Measuring Fraud in Overseas Aid: Options and Method

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Acronyms used in Report

ACFE	**Association of Certified Fraud Examiners**
ADB	**Asian Development Bank**
AfDB	**African Development Bank**
AML	**Anti-Money Laundering**
ASP	**Annual Statement of Progress**
AUD	**Australian dollars**
AusAID	**Australian Government Agency for International Aid**
CAFOD	**Catholic Overseas Development Agency**
CIDA	**Canadian International Development Agency**
CIPFA	**Chartered Institute of Public Finance and Accountancy**
CSO	**Civil Society Organisation**
DFID	**Department for International Development**
DWP	**Department of Work and Pensions**
EU	**European Union**
FAL	**Fraud amount Level**
FFL	**Fraud Frequency Level**
FLM	**Fraud Loss Measurement Exercise**
FRA	**Fiduciary Risk Assessment**
FrR	**Fraud Rate**
FTI	**Fast Track Initiative**
GDP	**Gross Domestic Product**
GF	**Global Fund**
HIPC	**(IMF's) Heavily Indebted Poor Countries Initiative**
IFI	**International Financial Institutions**
IMF	**International Monetary Fund**
IPIA	**USA Improper Payments Information Act 2002**
IrR	**Irregularity Rate**
IRR	**Internal Rate of Return**
Medicare	**USA Government Health Agency**
MDG	**Millennium Development Goal**
MOU	**Memorandum of Understanding**
NFA	**National Fraud Agency**
NGO	**Non-Government Organisation**
OAI	**Office of Audit and Investigation**
OECD	**Organisation for Economic Cooperation and Development**
OLAF	**European Anti-Fraud Office**
PAC	**UK Parliament Public Accounts Committee**
PEFA	**Public Expenditure and Financial Accountability**
PETS	**Public Expenditure Tracking Survey**
PFM	**Public Financial Management**
QSDS	**Quantitative Service Delivery Survey**
UNCAC	**United Nations Convention Against Corruption**
UNDP	**United Nations Development Programme**
USAID	**USA Government Agency for International Aid**
WB	**World Bank**

Executive Summary

This report seeks to identify and select an appropriate methodology to measure fraud losses in the different modalities of aid. It explores the experience of other countries, donors and multilateral bodies in measuring fraud in overseas aid and discovers little evidence that bilateral donors, multilateral agencies or UK NGOs use Fraud Loss Measurement Techniques (FLM) to assess fraud levels in their overseas aid budgets.

Some governments and multilateral agencies find it useful to have large sampling exercises to collect measures of wider losses due to what they call 'Improper Payments' or some similar term. Reported figures vary widely from organisation to organisation and over time: e.g. the total estimated Improper Payments rate for USAID was reported as 0.85% in 2008 and 0.28% for 2009; but the estimated financial impact of irregularities on the budget of the European Anti Fraud Office OLAF rose from 1.13% in 2009 to 1.27% 2010.

FLM-type exercises are used by government agencies such as the DWP, HMRC, the NHS and Medicare in the US. Again there is considerable variation between agencies and types of expenditure: the DWP estimated fraud rate varied from 0.0% for pensions to 4.1% for jobseekers allowance; the HMRC estimated a total 'direct tax gap' for 2009 at 5.8%; a recent NHS study highlighted a fraud loss rate of 4.7% for a medical locum agency's invoicing: and the US Medicare reported 7.6% 'Improper Payments' in 2009.

This report examines the potential for FLM exercises applied to the complex and challenging environment of overseas aid and aid modalities. It shows that FLM approaches, being rare in this context, would be difficult and expensive to apply to a bilateral donor **complete budget**. However, the report argues that there are elements of the a bilateral budget where FLM can be undertaken and with the development of fraud resilience checks and a fraud loss model much greater understanding of the risk of fraud in different contexts can be gauged.

As a result the report concludes on the need to:

- Recognise that FLM and the broader development of counter fraud capacity **are a form of aid**.
- Reject attempts to measure **total fraud in a 'super measure' on all the bilateral donor budget** as this is too complex and expensive to achieve.
- **Seek to use FLM to measure fraud** where this is practicable. Work should be focussed upon: the bilateral donor Administration, Direct Purchasing, Developing Countries' government departments and NGOs receiving aid from the donor.
- **Carry out further work to**: develop resilience checks for the overseas aid fraud context and to create models for predicting range of likely fraud losses.

The report also notes the need for **a political lead from the top of the bilateral aid donor** that enhancing the resilience to fraud should be a condition of aid to governments and

international agencies and that multilateral organisations should also move towards **enhancing the resilience to fraud** as a condition of their aid to countries and to NGOs.

The report makes the following recommendations that Bilateral aid agencies:

1. Consider FLM and the broader development of counter fraud capacity as a form of aid.
2. Reject attempts to measure total fraud in its budget as this is too complex and expensive to achieve.
3. Seek to use FLM to measure fraud. These should be focussed upon:
    - Administration;
    - Direct Purchasing;
    - Countries' government departments and NGOs receiving aid (number depending upon budget).
4. Carry out further work to:
    - Develop resilience check for overseas aid fraud context;
    - Create model for predicting range of likely fraud losses.

1. Introduction

This report will start by exploring the experience of other countries and multilateral bodies in measuring fraud in aid. The report will also investigate the methods used amongst other public bodies. The report will then move on to the challenges of measuring fraud in bilateral aid agencies, using FLM, before considering some of the methodologies which were ruled out. The report will then end with the preferred methodology followed with options for fraud loss measurement in bilateral agencies. However, before these issues are considered it is important to consider what is meant by fraud and corruption and the methods used for this report.

The report was commissioned by the Department for Internal Development (DFID) as part of its work on the identification and selection of an appropriate methodology and technique to measure fraud losses in different modalities of aid to developing countries on the basis of a data produced by statistically valid and accurate exercise. The brief also sought the research team to explore the experience of measurement of fraud in overseas aid in other countries and to examine best practice in the UK government for measuring fraud.

2. Definitions and Methods

Before the methods used to produce this report are discussed it is first important to define what is meant by fraud and corruption. Many commentators and reports lump 'fraud and corruption' together and some talk of corruption, but also include fraud. The definition is not only important for a clear conceptual framework, but because the measurement of fraud and corruption pose very different challenges.[1] Corruption is also a very broad covering a wide range of behaviours. The Asian Development Bank defines corruption as:

> … behaviour on the part of officials in the public and private sectors, in which they improperly and unlawfully enrich themselves and/or those close to them, or induce others to do so, by misusing the position in which they are placed.[2]

The essence of corruption is the abuse of a position for gain. There is much corruption – which although bad – may have little or no impact on the funds released. For example if a corrupt public official uses his/her position to ensure a contract to deliver services as part of an aid project goes to the supplier which has paid him/her off. This might mean the contract is delivered at a lower cost (i.e. the corrupt official tips off the favoured bidder with the price of the lowest bidder). An official who takes bribes to employ a specific person may also not mean any actual financial loss. Similarly a politician might spend aid as it was supposed to, but that might be done in their own constituency, for their own tribe, political

[1] See Samford, C., Shacklock, A., Connors, C. and Galtung, F. (Eds) (2006) *Measuring Corruption*. Aldershot: Ashgate.
[2] Asian Development Bank (n.d.) *Definitions of Corruption*. Retrieved 5 December 2011 from http://www.adb.org/documents/policies/anticorruption/anticorrupt300.asp

area etc. Technically (unless there are provisions for where it should be spent) this would not be fraud, but would be corruption.

However, corruption by an official could also mean losses to aid funds too, which could also be classified as fraud. For example if a corrupt official used funds given to his/her government to build a hospital to build a palace, that is an example of corruption and fraud.

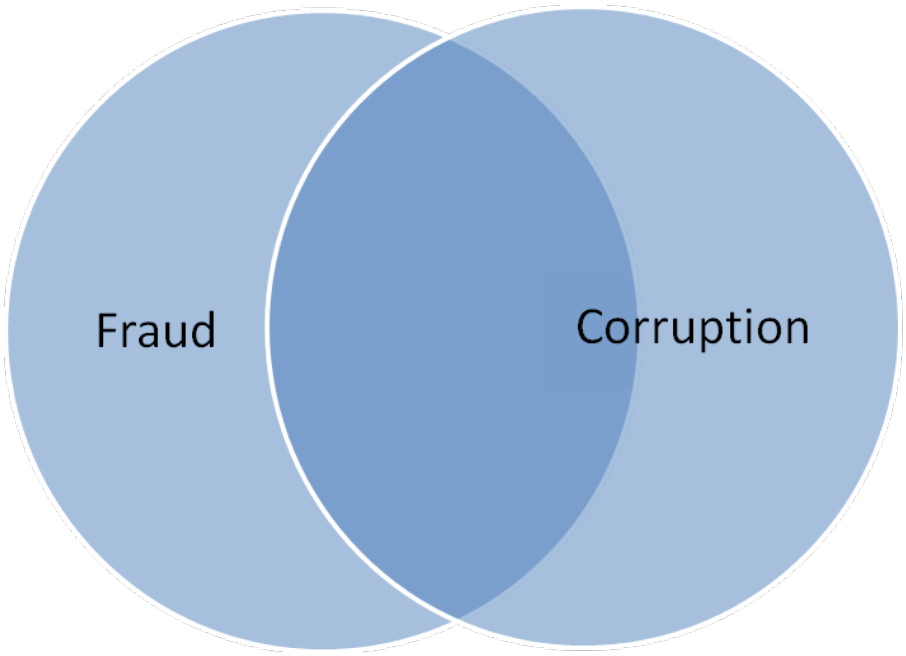
England and Wales is unique in codifying the offence of fraud with the passage of the Fraud Act 2006.[3] This sets out a number of ways in which fraud can be committed, to which aid type frauds are added:

- Fraud by False Representation (this could cover the submission of false invoices for payment).
- Fraud by Failing to Disclose information (this could be a contractor is paid to treat 1000 children, but only treats 700 and does not disclose this to the funder).
- Fraud by Abuse of Position (this is where a person in a position of trust abuses their position such as an official diverting funds to their own personal account).

There are many examples of fraud by those in positions in trust, which could also be described as corruption. There are also lots of acts of fraud which are committed by those against governments, NGOs etc who are not in positions of trust. A contractor who decides to inflate invoices or invoices in full for unfulfilled contracted services is not committing corruption. It is therefore better to consider fraud and corruption as two sets of partially overlapping criminal behaviours.

[3] See, Farrell, Yeo, N, Ladenburg, G. (2007) *Blackstone's Guide to the Fraud Act 2006*. Oxford: Oxford University Press.

