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Fraud and corruption control

An integrated approach to controlling fraud and corruption within the workplace

From the Chairperson

Fraud and corruption have the potential to cause significant financial and non-financial harm to the public and private sectors.[1] The threats are pervasive and may be both internal and external.

Yet, despite these threats, a CMC survey in 2003 found that only 27 per cent of Queensland public sector agencies had fraud-control plans. This state of ill-preparedness was disclosed by a report from the Queensland Audit Office, which said that less than half of the 61 entities reviewed during 2002–03 had formally assessed the risk of fraud as part of their agency-wide risk assessments.[2]

As a result of these findings, the CMC is preparing a comprehensive set of fraud and corruption control guidelines and supporting resources. This action forms part of its obligation under the *Crime and Misconduct Act 2001* to help public sector agencies build their capacity to prevent misconduct. The resources will prove valuable in combating threats of fraud and corruption from wherever they may emanate: from within an agency or from an external source.

Planning that caters for the risk of fraud and corruption is part of good management. For some agencies it may involve no more than reviewing existing systems, policies and procedures, and integrating those relating to risk management, internal controls, reporting, investigation, codes of conduct, and training.

This paper introduces fraud and corruption control planning, and outlines the 10-element model being developed by the CMC. It is designed to help agencies develop their own management programs in advance of the more detailed materials to be released by the CMC later this year.

Brendan Butler SC
Chairperson

What is fraud and corruption?

Fraud and corruption can take many forms. Fraud is normally characterised by the presence of some form of deliberate deception to facilitate or conceal the misappropriation of assets, whereas corruption involves a breach of trust in the performance of official duties.

Fraudulent and corrupt conduct by public officials may fall within the category of 'official misconduct' under the *Crime and Misconduct Act 2001*. Official misconduct is conduct by public officials, related to the officials' duties, that is dishonest or lacks impartiality, involves a breach of trust, or is a misuse of officially obtained information. The conduct must amount to a criminal offence or be serious enough to justify dismissal.

Many forms of fraud and corruption are criminal offences under state and federal legislation. These include offences such as extortion, stealing, misappropriation of property, false pretence, receipt or solicitation of secret commissions, forgery, revenue evasion, election fraud, currency violation, and drug dealing.

This paper does not treat fraud and corruption separately, nor does it give one priority over the other. Similarly, these guidelines do not deal with all the possible dimensions of fraud and corruption.

The impact of fraud and corruption

There is little doubt that fraud and corruption have a substantial impact on agencies at both the personal and organisational levels.

According to the Commonwealth Government, fraud is currently the most expensive category of crime in Australia. Standards Australia has suggested that the cost to the Australian economy is at least $3 billion a year.[3] It warns that both the incidence and the financial impact of fraud is increasing year by year, as is the average financial loss associated with fraudulent conduct, and notes that a significant portion of cases of detected fraud is not reported to the police for investigation.

Standards Australia goes on to note that:

- identity theft is becoming the most important fraud-related threat within the Australian economy, and
- Australian organisations are ill-prepared to detect and prevent fraud, with many having made no progress in developing or implementing any form of fraud-control strategy.

In addition to the financial costs associated with fraud and corruption, there are intangible harms caused by unwelcome public and media scrutiny, and diminished community confidence in public institutions. These can reduce the effectiveness of agencies in fulfilling their missions.

Fraud and corruption can also have a detrimental effect on individuals. Work groups can be severely disrupted during investigations, resulting in lowered morale and reduced productivity and even interference with the private lives of innocent individuals.[4]

Fraud and corruption thus threaten the wellbeing of an organisation through the harm done to its organisational fabric and the damage inflicted on personal relationships. These factors have serious implications for an agency's financial outcomes, human resources and community standing.

Some dimensions of the problem

A recent survey of the largest private and public sector organisations in Australia and New Zealand carried out by the consulting firm KPMG showed that:[5]

> … Australian and New Zealand business is vulnerable to fraudulent attack at both the hands of people within the organisation (directors, managers, supervisors, contractors and employees) and persons external to the organisation.

