

Better Governance Forum briefing paper

# Audit Committee Update

- helping audit committees to be effective

Issue 3

Countering fraud

October 2010

# Introduction

**Dear Audit Committee Member,**

This is the third issue of Audit Committee Update and we hope you find it helpful in your role on the Audit Committee.

In this issue we focus on counter-fraud arrangements and the important role the audit committee plays in reviewing the effectiveness of these as part of the overall governance arrangements. The articles are written by a range of experts outlining the importance of counter fraud arrangements for securing good governance and key features of good practice arrangements for a public service organisation. The role of the Audit Committee is also explained along with key questions you can ask.

Audit Committee Update is available free to all organisations that subscribe to the Better Governance Forum and we encourage you to circulate it to fellow audit committee members in your organisation.

If you haven't seen the previous issues they are available from our website by clicking here. [http://www.cipfanetworks.net/governance/library/default\\_view.asp?content\\_ref=9685](http://www.cipfanetworks.net/governance/library/default_view.asp?content_ref=9685)

Best wishes

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## Future editions of this briefing:

The next edition is planned for January and will feature risk management and how the audit committee can help make the management of risk more effective in the organisation.

We are also starting to plan the other 2011 editions. Possible topics for future editions are:

- Value for money
- International Financial Reporting Standards
- Scrutiny of treasury management
- Effectiveness of internal audit.

Let us know which topics are most important to you and any other suggestions.

## Workshops and training for audit committee members in 2010

**Scams, bribery, corruption** - a one day event suitable for all those involved in countering fraud.

Come to this workshop if you want to prevent losing money, harm, hurt and fear through countering fraud. Not only that, but learn how to generate income and show it.

This is an invaluable opportunity to share the knowledge, ideas and experiences of expert speakers on these key fraud risks.

21 October York

4 November London

[CIPFA Networks - Better Governance Forum](#)

### **Advanced Audit Committees**

Have you cracked the basics? Then how about your role in relation to value for money, treasury management or counter fraud?

17 November 2010 – York

<http://www.cipfanetworks.net/governance/events/>

### **Effective Audit Committees**

How the audit committee can gain an overview of the overall control environment, review the effectiveness of risk management and work with internal and external audit to get the best out of them.

23 November 2010 – London

<http://www.cipfanetworks.net/training/events/#3>

### **In-house training**

In house training, tailored to your needs is available. For further details contact Claire Simmons on 0208 6678542 or [Claire.Simmons@cipfa.org.uk](mailto:Claire.Simmons@cipfa.org.uk)

<http://www.cipfanetworks.net/training/>

We will also be developing new workshops that will be of benefit to audit committee members in 2011. We will bring you more news of these in the January issue.

## Receive our briefings directly:

This briefing will be sent to all key contacts of organisations that subscribe to the CIPFA Better Governance Forum with a request that it be forwarded to all audit committee members.

If you have an organisational email address (for example [jsmith@mycouncil.gov.uk](mailto:jsmith@mycouncil.gov.uk)) then you will also be able to register on our website. This will give you access to governance material, guidance documents. **If you would like to request that these briefings are sent directly to you please contact me** [Diana.Melville@cipfa.org.uk](mailto:Diana.Melville@cipfa.org.uk)

Sign up today at [www.cipfanetworks.net/governance](http://www.cipfanetworks.net/governance).

# Counter fraud arrangements – what is the role of the Audit Committee?

The audit committee exists to gain and provide independent assurance that there are adequate controls in place to mitigate key risks and to provide assurance that the organisation is operating effectively – calling the organisation to account. Its key role is overseeing and assessing the risk management, control and governance arrangements and advising the governing body (for example the full Council in a local authority) on the adequacy and effectiveness of these arrangements. An audit committee's main responsibilities include advising the organisation on all matters relating to its governance and in doing so considering the effectiveness of the risk management arrangements, the control environment and associated anti-fraud and anti-corruption arrangements.