Figure 1. Fraud and corruption overlap



This report will focus upon the measurement of fraud (which covers some aspects of corruption) as this was the terms of reference for this report. Thus, whenever reference is made to fraud in this report it will also cover some aspects of corruption. Reference will also be made to corruption specifically when the broader range of deviance is considered.

It is also important to note the concept of error as fraud and error are often 'lumped' together too. Error can be defined as:

> …. where inaccurate or incomplete information is provided, or incorrect processing of information is made that has a material outcome, such as the incorrect amount is paid, but where there is no suggestion of fraudulent intent.
>
> Error can be made by an official or any third party outside of government with whom there is a financial relationship of any kind.[4]

It is important to cover both fraud and error because they both involve financial loss to an organisation and FLM exercises identify them both. It is, however, important to distinguish between both, because the solutions for dealing with them are different.

It is also important to note early on in this report what is meant by FLM. This is an assessment of a statistically valid sample of transactions within a given population to determine whether they are fraudulent, an error or correct. From this assessment it is then possible to extrapolate to a given statistical level of confidence and within a range the extent of fraud and error. This is usually presented as a Fraud Frequency Rate (FFR), which is

[4] Unclassified document 20110930 Draft CAS Fraud Error Debt Definition v0 4 p9 supplied by DFID.

the number of transactions which are fraudulent or errors and the Fraud Loss Rate (FLR), which is monetary value of losses.

3. What Other Countries Do?

The research team sought to identify what countries do to measure fraud in overseas aid. There was very little evidence of the use of FLM and in many countries considered there was not even published detected statistics. The only example of a FLM approach was found in the USA. USAid is required to report improper payment information under the Improper Payments Information Act of 2002 (IPIA) and recovery auditing information under section 831 of the Recovery Auditing Act. The latest figures for Improper Payments come from the USAID annual reports.[5] Their standing procedures require them to *'Obtain a statistically valid estimate of the annual amount of improper payments in programs and activities.'* The total estimated Improper Payments rate for 2008 was reported as **0.85%** and for 2009 as **0.28%.** This varied considerably according to the payment stream: in 2009 from as low as **0.00%** for grants associated with combating weapons of mass destruction **to 0.91%** for Trade and Investment grants and 0.82% for Environmental programmes. The reason for the drop from 2008 to 2009 seems to be the procedures put in place to counter such payments[6], although a small amount of the difference could be because of the statistical sampling procedures used.

These estimates of Improper Payments are calculated from close scrutiny of a statistically valid sample of programmes, which seems to be a sensible approach given the amount of money available for such data collection and audit. An assumption is made that the improper payment percentage will fall further, to **0.20%, 0.12% and 0.04%** in future years. No explanation is given as to why this rate of fall is assumed or why it is a linear fall for the next three years. A more likely scenario is that the procedures now in place will continue to reduce the Improper payments rate but only to an 'irreducible minimum' percentage, which is unlikely to be **as low as 0.04%.**

In Australia there was no evidence of FLM, but statistics were published on detected fraud losses. Australia is a large giver of aid through AusAID. Its approach to Fraud is laid out in its Fraud Policy Statement and figures are given in its annual Fraud Fact Sheet.[7] During 2010-11 125 cases of alleged, suspected or detected fraud were reported to AusAID. In addition a further 24 potential instances were reported during the year but were found not to have involved fraud or not to have involved AusAID. It is likely that, as the remaining active cases

[5]USAID annual reports can be found at http://www.usaid.gov/policy/afr08/usaidfy08afr_lowres_508.pdf: and http://www.usaid.gov/policy/afr09/USAIDFY2009AFR.pdf

[6] The introduction to the 2009 report claims that 'USAID is committed to minimizing the risk of making erroneous or improper payments to contractors, grantees, and customers. This year, we revamped our approach by implementing a comprehensive annual internal control review and substantive testing of payments program in accordance with the Improper Payments Information Act (IPIA) and OMB Circular A-123 guidance. We also have an aggressive system in place to monitor payments. This is especially true for high profile programs, those associated with man-made disasters and reconstruction and stabilization efforts.'

[7] See *Fraud control at AusAID* http://www.ausaid.gov.au/publications/pubout.cfm?ID=7618_6876_7414_705_9251&Type=

are further investigated some additional cases will be found not to have involved fraud and/or AusAID. AusAID estimates that the amount involved in the 125 2010-11 cases is AUS $1.6m. Of this amount, AUD $400,000 had been recovered or prevented from being lost and the potential net loss to AusAID is therefore estimated to be approximately AUD $1.26m. This represents **0.028%** of the $4.498 billion appropriated to AusAID in 2010-11, a percentage consistent with previous years (**0.02%**).

The research team also sought information on the Republic of Ireland, Belgium, Canada, France and Germany. There was no evidence of any FLM or published statistics on the detected losses from fraud.

4. What Multilateral Bodies Do?

There is little to no evidence yet uncovered that multilateral agencies use FLM techniques. However, there are extensive efforts placed into minimizing fraud associated with grants or aid, particularly to developing countries. Three particular areas stand out:

a. Most agencies have a department or part of the organisation that has the reduction of Fraud, etc, as part of its remit.
b. Most agencies have a mechanism for collecting information on detected or suspected fraud and other irregularities, variously defined.
c. Some agencies have set up monitoring of specific indicators of fraud and irregularities, as a means of reporting back to senior management and of judging whether there is a trend in such activities. These divide into two types: statistical sampling of a number of cases and analysis of reported or suspected fraud cases. The first of these usually gives a much higher measure of fraud than does the second, which is constrained by the resources which are available to investigate the reported frauds.

The following section considers some of the multilateral bodies, beginning with the EU. The biggest single category of EU fraud is the diversion of funds from the EU's Structural Funds for regional and social development. Cigarette-smuggling is another major target. The third category is irregularities in agricultural expenditure. From the total EU budget of over €100 billion as much as 1% ends up in the wrong pockets.

The EU makes an annual statistical evaluation[8] of suspected or established frauds and expenditure type and 'irregularities' [9] by collating member states' reports. This is published

[8]See *Report from the Commission on the protection of the EU's financial interests and the fight against fraud* at http://ec.europa.eu/anti_fraud/reports/commission/2010/Ann2-EN.pdf

[9] The main 'irregularities' reported by member States are: Not eligible expenditure: Infringement of rules concerned with public procurement: Missing or incomplete supporting documents: Failure to fulfil commitments entered into: Failure to respect other regulations / contracts provisions: Action not carried out in accordance with rules.

by year, by member state. No Fraud Loss measurement exercises are available but the following indicators are used:

> Irregularity Rate defined as *the total financial amounts affected by irregularity divided by the total payments/expenditure made*. (IrR)
>
> Fraud rate defined as *the total financial amount affected by suspected and established fraud divided by total payments/expenditure made* (FrR)
>
> Fraud Frequency level defined as *the total number of cases of suspected and established fraud divided by the total number of reported irregularities* (FFL)
>
> Fraud amount level defined as *the total financial amount affected by suspected and established fraud divided by the total financial amount affected by irregularities* (FAL)

These procedures have been influenced by various reports of the EU Court of Auditors[10]. The CofA has no legal powers of its own but when they discover fraud or irregularities they inform OLAF, the European Anti-Fraud Office. In their most recent report they have criticized OLAF for the way it measures fraud and made recommendations for future indicators. However, these are entirely indicators associated with the action taken once irregularities and frauds have been discovered: such as the actual amounts recovered against the potential amounts that could be recovered. No suggestions have been made for FLM exercises to be conducted.

In summary, the irregularities notified per sector in 2010 in the statistical analysis were:

a. Total Expenditure: The number of irregularities reported increased to 10,332 in 2010 compared with 7,769 in 2009. The estimated financial impact of irregularities **rose to 1.27%** of total allocations in 2010 compared with **1.13%** in 2009.
b. Agriculture: The number of irregularities reported was 1,825 in 2010 and the financial impact was **0.23%** of the total allocations. Suspected fraud was **0.02%.** The variation across member states was from **around 0.2% to 5.0%.** €175 million was recovered (42%.)
c. Cohesion Policy: The number of irregularities reported was 7,062 in 2010. The financial impact was **3.15% of the total**. In 2010, €611 million was recovered (67%).
d. Pre-accession funds: The number of irregularities reported was 424 in 2010 and the financial impact was **5.26% of the total**. €14 million was recovered (30%).
e. Direct Expenditure: The number of irregularities reported was 1,021 in 2010 and the financial impact **was 0.27%** of the total. €25 million was recovered (59%).

[10] See Special Report 2/2011 concerning the 'Follow-up of Special report No 1/2005 concerning the Management of the European Anti-Fraud Office, OLAF.
http://eca.europa.eu/portal/pls/portal/docs/1/7670727.PDF

f. Own Resources: The number of irregularities reported was 4,744 in 2010 and the financial impact **1.88% of the total**. The money recovered was 46% of the total.

The Global Fund is one of the largest financiers of Health Care throughout the world. It works a lot in fragile states and to mitigate the facts of poor local control, its systems and processes institute strict controls over the allocation, management, and oversight of grant funds. The Global Fund has uncovered and published irregularities of at least $US 44m (2002-2008): Fraud - $US 11m: Unsupported Grants - $US 15m.: Ineligible Grants - $US 13m: Unaccounted Income/ Drugs - $US 2.9m: Other - $US 1.7m. However, recent press reports[11] quote an even higher (unpublished) figure of $55m. No percentages are available globally because only 1 in 7 of GF's programmes have been examined and the sample is not statistically valid.

However, some of these programmes have proved to be subject to very high levels of irregularities and fraud: up to 67% reported in one case (Mauretania anti-AIDS programme). Some commentators have criticised the GF: others have said that it has the strictest anti-fraud processes of all multilateral bodies and recovers a very high proportion of the irregularities discovered. The bad publicity has led to several donors to GF, e.g. the EU and Japan, holding back money until the position is clarified. The investigations seem to consist of straight-forward audits, called 'Fraud Probes' rather than anything like a FLM Exercise.

Whatever the extent of Fraud and Irregularities the Global Fund has been extremely open with the findings of the large number of audits and inspections that have taken place over the last couple of years.[12] Amounts of suspected frauds, the type of incident and the people involved have been published on their web site, partly as an aid to recovering money and partly in an attempt to shame the people and organisations involved in the frauds and irregularities.

Other multilateral bodies considered included the UNDP, where no evidence of FLM or published detected statistics was found. The World Bank produces a range of indicators such as PEFA and PETS (see later in report). The World Bank has an extensive system of audits and fraud reporting and a system of sanctions against companies, governments and individuals who have proven involvement in fraud and corruption. In particular companies can be debarred from future work with the World Bank and programmes of aid to developing countries can be put in abeyance if the World Bank feels that individuals, organizations or systems in that country are likely to lead to the improper diversion of money. Such lists are published openly. No World Bank statistics have been found that estimate fraud. Rather the Bank is concerned with individual cases and with procedures for minimizing fraud, allowing fraud to be reported and for sanctions to be taken against those found to have been involved.

