control requirements could undermine achievement of the objectives of the scheme if it were to act as a deterrent to applicants.

**3.4 The purpose of the grant:** Where the grant is for capital purposes, evidence of appropriate use of the funding is likely to be more readily available to the distributing organisation than if funding is for revenue purposes. This is in part due to the existence of physical evidence of the resources spent but also because expenditure on capital projects tends to be more easily disaggregated from other expenditure than revenue expenditure. In addition, professional “project monitors” may be in use, for example to certify the stage of completion of a project.

**3.5 The scale of the award:** Where larger grants are involved, the balance between the cost of controls and the risk of fraud allows for more costly controls to be put in place than where relatively small amounts are involved.

**3.6** Against this background, controls need to be designed to target the key data and assurances required by the Accounting Officer to carry out their duties (including in respect of regularity). Our review found a number of areas which organisations need to consider when designing or reviewing their anti-fraud measures.

## Applicants, partner organisations and agents all need to be aware of the organisation's response to fraud

**3.7** In paragraph 2.5 above, we referred to the need to publicise fraud strategies on the distributing organisations' web sites. To further emphasise this, some application forms and grant acceptance contracts include a specific reference to the organisation's fraud policies, but this was not always the case.

**3.8** In briefing partner organisations and agents as well as in their contracts the grant-maker needs to make known their requirements in relation to prevention and detection of fraud and reporting responsibilities.

## Grant schemes need to be adequately "fraud-proofed"<sup>8</sup>

**3.9** Having carried out an analysis of the particular risks of fraud for the individual grant scheme and the risk appetite for that scheme, procedures need to be fraud-proofed to the appropriate level. We found that fraud-proofing of grant schemes was not always explicit. Therefore fraud-proofing exercises may need to be carried out on existing schemes as well as new schemes as they are introduced and these exercises will need to be updated as the environment changes.

**3.10** We identified two fraud risks which we believe now need to be addressed more explicitly: multiple applications to a scheme from one recipient and multiple applications to several schemes/distributors for the same funding (where non-complementary funds are obtained for the same project from a number of bodies). More work to assess different types of fraud risk could be carried out e.g. to review fraud reports to Treasury and emerging trends being reported by the Police and others. It may be possible to develop a more complete database of fraud risks which would assist with fraud-proofing individual grant schemes.

**3.11** Where the risk is for multiple applications to the one distributor, some checks have already been developed to counter this risk, for example:

- a requirement for original receipts, providing proof of occurrence;
- computerised searches for multiple post codes/telephone numbers with messages/alerts sent to staff; and
- definitions of acceptable referees which focus on professionals (who would be guilty of professional misconduct if they provided false representations).

In the wake of the recent events it may be appropriate for distributors to look again at how data matching within their organisation can be extended.

**3.12** Where the risk involves applications to more than one distributor, whilst there is undoubtedly the potential for greater information sharing, issues of data protection may need to be addressed as discussed in paragraph 2.19 above.

## Counter-fraud checks should not only focus on high risk awards

**3.13** Whilst the design of counter-fraud measures should focus primarily on the awards which are more prone to fraud, in order to deter fraud more generally it is important for there to be checks in place which could potentially apply to any grant award. Best practice therefore consists of a combination of counter-fraud measures focussed on higher risk grants, supplemented by a random sample of lower risk grants.

<sup>8</sup> "Fraud-proofing" is the process by which the documentation and controls (both at original assessment and during monitoring and sign-off) for the scheme are reviewed as a whole by staff with relevant expertise in counter-fraud measures to identify gaps or weaknesses in design.



## There needs to be a clear rationale for differences in the approach to grant assessment, monitoring and payment controls

**3.14** Because our review covered a number of different organisations and grant schemes, it is not surprising that we found a lack of consistency and standardisation of monitoring and payment controls, both at the inter- and intra-organisational level. While some of these different approaches appear entirely justifiable because of the different nature of the risks associated with the schemes, others seemed to be less understandable.

**3.15** In some cases, there were no formal procedures in place to verify the existence of individuals or organisations in receipt of grant awards. Whilst it may not be cost effective to carry out detailed checks, developments in information technology, such as the internet, do mean that limited checking need not be as time or resource expensive as in the past. Similarly, in the case of significant capital projects, while some organisations required site visits or originals of receipts for refundable expenditure, others did not.

**3.16** For a few schemes, we understand that the extent of monitoring and evidence required to be submitted before payments were made, was at the discretion of the individual grants lead officer concerned, and there was a lack of clear, central guidance as to any minimum standard.

## The risks associated with the involvement of third parties in grant awards needs to be formally assessed

**3.17** Some grant schemes are administered by using third parties to assess, authorise and monitor the individual grants based on an “umbrella” award from the distributor. We found that there was not always clear evidence of the main distributor assessing the risk of fraudulent awards being made by the third party, nor was there clear evidence of a detailed assessment of the operation and effectiveness of the third party’s mitigating controls.