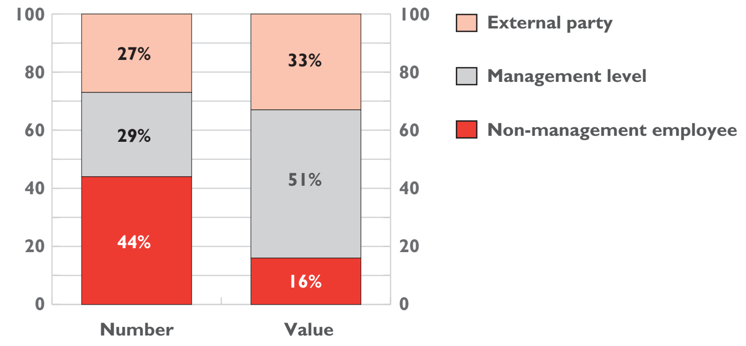
The survey disclosed that internal management and non-management personnel perpetrated 73 per cent of the largest single frauds. Figure 1 shows that, while the internal risks may involve people at all levels within an organisation, there is a significant risk of all types of fraud from external parties. When considering the financial services sector alone, the perpetrators are heavily weighted towards external parties.

At the same time, the survey also showed that the majority of the largest fraud incidents were detected by employees, or identified through the organisation's internal control systems (see Figure 2).

An agency's staff members thus form the single most potent force in detecting fraud, followed by strong control systems.

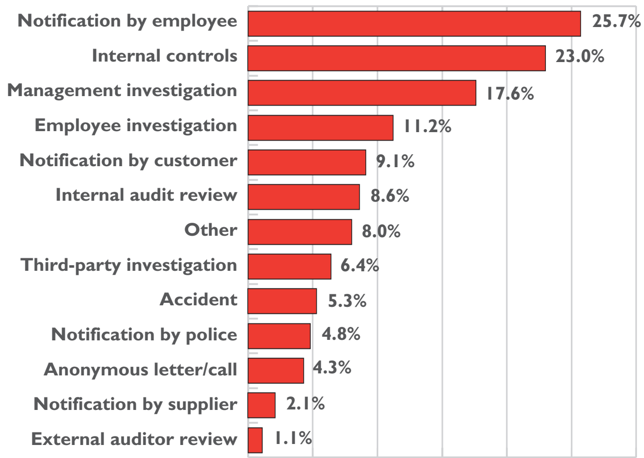
The importance of effective internal controls is illustrated by Figure 3, which shows that poor internal controls, or the overriding of internal controls, is far and away the principal underlying cause of major fraud.

Figure 1: Perpetrators of major fraud



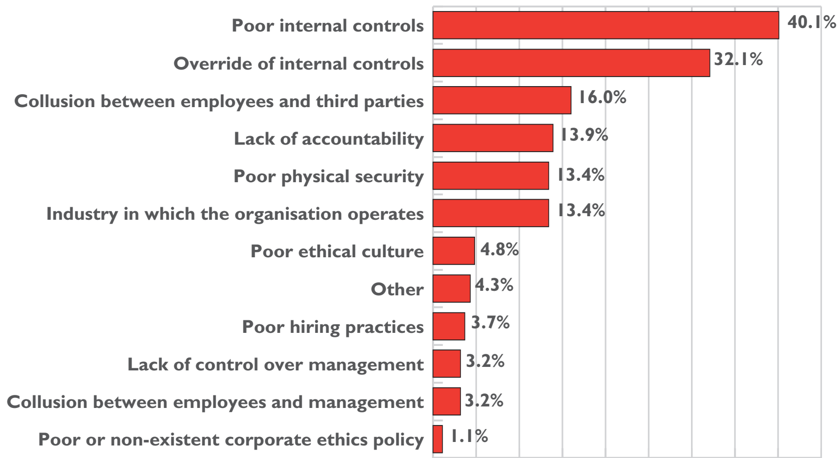
Source: KPMG Fraud Survey 2002.

Figure 2: Detection of major fraud



Note: Some respondents indicated more than one response.
Source: KPMG Fraud Survey 2002.

Figure 3: The underlying causes



Note: Some respondents indicated more than one response.
Source: KPMG Fraud Survey 2002.

The CMC model

The CMC recommends adopting an integrated approach to fraud and corruption control. This approach should incorporate proactive measures designed to enhance system integrity (prevention) and reactive responses (detection, investigation and prosecution). An integrated fraud and corruption control plan comprising 10 major elements is proposed. This plan should have full management support and universal acceptance throughout the organisation.

