National Audit Office

Report
by the Comptroller
and Auditor General

Department for International Development

Investigation into the Department's approach to tackling fraud

HC 1012 SESSION 2016-17 9 FEBRUARY 2017

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National Audit Office

Department for International Development

Investigation into the Department's approach to tackling fraud

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 7 February 2017

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act

Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

6 February 2017

HC 1012 | £10.00

Our investigation examines the Department for International Development's approach to tackling fraud and compares some aspects to equivalent activities in the Foreign & Commonwealth Office and the British Council.

Investigations

We conduct investigations to establish the underlying facts in circumstances where concerns have been raised with us, or in response to intelligence that we have gathered through our wider work.

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Contents

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What this investigation is about

1 This investigation is about how the Department for International Development (DFID) manages the risks to its expenditure from fraud. Where relevant, it compares DFID's approach to tackling fraud with the approaches taken by the Foreign & Commonwealth Office (FCO) and the British Council, which also spend money overseas.

Fraud definition

2 DFID defines fraud as: "an intentional act of dishonesty by one or more individuals internal or external to DFID with the intent of making a gain for themselves or anyone else, or inflicting a loss (or risk of loss) on another".

3 DFID is increasingly using the term 'aid diversion', which can be any activity that deliberately prevents aid from reaching its intended recipients. The risk could come from:

- fraud;
- terrorism financing;
- money laundering; and
- bribery; and other corrupt activity.

4 In this investigation we use the catch-all term 'fraud' to cover all categories of aid diversion listed above.

Fraud risks

5 DFID spends its budget through a variety of bilateral, multilateral and humanitarian channels, all of which have different fraud risks. In addition, two major changes have altered the fraud risk it faces. The first is the government's commitment to spend 0.7% of gross national income (GNI) on international aid, amounting to £12.133 billion in the calendar year 2015.[1] Although other departments are involved in providing international aid, 80.5% of the budget – some £9.767 billion – was spent by DFID. In line with the 0.7% commitment, DFID's budget has risen by more than a quarter (26.5%) since 2011, when it spent £7.722 billion.

1 Available at: *Statistics on International Development 2016,* p.13: www.gov.uk/government/uploads/system/uploads/attachment_data/file/572063/statistics-on-international-development-2016a.pdf

6 The second change was set out in the 2015 Strategic Defence and Security Review (SDSR15), which committed DFID to spending at least 50% of its budget in 'fragile states and regions' at least for the remainder of this Parliament.[2] Fragile states are more likely to be vulnerable to fraudulent activity, so the SDSR15 commitment could increase the risk of fraud in DFID's budget. DFID concentrates its bilateral funding on 32 countries.[3] Of these, 15 fall into the lower quartile (ie perceived as the most corrupt) of Transparency International's Corruption Perceptions Index.[4]

Scope of this investigation

7 We undertook this study in response to:

- parliamentary interest in how the aid budget is being spent;
- the changing nature of DFID's budget, which has risen substantially and is increasingly focused on countries and regions deemed as fragile; and
- concerns that fraud in the government's overseas expenditure is under-reported, and that public reporting of fraud may not be sufficiently transparent.

8 This investigation sets out how DFID tackles fraud across its budget, and also looks at measures put in place by the FCO and the British Council. In line with the principle of conducting investigations to establish the underlying facts, we do not conclude on whether DFID's counter-fraud work or its wider anti-corruption programmes represent value for money. Nor do we cover overseas expenditure incurred by other government departments, such as the Ministry of Defence.

9 Our methods are set out in Appendix One.

2 Fragile states are those that: "suffer external and social stresses that are particularly likely to result in violence; lack the capacity to manage conflict without violence; and neighbouring states that are particularly vulnerable to instability". Available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/573890/Bilateral-Development_Review-technical-note-2016.pdf, page 9.

3 In addition to the 32 countries, DFID gives aid through multi-country global programmes and core contributions to multilaterals, three regional programmes and relationships with aid-dependent Overseas Territories: www.gov.uk/government/organisations/department-for-international-development/about#what-we-do

4 The Index is a widely-recognised measure of how corrupt a country's public sector is perceived to be. Available at: www.transparency.org/cpi2015#downloads

Summary

Key findings

1 On the impact of the government's 2015 commitment to spending half of DFID's international aid budget in 'fragile states', we found **a clear relationship between those fragile states and countries also perceived as the most corrupt**. Based on the Department for International Development's (DFID) fraud cases, we found that there were **few allegations of fraud reported in some of the countries ranking among the most corrupt** (paragraphs 1.7, 4.14 and 4.15).

2 On **fraud prevention**, we found that **DFID has changed its counter-fraud strategy** in response to previous criticisms by external scrutiny bodies. It structures its approach according to a 'three lines of defence' model, involving front-line staff; a control and assurance team, and internal audit. It has built the consideration of fraud risk into the processes that teams must follow when setting up programmes; for example, conducting due diligence over delivery partners (paragraphs 2.4 to 2.8).

3 On **fraud detection**, the **number of allegations reported to DFID is rising** as a result of their work to increase awareness of fraud and reporting requirements among its staff and suppliers. Detection is particularly challenging **where DFID does not have direct control over all the funds it provides**; for example, in the 55% of expenditure routed through multilateral bodies. Two-thirds of allegations are notified to DFID by its partner organisations (paragraphs 1.3 and 3.2 to 3.7).

4 On **investigating fraud**, we found that DFID's central fraud team investigated 93% of the 429 allegations in 2015-16, providing advice to teams for the remainder. **DFID's fraud caseload quadrupled between 2010-11 and 2015-16**, primarily with increases in lower priority cases, with the most serious cases remaining steady at between 20 and 25 cases annually. There has been a further increase in the caseload in 2016-17, with 475 allegations received during the nine months to 31 December 2016. There has also been a recent increase in the number of the most serious cases, with 26 cases in the same period. **Annual gross losses to fraud in 2015-16 were around 0.03%** of DFID's budget. The theft or exploiting of assets or information accounted for the largest losses in 2014-15. Between 2003 and 2016, non-governmental organisations accounted for nearly 40% of all reported fraud cases (paragraphs 4.7, 4.8 and 4.11 to 4.17).

5 On **fraud recovery and sanctions**, DFID prioritises its actions to recover funds from those who have committed fraud. Since 2003, **DFID has recovered around two-thirds, by value, of the reported fraud loss**. There are a **range of sanctions that DFID applies** in response to fraud. DFID will pursue cases through the courts if it considers it proportionate and appropriate to do so. It does not make information public on the actions it takes in these cases, primarily to protect the identities of those reporting allegations (paragraphs 5.2 to 5.7).

6 On **fraud reporting**, DFID reports fraud information to its audit committee and the Cabinet Office's fraud team. Externally, **DFID provides less information than it used to in its annual report**, in order to reduce the overall size of the document. It provides the balance of its reporting through its website, but there is no link to it from the annual report. Neither the FCO nor the British Council provide more fraud information in their annual reports than DFID, although they all meet mandatory requirements. All three bodies report less information than some non-governmental organisations (paragraphs 6.2 to 6.5 and 6.9 to 6.11).

Part One

Background

1.1 This part provides background information on the UK's overseas expenditure, including important context on where and how the Department for International Development (DFID), the Foreign & Commonwealth Office (FCO) and the British Council spend their budgets and the kinds of fraud risks they face as a result. It also explains how this investigation is structured.

DFID's expenditure

1.2 In 2015, DFID spent £9.767 billion on its development and humanitarian programmes. To meet the UK's target of spending 0.7% of gross national income on activities classified as official development assistance (ODA), this figure has risen by 26.5% (from £7.722 billion) since 2011. However, as a percentage of total UK aid, DFID's contribution fell from 89.5% to 80.5% over the same period, as other government departments are increasingly involved in delivering ODA activities.[5] DFID's fraud risk lies mainly within its programme expenditure, although it also faces smaller risks within its administrative expenditure.

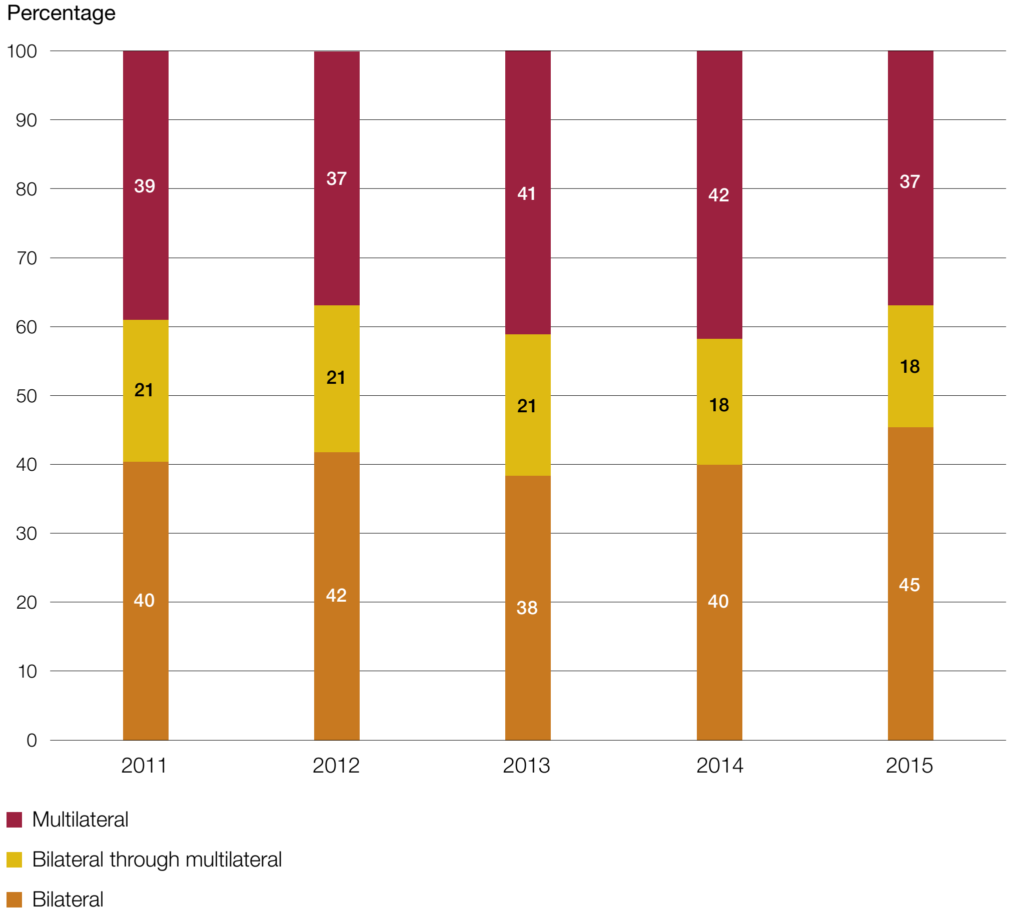
1.3 The UK's aid programme is delivered through two main mechanisms (**Figure 1**):

- Bilateral – spending allocated for a specific country, region or project. In 2015, 63% of the UK's aid expenditure was on bilateral aid, although 18% was delivered through multilateral bodies.
- Multilateral – expenditure allocated by the UK to multilateral organisations – such as the World Bank and the United Nations. This can be core funding (to be used for purposes in line with the organisation's mandate) or funding pooled with other donors for specific purposes. In 2015, multilateral organisations delivered 55% of the UK's aid programme, including the 18% of bilateral aid.

5 Available at: *Statistics on International Development 2016*, p.13: www.gov.uk/government/uploads/system/uploads/attachment_data/file/572063/statistics-on-international-development-2016a.pdf

Figure 1
UK aid expenditure by delivery mechanism

The UK's aid expenditure is delivered through a mix of bilateral and multilateral mechanisms



Source: Compiled by the National Audit Office based on data provided by the Department for International Development

DFID's fraud risk

1.4 To manage fraud risk, DFID relies on a set of controls across procurement, human resources, financial and programme management activities. DFID generally has more oversight of bilateral expenditure than of multilateral expenditure. For multilateral expenditure, DFID takes assurance from its own assessment of each multilateral organisation's anti-fraud measures. These measures include supervision of any local partners and non-governmental organisations (NGOs) who are subcontracted to deliver the aid.

1.5 The UK also focuses on delivering aid to 'fragile states and regions'. Fragile states are those that: "suffer external and social stresses that are particularly likely to result in violence; lack the capacity to manage conflict without violence, and neighbouring states that are particularly vulnerable to instability".[6] The 2015 Strategic Defence and Security Review committed 50% of DFID's expenditure to these countries.

1.6 Fraud risk can often be greater in fragile states. A widely recognised measure of fraud risk is Transparency International's Corruption Perceptions Index (CPI), which lists perceived corruption levels across 168 countries.[7] DFID concentrates its bilateral funding on 32 countries.[8] Of these, 15 fall into the lower quartile (ie perceived as the most corrupt) of the CPI.

1.7 **Figure 2** demonstrates a clear relationship between 'highly fragile' states and those within the lower CPI quartile score. All highly fragile countries that DFID focuses on fall within the lower CPI score, with Pakistan the only exception (deemed highly fragile but just outside the lowest CPI quartile).