Fundamentally, the Audit Committee makes sure that effective actions to counter fraud and corruption take place. It acts to enforce, enable and encourage successful actions to counter fraud. Good counter fraud is essential for organisations that want to stop losing money, harm, hurt and fear and maintain a high status and good reputation with their stakeholders, regulators and funders. On the other hand, poor governance weakens an organisation's potential and, at worst, can pave the way for financial difficulties, poor performance, loss of reputation, fraud and corruption.

The mere existence of an audit committee does not eliminate the risks of serious fraud, misconduct or misrepresentation of the financial position. However, an audit committee can:

- gain and give assurance through a process of independent and objective review
- raise awareness of the need for sound control and the implementation of recommendations by internal and external audit.

Managers (directly employed people) are responsible for establishing and implementing arrangements to counter fraud and corruption. The Audit Committee is responsible for overseeing these management arrangements. The Audit Committee is powerful (e.g. it has delegated responsibility to act on behalf of the full Council, and is "those charged with governance".)

The role of the Audit Committee is crucial to support managers in achieving their anti-fraud objectives. The action needed to be effective in countering fraud and corruption is described in the CIPFA Red Book2, *"Managing the Risk of Fraud – Actions to Counter Fraud and Corruption"*.

This is available from the following web link: [CIPFA Networks - Better Governance Forum](#)

Countering fraud and corruption is everyone's job. It requires organisational and individual commitment to a culture of zero-tolerance, Nolan principals and ensuring that money is spent on what it was intended for.

*"Taking actions to proactively stop fraud occurring in the first place is a far better remedy than merely managing the risk."*

Steve Freer, Chief Executive, The CIPFA Group.

It is management's responsibility to establish and implement effective arrangements. It is the job of the audit committee to oversee, monitor, support, enable, encourage, evaluate and when necessary enforce effective actions to counter fraud. A good committee agenda includes regular reports, updates and discussion of fraud issues and cases. It may be necessary to hold separate special meetings and/or exclude the press and public from main meetings.

Committee members are better able to accomplish their role when they have been provided with training to understand their counter fraud responsibilities, for example:

- Internal control
- Fraud risk factors: the fraud triangle – incentives, rationalization, opportunity

- Good governance
- Financial management and reporting
- International Financial Reporting Standards and Standards on Auditing
- Links to achieving organisational objectives
- Final accounts.

## Counter fraud arrangements – so, what questions should an Audit Committee ask?

### 20 Questions:

This checklist can be used by those responsible for governance (Audit Committees or equivalent) to assess their contribution to the fraud defences of their organisation and determine what action is needed. This is appropriate to use in any organisation. It is adapted from the checklist designed specifically for local authorities published by the Audit Commission<sup>1</sup> in September 2009 as part of [Protecting the public purse](#).

### Checklist for those responsible for governance

Issue	Yes	No	Action
1. Have we committed ourselves to zero tolerance against fraud?			
2. Do we have appropriate strategies, policies and plans?			
3. Do we have dedicated counter-fraud resources?			
4. Do the resources cover all of the activities of our organisation?			
5. Do we receive regular reports on fraud risks, plans and outcomes?			
6. Have we assessed our management of counter fraud resources against good practice?			
7. Do we raise awareness of fraud risks with: - new staff (including agency staff)? - existing staff? - non executives/members?			
8. Do we join in appropriately with national, regional and local networks and partnerships to ensure we are up to date with current fraud risks and issues?			

<sup>1</sup> We wish to acknowledge the contribution of the Audit Commission in producing this document.

Issue	Yes	No	Action
9. Do we have working arrangements with relevant organisations to ensure effective sharing of knowledge and data about fraud?			
10. Do we identify areas where internal controls may not be performing as intended?			
11. Do we maximise the benefit of our participation in data matching?			
12. Do we set the right "tone at the top" to influence the creation / maintenance of a strong counter fraud culture in the organisation?			
13. Is there a level of financial investment in work to counter fraud and corruption that is proportionate to the risk that has been identified?			
14. Have we reassessed our fraud risks because of the current economic climate?			
15. Have we amended our counter-fraud action plan as a result?			
16. Have we reallocated staffing as a result?			
17. Are we satisfied that payment controls are working as intended?			
18. Have we reviewed our contract letting procedures against the good practice guidance issued by the Office of Fair Trading to reduce the risk of illegal practices such as cartels?			
19. Are we satisfied that our recruitment procedures are: - preventing employment of people working under false identities? - validating employment references effectively? - ensuring applicants are eligible to work in the UK?			
20. Do we have a reporting mechanism that encourages our staff to raise their concerns of money laundering?			