[11] http://www.google.com/hostednews/ap/article/ALeqM5hAoAlWu6pD9b5i66zFDCF_QQWM1g?docId=04296fbd6f874ee991df7235ef1350dc gives an Associated Press report (Oct 2011)

[12] See *Global report Audits and investigations* at http://www.theglobalfund.org/en/oig/reports/

The IMF concentrates its efforts on attempting to improve the anti-fraud systems in place in individual countries. It does this by issuing guidelines on best practice and by offering technical assistance in the form of workshops and visiting experts. A good number of statistics are published, both on countries' financial systems and on indicators of financial probity. However, no figures of fraud have been discovered, either reported or estimated, or evidence that fraud loss measurements have been undertaken.

Before making grants and loans, the African Development Bank has a system of fiduciary assessment of individual countries and programmes that is based upon a series of indicators, including, but somewhat wider than, the PEFA indicators that are used by DFID. They use a Data Portal of governance indicators which is currently being updated to include a battery of indicators contained in their new African Governance Outlook, a regular reference publication that will include all the material necessary to judge the financial probity of a country[13]. After the grant is made, there are anti-fraud procedures allowing for fraud reporting to the Bank. No routine statistics seem to be published on reported fraud and no FLM exercises seem to be conducted.

5. What UK Government Departments Do?

The National Fraud Authority's Annual Fraud Indicator[14] provides a good snapshot of the variety of methods been used within the public sector to measure fraud. The gold standard are FLM exercises and the only departments which undertake these regularly are: Department for Work and Pensions (DWP), HM Revenue and Customs, and the NHS. No government department produces a global figure for fraud losses using FLM. Where there is an attempt to do this it is usually based upon multiple measures, sometimes of different types.

The DWP invests a great deal of time in measuring fraud losses. It conducts FLM exercises regularly across a range of benefits it issues, which enables it to estimate a global figure of fraud losses, which is largely the result of FLM, although the currency for some types of expenditure does vary.

It is also important to note the DWP invests substantial resources in measuring fraud at about £10M per year on fraud measurement. This is split between £0.4M on analytical (statistics) and £9.5M on performance management (actually doing the checks). About £1.5M of that is travel and subsistence of staff doing the checks. Depending upon the programme of measurement there could be between 200 to 300 staff engaged in measurement activity. Annex 1 shows the fraud and error rates vary by benefit from **0.1%** for pensions to **6.5%** for jobseekers allowance. The DWP also distinguish between fraud and

[13] The AFDB Data Portal can be accessed at See http://www.afdb.org/en/knowledge/statistics/data-portal/
[14] NFA (2011) Annual Fraud Indicator. Retrieved on November 21 2011 from http://www.homeoffice.gov.uk/publications/agencies-public-bodies/nfa/annual-fraud-indicator/annual-fraud-indicator-2011?view=Binary

error rates with the fraud alone rate varying from **0.0%** for pensions to **4.1%** for jobseekers allowance. It is also important to note the FLM exercises are not conducted every year for every benefit. For example the last FLM for Disability Living allowance was conducted in the 2004-05 year.

HMRC also invests significantly in accurate measurement mechanisms to determine the 'tax gap'. This is broader than fraud and error and it is defined:

> … as the difference between tax collected and the tax that should be collected (the theoretical liability). The theoretical tax liability represents the tax that would be paid if all individuals and companies complied with both the letter of the law and HMRC's interpretation of the intention of Parliament in setting law (referred to as the spirit of the law). The tax gap estimate is net of the Department's compliance activities. An equivalent way of defining the tax gap is the tax that is lost through non-payment, use of avoidance schemes, interpretation of tax effect of complex transactions, error, failure to take reasonable care, evasion, the hidden economy and organised criminal attack (HMRC, 2011: 5).

The analysis uses a variety of methodologies, some of which are based upon FLM approaches (largely direct taxes). Annex 2 lists some of the findings for the 'tax gap' across a range of taxes. For direct taxes where these FLM type methods are used the gap for 2009-10 ranged from £0.3 billion in 'Non-declaration of income and capital gains by individuals who do not receive returns' to £5.8 billion for 'inaccurate self-assessment returns from individuals (excluding large partnerships) for business taxpapers'. The total direct tax gap is estimated at **5.8%.** Other methods of measurement are also used based upon various techniques, such as economic activity based approaches for example. HMRC were unable to quantify actual cost of measurement because the staff involved are part of general enforcement activities. However, they were able to confirm it is likely to involve hundreds of staff at any time.

The NHS has also made use of FLM in the past for a number of areas of expenditure. These have included: patient prescription payments, patient optical fraud, procurement, and dental and optical contractor fraud to name most. NHS Protect, which undertakes this work (bar Scotland) has undergone significant organisational change and the resource dedicated to measurement has moved from a dedicated Risk Measurement Unit, which at its height employed 9 staff, to one person and pools of staff as and when required now. In its most recent performance statistics it has highlighted a FLM related to medical locum agency invoicing with a fraud loss rate of **4.7%**.[15]

[15] NHS Protect (2011) NHS CFS Performance Report 10/11. Retrieved on November 21 from http://www.nhsbsa.nhs.uk/Documents/CounterFraud/PERFORMANCE_REPORT.pdf

Beyond these government departments fraud losses are rarely measured using FLM. Rather there is a focus upon detected frauds. Indeed the Counter Fraud Task force has sought to encourage government departments to provide quarterly reports of fraud losses, amongst other measures and many are providing nil returns for fraud losses, which would seem highly unlikely given the sums of money involved and the numbers of transactions.[16] One interesting finding from the Annual Fraud Indicator, is the estimate of fraud losses in grants. After removing social security expenditure there is £52 billion in grant aid expenditure. During 2009-10 the NFA estimate that between **1%** and **3.5%** is lost to fraud based upon a variety of fraud measurement work undertaken by the DWP, HMRC, the NHS Counter Fraud Service and the Student Loans Company.[17]

6. What UK Charities Do?

In the 2011 fraud indicator the National Fraud Authority reported on research to seek to estimate the extent of fraud in charities. They conducted a survey of over 1000 charities and asked the respondent to estimate the fraud losses as a percentage of annual turnover. They were also asked the degree of confidence in this estimate. The NFA only used those (around 500) who were very sure or sure and from that the estimate was **2.4%**, when all levels of confidence were added the figure was over **7%**. The survey did not ask about error. Based upon the previous year the reported fraud losses were £32 million. If that is then used in a ratio of reported losses to the estimated losses the following year £1.3 billion it would give a ratio of **1 to 40.6** for detected to estimated fraud losses. Some of these figures could be useful in seeking to estimate the potential fraud losses in overseas aid.[18] The research team also wrote to the 14 member charities of the Disasters Emergency Committee, with limited responses (See Annex 3 for more detail).

7. To Measure or Not Measure that is the Question?

The first question that seriously needs to be addressed is whether it is worth seeking to accurately measure fraud in overseas aid. As this report will show there are many challenges which would mean any attempt to accurately measure fraud across the whole of a bilateral aid donor and its partner bodies would be likely to be very expensive and time consuming. Indeed, as was earlier illustrated the DWP spends about £10 million on measuring fraud in what is a simpler area to gauge. If this applied to a bilateral, this is resources that could be spent on aid helping people, rather than producing statistical tables. It is also likely that if the results then showed significant leakage to fraud this would likely cause political controversy and public outrage at a time of austerity across the rest of the public sector. Would it not be better to simply carry on with very limited knowledge of detected levels of fraud as the best indicator of levels of fraud and focus upon methods well proven in countering fraud?

[16] Personal Communication.
[17] NFA, op cit, p 25.
[18] NFA, op cit and Personal Communication

The authors believe this would be a short-term solution which would eventually unwind. Scandals would be bound to eventually emerge of frauds in overseas aid which may lead to perceptions that fraud is actually a bigger problem than it is. There is also the imperative to ensure that fraud is reduced to an absolute minimum. There is also the wider duty of trying to help countries who are receiving aid to become better at dealing with fraud and corruption, which ultimately affects the quality of their public services. A central starting point of any counter fraud strategy is, knowing the size and nature of the problem. If this basic question cannot be addressed how is it possible to develop an effective strategy to deal with it? For all these reasons it is worth investing time and resources in gauging the size of the problem. Given FLM exercises are the most accurate means to measure fraud, the question then is, how can FLM be applied to a bilateral aid donor and its partner bodies, if at all? The next section will illustrate some of the general challenges of applying FLM to a bilateral aid donor and its partner bodies.

8. General Challenges of Conducting a FLM

The nature and activities of a bilateral aid donor (and its partner bodies) pose major challenges to conducting FLM. FLM exercises are usually conducted on a sample of a population of comparable transactions. For example payments of the same social security benefit, insurance payments, payroll payments, expenses claims and procurement, to name some of the most common. Bilateral aid agencies pose a number of challenges in this respect because of the significant amount of funding which is passed on to other bodies to spend. As an illustration Table 1 below breaks down the 2010-11 budget into some of the most significant parts.