FCO and British Council expenditure

1.8 As noted in paragraph 1.2, other government departments accounted for 19.5% (£2.371 billion) of UK aid expenditure in 2015. The FCO was the most significant of these, spending £391 million (up from £321 million in 2011) which included both FCO and British Council programme expenditure. The FCO's own expenditure in 2015 included:

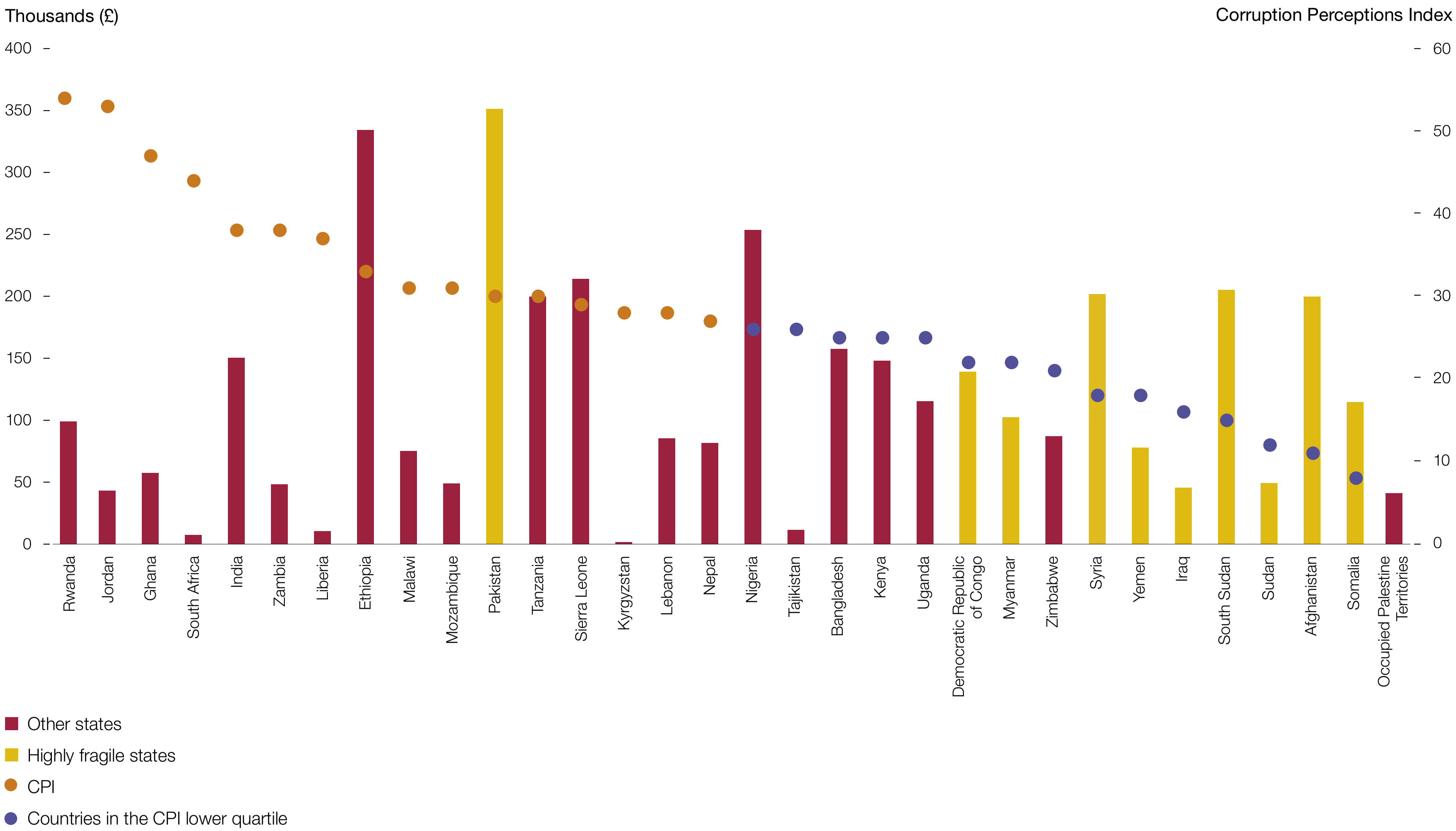
- over £135 million on education projects globally;
- over £50 million on promoting human rights, democracy and the role of civil society around the world;
- almost £10 million on projects aimed at preventing and resolving conflict; and
- almost £6 million on projects to tackle climate change.[9]

6 Available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/573890/Bilateral-Development_Review-technical-note-2016.pdf
7 Available at: www.transparency.org/cpi2015#downloads
8 In addition to the 32 countries, DFID gives aid through multi-country global programmes and core contributions to multilaterals, three regional programmes and relationships with aid-dependent Overseas Territories: www.gov.uk/government/organisations/department-for-international-development/about#what-we-do
9 Available at: www.gov.uk/government/collections/official-development-assistance-oda--2

Figure 2

DFID spend against the Corruption Perceptions Index (CPI)

There is a clear relationship between those countries DFID considers to be 'highly fragile' states and those perceived as the most corrupt



Note

1 No CPI data was available for Occupied Palestine Territories.

Source: Department for International Development expenditure, Excel tables, Statistics on international development 2016: www.gov.uk/government/statistics/statistics-on-international-development-2016; CPI index from: www.transparency.org/cpi2015

1.9 In terms of fraud risk, both the FCO and the British Council have focused on internal business risks; for example, deterring theft by locally-engaged staff. The FCO's rising programme expenditure means that it faces increasing fraud risks in this area, particularly in procurement and contract management. The FCO is starting to adapt its counter-fraud work to address these risks.

Policy and legal responsibilities

1.10 Accounting officers have policy and legal responsibilities for protecting their department's resources. These responsibilities shape how they design both their management systems and their delivery programmes and are driven by guidance from the centre of government, including:

- *Managing public money* – guidance from HM Treasury on managing fraud risks, which notes that accounting officers are responsible for managing public sector organisations' risks, including fraud. It states that the most effective way of managing the risk of fraud is to prevent it from happening by developing an effective anti-fraud culture.
- Central government policy – departments engage in the cross-government sanctions initiative which prevents anyone dismissed for fraudulent conduct from being re-employed in any participating department for a five-year period.

1.11 Departments are also bound by legislation relevant to their sector:

- The International Development Act 2002 – this clarified the purpose of aid expenditure as poverty reduction.
- The British Council is subject to UK Charity Law, which includes ensuring that its assets are safeguarded and properly used to meet its charitable objectives.

1.12 Public sector organisations are also subject to legislation that covers fraud, bribery and money laundering. The most important pieces of legislation for departments protecting overseas expenditure against fraud include the Fraud Act 2006, the Bribery Act 2010 and aspects of counter-terrorism legislation.

The operating environment

1.13 The UK delivers aid to many countries that operate with significantly different cultural and economic value systems, which in many respects the UK taxpayer would regard as fraudulent practices. For example, some societies operate within cultural norms that expect bribes to be paid to officials for access to services, including justice; where family members will be preferred to open competition when allocating work contracts; and where senior officials take a percentage of the salaries of junior staff members.

1.14 The UK also faces the challenge of operating in fragile and failed countries and regions, where the rule of law is weak and violence is often endemic. In many instances the result is that the UK relies more heavily on multilateral and/or local partners, but limited access on the ground makes it challenging to hold these partners to account for fraud risk.

This report

1.15 The rest of the report sets out our investigation using a simplified version of the commonly used fraud cycle conceptual framework: preventing fraud; detecting fraud; investigating fraud; fraud recovery and sanctions, and fraud reporting and lesson learning (**Figure 3**).

Figure 3
The fraud cycle

Source: National Audit Office analysis

Part Two

Findings on preventing fraud

Key findings

2.1 This part of the report looks at the approach the Department for International Development (DFID), the Foreign & Commonwealth Office (FCO) and the British Council take to preventing fraud. Our principal findings in this part are:

- On taking a **'zero tolerance'** approach to fraud, we found that DFID's policy was clearly understood by staff we spoke to. DFID told us that the result of raising fraud awareness among staff and suppliers was that the reported number of suspected or actual fraud cases in DFID has risen (paragraphs 2.2 and 2.3).
- **On DFID's overall approach to countering fraud**, we found that, in response to criticisms of its approach, DFID has changed its counter-fraud strategy (paragraphs 2.4 to 2.6).
- On **fraud prevention**, we found that DFID structures its approach in line with a 'three lines of defence' model. It has built the consideration of fraud risk into the processes teams must follow when setting up programmes and projects; for example, undertaking due diligence over potential delivery partners (paragraphs 2.7 and 2.8).
- On the **approach taken by the FCO and the British Council**, we found that both bodies have a similar policy of zero tolerance to fraud. The FCO team has historically focused on risk to fraud within the business, but greater programme expenditure presents increasing fraud risks. The British Council established its counter-fraud team in June 2015, and is developing its strategy (paragraphs 2.9 to 2.13).

A zero tolerance approach to fraud

2.2 The UK government has a clearly defined policy of 'zero tolerance' to fraud, which DFID implements. DFID's Annual Report and Accounts states: "All DFID staff, as well as programme delivery partners and contractors, are required to report any suspicions of fraud, suspected or detected to the counter-fraud section without delay".[10]

10 See: Department for International Development, *Annual Report & Accounts 2015-16*, p.33. Available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/538878/annual-report-accounts-201516a.pdf

2.3 To encourage 'zero tolerance' reporting of actual or suspected fraud by multilateral, local and non-governmental organisation (NGO) partners, DFID encourages reporting through a range of mechanisms. These include formal requirements as part of grants or contracts and assistance to encourage partners to take similar approaches to their own supply chains.

Background to DFID's counter-fraud strategy

2.4 In 2011, the Independent Commission for Aid Impact published a report on DFID's approach to anti-corruption.[11] The report found that the way DFID had organised responsibilities for fraud and corruption was fragmented, and that this prevented it from taking a coherent and strategic response to the risks to UK aid funds from fraud and corruption.

2.5 DFID responded to the report's recommendations by changing its approach:

- It developed two key strategy documents on anti-corruption and on counter-fraud. These are supplemented by anti-corruption strategies for the individual countries in which DFID operates.
- It worked to increase awareness of fraud and relevant policies and procedures among staff and delivery partners. This work has included corporate initiatives, such as the fraud awareness week for DFID staff, first held in 2013. The counter-fraud section has provided training and awareness sessions to staff based overseas. DFID departments also host fraud awareness events, often with delivery partners.
- DFID has embedded consideration of the risks of aid being diverted into the different stages of the project cycle that all programmes must follow. For example, there is a greater focus on due diligence when projects are set up and more monitoring of delivery partners.
- It has changed the guidance it produces for those responsible for managing projects and programmes. There are 'smart guides' for those managing projects, including one specifically covering fraud.
- Staff must undertake some mandatory training on fraud, and on risk and control. Other training sessions are on offer for those requiring more in-depth expertise. In 2016: over 200 staff attended fraud awareness sessions run by the control and assurance team; around 200 staff attended structured training on risk management, with 216 also attending ad hoc training on this and related topics (including due diligence and fraud); and 611 senior responsible owners within DFID attended specific training on risk management, with further sessions planned. Finance and procurement training events also include fraud sessions.

11 Available at: http://icai.independent.gov.uk/wp-content/uploads/DFIDs-Approach-to-Anti-Corruption3.pdf

2.6 DFID is developing a new strategy for its overall approach to countering all aid diversion risks. This covers counter-fraud, counter-terrorist financing, money laundering and bribery.

Applying DFID's approach to fraud prevention

2.7 In practical terms, DFID's approach to fraud is structured around a 'three lines of defence' model that sets out the different processes, roles and responsibilities within the business. Using this model, DFID aims to prevent fraud by:

- identifying fraud risks when projects are set up;
- designing control and assurance arrangements to monitor the risks; and
- carrying out proper due diligence of potential delivery partners – this includes considering their particular fraud risks and how capable they are of managing them.

2.8 The 'three lines of defence' model is an accepted HM Treasury framework for counter-fraud work. DFID applies the framework in the following manner (**Figure 4**):

- First line: operational delivery assurance, carried out by front-line staff – DFID identifies risks in its programmes and designs controls to check how well objectives are met. DFID undertakes due diligence and further monitoring to provide assurance.
- Second line: management activity. DFID's control and assurance team is responsible for the counter-fraud policy and provides training and guidance to staff, for example 'smart guides' on how to manage programmes. DFID adopted a new risk management framework in February 2016, which determines a level of risk on each project. The framework is reviewed at least annually with delivery partners. Each month, DFID's executive management committee also makes strategic risk decisions for the business.
- Third line: independent and objective assurance – this focuses on the role of internal audit, which carries out a programme of work to give the accounting officer an independent and objective opinion on the framework of governance, risk management and control. It examines how multilateral organisations are managing DFID expenditure. DFID told us that the counter-fraud teams within some multilaterals do not carry out many audits relative to the number of staff they have. In some cases, they also do not take a sufficiently sceptical approach to potential fraud and can be 'too trusting' of local delivery partners.