# National Fraud Authority: Tackling Public Sector Fraud – an update

The National Fraud Authority [NFA], part of the Attorney General's Office, was established to make the UK a more hostile environment for fraudsters. It leads and co-ordinates projects with tangible, measurable outcomes that strengthen the UK's response to fraud.

In January 2010, it unveiled the first 'Annual Fraud Indicator' which showed that fraud cost the UK £30.5 billion in 2008 alone. In March 2010 the NFA produced '*A fresh approach to combating fraud in the public sector*' which summarised the work of the Public Sector Fraud Taskforce. The taskforce comprised of DWP, HMRC, Local Authorities and the NHS. The report placed the cost of fraud in the public sector at nearly £5bn and made 33 recommendations for improvement measures.

In the few short months since the Taskforce published its report, the Government's planned spending cuts are becoming a reality for the public sector, meaning the need to reduce and prevent fraud losses in the public sector is now more important than ever.

As a result of the report, the NFA has established a Public Sector Fraud Team to deliver 15 different projects, based on the original 33 recommendations, all designed to cut key fraud risks in central and local government. The NFA's Public Sector Fraud Team comprises: Sanjay Mackintosh, formerly at the NHS Counter Fraud Service, Rachael Tiffen, formerly at the London Borough of Enfield, Piers Harrison, formerly at the Department for International Development. The 15 projects are:

1. Managing access to online public services including ID authentication
2. Better use of information assets to verify the identity of citizens
3. Verification of circumstances to prevent false claims for benefits/exemptions
4. Fraud policy development including designing out fraud
5. Housing tenancy and council tax single person discount fraud
6. Regional counter fraud partnerships
7. Fraud intelligence sharing, specifically through NFIB
8. Using data analytics to identify fraud
9. Procurement fraud
10. Fraud in grant awarding
11. Staff and insider-enabled fraud
12. Identity crime
13. Preventing the use of false accommodation addresses to obtain public services/benefits
14. Better fraud measurement in the public sector
15. Asset recovery

Some projects will be of particular interest to Audit Committees. These include work streams looking at procurement fraud, grants fraud, staff and insider-enabled fraud, council tax fraud and housing tenancy fraud.

These latter two areas, as well as procurement fraud, have been highlighted by the Audit Commission in "*Protecting the Public Purse*". The Audit Commission estimates that up to 50,000 properties may be unlawfully sublet and that up to £92m may be lost to Single Persons discount fraud. In the areas of council tax and housing tenancy frauds we are currently looking for examples of good practice and pathfinders to work with us and local authority Audit Committees should be satisfied that work is being undertaken to prevent fraud in these areas. The NFA has also been running good practice workshops for Councils and RSLs in September and the output of this will be circulated.

Some of these projects are already being delivered as part of the NFA's Business Plan & some are new projects which will require your knowledge and expertise for the benefits to be delivered across Government. If you have an interest in any of the above and are not already involved with NFA workstreams, please contact one of the team on 020 3356 1041.

**Rachael Tiffen, National Fraud Authority**

# Examples – How two Council Audit Committees contribute to the fight against fraud:

## Lambeth Council's Audit Committee - Countering Fraud & Corruption

Counter-fraud activity at Lambeth is reported to our Corporate Committee which performs the audit committee role in addition to other matters. It is the job of this committee to oversee, monitor, support, enable, encourage, evaluate and when necessary enforce effective actions to counter fraud.

The committee has monitored closely the implementation of a comprehensive approach to countering fraud which is being delivered in partnership with KPMG. In the last year, we have reported to the committee the successes of the 5 dedicated investigation teams. The successes involve clawing back resources lost through crime, and in the last financial year alone, this amounted to £8.4 million and 161 prosecutions.

The committee meets six times a year and is composed of 5 members from the three main political parties. There is cross party support on combating fraud and its agenda includes regular reports, updates and discussion of fraud issues and cases.

