Audit Scotland Report: Report on a Significant Fraud – Dundee City Council (Audit Scotland, March 2018)

Report by: Gary Fairley, Head of Finance and Integrated Service Support

1   Purpose of the Report

To provide Audit Committee with a summary of the Audit Scotland's 'Report on a Significant Fraud – Dundee City Council' and the council's position in relation to the report's findings. Link to the full report here:

http://www.audit-scotland.gov.uk/report/201617-audit-of-dundee-city-council-report-on-a-significant-fraud

2   Background

The Audit Scotland 2016/17 Audit of Dundee City Council report refers to a significant fraud perpetrated against Dundee City Council. The fraud was complex and resulted in a long-term employee embezzling £1.065 million from the council between August 2009 and May 2016. The report was submitted under section 102(1) of the Local Government (Scotland) Act 1973.

The report highlighted how the fraud was perpetrated and the weaknesses in the council's control systems.

3   The Accounts Commissions Findings

The Accounts Commission, in their role of providing assurance to the public about councils' governance and their custodianship of public money, underline the lessons to be learned by every council from this matter. Councils must ensure that fundamental internal controls are in place and working effectively. Such controls include appropriately segregating duties of those involved in managing controls, ensuring systems reconciliations are carried out, accurate documenting of procedures, and budget monitoring.

It is management's responsibility for ensuring that such arrangements are in place and thus help assure elected members and the public that risks are being identified and managed effectively. The Accounts Commission expect a council's external auditor to review such procedures and make recommendations where weaknesses are identified. Management are expected to act upon and apply recommendations from both external and internal auditors to address potential weaknesses and risks.

The wider lesson from this incident, for other councils to consider, is the importance of key internal controls. These are documented in Appendix 3 of the report together with an update on the Midlothian position.

4   **Lessons for Other Councils**

Audit Scotland noted in the report on the 2016/17 Audit of Dundee City Council that whilst the fraud was complex, weaknesses in the council's key internal controls, facilitated the fraud and meant that it was not detected for some time. Councils should consider whether the following fundamental internal controls are operating effectively:

- **Segregation of duties:** ensuring access to systems are restricted to appropriate levels (to negate the possibility of individuals processing transactions all the way through the payments process).

- **Reconciliations:** ensuring feeder systems are effectively reconciled to other systems (e.g. general ledger); using third party information (supplier's statements) and reconciling with payment systems.

- **System documentation**: system documentation should be maintained which details key controls to be carried out by staff to prevent fraud or error.

- **Budget monitoring:** budget monitoring should be at a level that would allow budget holders to identify anomalous payments at an early stage.

The 2018/19 Internal Audit Plan agreed by the Audit Committee in March 2018 contains planned reviews of Electronic Payments Systems (Review of security and authorisation controls, including segregation of duties), ICT Security Controls (Assess the adequacy of physical access and environmental controls to ICT equipment, software and data to prevent unauthorised access / damage, including 3rd party access and PSN compliance), and Revenue Financial Budget Monitoring (Assess the review, scrutiny and challenge on revenue financial budget monitoring reports by elected members) to provide independent and objective assurance to Management and Members around the control environments in these areas.

Currently, there are five interfaces/extracts from third party systems to the Council Finance system or direct to BACS to facilitate payments:

Interface/Extract From	Interface/Extract To	Purpose	2017-18 No.	2017-18 Value
Social Care Case Management (Mosaic)	Finance System (Integra)	Payment of suppliers	41,778	£38.02M
Council Tax (Open Revenues)	Finance System	Council Tax refunds	140	£55,416
Council Tax (Open Revenues)	BACS	Council Tax refunds	1,522	£431,578
Education Management System (SEEMiS)	BACS	Education Maintenance Allowance (EMA)	5,847	£206,910
Education Management System (SEEMiS)	BACS	Clothing Grants	4,761	£120,260

Staff in Finance, Digital Services and Business Services have reviewed current processes and procedures in order to learn lessons from events at Dundee City Council and strengthen existing controls.

Mosaic to Integra

Files are exported from the Social Care Case Management system (Mosaic) and imported to the Finance system (Integra) via automated scheduled tasks.

A report is produced by Business Services staff from Mosaic and is passed to the Payments Team, who match it to the Integra Interface File Report, checking the total number and total value of transactions.

Payments Team produce the payment run (twice weekly) and BACS files are generated.

Finance staff run an exception report against the BACS file to check for any payments over £10,000 or if there are more than one payment to the same bank account. If any exceptions are highlighted the report is passed back to a member of the Payments Team (always someone other than the person who originally produced the payment run in the Finance system) for them to validate.

The exception report is signed off to validate any such transactions.

Strengths	Weaknesses
Control totals between the two systems are checked via separate reports.	No formal record of control totals being checked.
Clear segregation of duties in place between staff preparing and making payments.	Control report from Mosaic not filed (although can be re-produced)
Separate process in place to authorise payments in Mosaic.	Lack of business process procedure documentation
Automatic export from Mosaic.	
Automatic import to Integra.	
Exception reports run against BACS file.	

Actions

- Creation of E-Form to formally record control checks and attach control reports from both Integra and Mosaic.
- Draft procedure documentation to include process mapping flows and clear roles and responsibilities for all staff involved.