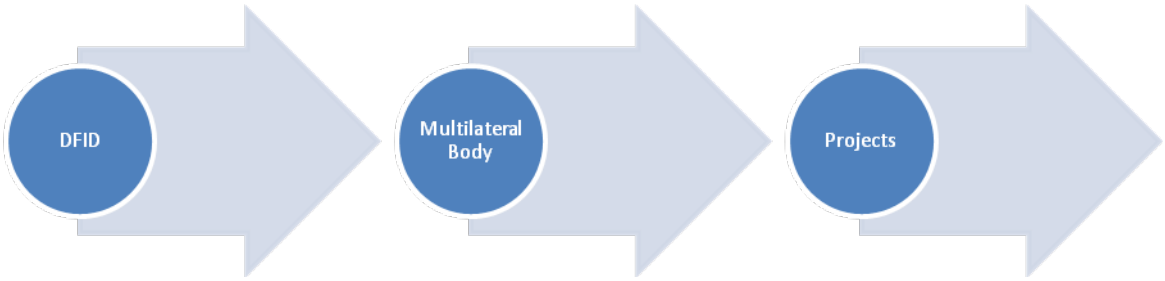
Table 1. DFID Expenditure on Development 2010-11[19]

	Expenditure £thousand	Percentage
DFID Bilateral Programme		
Poverty Reduction Budget Support of which	643671	8.37
General budget support	*360467*	*4.69*
Sector budget support	*283204*	*3.68*
Other Financial Aid[2]	550728	7.16
Technical co-operation	467939	6.09
Bilateral Aid Delivered though a Multilateral Organisation[3]	1465789	19.06
Bilateral Aid Delivered through a NGO of which	626752	8.15
Partnership Programme Agreements	*115347*	*1.5*
Other CSO's	*511405*	*6.65*
Other Bilateral Aid[4]	76009	0.99
Humanitarian assistance	350669	4.56
DIFID debt relief	66460	0.8
Total DFID Bilateral Programme	**4248018**	**55.25**
DFID Multilateral Programme		
European Commission	1268563	16.5
World Bank	926713	12.05
United Nations	355337	4.62
Other Multilateral	671061	8.73
Total DFID Multilateral Programme	**3221673**	**41.9**
Total DFID Programme (excl. Admin)	**7475391**	**97.22**
DFID Administration	219457	2.85
Total DFID Programme	**7689149**	100

[19] DFID (2011) DFID Expenditure on Development 2006/07-2010/11. Retrieved 6 February 2012 from www.**dfid**.gov.uk/Documents/publications1/.../Table%203_P1.xls

In this example, one of the first challenges is that a significant slice of DFID funds, 61%, are delivered through multilateral bodies, either through: 'Bilateral Aid Delivered though a Multilateral Organisation' at 19% or the 'Total DFID Multilateral Programme' at 41.9%. As figure 2 below shows the funding transfers from DFID to the multilateral body then go through to projects. In the multilateral body the funding may go for membership contributions, research, administration costs as well as to fund further projects. The projects may be delivered direct by the multilateral body or it may fund other bodies such as governments, CSOs to undertake work. To complicate matters further some of the projects may be funded by more than one body. The stream of UK funding is therefore lost in the complexity of other multiple funders and the variety of streams that it contributes to.

Figure 2. Multilateral funding pipeline



To use the analogy of the DWP (as they are often used as a model of fraud measurement), it would be like the DWP deciding to outsource welfare payments to a dozen or so charities leaving them with much of the discretion to set payments and eligibility etc and where some of those charities then further sub-contract and then the DWP seeking to gauge fraud amongst them. Unlike the current arrangements where the DWP have common systems in place to undertake a FLM it would be faced with different systems used by charities, different comparators, multiple deliverers, different welfare regimes and the challenge of getting the charities to co-operate. It would be a much more difficult and complex task.

The picture is not any simpler when bilateral aid is considered. Some funds are given to governments for direct either through general budget support or sector budget support. As an example in the 2010-11 budget this accounted for almost 10% of the DFID budget. Essentially a pot of money is given to the government department to spend, usually for a general purpose, such as 'poverty reduction', or 'improving health'. Often this support is

provided alongside other donors both bilateral and multilateral. This may involve expenditure on multiple projects. To therefore trace fraud in funds provided by a bilateral aid agency in such a pipeline would also be incredibly difficult. The government may also be unwilling to facilitate a FLM exercise and the systems in place may also make this difficult. Regarding debt relief this is provided to countries according to the IMF 'Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative.' This involves a complicated assessment of a country according to objective criteria. The actual amount of debt relief is unlikely to be at risk of fraud, that is, a country manipulating data to secure debt relief. However, the debt relief is granted on the expectation that that money is then spent on 'poverty reduction'. Should the government spend the money on arms or luxury palaces, that would be fraudulent expenditure. Therefore there would be scope to measure fraud in this area by assessing government expenditure and assessing whether it has been spent on what was expected.

Another significant slice of money is given to NGOs. Given there is no contractual mechanism to force them to conduct FLM at present they may also decline to participate. Their systems in some countries may also make it difficult to conduct FLM. They are also involved in humanitarian assistance, which also poses challenges.

Discussions with some bilateral aid staff suggested humanitarian assistance is a high risk for fraud, theft and corruption. This is because there is an overriding desire to get aid to the recipients as quickly as possible to save lives. The assessment procedure a bilateral aid agency may use is therefore a much quicker process. Another issue is that if aid, such as blankets, ends up for sale on a market, it is fraud if they were sold by officials, but if the recipients have sold them on, is that fraud? In reality no, but how would one determine this? Some humanitarian aid is food and water and clearly several months later determining whether it all reached those who needed it would be very difficult to determine. Finally much Humanitarian aid is delivered by NGOs, multilateral bodies and governments, so the same issues related to multilateral and bilateral aid above apply. Investigating the fraud losses in aid already delivered in a location which is likely to be fragile would therefore pose challenges.

There is also the more general challenge of fragile states. Some of these do not have appropriate system in place and are in regions with significant security risks which would pose significant barriers to conducting FLM.

Therefore the majority of the a bilateral aid agency budget poses significant challenges and complexities for conducting FLM exercises. Table 2 below summarises these challenges. This report will now seek to address some of these challenges to construct a methodology to measure fraud. It will begin with some of the methods which were ruled out.

Table 2. Summary of Challenges to FLM in Different Modalities of Aid

Aid Modality	**Challenges**
Multilateral Aid	Multiple donors making tracking of bilateral aid agency monies difficult. Fraud often further down pipeline in NGOs and Governments receiving aid. Difficulty of getting multilateral bodies to conduct an FLM.
Bilateral Aid	Where budget support given there are likely to be multiple donors making tracking of bilateral aid agency monies difficult. Governments may not want to conduct FLM. Systems might be weak.
NGO Delivered Aid	NGOs may not agree to FLM.
Humanitarian Aid	Imperative for speedy response to reduce loss of life. Many consumables given which are difficult to trace. Conditions may make the conducting of an FLM very difficult if not impossible. Much of the aid delivered by NGOs and Multilaterals, hence same issues as above.
Aid in Fragile States	Poor systems may make FLM difficult to conduct. Security issues may make FLM difficult to conduct.

9. FLM Methodologies Considered

The next section will consider some of the methodologies which were considered to measure the extent of fraud in overseas aid. The research team started their discussions and thoughts on this challenge to begin with on an 'academic basis' of how in theory fraud could be measured using a FLM approach. This produced two possibilities which were called 'Super FLMs' because they would be unprecedented in size, nothing like these has ever been carried out and they would be substantial pieces of work. For various reasons these were rejected as a means to measure fraud in bilateral aid agency. The next section then outlines the authors preferred approach for a bilateral to develop a basket of measures which use both FLMs and modelling.

10. The 'Super' FLM on Bilateral aid agency Payments

Overall because of the size of the task for this approach, the likely costs, the new methods which would need to be developed and the likely underestimation of fraud, the authors ruled out the 'Super FLM' approach. Nevertheless there would be political benefits for such an exercise as it would produce a global figure and that figure would probably be very low.

To illustrate the arguments we have utilised open source data from DFID to extrapolate a model. DFID is one of the only bilateral agencies which does provide a list of all payments made over £500 (excluding salary payments to DFID staff). In the latest Excel sheet published in September 2011[20] it provides a list of just over 25,000 transactions. Therefore one method for conducting a FLM could be to use a list of transactions such as this. A sample (which would need to be stratified) could then be selected for the 'Super FLM'. The delivery agent conducting the exercise could then investigate those transactions to determine fraud, error or correctness. There would, however, be a number of challenges and caveats to pursuing such a method.

The first challenge of this approach would be the sample. DFID's external expenditure over £500 per transaction for the first 9 months of 2011 was:

25077 transactions
Total paid out £3,739,500,335

269 (1.1%) transactions cover 70% of expenditure, £2,617,227,287
999 (4.0%) transactions cover 90% of expenditure, £3,363,775,054

DFID's external expenditure over £500 per transaction for the first 9 months of 2011 and summarised by recipient.

1937 organisation and recipients
22 (1.1%) of recipients received 70% of funds, £2,632,280,814
99 (5.1%) recipients received 90% of funds, £3,363,694,338

A random sample of, say n=1475, would not reflect the skewed Pareto distribution of transaction values. Therefore the sample would have to be stratified or proportioned to cover high value groups. The high value groups are predominantly multilateral partners which channel the funds to aid delivery organisations and large bilateral recipients. Therefore, assuming no fraud at the DFID / multilateral partner interface and relatively low fraud risks within these partners, the sample would inevitably produce an uninformative, unrepresentative low fraud result. Logically a randomly selected payment to the UN for example, would trigger a FLM on the UN and thence on its fund recipients.

[20] DFID. (2011). *Monthly spend over £500*. Retrieved November 09, 2011, from the DfID website: http://www.dfid.gov.uk/About-us/How-we-measure-progress/DFID-spend/

Though this methodology is possible, it is unfeasible: the costs would be extremely high, impossible to budget and dependent on co-operation with the randomly selected multilateral partner *and* their recipients.

Second most FLMs usually assess similar transactions such as payment of social security benefits, payroll, expense claims or procurement. A random sample of DFID's expenditure would produce a wide diversity in size, nature and complexity of transactions. This would represent a new and expensive form of FLM, never before undertaken. Furthermore those investigating would need to be able to undertake a wide range of checks including a large number overseas. This would increase the costs of the exercise yet further.

The principal technical disadvantage of this approach is that it would be very difficult to adequately investigate many transactions to judge whether they are fraudulent. As discussed above, payments to multilateral bodies would mask the fact that much of the fraud is likely to occur further down the 'pipeline', once the payment has been made to the body. The arrangements for much of the multilateral expenditure are such that at this stage in the pipeline there is likely to be very little fraud. It is unlikely the multilateral body would inflate the payment required, double invoice or some other type of fraud. Consider the largest payment in the September 2011 list, a £130million payment to the EU. This will contribute to a variety of programmes funded by the EU, many delivered by other bodies: CSO and governments as well as the administration costs of the EU. To investigate this one transaction would require a mammoth effort of essentially further FLM exercises. It would also require the support of the EU and other bodies. On the other hand, one could take the view that any fraud involving the £130M whilst under the EU's control is against the EU, *not* against DFID. Therefore the only necessary check is that this payment was correctly made with other appropriate approval.

If all transactions of this nature are included in an FLM, they are likely to produce lots of nil returns for fraud and error. Given that further down the pipeline there is likely to be fraud and error these nil returns would substantially underestimate fraud against funds. An adaptation of this approach could be to remove multilateral budget support and direct government support (which would face similar challenges) and examine a random sample from the remaining transactions. It would produce a more accurate level of fraud and error in these spend areas only, a minor portion of the budget. Furthermore it would still be burdened with the hugely expensive logistical difficulties associated with a random sample across a diverse range of transactional types. It would also require a new type of FLM to be produced, involve substantial resources and would ultimately only produce a partial picture of the levels of fraud.

