

7. Due Diligence and Fraud Risk

*All government grants shall be subject to **timely and proportionate due diligence and fraud risk assessment.***

Managing Public Money:

1. Departments' primary concern when administering grants is to have due regard to the guidance set out in Managing Public Money; nothing in this document is intended to contradict or override that guidance.
2. This standard is not intended to be an additional spending control; departments retain accountability for decisions on all grant expenditure.

Important note on scope:

3. This standard applies only to **general grants** made by departments and their Arm's Length Bodies (ALBs) using Exchequer funding.
4. It does not apply to **formula grants** or **Grant-in-Aid**.
5. The term 'general grants' is broadly defined below, to assist identification:

General Grants: grants made by departments or their grant making ALBs to outside bodies to reimburse expenditure on agreed items or functions, and often paid only on statutory conditions. These are the grants, which are most closely related in administration to contract procurement, whilst remaining legally distinct.

Risk Indicators

6. When developing general grant models and assessing individuals and organisations for a grant award, consideration shall be given to combinations of risk indicators, which may affect the value of the award, or whether the grant should be awarded at all. When developing general grant models and assessing individuals and organisations for a grant. Risk indicators may include the following:
 - grant to revenue ratio;
 - website/ search engine/ web presence;
 - length of grant period;
 - grant value;
 - type of recipient, such as, individuals, organisations, new recipients;
 - turnover of board members;
 - track record;
 - late financial reporting; and
 - address search/ use of a Post Office (PO) box.

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7. Further work is taking place in the Cabinet Office on assessing fraud risk; details will be added to this guidance note, which will be re-issued in due course.

Due Diligence

What is Due Diligence?

8. This refers to a process, or set of processes, that seek to appraise the: performance; eligibility; basic financial checks; past track record; and background of the potential grant recipient. These are part of the initial checks performed during the application assessment. Robust due diligence processes help mitigate reputational risks, potential fraud and / or error to the departments and possibly to the grant itself.

Why is Due Diligence important?

- Due Diligence helps ascertain that a grant maker understands and can manage the risks associated with various grants, and that they are working with organisations / entities / institutions that have a clear likelihood of successfully achieving their goals.
- It identifies potential early warning signs and avoids bad decisions.
- It also gathers information that will be useful for ensuring all the checks are completed prior to the application proceeding to the next stage of the grant making process.

How much time should be allocated for Due Diligence?

9. Time allocated for completion can vary widely with each situation. The amount of time for conducting due diligence is based on many factors, including prior experience with the applicant (if applicable), the value of the grant, tolerance of risk etc. It is impossible to learn everything about the applicant but it is important to learn enough such that you lower your risks to the appropriate level to make good, informed decisions. Please refer to the Due Diligence Checklist (via the grants hub here: <https://grantshub.civilservice.gov.uk/DataSolutionLogin>) for an example including further details and very basic checks to be carried out.

Resources to be allocated for Due Diligence

- Resources allocated to the due diligence process are completely at the discretion of respective departments.
- We do recommend that departments ensure that the right people with the right skills are assigned and consider the resources allocation based on the thresholds of grants outlined in the diagram below. For example, for grants with a value less than £100k, have the due diligence checks undertaken by a policy advisor with full understanding of the grant and its objectives.
- For complex / contentious grants or those above £100k consider using staff with specialist skills, for example, accountants, fraud investigators, lawyers, etc.

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- We do not prescribe the seniority of those conducting due diligence but ensure that they have the powers and authority to carry out due diligence in full and the SRO signs off on their due diligence findings.
- Departments are free to choose to conduct due diligence themselves, or outsource as and where appropriate.