Figure 4
DFID's three lines of defence model

First line – front-line staff

Responsible for identifying fraud risks in programmes and designing appropriate control, assurance and monitoring arrangements:

- Fraud risk assessments are a standard part of the business case.
- Staff carry out due diligence of suppliers and partners when programmes, projects and contracts are set up.
- DFID now has standard clauses in its contracts, memoranda of understanding and grant agreements with delivery partners and suppliers which cover the requirement to consider and report fraud.
- DFID requires all departments to complete annual returns confirming that they have adequate controls in place.

Second line – control and assurance team

Responsible for developing counter-fraud policy, for ensuring there are adequate governance, risk management and control and assurance processes in place, and for providing direction and support to front-line staff.

Policies include:

- 'Smart guides' on how to manage programmes, including a specific guide on counter-fraud and on due diligence.
- Training on risk and control frameworks.
- Fraud awareness activities, including delivering training.
- Specific consideration of fraud as part of 'fiduciary risk', one of the six categories for risk management all project managers are required to consider.

Third line – internal audit counter-fraud team

Responsible for the independent investigation of fraud allegations received and reporting of information on fraud caseload.

Internal audit also identifies and shares lessons from fraud cases with relevant areas of business.

Delivers fraud awareness and counter-fraud training.

Provides independent assurance over controls within the business.

Source: National Audit Office analysis of the Department for International Development's documents

The FCO's and the British Council's approach to preventing fraud

2.9 The FCO also takes a zero tolerance approach to fraud. Traditionally, most fraud in the FCO has been within the business; for example, theft by locally-employed staff. On our visit to Pakistan, FCO staff told us that 90% of fraud can be combated by using existing processes correctly. For example, we reviewed a case in which bullying and intimidation had initially bypassed existing processes and allowed fraud to be committed.

2.10 Consequently, ensuring that existing processes are applied correctly through training and cultural awareness of both UK-based and locally-employed staff is seen as critical in deterring most fraud within the business. When we visited the FCO in Pakistan we found that counter-fraud activity was a high priority and that fraud risk was taken seriously by staff.

2.11 Alongside fraud within administrative processes, the increased programme expenditure presents new fraud risks. For example, in Pakistan we found that the FCO managed the largest proportion (£10.7 million) of the £21.3 million Conflict, Security and Stabilisation Fund (CSSF) for the country.

2.12 As the largest recipient of bilateral aid from the UK – some £374 million in 2015 – the British Mission there has an 'integrated delivery plan for Pakistan' that involves DFID, the FCO and other UK government departments. As a result, the FCO can focus on securing experienced programme managers and working with DFID programme staff. However, during our visit to the far smaller FCO post in the Democratic Republic of Congo, staff told us that they had no dedicated or experienced programme staff; generalist staff are expected to administer their CSSF expenditure alongside their consular and other tasks.

2.13 The British Council also has a similar 'zero tolerance' approach to fraud, but does not have such well-established counter-fraud structures as DFID and the FCO. It has a counter-fraud team, established in June 2015 as an independent unit within the business, but which until recently consisted of a single member of staff for a business with £1 billion turnover and 11,000 employees. The team has been developing a counter-fraud strategy. This comprises four main elements – awareness, detection, responding and prevention. Under prevention, the British Council's aspiration is to embed a strong anti-fraud culture within the organisation, alongside improving systems and controls and how they are implemented.

Part Three

Findings on detecting fraud

Key findings

3.1 Part Two explained how the Department for International Development (DFID) aims to prevent fraud when it designs and sets up programmes. If fraud does occur, however, it is important that DFID is able to identify where this might be happening. This part examines how DFID detects potential fraudulent spend within its programmes. Our principal findings are:

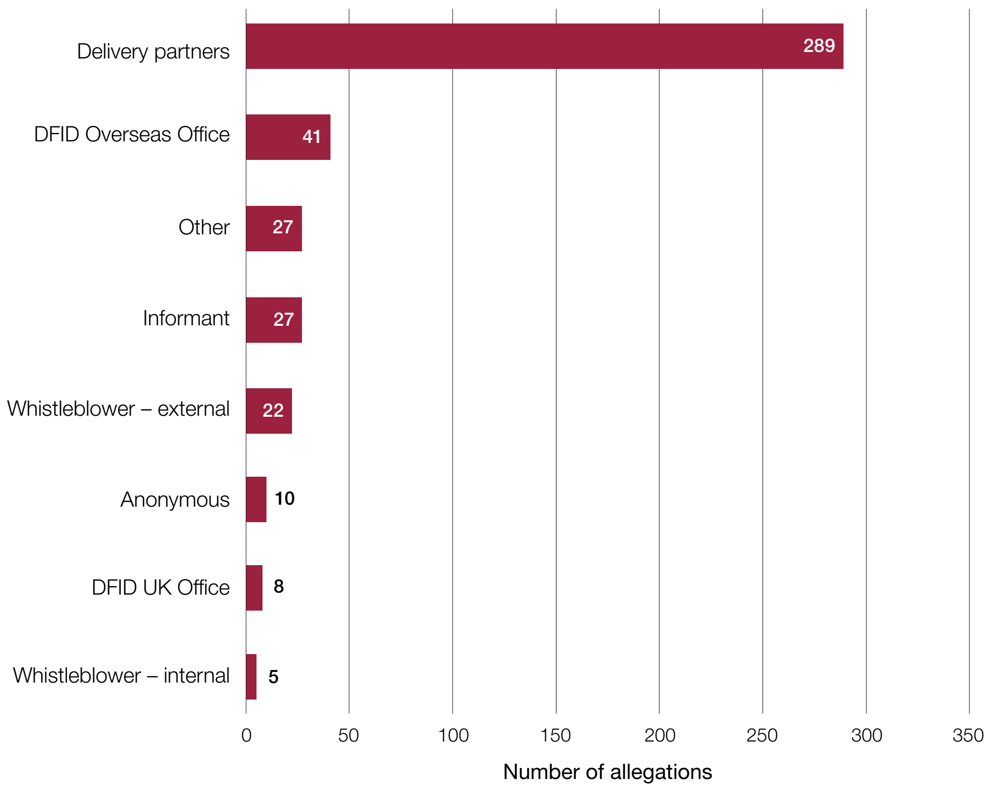
- On **detecting fraud**, we found that two-thirds (67%) of allegations come from DFID's delivery partners reporting suspicions of fraudulent activity (paragraphs 3.2, 3.3 and Figure 5).
- The **number of allegations reported is increasing**, which DFID believes is a result of its work to increase awareness of fraud and reporting requirements among its staff and suppliers (paragraph 3.3).
- There are **challenges to monitoring expenditure**, particularly where DFID does not have direct control over the funds it provides, for example in the 55% of expenditure routed through multilateral organisations. Fraud in the United Nations (UN) and other international organisations, for example, is likely to be under-reported (paragraphs 3.4 to 3.7).
- To detect fraud, the **FCO and the British Council** largely rely on people reporting concerns to them through a combination of management monitoring and staff reporting allegations directly (paragraphs 3.8 to 3.10).

How DFID detects fraud

3.2 The main way in which DFID detects fraud is through a combination of management monitoring and reporting, and through staff, delivery partners and suppliers reporting suspicions or making allegations. Two-thirds of allegations come from delivery partners (**Figure 5** overleaf). Project managers may identify fraud through their ongoing monitoring and controls over spend, or individuals may contact internal audit directly where they have a suspicion that something is not right.

Figure 5
Source of allegations raised with DFID internal audit 2015-16

Two-thirds of fraud allegations come from delivery partners



Source: National Audit Office analysis of the Department for International Development's data

3.3 DFID requires all of its staff to report fraud and, where it can, includes this as a mandatory requirement in its contracts, memoranda of understanding and grant agreements with its suppliers and delivery partners. DFID has worked to raise the profile of fraud reporting through awareness campaigns and staff training programmes, so that staff know where to go and what to do if they have concerns. DFID believes that this action has resulted in an increase in the number of allegations made. This is explored in more detail in Part Four. Other ways in which fraudulent activity may be identified include the following:

- DFID has a whistleblowing policy, and those who wish to report concerns can do so anonymously using a dedicated phone line. Callers could be DFID staff, individuals from delivery partners, or third parties who have concerns about how funds are being spent. Individuals using this route accounted for just over 6% of the 429 allegations raised in 2015-16.

- Internal audit may detect fraud through its ongoing programme of assurance work. For example, internal audit conducts regular reviews of country programmes. It will also carry out reviews where there are specific concerns raised.

Monitoring DFID expenditure

3.4 DFID does not have direct control over the 55% of expenditure (paragraph 1.3) that it routes through multilateral organisations, such as the UN or World Bank. DFID has agreements in place with multilateral organisations, as it does with other delivery partners, which require them to report fraud or any suspicious activity. However, this means that DFID relies on their systems for identifying and reporting potential fraud, and the capacity and capability of these organisations is variable. DFID's access rights and oversight arrangements are also different depending on the organisation.

3.5 DFID relies on UN organisations and other multilaterals to detect fraud relating to the core funding that DFID allocates to them. The effectiveness of a multilateral in doing this depends on its knowledge of its delivery partners, which is variable. DFID runs a 'know your partner' initiative, which requires a central assurance assessment every three years, multilateral aid review assessments and a review of multilaterals' commercial expertise. To detect fraud, DFID relies on each body's own system, on its audited annual accounts, and on reports produced by the UN Board of Auditors. DFID requires UN agencies to inform it of any credible allegation of fraud. The team overseeing UN expenditure will assess allegations, and sift out any that are not credible.

3.6 In many cases, DFID's funds are pooled with those of other countries or organisations, so it can be difficult to identify the degree to which they are affected by potential fraud. DFID told us it can request additional audits if it has concerns about how funds are being spent, but does not have a right to send in independent auditors in all cases because of the single audit principle, whereby all countries providing core funds must depend on each organisation's own reporting systems.

3.7 There are concerns that fraud in UN organisations is under-reported. The UN Joint Inspection Unit recently found that under-reporting and/or non-detection across its organisations could be significant and endemic. It noted that reported fraud was in the range of 0.03% of expenditure in the UN system, which was unusually low compared with other public and private sector bodies, at between 1% and 5%.[12]

Detecting fraud in the FCO and the British Council

3.8 To detect potential fraud, the FCO and the British Council rely mainly on a combination of management monitoring and reporting, and on staff and partners raising allegations of suspicious activity. Staff and partners can do this either through formal mechanisms for the ongoing monitoring of expenditure, or anonymously. Although the FCO does not make use of analytical techniques, it is also taking part in the Cabinet Office's random sampling exercises to identify potential levels of fraud and error.

12 See: *Fraud Detection, Prevention and Response in United Nations System Organisations*, 2016, p.iii. Available at: www.unjiu.org/en/reports-notes/JIU%20Products/JIU_REP_2016_4_English.pdf

3.9 Around half of the FCO’s non-programme expenditure relates to payroll, where it told us it has established controls over spending. Programme funds are made up largely of contributions to other organisations, so the FCO faces similar challenges to DFID in terms of relying on other organisations’ systems and controls for identifying and reporting fraud.

3.10 The British Council has an online reporting tool that allows any staff member to report potential fraud direct to the counter-fraud team, in accordance with their obligations under the organisation’s code of conduct. Staff now also undertake mandatory fraud awareness training. As part of its new counter-fraud strategy, the British Council is looking at developing analytical techniques and methods that will help it to prevent and detect fraudulent activity.

Part Four

Findings on investigating fraud

Key findings

4.1 This part looks at how the Department for International Development (DFID), the Foreign & Commonwealth Office (FCO) and the British Council investigate potential fraudulent activity. It also examines in detail the fraud caseload reported by each organisation. Our principal findings are:

- On **investigating fraud**, we found that DFID's counter-fraud team has an established process in place for investigating the allegations of fraud that it receives. The team received 429 allegations in 2015-16, investigated 93% of them, and provided advice for the remainder (paragraphs 4.2 to 4.5).
- We found that **DFID's fraud caseload** quadrupled between 2010-11 and 2015-16 to 429 cases. The increase was mainly in the number of lower priority cases reported, with the most serious cases remaining steady at between 20 and 25 annually. In 2016-17, the caseload continued to increase, with 475 allegations received during the nine months to 31 December 2016. This included an increase in the number of the most serious cases to 26 during the same period (paragraphs 4.7 to 4.10).
- On the **amounts lost to fraud**, we found that reported gross losses to fraud represented 0.03% of DFID's programme expenditure in 2015-16. This contrasts with higher levels in other public and private sector organisations (paragraphs 4.11 to 4.13).
- On the **types and location of fraud cases**, we found that there are few allegations of fraud reported in some of the countries ranking among the most corrupt. The most common type of fraud is the theft of assets or information, around a third of the amount lost to fraud in 2014-15. Nearly 40% of DFID's fraud cases between 2003 and 2016 were attributable to non-governmental organisations (paragraphs 4.14 to 4.17).
- We found that **FCO's caseload** of suspected fraud doubled to 50 cases between 2011-12 and 2015-16, although the monetary value of reported losses remains low. Most of FCO's fraud cases are internal frauds (paragraphs 4.18 and 4.19).
- **The British Council** has only been collecting meaningful data on its fraud caseload since January 2016. Like the FCO, most of its cases have been internal fraud (paragraphs 4.20 and 4.21).