In addition, we hold separate special meetings (challenge sessions) and exclude the press and public from these sessions. The sessions are determined by across the board weaknesses identified in a number of investigation reports. For example, we found that contract management was less than robust and exposed the council to the risk of losses from fraud and non realisation of the value gap (value promised in the contracts compared to the value actually realised). Senior officers were subject to face to face questioning by members and an action plan was agreed and delivered to strengthen contract management. The committee also resolved that failure to strengthen contract management following the training should result in tough senior management action.

Other counter-fraud matters considered by the committee include strategy and annual work plan, fraud response plan, whistleblowing process and outcomes, violations of the council's staff code of conduct and HR rectification actions, parallel sanction policy and process against employees who have committed fraud, adequacy of controls that act as safeguards against fraud and irregularity, and so on. The committee is focussed on ensuring that lessons are learnt for all incidents where controls have failed or the response could have been better and that these procedures are incorporated into new procedures or staff development programmes. Sanctions taken against those involved in dishonesty and poor practices are sometimes challenged by the committee in terms of their robustness.

The committee also request special investigations around identified problem areas when they seek independent assurance on the underlying reasons and the actions taken by management. We have scrutinised temporary accommodation overspend and measures to detect illegal sub-letting.

Emerging fraud risks are also reported regularly to the committee and the extent to which these are mitigated through the control measures in place.

On whistleblowing, the Committee receives reports showing the nature of the concern and the results of any investigation. The Committee requested that further information be included on the impact the outcome has had on changing behaviours and related policies and procedures.

We also report to the committee on the activity of the police detective on secondment to the council. The committee strongly supports a zero tolerance to fraudulent activities and ensures that the police officer is able to undertake his criminal prosecutions.



Training has been provided to the Committee members so that they are better able to accomplish their counter fraud responsibilities. The committee understands that countering fraud and corruption is everyone's job and that it is part of the political management's commitment to a culture of zero-tolerance.

**Mohammed Khan, Chief Internal Auditor, London Borough of Lambeth**

## **Croydon Council Audit Advisory Committee - Countering Fraud & Corruption**

The Audit Advisory Committee is made up of seven members, four from the majority party, two from the minority party and one non-elected independent member. There used to be only five members, but there was such a list of members wanting to join because of the high profile that it developed that the number was increased after only two years.

Amongst its usual roles in relation to internal and external audit, risk management and financial reporting, the committee is responsible for overseeing the Council's anti-fraud work. There are six meetings per year and a report on activity and outcomes is presented at each meeting by the head of service.

The Committee has taken a particular interest in the raising of fraud awareness within the organisation, taking the view that the Council's staff are the first and best line of defence against fraudsters.

The Committee has overseen the development of three key initiatives to monitor and raise staff awareness:

- Carrying out a survey across the organisation of awareness and attitudes to a number of fraud and propriety questions. This survey has now been carried out every 12 to 18 months over several years and has shown a steady increase in awareness. The results of this are presented to Committee Members. Its success has also shown an increase in internal referrals to the Corporate Anti-Fraud Team.
- A quarterly newsletter for members and staff giving a flavour of anti-fraud work and issues. The Chair of the Committee writes the introduction and critically reviews the newsletter before it is issued.
- Fraud awareness training: This has been carried out across the organisation and now forms a regular feature in the Council's Management Development programme. Training has been provided to both staff and members.

**Simon Maddocks, Head of Governance, Croydon Council**

## Watch out for the accounts - Clearing the wool from our eyes

Recently there has been much talk about the need for more transparency in government and nowhere is this more important than in public sector accounting, reports Richard Mackillican.

As public sector bodies face a period of austerity, it has become more important than ever to be able to account for every single penny which is spent from the public purse. Given that this requires a clear form of accounting, it could be said that the adoption of International Financial Reporting Standards (IFRS) has come at just the right point. "In a way, the adoption of IFRS can help in the battle against public sector fraud, because there is greater clarity, comparability and consistency in what's disclosed in the accounts." explained Greg Marks.