11. The 'Super' FLM on a bilateral aid agency projects

A variation on the above would be to focus upon the bilateral aid agency project database. To illustrate, DFID publish a list of current projects and values on their website[21]. The schedule includes 3,130 projects of which 1,127 are completed. 1,196 are live and operational worth £35.8B and a further 77 worth £68M are planned. The schedule includes all the funding ambitions of DFID including the large donations to the major international entities such as the UN, EU and IMF. Conducting FLM exercises on projects has merits in that the distribution and use of DFID's funds could be followed and tested for fraud. In essence it would be similar to a Public Expenditure Tracking Survey (PETS), which will be discussed later in this report, but with more focus on distinguishing fraud. However, following the money, like tracing assets for civil recoveries is tortuous, expensive difficult to track through dissimilar systems and methods. Indeed PETS are estimated to cost $50k to $100k per project and the Super FLM exercise would likely to be more.[22]

All aspects of the project would need to be investigated to produce an estimate of the fraud loss in the project as a whole. A larger project would be burdened with the same difficulties as the 'Super FLM' exercise: it would require sampling across a range of non-homogeneous transactional types and, in many cases, severe logistical problems tracing transactions through several jurisdictions. This would again involve a FLM of a type not yet undertaken, a risky proposition. The complexity, likely costs and risks have led the authors to also rule this option out.

12. The Basket Approach

There is no bilateral aid agency, multilateral, NGO or UK government department that currently estimates fraud losses as a whole in their organisation using one method. The two best examples are the DWP and HMRC which use a basket of measures to produce a global measure. Given the complexity of bilateral aid agency delivery model a basket based approach where a variety of methods are used for different types of expenditure would seem the most sensible option. There are essentially 5 financial output modes in expenditure:

- Administration (payroll and purchasing)
- Direct purchasing for aid purposes
- Funding to multilateral bodies
- Funding to governments
- Funding to NGOs

[21] DFID. (2011). *List of DfID projects*. Retrieved November 22, 2011 from the DfID website: http://projects.dfid.gov.uk/

[22] See Reinekka, R. and Smith, N. (n.d.) Public Expenditure Tracking Surveys in Education. Paris: International Institute for Educational Planning. Retrieved 18 December 2011 from http://www.unesco.org/iiep/PDF/pubs/Reinikka.pdf

Below these expenditure modes are illustrated using open source data from DFID. The following sections will outline how a methodology could be created to measure fraud in these different areas of expenditure. It is also important to see it as a starting point which is gradually rolled out and enhanced after pilot studies. There is an analogy to the measurement of crime in general in the UK. The use of recorded crime statistics were well known to under-estimate and hide trends in crime, so a prevalence survey amongst the population was sought. This began with the British Crime Survey in 1982 with around 11000 interviews with members of the public and was periodically repeated throughout the 1980s and 1990s. Now it is carried out on annual basis involving 50000 interviews and is considered the 'gold standard' of crime measurement. Before the proposed methodology is outlined, the important point that FLM can be considered as aid, will be set out.

FLM as Aid

It is important to consider FLM in the context of overseas governments and NGOs receiving aid, as aid in its own right. There can be no doubt that fraud losses in the sums provided by the donor government are a major issue for taxpayers at a time of general austerity. However, fraud losses throughout the fraud pipeline also hurt the people aid is intended for. It deprives them of resources, infra-structure and services. More effectively countering fraud in overseas aid satisfies the donor country taxpayer that money is not been wasted and ensures recipients get all that they should. There is also the additional benefit of creating capacity and approaches to countering fraud that spread beyond the areas of aid expenditure. Countering fraud effectively in countries and NGOs therefore has a wider benefit. Therefore the methodology for FLM for governments and NGOs should not be seen as an additional layer of bureaucracy but as a programme in its own right to develop capacity in measurement and countering fraud which has a wider benefit on the government and society of aid recipients.

Bilateral aid agency Administration

This expenditure mode is largely made up of salaries, other staff costs, office costs etc. One would assume that such administrative fraud and error losses are likely to be lower than other areas of activities. However, it would be relatively easy to contract with an organisation competent in FLM to undertake a FLM on the most significant aspects of expenditure. One has to ask whether the costs of conducting such an exercise would be justifiable when there are other areas of expenditure where the fraud risk is likely to be higher and the need to ascertain the risk more pressing.

However the authors believe there are compelling reasons to conduct such a FLM in a bilateral aid agency. First of all it would provide invaluable data of the extent of fraud in a relatively low risk environment which could be used as a benchmark and for the purposes of

modelling (something to be developed in depth later). Second, it would send out a clear message to the agency staff and its partners that it was serious about fraud. Third, if FLM exercises are going to be mandated and encouraged in other organisations, it needs to set the example by conducting one on itself. The first question many multilateral bodies, NGOs and governments asked to conduct FLM will be: "Do you do it?"

Direct Purchasing for Aid Purposes

There is a risk of fraud in these transactions and there should be FLM conducted upon this expenditure. There are two ways this could be conducted. One would be to list all transactions and then select an appropriate sample and investigate these for fraud. This would involve a number of transactions in other countries, so those conducting the exercise would need to travel to these various locations.

A more efficient method would be to focus upon bilateral aid agency country offices. A sample of country offices could be selected and then a sample drawn from those transactions in the country office to produce the FFR and FLR. This would also aid the wider objective - to be explored later – of producing additional data on a country to aid modelling of fraud losses overall. It would also be useful to assess the UK office direct expenditure to provide a benchmark of the FFR and FLR in what is likely to be comparatively a low risk environment. The central question with this approach would be how many countries to select? This would be a resource question, but the authors consider three overseas offices would suffice with one drawn from a high risk, another medium risk and the final a low risk area for fraud.

Funding to Multilateral Bodies

Bilateral aid agencies provide a significant proportion of their budget to multilateral organisations. The risk of bilateral aid agency funds to fraud in this area is tied up within their internal budgets and programme spend. These resources would have been secured from more than the one bilateral agency and it is therefore difficult to trace one set of funds. Programme spend further down the pipeline is also a further step removed from the donor country and therefore also difficult to measure the loss to the donor government. The only means to measure fraud in multilateral bodies would be for them to seek to accurately measure fraud losses through a FLM approach, and then based upon the percentage of funds provided by the donor government, estimate the likely losses in the expenditure. However, the arrangements for the provision of this aid are by Treaties and other legally binding documents with no provision for a FLM at present. It would seem highly unlikely the donor government could force these bodies to participate in FLM. It would therefore seem the best option for this area of spend would be try and encourage them to undertake a FLM exercise in a specific areas of expenditure, such as payroll or

procurement and as will be outlined later encourage or mandate those further down the aid pipeline to conduct FLM.

The complex structure of the aid sector means that funds supplied to the multilateral agencies may end up with the same NGOs or government departments as direct bilateral aid from the donor government. A reasonable assumption is that the output from the multilaterals goes to the same population of recipients as the aid direct from the donor government. Consequently by sampling Bilateral aid agency other donor country partners, there is no need to sample the multilateral partners' recipients as an additional exercise. It is possible to make the plausible assumption that the fraud losses in the multilateral partners' recipients are similar to the bilateral aid agency and its partners' recipients. In the absence of any FLM amongst multilaterals one could apply the same rates of loss as for funding to NGOs and governments (to be discussed shortly).

Funding to Governments

Where the bilateral aid agency supplies direct budget support to countries there are many challenges to conducting a FLM in this area. First of all the aid is provided usually in a general sense with very little detail of the exact expectations of the expenditure. It is often provided alongside support from other governments and multilateral bodies. The MoUs related to these only provide very general aims. As such it would be also be very difficult to determine fraud and error in this type of expenditure. It would also pose challenges – which would vary from country to country – on the negotiation of access to assess these payments.

One possible way around this might be to focus upon an area of government in these countries where funding has been released. This could be applied to both general and sector budget support.

To illustrate, in the case of Rwanda where according to the DFID website over £105 million has been allocated for general budget support to 'To improve the effectiveness of the government budget in achieving the economic, social and governance targets of the Economic Development and Poverty Reduction Strategy.'[23] In this case DFID could fund a FLM in areas of expenditure within the Rwandan government such as payroll, procurement, grant aid etc.[24] This would produce a FFR and FLR which could then be utilised to develop an appropriate strategy to reduce that risk and then re-measure after 2 to 3 years. This would then give an indicator to DFID of the likely risk to their funds. For example if an examination of procurement spending within the Rwandan Government, or a part thereof, showed a FLR

[23] http://projects.dfid.gov.uk/project.aspx?Project=201005

[24] Indeed there has already been many studies showing substantial numbers of 'ghosts' on payroll in different countries: Honduras 5% of teachers and 8.3% of workers; Uganda 20% of teachers. From Reinekka, R. and Svensson, J. (n.d.) Survey Techniques to Measure and Explain Corruption. Retrieved 18 December, 2011 from http://siteresources.worldbank.org/INTPEAM/Resources/PETS2.pdf

of 7% and another of payroll showed 6%, DFID would have a good idea of the risk to their funds been directed to Rwanda. A programme to aid them to develop a strategy to reduce this fraud could then be implemented and the same areas of expenditure measured again 2 to 3 years later to assess the impact of the programme on fraud and the therefore likely risk to DFID funds.

A similar approach could also be taken to sector support. For example, in DFID funding in Kenya the £105 million health programme could be subjected to FLM on specific aspects of expenditure. These could include: the procurement, payroll etc in the Kenyan Ministry of Health. As with the general budget support described above the exercises could be repeated and linked to measures to reduce the risk. As some humanitarian aid is delivered by governments this would also be covered.

A key question would be how many countries to select to undertake this work? This would rest significantly upon the budget available. Ideally there should be at least one exercise in every country the bilateral aid agency delivers aid. This is likely to be very expensive, so a sampling of countries would probably need to occur. There is much information that bilateral aid agency already collects, as well as other organisations, which could enable a ranking of countries receiving aid according to risk. If as a result of this countries were placed in high, medium and low risk groups, a selection – according to budget – could be taken from each of these categories. A longer term programme could also be created to ensure every country experienced a FLM over a specific period of time. An alternative simpler method could be to rank countries by total aid received from the bilateral aid agency and then start with those receiving the most and then gradually work down the list.

A major challenge would be to secure consent to undertake this from the governments. Some bilateral aid agency staff interviewed indicated that some governments might decline or, at best, agree to the FLM with strings attached; such conditions might undermine the validity of FLM. Political leadership from the very top would be required to stipulate that aid will be given, but under a range of conditions, including the requirement for unhindered FLM (among other counter fraud controls). The involvement of other countries and multilateral bodies in signing up to such a message would also be helpful. The politics of this might mean that the first countries to be subject to FLM maybe the willing volunteers where the risk of fraud might be lower. However, even if this is all that is achievable in the short-term, this would provide invaluable data and lessons from what is, in all likelihood, a relatively lower risk environment.