Open Revenues to Integra

Where no bank details are held for the payer, the system automation tool extracts a file and places it in a location and loaded into Integra. A report is then produced from OR and passed to Creditors team to match against the Integra import report.

Any transactions then form part of the twice weekly payment runs and individuals are paid by cheque.

Strengths	Weaknesses
Control totals between the two systems are checked via separate reports.	No formal record of control totals being checked.
Reports are scanned and filed.	Lack of business process procedure documentation.
Clear segregation of duties in place between staff preparing and making payments.	
Automatic extract of file from OR.	
Automatic import to Integra	

Actions

- Creation of E-Form to formally record control checks and attach control reports from both Integra and Mosaic.
- Draft procedure documentation to include process mapping flows and clear roles and responsibilities for all staff involved.

Open Revenues to BACS

Files are automatically extracted from the Council Tax system and transferred to the secure BACS file location.

Finance staff check the control reports from the Council Tax system against the import file in the Finance system to ensure that the number of transactions and total value are identical.

Finance staff run an exception report against the BACS file that highlights any single payment over £500 or if there are more than one payment to the same bank account. If any exceptions are highlighted the report is passed back to a member of Business Applications (always someone other than the person who originally ran the file).

The exception report is signed off to validate any such transactions. Finance staff scan the control and exception reports to maintain the audit trail.

Strengths	Weaknesses
Control totals between the two systems are checked via separate reports.	
Clear segregation of duties in place between staff preparing and making payments.	
Reports are scanned and filed.	
Exception reports run against BACS file.	

Actions

None.

SEEMiS to BACS – Education Maintenance Allowance & Clothing Grants

Business Services staff generate the payment run every two weeks within SEEMiS. This then has to be authorised by another user.

SEEMIS generate a BACS file overnight – this file is stored on a secure FTP site.

Business Services staff download the BACS file (read only access) and stores it in a secure location on the council's network. The file is picked up by finance staff and transferred to the secure BACS file store.

Finance staff do not process the file until they has received a signed off BACS Transmission Control form from Business Services. This form is approved by a manager/supervisor in Business Services

Finance staff run an exception report against the BACS file that highlights any single payment over £1000 for EMA's and £500 for Clothing Grants. Finance staff also check if there is more than one payment to the same bank account. If any exceptions are highlighted the report is passed back to a member of Business Services.

The exception report is signed off to validate any such transactions. Finance staff scan the control and exception reports to maintain the audit trail.

Strengths	Weaknesses
Check and authorisation of BACS Transmission Control Form.	Procedure documentation is very basic.
Clear segregation of duties in place between staff preparing and making payments.	
Reports are scanned and filed.	
Exception reports run against BACS file.	

Actions

- Draft procedure documentation to include process mapping flows and clear roles and responsibilities for all staff involved.

BACS Files

There is clear segregation of duties within Digital Services between access to BACS Files and access to applications and data. Staff who have access to BACS files do not have access to the applications and vice versa.

For Mosaic and Open Revenues, BACS Files are automatically transferred from the application folder to a secure BACS file store. This routine is run every minute of every day.

Finance staff only have the ability to move files, they cannot change the content of the file once it is located in the secure BACS file store.

Digital Services maintain documentation detailing BACS file security and procedure documentation that details how each interface file works and how subsequent BACS files are processed.

Exception reports are run prior to the processing of every BACS file (including direct debit collection) and are checked and validated by Finance and Business Services staff.

5   Report Implications

5.1   Resource
There are no additional resource implications.

5.2   Risk
Whilst there are no additional direct risks associated with this report, the Audit Scotland Report, does ask members to consider the wider scrutiny and performance management and risk elements associated with their role.

5.3   Single Midlothian Plan
Themes addressed in this report:

- ☐ Community safety
- ☐ Adult health, care and housing
- ☐ Getting it right for every Midlothian child
- ☐ Improving opportunities in Midlothian
- ☐ Sustainable growth
- ☒ Business transformation and Best Value
- ☐ None of the above

5.4   Key Priorities within Single Midlothian Plan
This report does not directly impact actions and plans relating to key priorities within the Single Midlothian Plan.

5.5   Impact on Performance and Outcomes
The report does not directly impact Midlothian Council's and wider partners performance and outcomes but it does stress the need to ensure consideration is given to the wider strategic planning and objectives as part of the council's response to Audit Scotland's finding noted in their report.

5.6   Adopting a Preventative Approach
This report does not directly impact actions and plans in place to adopt a preventative approach.

5.7   Involving Communities and Other Stakeholders
This report does not directly relate to involving communities.

5.8   Ensuring Equalities
This report does not recommend any change to policy or practice and therefore does not require and Equalities Impact Assessment.

5.9   Supporting Sustainable Development
The recommendations in this report support Midlothian Council's position in relation to Audit Scotland's findings in the 2016/17 Audit of Dundee City Council – a report of Significant Fraud (March 2018).

5.10 IT Issues
There are no IT issues arising from this report at this time.

6   Recommendations
The Committee is asked to note the Audit Scotland report and the position of Midlothian Council in relation to the report's recommendations.

Date: 28 May 2018

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Background Papers:

2016/17 Audit of Dundee City Council – a report of Significant Fraud (March 2018)