"For example, it brings on to the balance sheet the long term liabilities involved in PFI schemes & leases that were previously confined to revenue accounts. An intention of IFRS is greater transparency & accountability – things that are considered to be good governance. The process of delivering IFRS accounts has provided the opportunity to re-examine the information that supports accounts, for instance it may have clarified the ownership of minor assets."

According to Greg, the switch over to IFRS has relevance to managers throughout the public sector, not just those directly involved with overseeing public sector finance. "It's easy to think that the move to IFRS only concerns technicalities and accountants, but the impact is more than just on presentation of the accounts – for instance forecasting & budgeting by managers and performance targets.

"Because of this and the consequent changes to not only financial reporting, but also internal controls and procedures, it's important to involve staff & take a 'whole organisation' approach and IFRS supports this wider engagement."

Although the introduction of IFRS has the potential to increase transparency in public sector spending, it also needs to be implemented in the correct way for all of those benefits to be realised. According to Greg, what is needed is a more holistic approach towards organisational implementation. "For it to get buy-in, it needs the right 'tone at the top', with supportive messages & clear decision making. Ideally, this would result in a combined 'top-down' and 'bottom-up approach', potentially involving people like IT, internal audit, legal, HR, property and procurement."

Even though once fully implemented IFRS will allow for more clarity around public sector accounting, the period during that implementation will, according to Greg, leave the system potentially open for abuse. "All change carries with it risks and the role of organizational leaders includes helping to make sure these have been addressed. The Audit Commission has produced "Countdown to IFRS" – a checklist of potential questions for members to ask officers. Not least of the risks is the risk of fraud. This includes the possibility of concentration on implementation diverting attention and creating distractions from the operation of internal controls, checks and balances. Greater transparency can be a double edged sword because although we have access to better information, therefore enhancing accountability, unfortunately so do potential fraudsters. For instance, information from the accounts can be used by external organisations to monitor other members of cartels.

"Another threat is internal fraud – arguably IFRS implementation provides all the elements of the traditional fraud triangle – opportunity (e.g. changes to internal controls), incentive (e.g. not making the accounts look worse than before), rationalization (e.g. I might be committing financial statement fraud, but I'm doing this to protect the reputation of the organisation). IFRS can give opportunities for both good and bad. Its enhancing clarity, consistency and comparability and it's important to recognise & counter the risk of fraud."

**Greg Marks, as told to Richard Mackillican, Public Sector Executive magazine, October 2010**

## Developments you may need to know about:

**Housing Fraud** - A new briefing was launched at the CIPFA Better Governance Forum Annual Conference on 14<sup>th</sup> October 2010. The Counter Fraud Advisory Panel produced the paper which provides proven ways of how to prevent and stop Council Tax single person discount fraud and housing allocation fraud.

**Role of the head of internal audit** - Consultation on CIPFA's Statement on the role of the head of internal audit in public service organisations closed on 10<sup>th</sup> September. The final statement will be published in November. Audit Committees are recommended to take the statement into account when they review their internal audit arrangements. In local government in England those charged with governance are required to review the effectiveness of the system of internal audit, including internal audit itself, to support their review of the Annual Governance Statement.

**Audit Commission update (England)** - External auditors are key contacts for an audit committee. As well as the opinion on the accounts, audit committees currently receive a wider set of assurances covering the organisation's internal control and governance arrangements. When the press release (13<sup>th</sup> August) announcing that the Audit Commission was to be disbanded was released by the Communities and Local Government (CLG), it suggested that '*councils will be able to appoint their own independent external auditors from a more competitive and open market among audit firms*'. It was proposed that the new arrangements will be in place for the 2012/13 financial year. A new audit framework for the health sector will also be required.

Things are still at an early stage, and CLG have yet to provide any further information on their proposals. CIPFA is involved in the CLG project team work, and the Better Governance Forum will provide updates as more information becomes publicly available.

**Audit Commission publication – Protecting the Public Purse 2010** - The Audit Commission publication *Protecting the Public Purse 2010 – fighting fraud against local government and local taxpayers* will be published on 27<sup>th</sup> October 2010. This report identifies current and emerging fraud risks in local government and the good practice taken by councils to tackle such fraud. However, the report concludes that such good practice is not universal and encourages all councils to utilise the good practice checklist, specifically written for audit committees and included in the publication, to assess their own arrangements and take action where appropriate. In particular the report focuses on housing tenancy, single person discount on council tax, recruitment, procurement, personal budgets in social care and housing and council tax benefit frauds. In addition the report for the first time includes the results from the Commission's annual survey of detected fraud across all of local government, police, fire and emergency services in England.