Investigating allegations of fraud

4.2 DFID's counter-fraud team is part of internal audit, and staff, suppliers and partners are required to report all allegations of fraud to the team. The counter-fraud team treats each allegation raised in the same way. It first assesses whether the allegation should be investigated further or whether it is sufficient to provide support and advice. It also considers what action should be taken next. The counter-fraud team investigated 93% of the allegations it received in 2015-16.

4.3 The counter-fraud team assesses each case taken forward to investigation under a triage system, which it is currently reviewing. Under the current system DFID assigns cases a priority level to indicate the seriousness of the case, depending on the value, nature and reputational risk of the allegations:

- Priority one – these require immediate and urgent action or advice. There could be potential high losses of funds, failed development work or reputational damage, in addition to media, senior management or ministerial interest.
- Priority two – these require immediate and urgent action or advice, but the potential loss of funds, reputational damage or impact on delivery of aid is not as serious as priority one.
- Priority three – these require less urgent action or advice. Potential losses, reputational damage and impact on aid delivery are not as severe.
- Priority four – these usually do not require an investigation, but advisory support and guidance on fraud risk will be provided.

4.4 Counter-fraud team resources have increased over the last two years in response to the increased workload. There are now 11 members of staff who can carry out investigations or provide advice and support to others. The team is also able to engage additional resources from within DFID's fraud liaison network (a network of staff trained in counter-fraud) or from external providers.

4.5 Where delivery partners have reported potential frauds, DFID expects them to carry out their own investigation to the required standards. DFID's counter-fraud team will provide support and oversight. The key principle is that any investigation must be robust. DFID will assess whether the organisation has the capability to carry out a robust investigation. If there are concerns the counter-fraud team may play a more active role, including the option of taking over the investigation.

4.6 Within the FCO, internal audit is also responsible for investigating allegations of fraud. There is a team of six personnel who undertake counter-fraud work alongside conducting internal audits, with a minimum of 350 staff days a year ring-fenced for fraud work. In 2015-16, the FCO actually undertook 209 days at a cost of £79,000, but this excludes some specific fraud investigation costs not available centrally, for example where investigations are carried out by locally-based staff.[13] The British Council has taken a different approach and has a separate counter-fraud unit. It appointed its first head of counter-fraud in June 2015 and the team has now increased to three staff, who carry out investigations into allegations raised. There are plans to increase the resources available, with the possible addition of three trained investigators based overseas, and training for staff who will support more routine investigations.

DFID's fraud caseload

Number of fraud cases and change since 2010-11

4.7 DFID's counter-fraud team collates and reports information on fraud cases. We examined DFID's data on fraud cases since 2010-11. The caseload has increased over the last five years, with four times more allegations received in 2015-16 (429) than in 2010-11 (102). Before 2013-14, the team investigated between 80 and 100 cases each year, but the number has increased significantly since then (**Figure 6** overleaf). The caseload has continued to increase in 2016-17, and the counter-fraud team has received 475 allegations during the nine months to 31 December 2016, 11% more than during the whole of 2015-16.

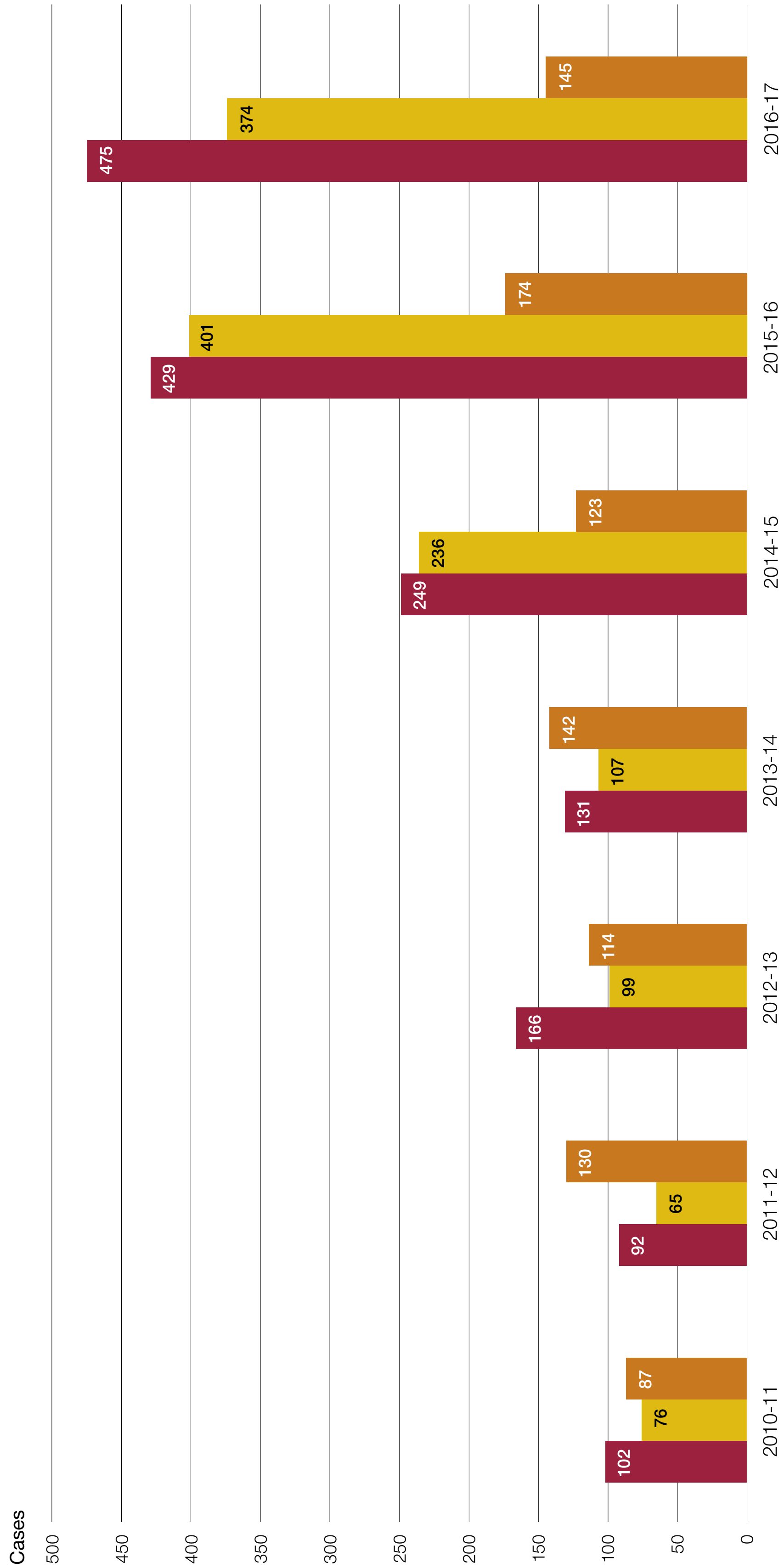
4.8 Although the overall number of cases quadrupled between 2010-11 and 2015-16, the increase was mainly in the numbers of priority three cases. Priority three cases made up just over half the caseload in 2013-14, compared to 87% in 2015-16 (**Figure 7** on page 27). The number of the most serious cases remained steady, at between 20 and 25 annually, although this has also increased in 2016-17, with 26 priority one cases during the nine months to 31st December 2016, 50% more than during the whole of 2015-16. DFID believes this indicates its work to raise awareness of fraud is having an impact, as staff and partners are reporting suspicions, however minor.

13 As FCO estimates a 70% productivity rate (when taking into account training, sickness absence, annual leave etc) the cost rises to £103,000.

Figure 6

DFID's fraud caseload: 2010-11 to 2016-17

DFID's fraud caseload has quadrupled over the last five years



Allegations received

Number of investigations raised in year

Number of cases closed in year

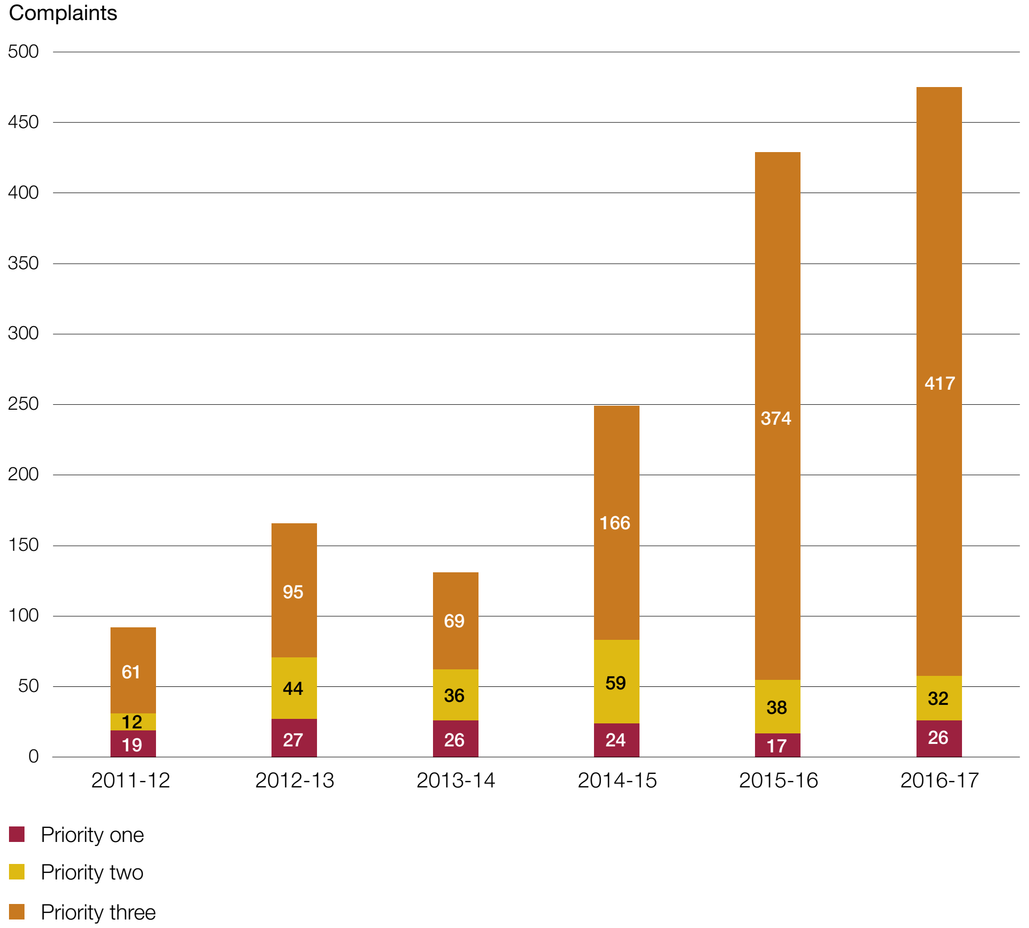
Note

1 Figure for 2016-17 as at 31 December 2016; it does not represent a complete financial year.

Source: National Audit Office analysis of the Department for International Development's fraud caseload data

Figure 7
DFID's fraud caseload by priority level

The increase in DFID's caseload was mainly in the number of lower priority cases



Note
1 Figures for 2016-17 reflect the number of complaints up to 31 December 2016 (quarters 1 to 3).

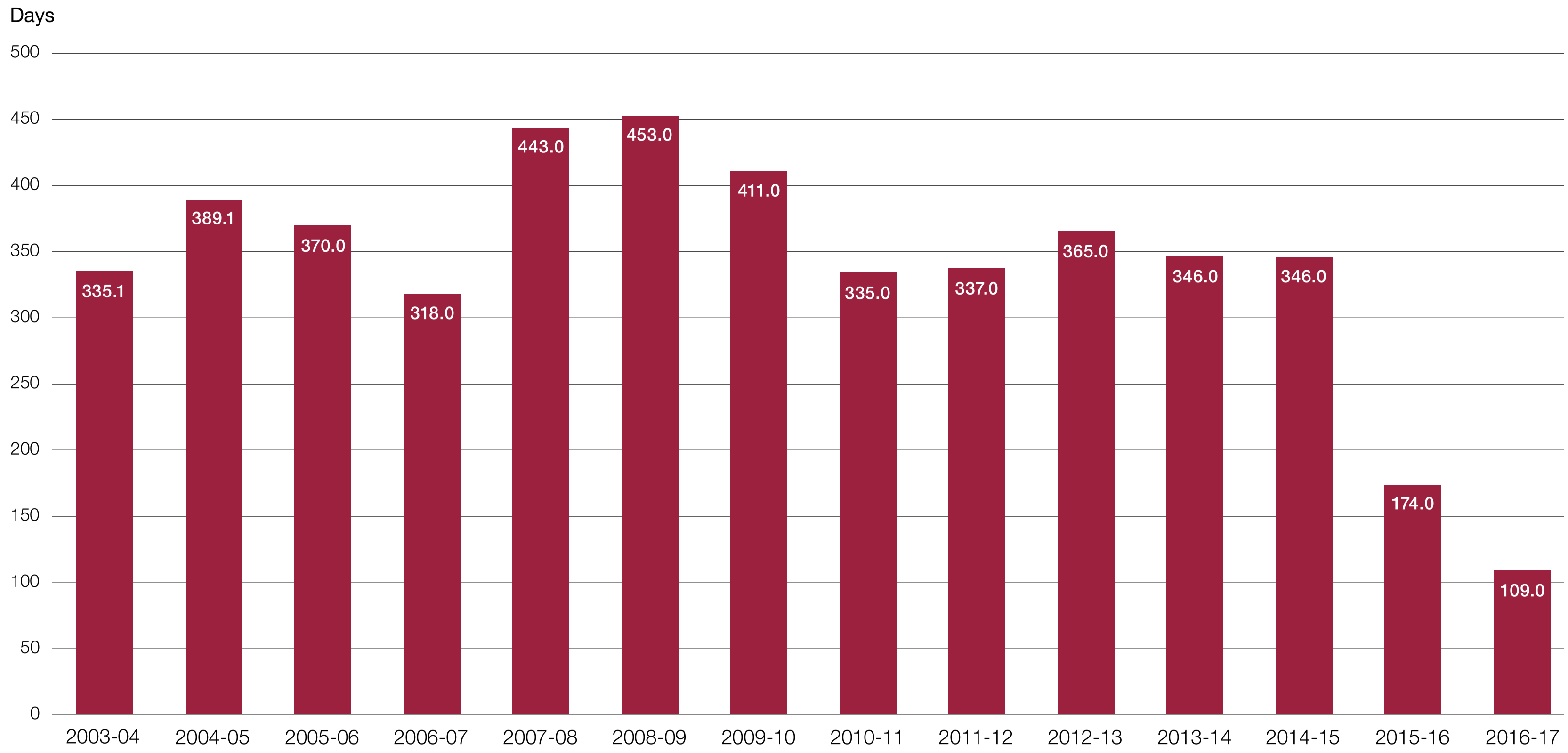
Source: National Audit Office analysis of Department for International Development's fraud caseload data