Another issue would be the quality of information/systems etc in the country to enable a FLM to be undertaken. This is not an insurmountable issue, even if systems are poor, but it would increase the time and therefore costs for undertaking such an exercise. It would also provide a benefit to the country in helping them to develop better systems to manage finance and reduce the risk of fraud.

Funding to NGOs

A significant amount of bilateral aid agency expenditure is given to NGOs, either direct or via multilateral bodies or other governments. NGOs also take a significant slice of the humanitarian aid budget. NGOs are therefore also a significant risk. Similar to governments, as stated above, the bilateral aid agency could fund FLM on areas of activity by NGOs in specific countries. Thus an NGO could be selected and a FLM conducted on the most significant areas of expenditure in a country where it is receiving funds from the bilateral aid agency. As with governments, key decisions would be how to select an NGO and then a country where it is operating. Again this could be done with a fraud risk based or expenditure based approaches. An important consideration would be whether to mirror the same countries as for governments or to select other countries. Selecting the same countries would provide corroborative information concerning the ethical nature of the local cultures. Selecting a different range of countries would provide a broader but shallower range of data.

Similar challenges would be faced as with governments. There might be reluctance to engage and the local NGOs' administrative systems might not be conducive to FLM thus increasing costs. However, conditions could be attached to future aid requiring FLM and the development of auditable administrative systems. Many NGOs may understandably be concerned at the impact a FLM may have to them on funding from donors. This could be accommodated by making the data anonymous. Usually the bilateral aid agency donor is in a stronger position than it is with governments to ask NGOs to participate.

Humanitarian Aid and Fragile Countries

Humanitarian aid also poses significant challenge for conducting FLM. By the nature of the aid the importance of time and response and the absence of interference in delivery are very important. Indeed there has been recent coverage that that the slow response to the crisis in East Africa led to deaths of between 50,000 and 100,000.[25] Conducting a FLM exercise might interfere with the response or at the very least distract attention from the effort. Conducting FLM in a disaster zone would not be appropriate. The authors have therefore come to the conclusion that, as NGOs and multilateral bodies deliver much of this aid, a better approach is to focus upon the NGOs generally to ensure their risks are as low as possible; this focus should include FLM and the development of predictive resilience modelling. Consequently the bilateral aid agency would at least have confidence that those NGOs delivering humanitarian assistance are as resilient to fraud as is possible within that type of environment.

[25] BBC News (2011) Slow Response to East Africa Famine 'Cost Lives'. Retrieved 20 January 2012 from http://www.bbc.co.uk/news/world-africa-16606021

The fragile countries where bilateral aid agencies deliver aid to would pose even greater challenges. One means to address this might be to create a model which predicts the likely fraud risks within a specific range. Data currently collected by bilateral aid agencies and other bodies, the proposed FLM and resilience data from non-fragile countries could be collated and analysed to create a predictive model. Once established this model could be applied to fragile states. Some of the issues related to this will now be considered in the next section.

13. Modelling Fraud Losses

Central to the basket approach is a significant degree of modelling to produce estimates of fraud loss risk. This is not something a bilateral aid agency can buy 'off the shelf' but it can start collecting data for the development of the model. Bilateral aid agencies already produce a wide range of tools or can draw upon other assessments which provide indicators which can be utilised in the overall assessment of a country, NGO or project for the likely risks of fraud. Although they do provide useful information for the purposes of modelling, further bespoke fraud risk resilience checks need to be undertaken. Before the reasons for this are explored the principles of a model will be outlined.

Creating a Model

In this section the general principles of a model to predict the potential risk of fraud are outlined. The first point is to note that levels of fraud are influenced by a number of key factors:

- Number of opportunities to commit fraud. The more opportunities there are to commit fraud the greater the risk of fraud.
- Organisational culture. All organisations have their own distinct cultures and they vary on the propensity of staff/clients etc (who interact with or work within them) to commit fraud against the organisation. The more open to fraud the organisational culture is the greater the risk of fraud.
- National culture. The organisational culture is influenced by the national culture. Different nations are characterised by cultures which vary in their attitudes to fraud and corruption.
- The resilience of the organisation to fraud. The effectiveness of the organisation's strategy and structures to counter fraud is also important. At its most simplest, if there were no strategies and structures in place there would be a greater risk a fraud would occur than if there were lots in place. The influence of different strategies other than work by ACFE in their *Report to the Nation* is difficult to determine at present.[26]

[26] Association of Certified Fraud Examiners. (2010). *Report to the nations on occupational fraud and abuse*. Retrieved January 04, 2011, from ACFE website: http://www.acfe.com/rttn/rttn-2010.pdf

- The resilience of the country to fraud. It is also important that the country has in place an appropriate strategy and structure to deal with fraud. The better this is the more likely there is to be an impact on fraud.

The other data on organisational and national culture, which would be crucial to the model, could be secured from some of the analyses already undertaken such as the PETS, PEFAs (see Annex 4). There is also substantial data collected by Transparency International on attitudes to corruption. Some countries will have research conducted on attitudes to fraud and corruption which could be utilised. It may also be appropriate to commission research on attitudes to fraud in organisations and nationally.

If the programme of FLM exercises, as outlined earlier in this report, are undertaken and data was secured on the organisational and country resilience to fraud, statistical multivariate analysis could then start to be undertaken to assess the relative influence of different factors on the levels of fraud in different contexts. Collection of FLM data may also enable other data to be utilised in models such as the ratio of detected frauds to actual frauds. It would be possible to then move to a predictive model for risks of fraud within a specific range. Central to this is the need for two new forms of fraud resilience checks. Before the nature of what should be developed is outlined, table 3 below briefly examines some of the many assessments which are already undertaken and why they are not fit-for-purpose (see Annex 3 for more detailed assessments).

Table 3. The Strengths and Weaknesses of Assessments

Assessment	**Strengths**	**Weaknesses**
Public Expenditure and Financial Accountability (PEFA)	Very detailed assessment of public financial management systems	No detailed focus on counter fraud and corruption strategies
Fiduciary Risk Assessment (FRA)	Detailed assessment of measures to deal with public sector corruption	The focus is corruption rather than fraud
Business Case Core Script Procedure	Detailed consideration of the merits of a project	No detailed focus on fraud risks and counter fraud strategies
Project Control Systems	General assessment of projects	No detailed focus on fraud
Public Expenditure Tracking Surveys (PETS)	Identify leakage in funds	Project based covering fraud, error and inefficiency Expensive

Some of the authors of this report have been involved in developing fraud resilience checks based upon the CIPFA Red Book 2, which is one of the best standards/templates for a counter fraud strategy. The standards set out in the Red book 2 are what an organisation should do to counter fraud successfully under 5 sections:

- Adopting the right strategy
- Accurately identifying the risks
- Creating and maintaining a strong structure
- Taking action to tackle the problem
- Defining success

The detailed guidance under each of these sections was converted into 29 questions providing a score of up to 50 points. These checks have been developed largely for a UK or developed world context. Further research would need to be conducted to ascertain if they could be utilised in the overseas aid context or whether further refinement is needed. The authors suspect the challenges are such in the overseas aid context that further refinement would be required.

There is also the need to develop a resilience check of the country's counter fraud capacity. Some of the issues – amongst many others – which would need to be considered are:

- Is fraud and corruption appropriately defined in law?

- Is there a national strategy to counter fraud and corruption?
- Are appropriate quality resources provided to deal with it?
- Is there a significant risk of getting caught?
- Are penalties appropriate to provide deterrence?

The bilateral aid agency could therefore commission further research to develop two types of fraud and corruption resilience check:

- Organisational fraud resilience check (Government department, NGO, company etc); and a
- Country fraud resilience check.

The task should be based first on drawing together bilateral aid agency staff, partners and key counter fraud personnel in aid receiving countries to map out the key criteria for a counter fraud strategy at an organisational and country level. There may even be an opportunity to create the equivalent of the CIPFA Red Book for the international aid community showcasing the UK's expertise and lead in this area. From this a set of questions can be developed with points to enable an ultimate classification of an organisation and country. The scores from these assessments would not only be vital in any modelling, but they would also provide a guide for enhancing their strategies to deal with fraud.

14. Producing a Fraud Basket

Once a programme of FLM had been undertaken these could be used to estimate and model fraud losses across the department and a country level. Tables 4 and 5 outline hypothetical tables illustrating how fraud losses could look. The table breaks down expenditure into the main categories. There is then a column indicating the fraud calculation basis. This could be undertaken, depending upon the area of expenditure by actual FLM and models (based upon some of the principles above). Thus those assessing the table would know the evidence based which went into the calculation. Next to that could be the estimated aggregated fraud losses (the FLR) and the application of that to the total estimated losses. This could be compared on a yearly basis and a variance figure on actual fraud losses identified.

Table 4. A hypothetical bilateral aid agency fraud basket for year 2015

	Expenditure £m	**Fraud Calculation Basis**	**Estimated Aggregated FLR**	**Total Estimated Fraud Losses**	**Variance on previous year**
Administration (payroll and purchasing)		**FLM in 2013**			
Direct purchasing for aid purposes		**FLM in 2013**			
Funding to multilateral bodies		**Modelled**			
Funding to governments		**7 FLM in 2013, 9 FLM in 2014 and Modelled**			
Funding to NGOs		**6 FLM in 2013 and 7 FLM in 2014 and Modelled**			
Total					

This could also be applied to a country level and table 5 illustrates how the table might look for this. The bilateral aid agency would then be able to present data based upon both actual FLM and modelling for all countries. Eventually it would also be possible to look at an NGO and compare its loss rates by country.

Table 5. A hypothetical fraud basket for a country for year 2015

	Expenditure	**Fraud Calculation Basis**	**Estimated Aggregated FLR**	**Total Estimated Fraud Losses**	**% Variance on previous year**
Funding to multilateral bodies operating in country		**Modelled**			
Funding to government		**1 FLM in 2013 and 1 FLM in 2014 and Modelled**			
Funding to NGO		**1 FLM in 2013 and 3 FLM in 2014 and Modelled**			
Total					

15. Challenges and Limitations

Focusing FLM on governments and NGOs receiving aid is the best way to secure accurate data on the extent of fraud. It is important, however, to set forth some of the challenges and limitations of this approach. First, there would be the challenge of getting them to participate. Unlike some multilateral bodies this is much more achievable. First of all if a bilateral aid agency funds this as part of programme spend, it will not cost them anything. Also conditions could be attached on the giving of aid.

There is also the challenge of how many countries, government bodies and NGOs to target. A plan – according to the budget - should be set in place to gradually extend FLM out to have at least one in every country where it is possible to do by a certain point in time.