10. Departments and their ALBs will develop due diligence and fraud risk assessment models, which take account of best practice and guidance and which are proportionate to the value of the grant, as demonstrated in the table below:

Mandatory due diligence checks to reflect spend and level of risk

Below £100k And Low Risk	£100k - £5million Or High Risk	Above £5million
<p>To be conducted by Grants or policy team with support from Finance:</p> <ul style="list-style-type: none"> • Check if individual or organisation has or has had another source of government funding (GGIS) • Evaluate feedback if previous grant recipient (GGIS) • Individual/ legal entity checks (Charities Commission) • Financial viability checks • Basic fraud risk assessment 	<p>Due diligence conducted by internal finance teams</p> <p>Further requirements:</p> <ul style="list-style-type: none"> • Financial: cash flow and reserves consider impact of recipient taking on outcome based grant • Commercial: consider impact on competitors or market if recipient received grant (State Aid) • Operational: investigate if grant recipient has the people processes and products required for delivery – site visit advisable • Governance: is the governance structure robust 	<p>Due Diligence be compliant with HMT guidelines to be conducted by finance team with support from externals if required:</p> <ul style="list-style-type: none"> • Site visit mandatory and detailed analysis of financial accounts • Recommended non-executive member to sit on programme board • Quarterly reviews against performance

Grants should not only go to safe bets but steps to mitigate risk must be built into grant agreement such as part payment plan or higher frequency review

11. As part of the guidance refresh process, we have developed and included a link to a detailed Due Diligence checklist.

12. As a minimum, it is expected that the following to be considered, as part of the business case process:

- minimum due diligence requirements are in place for grants to ensure that low value grant funding is not being abused;
- the short and medium term financial viability of the applicant organisation, including the extent of reliance on grant and other government funding;
- checks covering capability, track record and credibility;
- check the Government Grants Information System (GGIS) and other sources of data;
- verification of identity / legal status via legal teams, Companies House, the Charities Commission;

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- fraud risk assessment, in line with the toolkit on the Grants Hub and fraud risk indicators;
- results of the periodic random sampling undertaken by the Fraud, Error, Debt and Grants team in Cabinet Office;
- whether disclosed directors or trustees have links to other grant recipients and whether there is any risk associated with those shared directorships;
- the track record of the directors of the applicant and whether historical poor performance may be indicative of higher risk of misuse of grant funding;
- assessment to identify the extent to which a risk of overlap in awards and recipients exists;
- examples of grant fraud themes include lack of segregation of duties, companies with common directors and poor control environment;
- Due Diligence covers research to investigate specific areas of risks such as conflicts of interest, Anti Money Laundering (AML), Countering Terrorist Financing (CTF), Bribery and other criminal activities associated with the activity being funded. In particular when working with vulnerable adults or children.

Due Diligence Outcomes

13. The three main potential outcomes are:

- **fully approved** – recommend to proceed with the award;
- **partially approved** – depending on the concerns raised a variety of options are available such as: a reduction in grant value to lessen the department's exposure, further / enhanced due diligence steps, and / or even funding in tranches with enhanced monitoring ; and
- **not approved** – recommend not to proceed with the award.

Government Grants Information System (GGIS)

14. Risk ratings, high, medium or low, can be recorded on the GGIS through a field launched to support these standards. Guidance on how to decide on the appropriate rating is included on the system in the 'Glossary of Terms'.

15. We have included a few case studies, which might be useful to consider whilst carrying out the due diligence checks.

Case Study 1 - Overlapping funding

One small business received 13 grants from one department totalling £1.9 million during one financial year. They also received €740,000 in EU funding for very similar projects over the same timeframe. The awarding department did not routinely check for EU funding overlaps, raising the risk of fraud or inefficiency. An effective due diligence process will consider all previous funding given to a recipient, rather than examining applications in isolation. A simple step could be to ask applicants whether they are receiving other forms of funding on the application form - if a company doesn't disclose this information when asked, or provides a false declaration, the fraud risk associated with that application increases.

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Case Study 2 - Shared directors

A group of eight companies that were connected via shared directors all successfully applied for the same grant scheme in one financial year. The application form asked whether applicants held any financial interests in other companies applying for the scheme and they had all ticked "No". A robust due diligence process would have identified the overlapping directorships and considered whether the awards represented value for money or even potential fraud. An open source search on the Companies House or Charities Commission website can reveal the other financial interests of applicants, their co-directors and other people with significant control over an organisation.