4.9 We analysed DFID's data on fraud cases: we found the average time taken to complete a fraud investigation between 2003-04 and 2014-15 was consistently greater than 300 days. This fell to 174 days in 2015-16 – the last complete year of data – and close to 100 days so far in 2016-17 (**Figure 8** overleaf). These periods include the time taken to recover funds, where DFID is often reliant on delivery partners, such as the UN, to complete this process.

Figure 8

Average number of days to complete a fraud investigation

Until 2015-16, the average time taken to complete a fraud investigation was greater than 300 days



Note

1 Figure for 2016-17 as at 31 December 2016; it does not represent a complete financial year.

Source: National Audit Office analysis of the Department for International Development's fraud caseload data

4.10 DFID told us that the increase in caseload is putting pressure on resources for investigating allegations. Analysis of the status of cases shows that the number of cases recorded as 'open' or 'pending open' increased in 2015-16 and 2016-17 (**Figure 9** overleaf).

Fraud caseload – monetary losses

4.11 Although the number of fraud cases has increased significantly in the last three years, until recently (see Figure 7) this has mainly been in the lower priority cases involving small sums of money or minimal risks to DFID's reputation. DFID estimates that the gross amount of fraud in 2015-16 was £3.2 million, before any recovery action taken by DFID is considered (**Figure 10** on page 31).

4.12 The £3.205 million gross losses to fraud in 2015-16 represents around 0.03% of the £9.767 billion DFID spent on development in 2015. Between 2011-12 and 2014-15, reported fraud levels in DFID were less than 0.05%. Other departments and international organisations report various levels of reported fraud:

- The Department for Work & Pensions estimated that it lost around 0.7% to fraud during the same period, and HM Revenue & Customs around 3%.
- In 2015, US Aid reported that 0.0055% of its annual budget was lost to fraud and corruption,[14] and AUSAID reported that it lost 0.026%.[15]
- Over the past ten years, around 0.03% of the average reported budget was estimated to be lost to fraud across a wide range of United Nations' bodies.[16]
- A 2013 survey of companies working in similar environments to aid organisations estimated that around 1.4% of the budget is lost to fraud and corruption (this rose to 2.4% in Africa).[17]

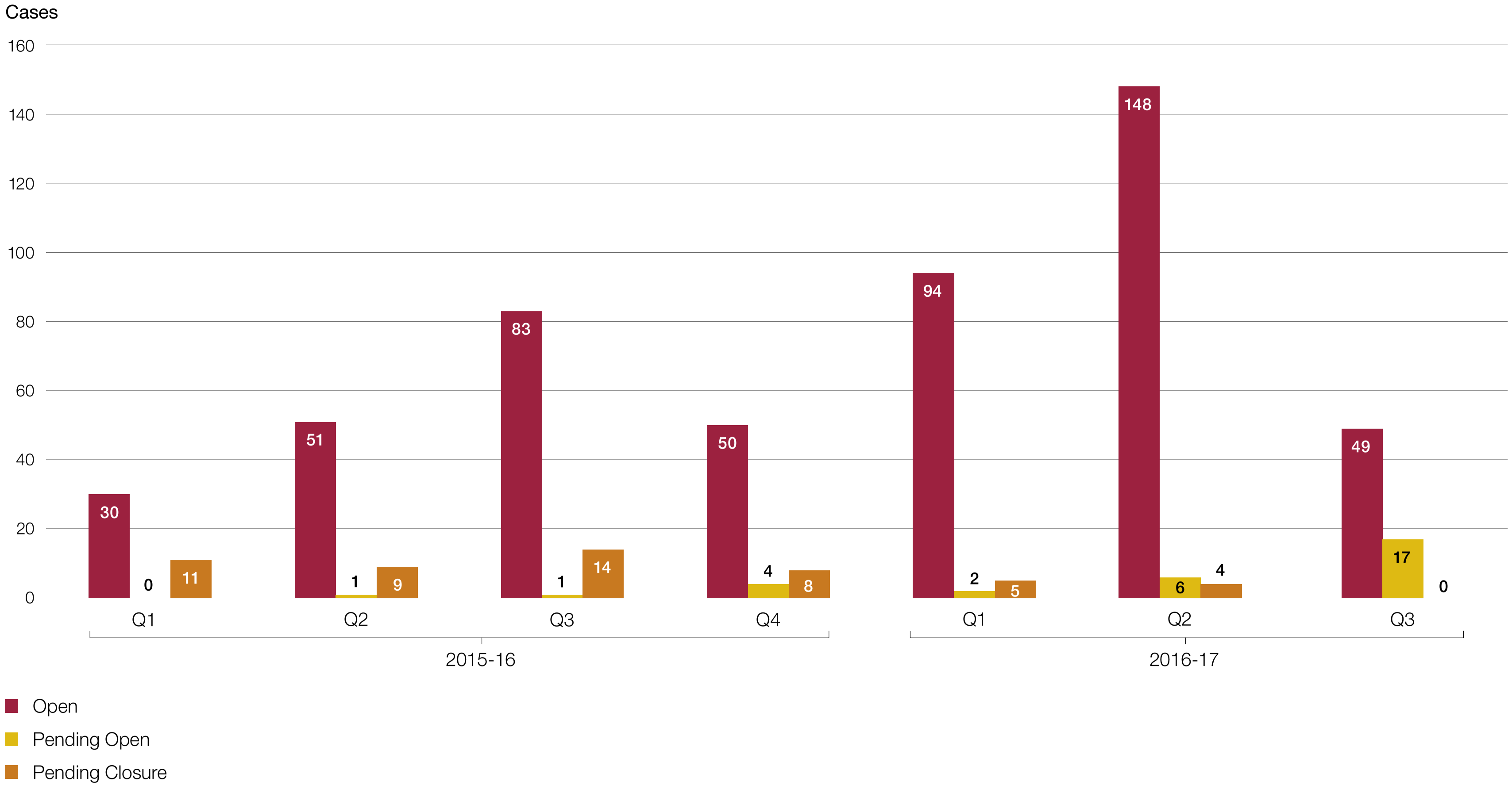
4.13 Providing an accurate calculation of the amount any organisation or sector is losing to fraud is difficult, as data are only readily available for detected fraud. As part of academic research carried out to estimate the true cost of fraud to the economy, the centre for counter fraud studies at the University of Portsmouth has estimated that the amount of expenditure lost to fraud and error across a number of organisations is likely to be between 3% and 10% of total expenditure.[18]

14 *US Aid Annual Report*, 2015. Available at: www.usaid.gov/sites/default/files/documents/1868/USAIDFY2015AFR_508a.pdf, p.144.
15 Fraud Control and Anti-Corruption within DFAT, including the Australian Aid program. Fact sheet, October 2015, p2.
16 *Fraud Prevention, Detection and Response in the United Nations system organization*, p19, 2016. Available at: http://dfat.gov.au/about-us/publications/Documents/fraud-control-fact-sheet.pdf
17 *Fighting Fraud and Corruption in the humanitarian and global development sector*, Oliver May, May 2016.
18 *The Financial Cost of Fraud 2015*, University of Portsmouth and PKF Littlejohn, 2015. Available at: www.pkf.com/media/31640/PKF-The-financial-cost-of-fraud-2015.pdf

Figure 9

Quarterly status of DFID's fraud caseload in 2015-16 and 2016-17

The number of 'open' and 'pending open' cases has increased over the last two years



Notes

1 Status of fraud cases for 2016-17 as at 31 December 2016; it does not represent a complete financial year.

2 Open: the counter-fraud team are actively working on the case.

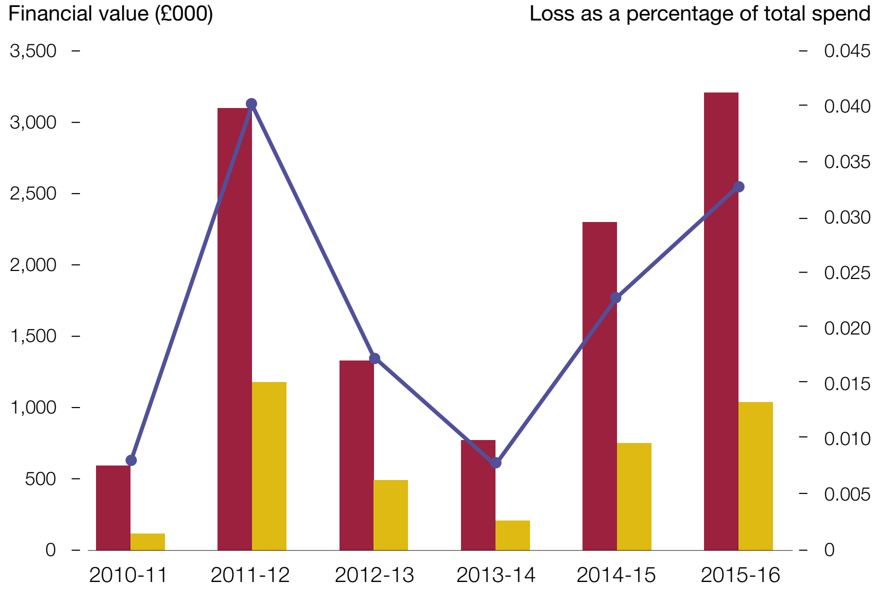
3 Pending Open: counter-fraud team have received an allegation, and opened a file, but are awaiting further information from the DFID operating unit to start work on the case.

4 Pending Closure: case records are complete, but awaiting a data quality check before the case can be closed on the system.

Source: National Audit Office analysis of data provided by the Department for International Development

Figure 10
DFID gross and net losses from fraud: 2010-11 to 2015-16

Gross losses from fraud in 2015-16 were £3.2 million before any recovery action



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Gross losses	592,217	3,098,114	1,329,598	772,248	2,297,650	3,205,288
Net loss	115,182	1,178,071	492,255	207,472	748,980	1,038,720
Gross losses as a percentage of DFID ODA spend	0.008	0.040	0.017	0.008	0.023	0.033

Source: National Audit Office analysis of data provided by the Department for International Development