Another issue is the lack of knowledge on the quality of systems and information in place in governments and NGOs to actually undertake FLM. It is unlikely that these would make conducting FLM insurmountable - and if they did – this would raise the need for greater investment in the systems in place. However, greater challenges would inevitably raise the costs of conducting a FLM exercise.

A fourth issue a critic of FLM might raise is that it might not pick up decisions undertaken by politicians and officials which are 'legitimate', but which are not within the general terms or spirit of the giving of aid. For example consider the hypothetical decision of a government's

Ministry of Health to purchase a fleet of 12 Mercedes limousines for the transportation of senior officials when there is a variety of pressing financial needs for the provision of basic healthcare services. If this was a decision taken by a person who was entitled to allocate budgets in this area and undertaken according to the lawful procurement procedures this transaction, if scrutinised under FLM, would be unlikely to be classed as fraudulent (unless the exercise discovered these were actually purchased for the officials or that 3 of the 12 could not be accounted for). However, in the absence of detailed specifications for what aid should be spent on such a transaction would always be difficult to class as fraudulent and fall more into the category of a poor decision. That would also be a much broader question than the brief for this project.

For all these reasons it would seem sensible to start this process with pilots which provide lessons as the FLM exercises are gradually rolled out. It is also very clear to the authors that a 'big bang' of lots of FLM exercises across the globe would be a very risky decision. It would be far more sensible to start with pilots in a range of areas, learn from these, and then gradually extend out. The aim and aspiration should be to be working towards a global basket, rather than moving immediately to it.

16. Conclusion and Recommendations

This report has set out recommendations for how FLM can be applied to the complex and challenging environment of overseas aid. It has shown that FLM approaches are rare in this context and would be difficult and expensive to apply to a bilateral aid agency complete budget. There is little evidence of other countries, multilateral bodies or other government departments producing global pictures of fraud based upon FLM approaches. A bilateral aid agency could seek to use FLM to measure fraud where this is practicable. Work should be focussed upon: Administration, Direct Purchasing, Developing Countries' government departments and NGOs receiving aid. Further work could be carried out to: develop resilience checks for the overseas aid fraud context. This will have the benefit of helping to enhance the capacity of bilateral aid agencies, NGOs and countries receiving aid in countering fraud. It will also provide data which can be used, alongside the FLM work, to start creating a model to predict the risk of fraud.

The report also notes the need for a political lead from the top that enhancing the resilience to fraud should be a condition of aid to governments and international agencies and that multilateral organisations should also move towards enhancing the resilience to fraud as a condition of their aid to countries and to NGOs. It is vital there is this political lead if such measures are to be embraced by other bodies and countries. It should also be recognised that FLM and the broader development of counter fraud capacity are a form of aid. Ensuring more funds are protected and not lost though fraud, error or corruption means the aid budget of donors and the budgets of countries receiving aid will go further.

The authors would as result of this research make the following recommendations:

1. Consider FLM and the broader development of counter fraud capacity as a form of aid.
2. Reject attempts to measure total fraud in its budget as this is too complex and expensive to achieve.
3. Seek to use FLM to measure fraud. These should be focussed upon:
    - Administration;
    - Direct Purchasing;
    - Countries' government departments and NGOs receiving aid (number depending upon budget).
4. Carry out further work to:
    - Develop resilience check for overseas aid fraud context;
    - Create model for predicting range of likely fraud losses.

17. Annexes

Annex 1

Bilateral aid agencies and fraud loss measurement current state of play

Department for International Development as an example of a bilateral aid agency

The DFID budget is set to increase from £7.5 billion during 2010-11 to £11.1 billion during 2014-15.[27] This is a substantial real increase of about a third at a time when nearly every other government department is facing a reduction. The expanding budget of DFID is also going to occur alongside a real terms reduction of one third in the administration budget from £128 million to £94 million during the same period. During late 2011 two significant reports were published which, although recognising many positives, both questioned the effectiveness of certain aspects of financial management and the countering of fraud and corruption within DFID.[28] The Public Accounts Committee stated:

> The Department does not estimate levels of leakage through fraud and corruption, which undermines its ability to make informed investment decisions and gain assurance that it has appropriate and effective controls in place. Fraud investigation is reactive and reported levels of fraud are unbelievably low.[29]

The report by the Independent Commission for Aid Impact concluded:

> Our assessment is that DFID's current organisation of responsibilities for fraud and corruption is fragmented and that this inhibits a coherent and strategic response to this critical issue. DFID needs to give significantly greater attention to the fight against corruption to manage this increasing risk.[30]

The report overall rated DFID amber/red which means 'The programme meets some of the criteria for effectiveness and value for money but is not performing well. Significant improvements should be made.'[31] DFID already provides aid to many countries which are high risk for fraud and corruption and is planning to do more in them. Indeed the Public Accounts Committee noted:

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[27] DFID (2011) Business Plan 2011-2015. Retrieved 20 January, 2012 from http://www.dfid.gov.uk/Documents/DFID-business-plan.pdf

[28] Public Accounts Committee (2011) DFID financial Management. Retrieved 20 January, 2011 from http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1398/139804.htm and Independent Commission on Aid Impact (2011)The Department for International Development's Approach to anti-Corruption. Retrieved 20 January 2012 from http://icai.independent.gov.uk/wp-content/uploads/2010/11/DFIDs-Approach-to-Anti-Corruption.pdf

[29] Public accounts Committee, op cit, p5

[30] Independent Commission on Aid Impact, op cit, p1.

[31] Ibid.

> All of the countries in which the Department plans to increase its spending by more than 50% over the next four years have a score lower than 3.0 in the Transparency International index of the perceived extent of public sector corruption (on a scale which ranges from zero which represents 'highly corrupt' to 10.0 which represents 'very clean').

It faces the challenge of increasing aid rapidly, in environments which are high risk for fraud and corruption at a time when its administrative resources, in which the counter fraud capacity is located, will decline. This is a potentially toxic combination for increased fraud and corruption. It is therefore vital that the resources that are available are marshalled to counter fraud and corruption in the most effective way possible. Central to this is the need to understand the scale and nature of the problem. Only then can an effective strategy be put in place to address it and progress on how well it is working can be monitored. This report will set out one small part of the overall strategy setting out a potential methodology to measure fraud in DFID and its partner bodies (multilateral bodies, NGOs and the governments of countries receiving aid).

Dr Mark Button from the Centre for Counter Fraud Studies was commissioned to provide research for development with the key task for:

> The identification and selection of an appropriate methodology and technique to measure fraud losses in different modalities of aid to developing countries on the basis of a data produced by statistically valid and accurate exercise.

The brief also sought the research team to explore the experience of measurement of fraud in overseas aid in other countries and to examine best practice in the UK government for measuring fraud. There was a requirement to develop a methodology to measure fraud in overseas aid and to produce a toolkit on how to measure fraud. This report sets out these requirements.

Annex 2

DWP Estimated overpayments 2010-11[32]

Benefit	Expenditure	Fraud & Error		Fraud		Customer Error		Official Error		Last Measured
Continuously reviewed										
Income Support	£7.9bn	4.4%	£350m	2.4%	£190m	1.1%	£90m	0.9%	£70m	Oct 09 - Sep 10
Jobseeker's Allowance	£4.5bn	6.5%	£290m	4.1%	£180m	0.3%	£20m	2.1%	£100m	Oct 09 - Sep 10
Pension Credit[1]	£8.3bn	6.0%	£500m	2.3%	£190m	1.7%	£140m	2.0%	£170m	Oct 09 - Sep 10
Housing Benefit[2]	£21.6bn	4.4%	£960m	1.3%	£290m	2.6%	£560m	0.5%	£110m	Oct 09 - Sep 10
Incapacity Benefit[3]	£5.6bn	2.4%	£130m	0.3%	£20m	0.9%	£50m	1.2%	£70m	Oct 09 - Sep 10
Instrument of Payment			£0m		£0m					Oct 09 - Sep 10
Occasionally reviewed										
Disability Living Allowance[4]	£12.0bn	1.9%	£220m	0.5%	£60m	0.6%	£70m	0.8%	£90m	Apr 04 - Mar 05
Retirement Pension[5,6]	£69.9bn	0.1%	£100m	0.0%	£0m	0.1%	£60m	0.1%	£40m	Apr 05 - Mar 06
Carer's Allowance	£1.6bn	5.5%	£90m	3.9%	£60m	1.0%	£20m	0.6%	£10m	Apr 96 - Mar 97
Interdependencies[7]			£40m		£10m		£10m		£20m	Apr 10 - Mar 11
Unreviewed										
Unreviewed (excl CTB) [8,9]	£17.2bn	2.3%	£390m	0.9%	£160m	0.6%	£100m	0.8%	£130m	
Council Tax Benefit[10]	£5.0bn	4.0%	£200m	1.2%	£60m	2.3%	£110m	0.5%	£30m	Oct 09 - Sep 10
Total[11]	**£153.6bn**	**2.1%**	**£3.3bn**	**0.8%**	**£1.2bn**	**0.8%**	**£1.2bn**	**0.5%**	**£0.8bn**	
Range[12]		(1.9,2.5)	(2.9,3.8)	(0.7,1.1)	(1.0,1.6)	(0.7,1.0)	(1.0,1.6)	(0.4,0.8)	(0.7,1.2)	

[32] DWP (2011) Fraud and Error in the Benefit System: Preliminary 2010/11 Estimates. Retrieved on November 14 2011 from http://statistics.dwp.gov.uk/asd/asd2/fem/fem_oct09_sep10.pdf, p 12.