Case Study 3 - Financial checks

A company received a grant for £33,000 but had entered administration three months before the grant was awarded. The company was then wound up shortly after the grant ended. Good due diligence will consider the financial health of the applicant - are there any signs that they might not be able to fulfil the aim of the grant, or that they might be under financial pressure? Both the fraud and value for money risk increases when grants are awarded to companies in poor financial health, as it becomes more likely that the grant could be diverted from its intended purpose. Part of the due diligence process can be a frank dialogue with applicants and a requirement to provide more evidence that they are financially capable of performing the grant as intended.

Case Study 4 - Risk Management

A large grant recipient in receipt of £18.7 million in one financial year received an adverse rating from a regulatory body, which led to its grant funding being stopped. The financial model of this company was so reliant upon grants that it quickly went into administration, leaving several subcontractors also in financial distress. It is important to design in contingency planning to grant schemes, and continually re-assess risk throughout the lifetime of a grant that can be affected in this way. This will help to minimise the disruption and negative publicity that can arise from an unexpected collapse of a recipient organisation.

What do I do if I would like to raise a specific concern or share best practice with other Grant making departments?

16. Please send through to grantsubsupport@cabinetoffice.gov.uk

Risk

17. The Government pays out approximately £115 billion per year on grants (almost 20% of total government expenditure). As such, it is vital that grants are subjected to proper scrutiny and control, including minimising losses from ineffective grant management and reducing losses from fraud and error, in order to mitigate reputational risk, improve ROI, and achieve cash savings.
18. Risks are inevitable. The aim is not to eliminate risk altogether but to understand risk, manage it more effectively, and to identify it, thereby enhancing performance. Risk assessment should be embedded in organisational culture, normal working routines and used to provide direction regarding performance and improvement. Risk management has the potential to positively impact grants management and improve the effectiveness and efficiency of distributing government funds.



Risk management at a glance

19. The risk management process is a series of logical steps, which are carried out in sequence to progress through each stage of managing a risk. The process is cyclical and it is often necessary to revisit earlier steps and carry them out again to ensure you have a complete picture of the risks to the activity/outcome you are assessing.
20. The risk management process (illustrated in diagram) begins by establishing the context around which you want to identify and assess risks. This could relate to an activity, objective or outcome. Risks, which could impact on the successful delivery/achievement of the activity, objective or outcome, should be identified and a full description provided which includes potential triggers and impacts – what could make the risk materialise? What would the impact be if it did?

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21. The next step in the risk management process is risk assessment; a risk matrix is used in the risk assessment process. Having identified a risk and assessed its impact and probability, the next step in the process is to develop actions to manage the risk. These are referred to as 'control actions'. Controls are intended to help in mitigating either the impact or likelihood of the risk. There should be communication and consultation throughout the process and the need for continual monitoring and review of the risk(s) throughout the lifecycle of the activity/objective/outcome.

Benefits of risk management

- promotes and sustains high credibility within government departments;
- enables departments to make more informed grant award decisions;
- increases awareness, knowledge, understanding of risk across the department's grants portfolio;
- aligns risks with government / scheme goals and objectives; and
- encourage Value for Money and reduce the risk of Fraud.

Risk across the grants lifecycle

22. Risk should be actively managed across the grant-making process, bearing in mind the principle of proportionality. Suggested activities are listed below:

- a) **Design and development:** Use tools and analytics to conduct risk analysis pre-award:
 - conduct early options and risk analysis;
 - determine the right grant arrangement;
 - secure business case and efficiency controls approvals or advise New Grants Advisory Panel (NGAP) (see standard three - New Grants Advice Panel for more information); and
 - engage with appropriate teams, including Commercial and Legal.
- b) **Market engagement:** Use tools and analytics to conduct risk analysis pre-award:
 - prepare the requirement and application documents and evaluation strategy, having regard to risk appetite.
- c) **Application assessment:** Use tools and analytics to conduct risk analysis pre-award:
 - review grant applications (in light of the risk indicators outlined below);
 - rank grant applications; and
 - assess grantee risk.
- d) **Grant award:** Use relevant data to determine risks and take appropriate action prior to making awards:

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- approve grant applications and notify grantee; and
 - plan risk mitigation actions, for example:
 - increasing the frequency or scope of monitoring;
 - providing targeted technical assistance;
 - requiring additional progress reporting; and
 - applying special conditions.
- e) **Performance monitoring:** Plan for and execute monitoring and mitigation activities, relative to your department's needs:
- monitor grantee performance; and
 - execute risk mitigation (if required).
- f) **Final evaluation:** Manage grants using a common set of risk based standards:
- document grantee performance; and
 - document lessons learnt.