Fraud cases – location and type

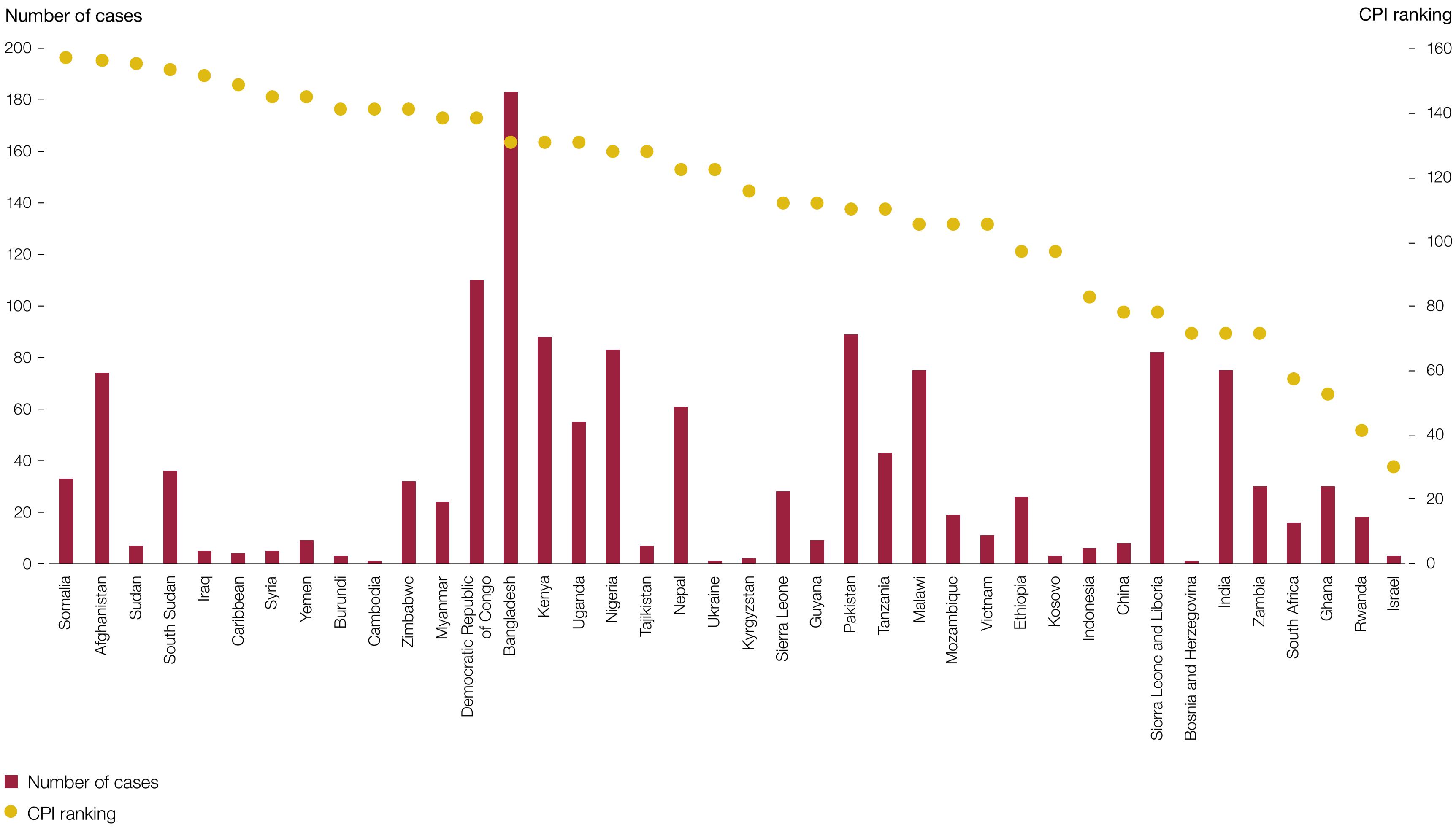
4.14 We looked at the most serious fraud cases over the last seven years (priority one and two cases) and found that these occurred across a number of different countries. The largest numbers were in Afghanistan, Somalia, Syria and the Democratic Republic of Congo. All of these are classed as fragile and conflict affected states, scoring highly on Transparency International's Corruption Perception Index.

4.15 Other countries that score highly on the index, however, have reported only small numbers of serious fraud cases (for example, Iraq, Zimbabwe, and South Sudan). There is no clear correlation between perceptions of corruption and numbers of fraud cases reported (**Figure 11** overleaf).

Figure 11

DFID caseload 2003–2016 with Corruption Perception Index (CPI) ranking

There is no clear relationship between perceptions of corruption and the number of DFID fraud cases in individual countries over the last seven years



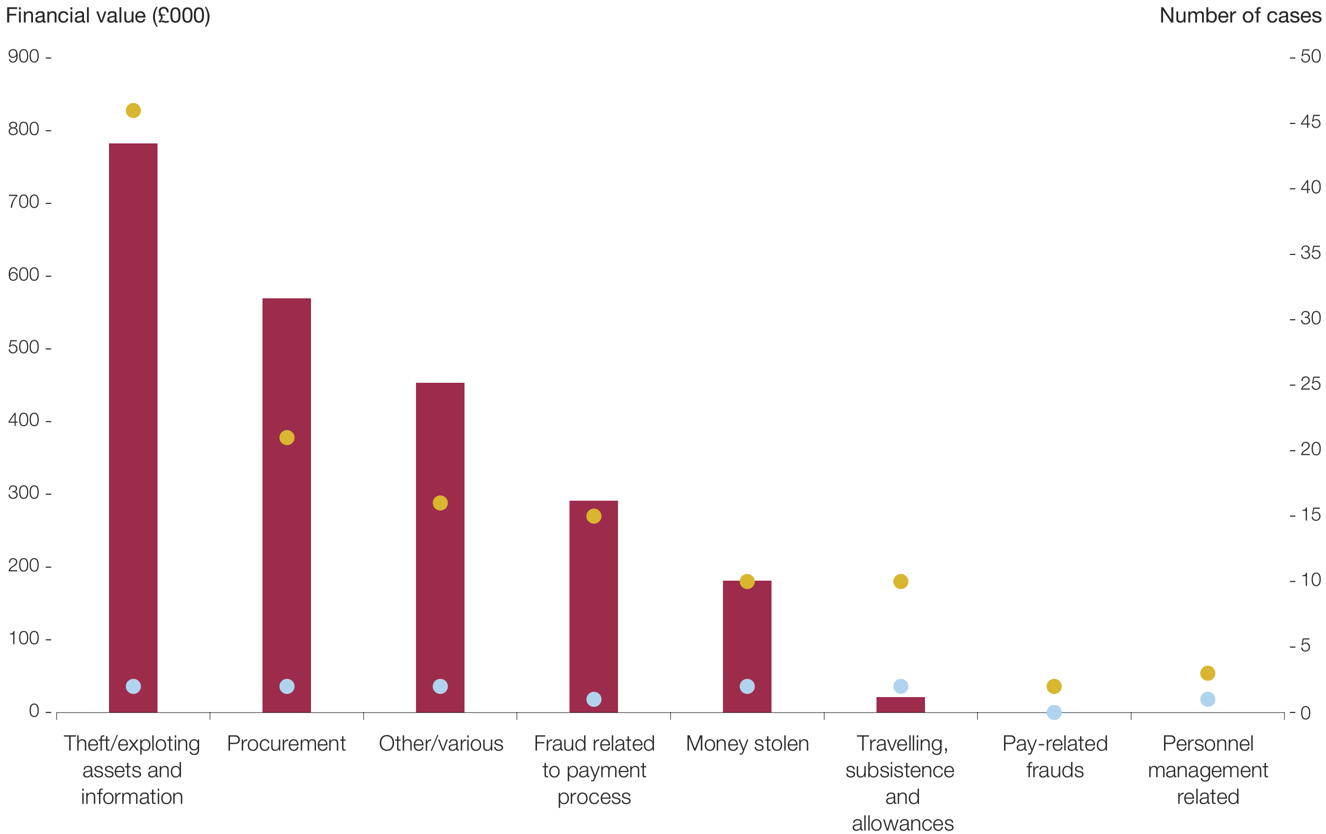
Source: National Audit Office analysis of data provided by the Department for International Development

4.16 The most common types of fraud in 2014-15 was the £782,000 (46 cases) of theft or exploitation of assets or information, which amounted to around a third of fraud in DFID, by value. The £569,000 of procurement fraud (21 cases) accounted for a further 25%, by value, of losses (**Figure 12** overleaf).

4.17 Nearly 40% of fraud cases were attributable to non-governmental organisations (NGOs) (**Figure 13** on page 35). NGOs are implementing partners for the delivery of both bilateral and multilateral aid. Particularly in the latter case, DFID has less visibility of NGO activities as the department's access rights often only extend as far as the multilateral body, not their subcontractors or supply chain. This is due to the single audit principle in the UN system, through which all donors rely on the work of the UN's auditors, rather than undertaking their own individual audits.

Figure 12
DFID fraud caseload: 2014-15

Theft or exploitation of assets and information was the most common type of fraud in 2014-15, accounting for a third of the gross amount lost to fraud



	Theft/exploting assets and information	Procurement	Other/various	Fraud related to payment process	Money stolen	Travelling, subsistence and allowances	Pay-related frauds	Personnel management related
Financial value (£000)	782,161	569,169	453,185	290,872	181,182	21,077	0	0
Number of cases	46	21	16	15	10	10	2	3
Of which DFID staff were involved	2	2	2	1	2	2	0	1

Notes

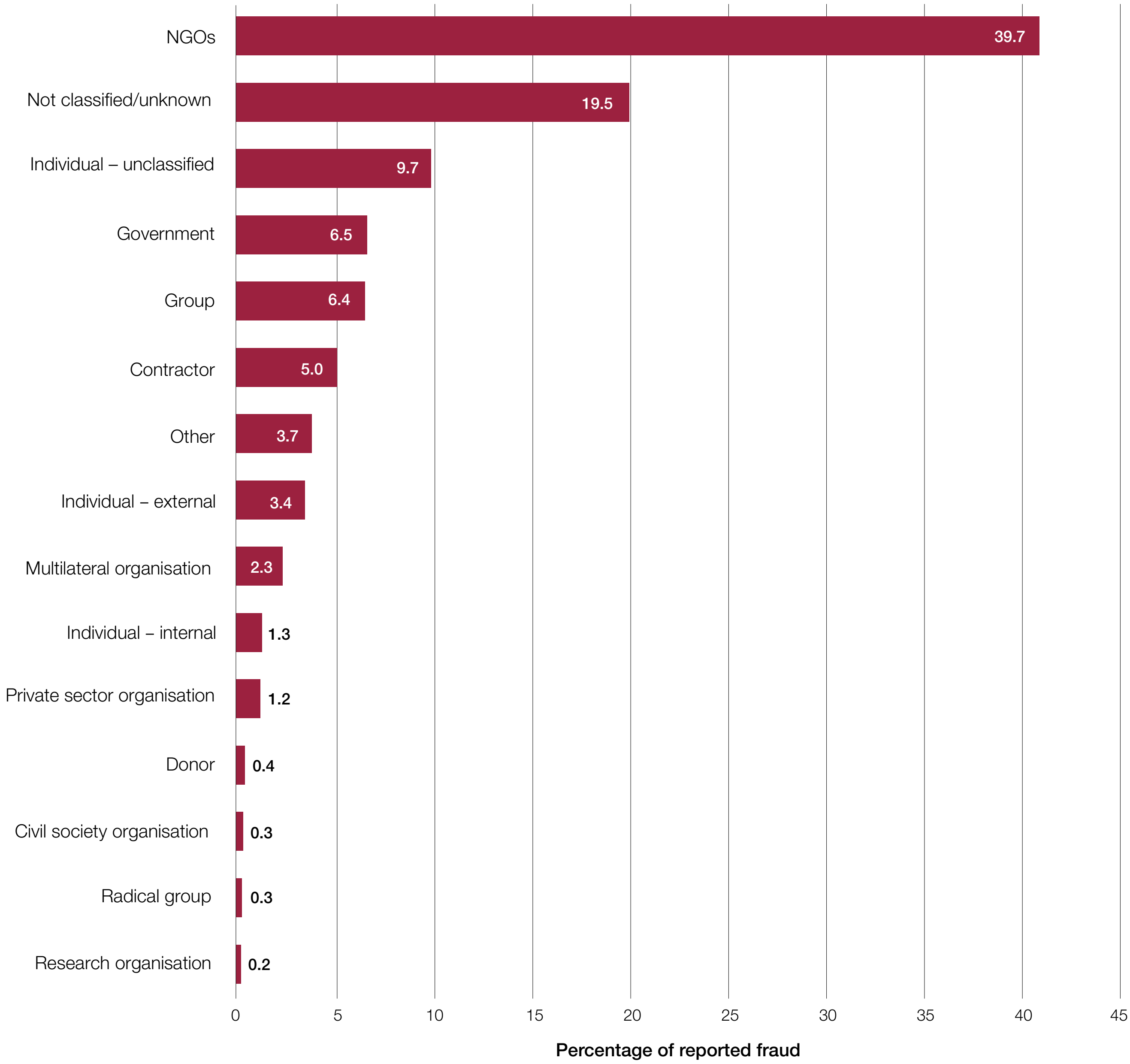
1 Of the cases where DFID staff were involved, seven resulted in unsubstantiated allegations, two staff received written warnings and three staff were dismissed from the organisation.

2 Financial value of fraud represents the gross value of fraud before any recoveries.

Source: National Audit Office analysis of data provided by the Department for International Development

Figure 13
Who commits fraud: 2003 to 31 December 2016

Approximately 40% of cases were attributable to non-governmental organisations (NGOs)



Note

1 Data as at 31 December 2016.

Source: National Audit Office analysis of data provided by the Department for International Development

The FCO's fraud caseload

4.18 The FCO has also seen a significant increase in its fraud caseload. There were 50 cases of alleged fraud in 2015-16, twice the number reported in 2011-12 (**Figure 14**). The value of the reported gross losses has remained below £1 million each year, but has not shown a clear upward or downward trend. In 2014-15, the value of losses was £890,000, but in 2015-16 the FCO reported gross losses of only £16,000. This represents 0.001% of the £1.9 billion the FCO spent in 2015-16.