**The importance of good governance and leadership** - CIPFA has issued a report 'Leading in Hard Times' aimed at all public service leaders. It emphasises the need for good governance and effective financial and risk management in addressing the funding challenges facing the public services over the next few years.

<http://www.cipfa.org.uk/managingthecuts/>

**Audit Committees in Wales** - The Welsh Assembly Government is consulting on new regulations that propose making audit committees mandatory in all Welsh authorities. The consultation can be viewed on the attached. <http://www.assemblywales.org/bus-home/bus-legislation/bus-leg-measures/business-legislation-measures-localgov.htm>

**Pensions Governance** - All Local Government Pension Schemes need to assess and publish their compliance with the revised Myners' Principles. The 6 high level principles for pension fund investment, scheme governance, disclosure and consultation were agreed in 2008. If you are a member of an Audit Committee in local government then you should be aware of how the pension fund your authority contributes to complies with these principles and any governance issues arising. The assessment should be available in the pension fund annual report or on the agenda of the Pension Fund Committee.

# The Audit Committee Cycle

## **Strategic risks around service changes or reductions**

When reviewing risk registers it is likely that many organisations will identify strategic risks around reduced funding and the need to make service changes in response. Good governance principles and effective risk management should support those making these difficult decisions. The role of the audit committee is not to scrutinise the decisions themselves or to advise what those decisions might be, but it is reasonable for the audit committee to seek assurance that the decision making process is thorough, robust and cognisant of the risks. No decision is risk-free, particular in changing times; however it is reasonable to ask what arrangements are in place to manage the risks arising.

The Better Governance Forum has developed a risk tool to help organisations identify governance risks arising from service changes. It is available from the Better Governance Forum website. <http://www.cipfanetworks.net/governance/>

The next issue of Audit Committee Update in January will consider the audit committee role in relation to risk management in more detail.

## **Reviewing your assurance needs**

In preparation for the Annual Governance Statement, Statement on Internal Control or Statement on Internal Financial Control at the end of 2010/2011 it is good practice to plan ahead for your assurance needs. Further information on the audit committee role in reviewing these statements is available in the previous issue (May 2010). It is particularly important to review your assurance needs when changes are introduced.

The government has abolished the Comprehensive Area Assessment and the Use of Resources assessments for local authorities in England. Audit committees in those organisations will not be receiving reports on these in 2010. As an audit committee it is recommended that you consider whether there are any implications for your assurance needs, particularly in relation to the Annual Governance Statement. Do you receive other assurances on the effective use of resources, for example from the chief financial officer or through internal audit? Would this be the right time to review your assurance plan to identify gaps or duplication?

## **Adequacy of Internal Audit provision**

The Accounts and Audit Regulations 2006 (England) require a local authority to maintain 'an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper practices in relation to internal control.' The CIPFA Code of Practice for Internal Audit in Local Government is proper practice for all principal local authorities in the UK.

Heads of internal audit will address their resourcing levels when they review their audit strategy. The Code requires them to report if their resource levels limit their scope or prejudice their ability to deliver their service. If an audit committee receives such a report then it needs to consider the consequences:

- Less reliance can be placed on the annual internal audit opinion on the adequacy of the control environment. This is a key source of assurance for the annual governance statement.
- The external auditors may not be able to rely on internal audit work, which could result in a higher audit fee.
- Internal audit's ability to support organisational improvement may be restricted. This may be hard to measure, but an effective internal audit service makes a significant contribution to the achievement of organisational objectives.

A recent Better Governance Forum guide 'Effective Internal Audit' includes a self-assessment to identify how internal audit supports the goals of an organisation.

[http://www.cipfanetworks.net/governance/tool\\_finder\\_eia/default.asp](http://www.cipfanetworks.net/governance/tool_finder_eia/default.asp)



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