Risk indicators

23. When developing general grant models and assessing individuals and/or organisations for a grant award, consideration should be given to combinations of risk indicators, which may include the following:

- financial stability of applicant e.g. grant to revenue ratio;
- applicant's previous experience, if any, in managing grant awards;
- whether the applicant has adequate internal, fiscal and administrative controls;
- applicant's performance under other government grant awards;
- any adverse information regarding the applicant's officials or key employees that calls into question the applicant's ability to perform satisfactorily;
- website/ search engine/ web presence;
- length of grant period;
- grant value;
- type of recipient, such as, individuals, organisations, new recipients;
- turnover of board members;
- late financial reporting;
- address search/ use of a Post Office (PO) box.

Risk ratings and recording

24. As part of the development of the business case and ongoing management of a grant, an assessment should be made as to the level of risk associated with a scheme. It is up to each department to define their methodology for categorising risk however it is encouraged that a consistent approach be deployed across the department.

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25. A risk matrix is a useful tool in the risk assessment process. It creates a risk score from the combination of the likelihood and the impact of the Risk. The risk becomes more severe as the likelihood and impact increase. To ensure consistency in assessment and the ability to compare and report on the various levels of risk; it is suggested to use standard 4x4 risk matrix when scoring all risks (see table below).

Table: Risk Matrix

		Impact (Negative)				
		Minor	Moderate	Major	Critical	
		1	2	3	4	
Probability	4	Almost certain	Medium (4)	High (8)	Very High (12)	Very High (16)
	3	Likely	Medium (3)	High (6)	High (9)	Very High (12)
	2	Possible	Low (2)	Medium (4)	High (6)	High (8)
	1	Unlikely	Low (1)	Low (2)	Medium (3)	Medium (4)

26. Risk ratings, high, medium or low, should be recorded in the appropriate field on the GGIS system database. As part of the management of a grant, an assessment should be made as to the level of risk associated with a scheme. It is down to departments to define their methodology for categorising risk. We have provided guidance of things you may wish to consider but this is not exhaustive and may vary based on respective Departments risk management existing processes for grant management.

High / Very high risk – Grants rated high / very high risk may include a number of risk factors in combination, which lead to a greater level of uncertainty in delivery terms, for example, a high value grant awarded to an organisation which does not have long a track record of delivery in government grants, and/ or where a grant is focused in a policy area which is new to the department or highly innovative. Novel and contentious grants and those, which are awarded as a result of a Ministerial direction should also be considered for a high-risk rating. Significant impact on the department’s strategy or operational activities. Significant stakeholder concern in the event of the risk materialising.

Medium risk – Grants rated medium risk may be lower value than high risk grants and will usually be in policy areas which are familiar to the department, but perhaps where the department is seeking to break new ground or innovate, or those which are awarded to organisations which might be considered slightly more risky in terms of credibility or financial viability, due to the lack of alternative options in the market. Moderate impact on the department’s strategy or operational activities. Moderate stakeholder concern in the event of the risk materialising.

Low risk – Grants rated low risk will consist of low value, routine or repeat grants in policy areas which are familiar to the department, awarded to recipients with a proven track record of successful delivery in the public and/ or private sector. Low impact on the department’s strategy or operational activities. Low stakeholder concern in the event of the risk materialising.