4.19 Most of the FCO's fraud allegations are classed as internal fraud – three-quarters of the 50 cases reported in 2015 were classed as staff fraud; for example, travel and subsistence and procurement, with the remaining quarter split roughly evenly between contractors and grants. The percentage relating to internal (staff) fraud increased from 60% in 2014-15 to 75% in 2015-16 (**Figure 15** on page 38). Most fraud is committed by staff working overseas, with only a small percentage by staff based in the UK. Over the last 18 months, the FCO identified fraud in 19 countries, of which three (Pakistan, South Africa and Somalia) reported two cases each. At 75%, the percentage of internal fraud reported by the FCO in 2015-16 is higher than the average typically reported by other government organisations and other sectors.[19]

The British Council's fraud caseload

4.20 The British Council's new counter-fraud team has only been collecting central data on fraud cases since January 2016, so information on trends is not available. Before January 2016, cases were reported directly to internal audit. The counter-fraud team received 40 reports of fraud in 2016, which was twice the 20 cases recorded, on average, in previous years. The counter-fraud team estimates that this number will rise considerably as reporting increases: in an organisation with 11,000 employees, a £1 billion turnover and operating in 114 countries it noted it would expect to see higher levels of fraud cases, likely to number in the hundreds.

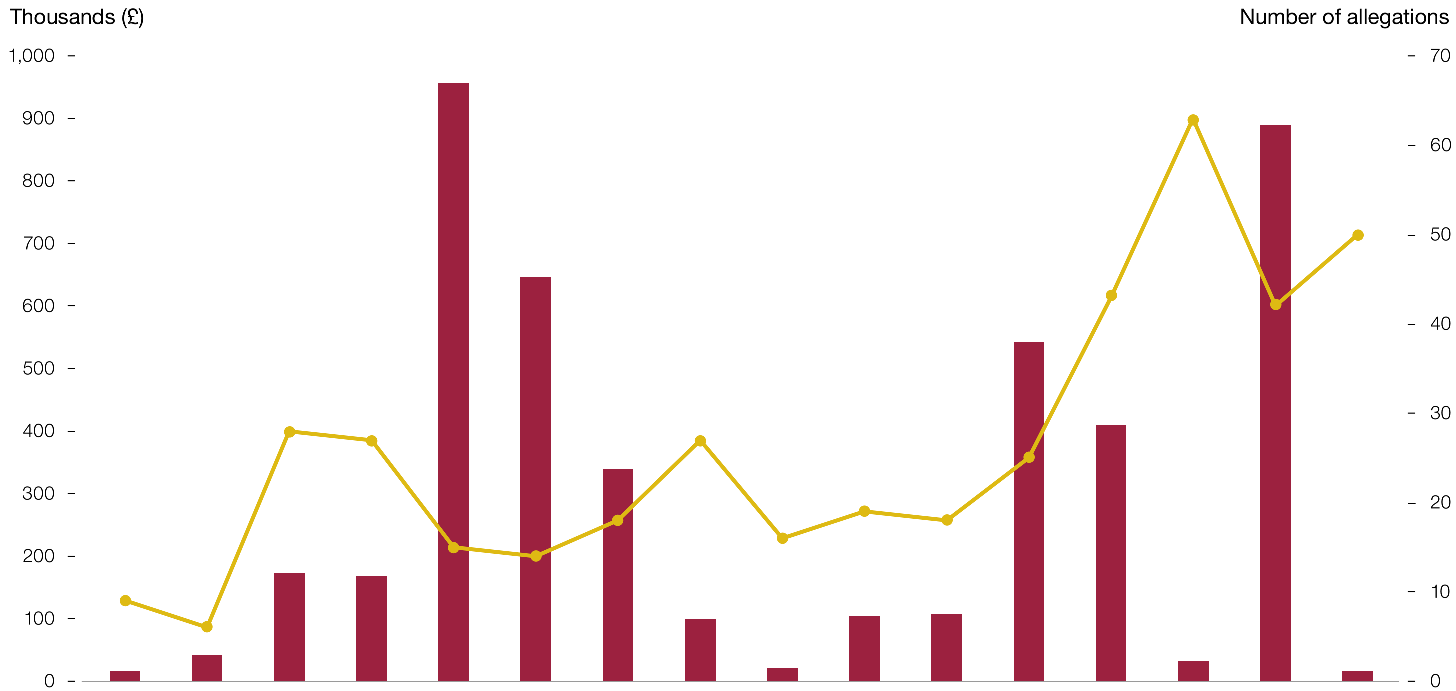
4.21 The British Council estimates that it lost around £35,000 to fraud from the cases in 2016, before any action was taken to recover funds (see paragraph 5.10 for recovery rates). Around 70% of the British Council's fraud cases were classed as internal frauds.

19 We looked at a range of different reports and surveys which gave estimates of levels of internal and external fraud. These included the NAO Fraud Landscape Review. Available at: www.nao.org.uk/wp-content/uploads/2016/02/Fraud-landscape-review.pdf and PWC Global Economic Crime Survey 2016 – UK. Also, www.iia.org.uk/media/1591902/2-economic-crime-survey-2016-pwc.pdf

Figure 14

Foreign & Commonwealth Office fraud caseload

Foreign & Commonwealth Office's caseload has increased over the years but the gross annual loss remains below £1 million



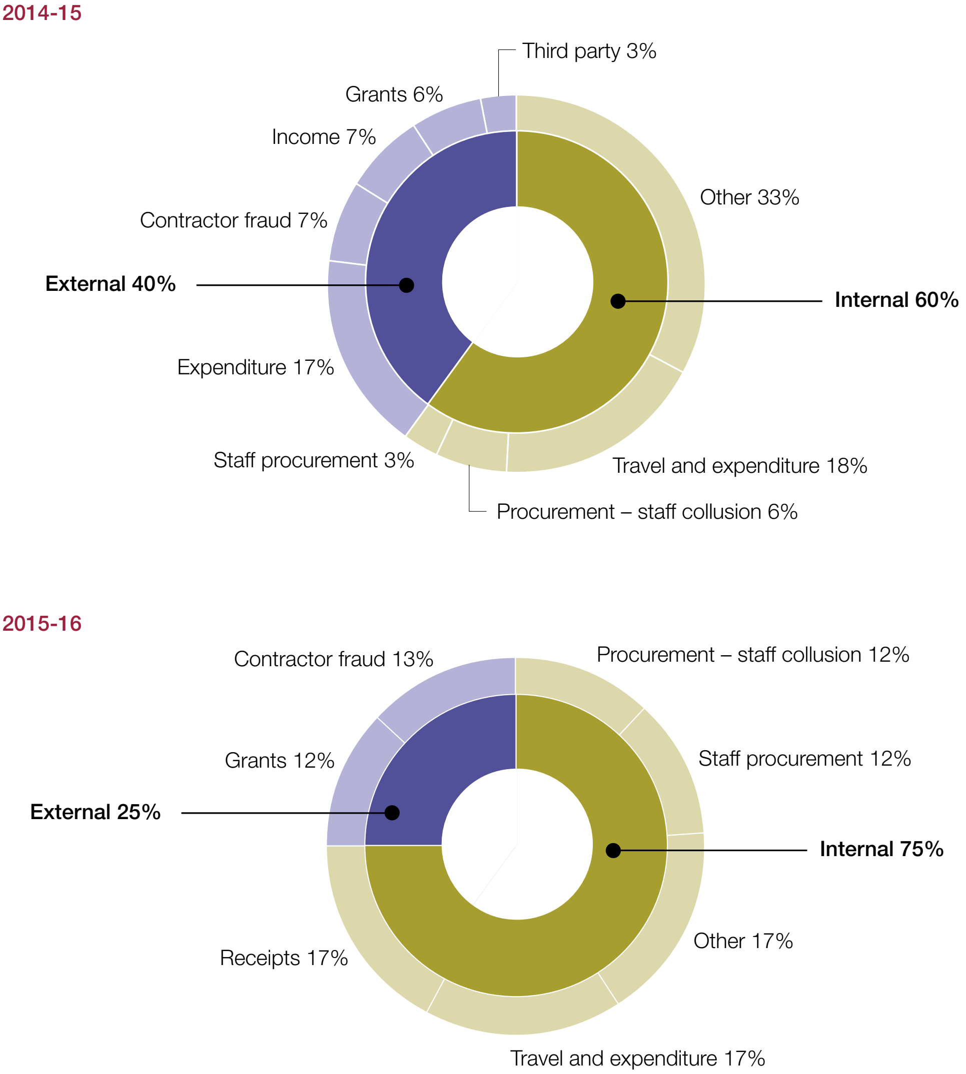
	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Fraud losses	16,000	41,000	172,000	168,000	957,000	646,000	339,000	99,000	20,000	103,000	108,000	542,000	410,000	32,000	890,000	16,000
Numbers of reported fraud	9	6	28	27	15	14	18	27	16	19	18	25	43	63	42	50

Source: National Audit Office analysis of Foreign & Commonwealth Office internal audit reports

Figure 15

Foreign & Commonwealth Office fraud allegations: 2014-15 and 2015-16

Most of FCO's allegations are classed as internal fraud



Source: Foreign & Commonwealth Office internal audit reports

Part Five

Findings on fraud loss recovery and sanctions

Key findings

5.1 This part of the report looks at the actions that the Department for International Development (DFID), the Foreign & Commonwealth Office (FCO) and the British Council take in response to confirmed fraudulent activity. Our principal findings are:

- We found that **DFID prioritises its actions to recover funds** from those who have committed fraud, through a variety of mechanisms, and expects its delivery partners to take the same approach (paragraphs 5.2 and 5.3).
- DFID **has recovered two-thirds of its gross fraud losses since 2003** (paragraph 5.4).
- There are a **range of sanctions** that DFID can take in response to fraud and it will pursue cases through the courts if it considers it proportionate to do so. DFID does not make information public on the actions it takes in response to fraud (paragraphs 5.5 to 5.7).
- **The FCO and the British Council** also recover a high proportion of fraud losses, which is made easier with the higher proportion of internal fraud cases. They have a similar range of sanctions available, and have pursued cases in court (paragraphs 5.8 to 5.11).

DFID's approach to fraud loss recovery

5.2 In responding to confirmed fraud, DFID focuses on recovering as much of the funds it has lost as possible. It prefers to do this by working with partners to recover funds through negotiation initially rather than taking the more punitive options it has available. The decision on the appropriate course of action is made on a case-by-case basis.

Recovering funds

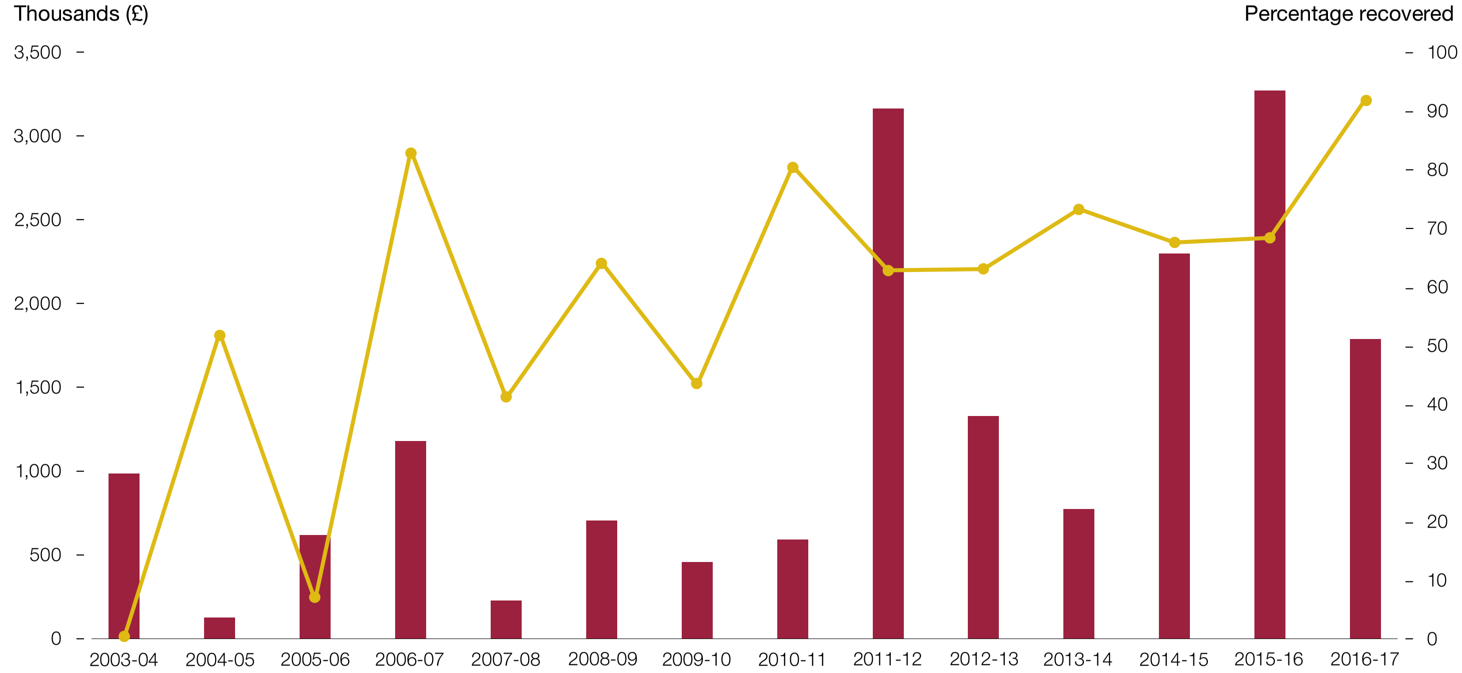
5.3 DFID has a range of different mechanisms it can use to recover funds from confirmed fraud. Depending on the nature of the fraud, and who is responsible, DFID can take the following actions to recover funds:

- DFID can ask individuals who have committed fraud to repay the money directly. For fraud committed by staff, DFID can also make deductions from future expense payments (for travel and subsistence fraud) or from wages, final salary or any termination payments should it choose to dismiss the individual in question.
- For frauds within delivery partners, DFID can require the organisation to repay the funds either directly, or using their insurance arrangements. It can also suspend funding to a programme until recoveries have been made.
- If the fraud involves loss of an asset, DFID can require delivery partners to replace these from their own funds.
- DFID can pursue the recovery of funds through the legal process, and will do this where appropriate and if the value of doing so is considered to be proportionate to the value of the loss. It also takes into account any reputational or political risks from this course of action.