## Where more than one distributor is funding the same project, assessment and monitoring procedures should be explicit and streamlined

**3.18** A number of awards of lottery funding have required the applicant to secure “match” funding. We are aware of anecdotal evidence that the prior award of funding from another distributor was seen as sufficient evidence of the bona fides of the application. Clearly there is a risk that all of the funders might rely on other funders’ checks and that no substantial checking would then be carried out.

**3.19** Even where checking is being done, this needs to be proportionate to the total level of public funding secured. There is also a risk that each funder will separately require different types of evidence to meet their own assessment and monitoring procedures, thereby increasing the burden on the grant recipient.

**3.20** Where distributors are aware of funding being provided by other public sector organisations, control would be enhanced and potentially streamlined if a protocol were agreed by the funders as to which funder would have principal responsibility for monitoring the project and reporting to other funders on the regularity of the project expenditure.

## Where controls are built in to grant management procedures, it is important for them to be operated

**3.21** Through our more detailed testing of grants, we found that there was not always evidence that the internal grant control procedures had consistently been adhered to. This was sometimes due to a failure to retain evidence that the control checks had actually been carried out in accordance with the grant terms and conditions and conditions for payment had been met (or there was a valid reason that they had not been required to be met). Even if these controls had been operated and the issue was merely one of a failure to retain evidence of the work done, the distributor remains open to challenge.

**3.22** As part of the evidence required by management about the effectiveness of their internal control environment, it is important that specific evidence is sought as to the extent of compliance with grant management procedures. Here the key responsibility of management is to ensure that, once the system of control has been agreed for grant award and monitoring, controls are operated with rigour and that the organisation should seek evidence that this is the case. Internal Audit and other agencies such as a fraud investigation team have a key role in providing assurance to Accounting Officers that such systems are operating as required. Compliance would also be facilitated in some cases by the development of checklists and standardised information retention requirements.

**3.23** The failure of staff to comply fully and consistently with the procedures designed to prevent and detect fraud may, in some cases, be due to a lack of clear understanding of the risks which these procedures are designed to mitigate. Improved fraud awareness training, as discussed in paragraph 2.16 above, would assist in ensuring that all staff were aware of the importance of these procedures.

## Recommendations

**3.24** We recommend that grant schemes be assessed against the following good practice:

- Information should be provided to applicants on the organisation's policy on fraudulent claims, possibly through specific references in grant application information (paragraph 3.7).
- Briefing of and contracts with Partner organisations and agents such as project monitors need to contain appropriate provisions for dealing with fraud so that all are aware of their respective roles and responsibilities for the prevention, detection and reporting of fraud (paragraph 3.8).
- Grant schemes should be specifically fraud-proofed, particularly against the risks of multiple applications to either the one organisation or to a number of different funders (paragraph 3.9 to 3.12).
- Counter-fraud measures should not only cover the higher risk grants but should also ensure that all grants have a chance of detailed review, although the extent of coverage of lower risk grants should be less (paragraph 3.13).
- There should be a clear rationale for different counter-fraud procedures being applied to different schemes (3.14 to 3.16).
- Where third parties are involved in the award or payment of grants, organisations should overtly assess the third party's counter-fraud measures (paragraph 3.17).
- Where more than one distributor is funding the same project, assessment and monitoring procedures should be explicit and streamlined (paragraph 3.18 to 3.20).
- The key responsibility of management is to ensure that, once the system of control has been agreed for grant award and monitoring, controls are operated with rigour and the organisation should seek evidence that this is the case. Internal Audit and other agencies such as a fraud investigation team have a key role in providing assurance to Accounting Officers that such systems are operating as required (paragraph 3.21 to 3.23).

## Further references

- 1 NAO report: Working with the Third Sector

[http://www.nao.org.uk/publications/nao\\_reports/05-06/050675.pdf](http://www.nao.org.uk/publications/nao_reports/05-06/050675.pdf) eg Part 4

- 2 NAO report: Tackling Benefit Fraud

[http://www.nao.org.uk/publications/nao\\_reports/02-03/0203393.pdf](http://www.nao.org.uk/publications/nao_reports/02-03/0203393.pdf)

- 3 NAO report: Tackling VAT fraud

[http://www.nao.org.uk/publications/nao\\_reports/03-04/0304357.pdf](http://www.nao.org.uk/publications/nao_reports/03-04/0304357.pdf)

- 4 HM Treasury website: contents relating to fraud policy

[http://www.hm-treasury.gov.uk/documents/public\\_spending\\_and\\_services/audit\\_and\\_accounting/pss\\_aud\\_fraud.cfm](http://www.hm-treasury.gov.uk/documents/public_spending_and_services/audit_and_accounting/pss_aud_fraud.cfm)