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Types of risks:

- I. **Strategic risk:** The risk that an organisation's strategy becomes less effective and the organisation struggles to reach its goals as a result. It could be due to political changes, technological changes or any number of other large-scale changes;
- II. **Compliance risk:** The implication of an organisation not being compliant with all the necessary laws and regulations, which apply. These could result in huge financial penalties, fines etc.;
- III. **Operational risk:** Operational risk refers to an unexpected failure in an organisation's day-to-day operations. It could be a technical failure, or caused by its people or processes;
- IV. **Financial risk:** Most categories of risk have a financial impact, in terms of extra costs or lost revenue. But the category of financial risk refers specifically to the money flowing in and out of your organisation, and the possibility of a sudden financial loss;
- V. **Reputational risk:** Reputational risk can take the form of a major lawsuit, negative publicity about your organisation or your staff, or high-profile criticism of your organisation's services.

Guidance on Grants Counter Fraud Risk management Definition

27. Grant Fraud is defined as deliberately obtaining grant funding that a person or organisation would not be entitled to by making a false declaration or failing to report material changes.

28. Some of the most common grant fraud scenarios include:

- falsifying information in grant applications or contract proposals;
- charging personal expenses as business expenses against the grant;
- charging for costs which have not been incurred or are not attributable to the grant;
- charging for inflated labour costs or hours, or categories of labour which have not been incurred (for example, fictitious employees, contractors or consultants);
- grant application from fictitious or shell organisations;
- billing more than one grant or contract for the same work;
- falsifying test results or other data;
- substituting approved materials with unauthorised products;
- misrepresenting a project's status to continue receiving government funds;
- charging higher rates than those stated or negotiated for in the bid or contract; and
- influencing government employees to award a grant or contract to a particular company, family member, or friend.

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Grants Management Function: Counter Fraud Strategy

29. The aim of the Grants Management Function Counter Fraud Strategy is to reduce the risk of harm and loss due to fraud in government grant spend, by creating a central Cabinet Office function that supports all Government Departments' ability to identify risks in grant awards and helps their capacity and capability to intervene appropriately on those risks to prevent or detect, correct and punish fraudulent, negligent or erroneous grant awards or applications.

Items to consider to reduce fraud at the point of scheme design

30. Fraud presents a major reputational risk for both government as a whole, as well as individual for departments. When seeking to reduce fraud, it is important to focus on fraud prevention at the point of scheme design, as this will result in a decreased risk of fraud throughout the remainder of the grants lifecycle.

31. A key part of the process of design of a scheme should be considering possible ways it could be attacked through fraud. Some schemes may be more vulnerable to fraudulent applications, whereas others may be more exposed to fraud within the life cycle of the grant. A strong fraud risk assessment will identify higher risk areas and build in mitigating checks.

Case Study

An ALB had difficulty in identifying the involvement of undeclared commercial third parties in the writing of application forms but suspected it was happening regularly. Simple steps to reduce the risk upfront that could be to explicitly ask applicants on the application form to declare the name of any third party that had provided them with assistance with the application form and to build a policy on third parties into the design of the scheme. This would increase transparency and enable grant makers to monitor and evaluate third party involvement.

Items to consider when screening applicants for possible fraud may include:

- Associations between those directors linked to companies in GGIS and those directors included on the register of disqualified directors on Companies House. Consider conducting text mining analysis of data within GGIS to identify overlap in grant purpose wording and applicant addresses and review findings;
- Inactive companies: Ensure that the award recipient is from an active company and check periodically throughout the life of the grant to ensure this remains the case. It is recommended to conduct reviews of payments data for payments made to all companies listed on Companies House as inactive, to consider the timeliness and appropriateness of the payments made.
- Organisational Financial health: Be aware of organisations who may use grant funding to keep an organisation afloat which might otherwise fail;

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- Lower value grants (less than £100K): It is recommended to employ a defined due diligence process, including standardised procedures, for lower value awards in order to:
 - ensure that low value grant funding is not being abused;
 - ensure the short and medium term financial viability of the applicant organisation, including the extent of reliance on grant and other government funding;
 - establish whether disclosed directors or trustees have links to other grant recipients and whether there is any risk associated with those shared directorships; and
 - the track record of the directors of the applicant and whether historical poor performance may be indicative of higher risk of misuse of grant funding.

Be aware of potentially undisclosed connections via common directorships/ shareholdings across charities with GGIS. Lessons learnt should be captured and shared to aid the prevention of fraud in future grants.