5.4 Since 2003, DFID has recovered two-thirds (67%) of its estimated gross fraud losses. If a rolling average of the recovery rate is taken, the rate has risen from 28% to 82% between 2003-04 and 2015-16 (**Figure 16**). However, the year-on-year rate has risen from 68% in 2014-15 to 92% to date for 2016-17. There is no recovery in some cases, but in other cases 100% of the loss is returned to DFID. Where funds cannot be recovered after pursuing all options, DFID writes off the money as a loss.

Figure 16
DFID fraud loss recovery rates

The proportion of fraud loss DFID recovers has increased from 68% in 2014-15 to 92% to date in 2016-17



	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Gross loss	985,946	125,198	616,970	1,179,393	226,695	705,528	459,392	592,217	3,164,879	1,329,598	774,472	2,297,650	3,271,618	1,788,826
Percentage recovered	0.20	52.14	6.57	83.26	41.05	64.12	43.24	80.55	62.78	62.98	73.21	67.56	68.32	91.92

Notes

1 Data for 2016-17 as at 31 December 2016; it does not represent a complete financial year.

2 Financial value of fraud represents the gross value of fraud before any recoveries.

3 Fraud loss and recovery rate is based on the financial years in which cases were closed.

Source: National Audit Office analysis of the Department for International Development's fraud data

Sanctions for confirmed fraudulent activity

5.5 In addition to recovering funds, DFID will decide for each confirmed fraud case whether to take any further action against the individual or organisation responsible. There are different sanctions that DFID can apply for both individuals and delivery partners. DFID will decide which, if any, course of action it will take for each case rather than apply the same policy in all cases:

- Where individual staff members have committed fraud, DFID can apply sanctions as part of a formal disciplinary process. Depending on the seriousness of the case, DFID can give staff a formal warning, dismiss them for gross misconduct or take legal sanctions against them.
- Where the fraud has been committed within a delivery partner organisation, DFID can make use of clauses within its contracts and agreements. These allow it to suspend programmes while investigations are concluded, or to withdraw funds from organisations where it has concerns about their activities. For example, in 2016, DFID withdrew funding for part of a high-value education programme due to allegations of fraud.
- DFID can also terminate programmes or contracts early or decide not to renew agreements where confirmed fraud has taken place.
- Where the fraud has been committed in the supply chain, the delivery partner may take action against the perpetrator. DFID must consider whether the delivery partner's approach is proportionate. DFID can ask partners to impose further sanctions if it feels that their actions are not significant enough.

5.6 DFID has the option to prosecute individual staff members or delivery partners if it decides this is appropriate, although there is a cost attached to taking legal action. DFID told us that it has pursued some cases through the courts, but that there are challenges in doing this, and it prefers to focus efforts on recovering funds. It is easier to prosecute if a fraud has been committed in the UK, as frauds committed overseas may come under the remit of the local legal system, where outcomes may be less predictable.

5.7 Where DFID sanctions those who have committed frauds, it does not publicise the actions it has taken. This contrasts with the approach taken in some other organisations, which choose to publish information on action they have taken to sanction the perpetrators of fraud, as they believe this will act as a deterrent for anyone who may be thinking of committing a similar offence. For example, the charity Plan International publishes information on its website about completed fraud investigations and actions taken, although their primary rationale for doing so is in the interests of transparency to donors and supporters. DFID told us that its own approach to sanctions is guided primarily by its wish to protect the identity of those alleging fraud.

The FCO's and the British Council's approach

5.8 The majority of the FCO's fraud cases are internal frauds. When the amounts are small, the FCO is usually able to recover the loss through, for example, stopping payments to the staff member involved. In terms of sanctions, the FCO can take disciplinary actions against staff. The level of proof required to dismiss staff specifically for fraudulent activity can be high, but the FCO can dismiss staff for other reasons, such as 'breach of trust'. Like DFID, it does not publicly report the action it takes to sanction those found to have committed fraud.

5.9 The FCO told us that, where it has clear evidence of wrongdoing, it reports its fraud cases to the police – either to the UK police in the case of diplomats, or to local police where local staff are involved. However, the FCO told us that it will also take into consideration whether this conflicts with other policies, for example on human rights. FCO has taken five cases to court in the last seven years, of which two resulted in convictions and one was abandoned because of rising costs. The remaining two are ongoing.

5.10 As its counter-fraud unit is newly established, the British Council has no trend data for previous years. The British Council has recovered 68% of the £35,000 it estimates it lost to fraud in 2016. Of the 40 substantive cases in 2016, around 70% were internal. Cases were generally either zero losses because they were discovered before any payments were made, or low value so the funds could be recovered; for example, from final salary payments. In terms of sanctions, 16 members of staff were dismissed in 2016, including one in the UK, and nine reports were handed to the police.

5.11 The British Council is still developing its approach to recovery and sanctions; for example, it is working with its human resources department on the disciplinary process, and is also seeking to introduce fraud clauses into contracts with vendors and contractors, which will help in recovering funds. The British Council does not usually make information public on outcomes of fraud cases and sanctions taken.

Part Six

Findings on fraud reporting and lesson learning

Key findings

6.1 In this part of the report we look at how the Department for International Development (DFID), the Foreign & Commonwealth Office (FCO) and the British Council report information on fraud cases in their respective organisations. We also consider how these departments learn and disseminate lessons from fraud cases and how they report to the central fraud team in the Cabinet Office. We found that:

- DFID reports fraud information internally to its audit committee but provides **less information than before** through its annual report and accounts (paragraphs 6.2 to 6.5).
- DFID conducts **lessons learned exercises** and reviews on particular countries and programmes, where relevant (paragraphs 6.6 to 6.8).
- Neither the FCO nor the British Council provide more fraud information in their annual reports than DFID (paragraphs 6.9 to 6.12).
- All three bodies report to the fraud team in the Cabinet Office on a quarterly basis (paragraph 6.13).

DFID external reporting of fraud

6.2 DFID's reporting of fraud cases through its annual report and accounts has reduced significantly in recent years. In its 2013-14 annual report, DFID provided a table listing all gross and net losses, by country, between 2011-12 and 2013-14.

6.3 In its 2014-15 and 2015-2016 annual reports DFID no longer provided any specific information on fraud cases, as part of a move to reduce the overall size of the document. In line with standard departmental reporting, DFID did provide a note in the accounts covering all losses and special payments. Losses – where fraud losses would be expected to be recorded – were reported as £738,000 in 2014-15 and £1.955 million in 2015-16. However, as HM Treasury guidance only requires departments to report individual losses greater than £300,000, DFID provided no detail on any fraud cases after its 2013-14 annual report and accounts.[20] DFID provides the balance of information on its website, but there is no link to it from the annual report.

20 See: Department for International Development, *Annual Report and Accounts 2014-15*, p.141. Available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/445698/Annual-Report-2014-2015.pdf and *Annual Report and Accounts 2015-16*, p.81. Available at: www.gov.uk/government/publications/dfid-annual-report-and-accounts-2015-16

6.4 'Losses' in the accounts covers a wider range of losses than simply fraud, so the aggregate value reported in 2014-15 and 2015-16 does not provide an estimate of specific fraud loss.

6.5 Other organisations adopt a more transparent approach to external reporting. For example, Plan International publishes a quarterly update on fraud cases, providing a date; location (region); allegation and resolution; net loss to Plan International, and lessons learned and actions taken.[21]

Identifying and disseminating lessons from fraud cases

6.6 DFID's internal audit function identifies lessons from fraud cases and reports these internally. Learning lessons is also used by other parts of the business, for example by policy teams, and fraud case examples are used in training materials. DFID also shares knowledge with other organisations by participating in relevant cross-government and other working groups; for example, it attends the Charity Commission's counter-fraud working group.

6.7 Front-line staff also have valuable experiences to contribute. DFID staff in Pakistan, who manage the largest bilateral aid budget, contribute to a community of practice group that meets every six weeks, led by the Governance and Open Society division in DFID.

6.8 In 2013, DFID established the first counter-fraud strategy for Pakistan. There was due to be a stocktake on the strategy in December 2016. The new strategy will be informed by lessons learned from delivering aid in Pakistan, and based on work achieved at the May 2016 anti-corruption summit held in London.[22]

Fraud reporting and learning lessons in the FCO and the British Council

6.9 The FCO similarly reports little information on its fraud cases. Within government, it reports losses quarterly to the Cabinet Office on all cases. Externally, it only reports on individual fraud cases valued at over £250,000 in its annual report and accounts, as required by HM Treasury.[23] This resulted in no reporting in 2015-16, and a single case for £879,000 in 2014-15.[24,25] At the request of the Foreign Affairs Committee, the FCO also advises the Committee of any relevant fraud (any fraud which is considered novel or interesting).

21 Available at: https://plan-international.org/sites/files/plan/field/field_document/plan_international_counter_fraud_report_fy17_q1.pdf
22 Available at: www.gov.uk/government/topical-events/anti-corruption-summit-london-2016
23 This threshold has now risen to £300,000.
24 Available at: p.82 www.gov.uk/government/uploads/system/uploads/attachment_data/file/539413/FCO_Annual_Report_2016_ONLINE.pdf
25 Available at: p.109 www.gov.uk/government/uploads/system/uploads/attachment_data/file/444067/Amended_FCO_Annual_Report_2015_web__1_.pdf

6.10 The British Council is a non-departmental public body that received £162 million in grant-in-aid funding from the FCO in 2015-16, as well as being a registered charity and a public corporation. Its reporting requirements are, therefore, different to DFID and the FCO. Internally, the British Council's fraud team reports to the Council's audit and finance committee and to the board of trustees. Externally, it reports to the FCO, the Cabinet Office and the Charity Commission.

6.11 As part of its financial memorandum with the FCO, the British Council reports all suspected fraud cases over £20,000. The British Council has no trend data on the number, type or scale of fraud cases before its dedicated counter-fraud team was established in 2015. Nor does it provide a specific fraud report in its annual report & accounts, although individual cases above the £20,000 threshold are disclosed. The British Council's processes for learning from fraud cases are relatively immature, but it is working to improve its approach in this area. For example, the counter-fraud team is supporting the financial governance team in developing the control framework and propose to include the findings from fraud investigations in internal audit's action tracker, so that lessons can be shared more widely across the organisation.

6.12 The British Council contributes to the Charity Commission's counter-fraud working group, as well as liaising with other international charities such as Save the Children and Oxfam to share strategies and learn and implement lessons. British Council staff are part of the international investigators' network, which includes organisations such as the World Bank, the United Nations and the Global Fund.

Reporting to the Cabinet Office

6.13 As noted above, DFID and the FCO report information on fraud and error to the Cabinet Office on a quarterly basis. The British Council also submit this information through the FCO. The Cabinet Office planned to publish this information by the end of 2016, but has not yet done so. DFID has also taken part in the Cabinet Office's National Fraud Initiative, and has undertaken a random sampling exercise to identify potential levels of fraud and error. The Cabinet Office is developing government functional standards on fraud, and DFID is currently working to make sure that its processes comply with these guidelines. The British Council are also involved in the Cabinet Office's work on counter-fraud across government; for example, the head of counter-fraud sits on the working groups for standards.

Appendix One

Our investigative approach

Scope

1 We conducted an investigation into three specific concerns. These were:

- that cases of fraud and diversion were significantly under-reported;
- the increased number of cases of reported fraud at the Department for International Development (DFID) in the last five years; and
- the UK government's 2015 commitment to spend at least 50% of DFID's budget in 'fragile states and regions'.

Methods

2 In examining these issues, we drew on a variety of evidence sources:

- We interviewed key individuals from DFID, the Foreign & Commonwealth Office (FCO), the British Council, the Cabinet Office, and from charities to establish the level of understanding, reporting, and detection of fraud across government functions and the development sector. The people we interviewed included staff from accounting and programme teams.
- We developed a structured questionnaire to establish basic information on counter-fraud activity from each department.
- We reviewed key documents relating to counter-fraud activity from DFID, FCO and the British Council.
- We analysed data on the fraud caseload at DFID, the FCO and the British Council.
- We conducted a fieldwork visit to DFID and the FCO's offices in Pakistan and DFID's offices in Ghana and the Democratic Republic of Congo and conducted interviews with staff there to understand the risks of fraud and diversion.

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National Audit Office

£10.00

ISBN 978-1-78604-106-7

Design and Production by NAO External Relations
DP Ref: 11431-001