Annex 2

Tax gaps for HRMC administered 2008-09 and 2009-10 £billion[33]

Tax	Component	Point estimates (£ billion) [1,2,4]		Percentage tax gap [3]	
		2008-09	2009-10	2008-09	2009-10
Indirect taxes[5]					
Value Added Tax (VAT)		14.6	11.4	15.5%	13.8%
Spirits duty		0.1	0.1	2%	3.4%
Beer duty		0.4	0.6	10%	14%
Cigarette duty		1.4	1.1	13%	10%
Hand rolling tobacco duty		0.6	0.6	50%	46%
Great Britain diesel duty		0.7	0.5	5%	4%
Great Britain petrol duty[6]		0.0	0.0	0%	0%
Northern Ireland diesel duty[7]		0.1	0.1	27%	12%
Northern Ireland petrol duty[6,7]		0.0	-	16%	-
Other indirect taxes[8]		1.0	0.8	7%	6.0%
Total indirect taxes		**18.9**	**15.1**	**12.7%**	**10.9%**
Direct taxes					
Income Tax, National Insurance Contributions, Capital Gains Tax	Inaccurate self assessment returns from individuals (excluding large partnerships[9])	5.6	5.8		
	Business taxpayers	*5.0*	*5.1*		
	Non-business taxpayers	*0.6*	*0.8*		
	Inaccurate self assessment returns from large partnerships[9]	0.8	0.9		
	Inaccurate returns from small and medium-sized employers (PAYE)[10]	0.6	0.9		
	Inaccurate returns from large employers (PAYE)	2.0	2.0		
	Avoidance	1.4	1.5		
	Non-declaration of income and capital gains by individuals who do not receive returns	0.3	0.3		
	Ghosts[11]	1.3	1.3		
	Moonlighters[12]	1.8	1.8		
	Total	**13.9**	**14.5**	**5.2%**	**5.8%**
Corporation Tax	Businesses managed by the Large Business Service	1.3	1.2		
	Avoidance	*1.1*	*1.0*		
	Technical issues	*0.2*	*0.2*		
	Large and complex businesses	0.9	0.9		
	Small and medium-sized businesses	2.7	2.7		
	Total	**5.0**	**4.8**	**10.3%**	**11.7%**
Other direct taxes	Inheritance Tax	0.1	0.05		
	Stamp Duties[13]	0.8	0.5		
	Stamp Duty Land Tax	*N/A*	*0.2*		
	Shares Stamp Duty	*N/A*	*0.3*		
	Petroleum Revenue Tax	0.05	0.02		
	Total	**0.9**	**0.6**	**6.5%**	**4.9%**
Total direct taxes		**19.8**	**19.8**	**6.0%**	**6.5%**
Total tax gap		**39**	**35**	**8.1%**	**7.9%**

[33] HMRC (2011) Measuring Tax Gaps 2011. Retrieved on November 14 2011 from http://www.hmrc.gov.uk/stats/mtg-2011.pdf p 6.

Annex 3

The research team wrote to the 14 member charities of the Disasters Emergency Committee to ask for information on their approaches to the measurement of fraud. These NGOs were: Action Aid, Age UK, British Red Cross, CAFOD, Care International UK (site is not working), Christian Aid, Concern Worldwide, Islamic Relief, Merlin, Oxfam, Plan UK, Save the Children, tear Fund and World Vision. All of these NGOs were registered on the Disaster Emergency Committee website. Of these 14, 9 have responded so far, although not all of these have addressed the questions set. Some of the responses were:

> We are 'too busy to help with this matter',
>
> Are the 'the results confidential' (a following email was sent to confirm this matter and the offer of a telephone conversation suitable to them was offered as well)
>
> 'While we are in principle very happy to cooperate in your study, we would be grateful for further information, as we were not previously aware of it. Could you let us have the credentials for the study and the terms under which we would be providing you with information'? This information has been provided.
>
> 'Unfortunately, as we are a charity for people in later life we do not have the resources to answer your questions and we do not measure fraud. I am sorry about this.
>
> 'We are unable to respond to your exact request'

Annex 5

Existing Assessments

1. Public Expenditure and Financial Accountability (PEFA)

DFID's template for good government financial management is derived from PEFA[34]. It includes 6 core areas in a budget cycle, which if executed effectively produce a credible national budget. PEFA produces reports which provide 28 performance indicators covering the core areas pus 3 covering donor practice. The indicators are scored A, B+, B, C+, C, D+, D. Currently 83 counties have been assessed.[35]

The main rationale for PEFA assessments is to identify strengths and weaknesses in the Public Financial Management systems of recipient countries. Its performance indicators are internationally agreed measures which feed into a consistent approach to programme risk

[34] Training slides provided by DFID
[35] See http://web.worldbank.org/WBSITE/EXTERNAL/PEFA/0,,contentMDK:22687152~menuPK:7313203~pagePK:7313176~piPK:7327442~theSitePK:7327438,00.html

assessments. They furnish project managers with a suite of data which describe the risk landscape in each country.

The PEFA model does not justify fraud and corruption as a distinct measure, but does consider their perceived impacts on other measures. The PEFA PFM assessment of Kenya[36] includes just one comment on fraud under PI-14 (effectiveness of measures for taxpayer registration and tax assessment):

> "The Investigation and Enforcement Department (of the Kenya Revenue Agency) responsible for fraud investigation implements its audit work plan with clear fraud risk assessment criteria."

Kenya scored a B for PI-14 which DfID interpret as good to fair. A further comment on government corruption appeared in the report under PI-19 (competition, value for money and controls in procurement) for which Kenya also scored a B:

> "However, irregularities still abound in the procurement system as evidenced by Kenya Anti-Corruption Commission reports and complaints by components in Ministries, State Corporations and Local Authorities."

This is a superficial assessment of the fraud risks in Kenya based on a procedure within the Kenya Revenue Authority, reports of "irregularities" and untraceable complaints. There is no data on the scale of the problem. There is no comment about the level of private sector fraud and corruption.

2. Fiduciary Risk Assessment (FRA)

DFID's FRA as with other bilateral donor assessments builds on the PEFA assessments to evaluate risks in its areas of operation. Its "How to note" provides guidance on preparing FRAs[37]. In principle it comprises two core components:

- Analytical risk assessment
- Risk reduction methods

Two types of FRA are conducted: the full FRA is undertaken every 3 years, the "light touch" Annual Statement of Progress (ASP) is conducted annually.

The FRA practice paper includes a substantial section on corruption risk assessment, providing a framework covering the following five areas.

[36] EC. (2009). *PEFA public financial management perrformance assessment report for Kenya*. Brussels: EC. Retrieved November 25, 2011, from the European Community website: http://ec.europa.eu/europeaid/what/economic-support/publicfinance/documents/kenya_pefa_final_report_2008.pdf#Top

[37] DFID. (2009). *How to note: managing fiduciary risk when providing financial aid*. London: DfID.

Country governance context	The level of state capability, accountability and responsiveness Transparency International data UNCAC signatory
Preventive measures	The strength of the package of preventive measures currently in place. Public sector procurement procedures, audit systems Public reporting Access to information and whistleblowing protection Private sector accounting standards Membership of anti-money laundering body
Criminalisation and enforcement	Provisions in place to criminalise the key corruption offences and Mechanisms in place for international bribery, AML, asset recoveries
International drivers and co-operation	Significance of international factors in driving country corruption Mechanisms in place for international bribery, AML, asset recoveries
Technical assistance	The extent and nature of external support on anti-corruption, e.g. UNCAC, IFIs, regional body, donor

The framework is primarily targeted at assessing what systems are in place to tackle public sector *corruption*. Fraud is not specifically covered. The framework is by necessity generic, but could be developed into a more detailed fraud resilience framework with more detailed prompts about the range of deterrence and remedy systems, such as specific criminal and civil laws, a list of empowered regulation and prosecuting agencies, the number of prosecutions and the local commercial norms. Without an adequate country or regional risk assessment, DFID cannot design specific counter-fraud controls. A more appropriate solution, which will be discussed later, is to create a specific counter fraud resilience check.

3. Business Case Core Script Procedure

Many bilateral aid agencies utlise some form of business case for approval of programmes or projects. This varies. The Business Case Core Script procedure provided by DFID for this report briefly describes the requirements of business case structures introduced from 1st January 2011. The need for change is properly justified:

- Improve consistency, quality and transparency of project documents
- With greater public scrutiny there is a need to ensure value for money

There are 5 key elements to each business case:

- Strategic case – need, goal, outcome of a project
- Appraisal case – how the proposal meets the strategy

- Commercial case – procurement requirements and management
- Financial case – forecast costs and how they will be accounted
- Management case – governance, management, monitoring, risk arrangements to deliver the project

The procedure provides a structure for ensuring some consistency in the format of business case reports. It does not mention fraud or corruption specifically. Those who designed the template could claim that fraud risk is implied in the risk section.

4. Project Control Systems

The three core components of the project control systems are:

- Logical Framework (logframe)[38]
- Annual Review
- Completion Review

The "logframe" assists in the origination of the business case and provides a structured approach to subsequent project monitoring. The DFID practice paper describes how the system connects resource inputs to a hierarchy of results: impact (e.g. increase literacy), outcome (get more children through school), outputs (build more schools). In this example the value of a school building programme is ultimately in increasing literacy.

Both annual and project review templates provide a structure for assessing the performance of projects in a consistent manner aligned with the logframe. The reviews include a section on risk in general, but do not specifically trigger corruption or fraud risk reviews. Those who designed the templates would undoubtedly claim that corruption risk is implied in the risk section. This is again a missed opportunity to reinforce the dangers of fraud with DFID's employees, suppliers and partners.

5. Public Expenditure Tracking Surveys (PETS)

PETS are used to assess the wastage, fraud and corruption in expenditure. They look at what happens to the original money which was allocated for a project as it travels through different layers of bureaucracy to ultimate delivery. As Reinekka and Svensson argue:

> It is therefore useful as a method for locating and quantifying political and bureaucratic capture, leakage of funds, and problems in the deployment of human and in-kind resources, such as staff, textbooks, and drugs.[39]

[38] DFID. (2009). *Guidance on using the revised logical framework*. London: DFID.
[39] Reinekka, R. and Svensson, J. (n.d.) Survey Techniques to Measure and Explain Corruption. Retrieved 18 December, 2011 from http://siteresources.worldbank.org/INTPEAM/Resources/PETS2.pdf

The first major PETS was on the Ugandan Education department in 1996. The motivation was that despite substantial increases in expenditure there had not been similar increases in primary school enrolment. The PETS found that only 13% of the annual capitation grant (student) reached the schools between 1991-95, with 87% disappearing for private gain or spending on other unrelated purposes.[40] This led to PETS been implemented in a number of other countries, which also showed generally substantial leakage.

A variation of the PETS is the Frontline Provider Survey or Quantitative Service Delivery Survey (QSDS). This assesses front-line services against the expectations from the funding provided. Similar to a FLM a statistically valid sample of locations are identified and then visited on an unannounced basis to assess service delivery. A QSDS in Bangladesh found 35% and 40% of health-workers and doctors absent.[41] This shows that even when funding reaches the service point, other factors can further add to the attrition to the original funds.

PETS uncover the attrition in funds which includes fraud, corruption, error as well as bureaucracy and inefficiency. They are nevertheless very resource intensive to undertake and uncover a wider range of leakages than fraud and error. [42] In the absence of FLM they do provide a good indication of the risk of fraud, corruption and error. Where these have been conducted they could be utilised in a model to predict fraud loss rates/risk.

[40] Ibid.
[41] Ibid.
[42] Koziol, M. and Tolmie, C. (2010) Using Public Expenditure Tracking Surveys to Monitor Projects and Small-scale Programs – A Guide. Washington DC: The World Bank; and Reinekka, R. and Smith, N. (n.d.) Public Expenditure Tracking Surveys in Education. Paris: International Institute for Educational Planning. Retrieved 18 December 2011 from http://www.unesco.org/iiep/PDF/pubs/Reinikka.pdf