The structure of this proposed plan, and its component elements, is consistent with other Australian and international formats and builds on earlier models developed by the CMC. The components are closely interrelated, with each element playing a key role in realising the best outcomes. Implementation of the plan therefore should not focus exclusively on any one attribute, control system or area of operation, but be based on an holistic approach.

These guidelines outline the nature of that 10-element planning framework. Development of an overall fraud and corruption control plan should take adequate account of all 10 elements in achieving a comprehensive and integrated treatment of the dominant issues, timelines and responsibilities. According to the Commonwealth guidelines,[6] the plan should contain:

- an outline of the structure of the agency
- a statement of the agency's attitude and approach to fraud control [element 1 of the CMC model]
- a summary of the risks identified in the risk assessment process [element 2 of the CMC model]
- details of the strategies that will address these risks, including:
  - — allocation of responsibility for implementing the strategies
  - — timeframes, including expected start and completion dates for implementing the strategies, and
  - — mechanisms for monitoring the implementation of the strategies

  [element 3 of the CMC model]
- details of the strategies to ensure compliance with other elements in the guidelines including:
  - — strategies and timetables to ensure the agency meets the training and awareness requirements [elements 9 and 10 of the CMC model]
  - — strategies for collecting and reporting on fraud and corruption
- details of how employees, service providers, contractors and members of the public can report fraud against the agency [elements 4, 5 and 6 of the CMC model].

The developed plan must be made readily available to all relevant stakeholders with due consideration given to any security implications.

The plan must be reviewed periodically and amended as necessary — the frequency of reviews depending on the environment in which the agency operates. For example, an agency operating under conditions of rapid changes in legislation, organisational structure or technology may need more frequent reviews than one experiencing less rapid change.

These reviews should assess progress and performance against predetermined objectives. Reasons for non-conformance should be identified to pinpoint deficiencies and make improvements.[7]

Accountability for the implementation and ongoing monitoring of the plan should be allocated to a fraud and corruption control officer, or committee/ team appointed for the purpose, with appropriate authority, skills and experience and having the time and other resources necessary to discharge this responsibility properly.

1. Agency-wide policy

Responsibility for developing and implementing a fraud and corruption control plan rests with the CEO or accountable officer. To ensure that all relevant components of the plan are considered, the most practical approach may be to write a fraud and corruption control policy that takes into account subsidiary policies catering for each of the elements of the plan.

This overarching policy should clearly describe the agency's stance on fraud and corruption control. It should then detail a range of actions for carrying out the strategy in each division, unit or region of the agency, and show the relationships between the various parts of the plan.

To be effective, the policy should apply at all levels and across all operational areas of the organisation, taking into account both internal and external threats to the agency. Responsibility for various parts of the plan should be delegated to sections and individuals within the agency.

Implementation should include suitable monitoring arrangements to ensure that the plan's objectives are being achieved.

2. Risk assessment

Risk management is an essential ingredient of good management. To ensure it becomes an integral part of organisational culture, Queensland agencies are required to develop and implement systems for effectively managing the risks that may affect their operations.[8] In fulfilling the state legislation, all aspects of risk management must be considered, including fraud and corruption.

While the total elimination of fraud and corruption may be unrealistic, it should remain the desired objective on the premise that working towards this objective will result in fewer opportunities for fraud and corruption.[9]

Standards Australia recommends that a comprehensive assessment of the risks of fraud and corruption be undertaken periodically. Typically, this will mean carrying out an assessment every two years, but the frequency will vary with the agency's size, diversity of business functions, geographic spread, the extent to which the agency is monitored by other agencies or regulators, the rate of technological change, and the risks inherent within the industry sector in which the agency operates.[10]

These risk assessments should be carried out in accordance with the principles of AS 8001-2003, which in turn are based on the Risk Management Standard (AS/NZS 4360:1999). For completeness, they should consider not only the current environment and threats from both internal and external sources but also any risks that may emerge in the future.

After identifying and assessing potential risks, agencies must implement a plan to minimise and control them. As part of this risk assessment and management process, it may also be necessary to establish new or additional systems for monitoring, detection and control.

3. Internal controls

After a thorough risk analysis, relevant and effective internal controls must be put in place. Internal controls are methods employed to help maintain the integrity of systems and processes, safeguard agency assets and encourage compliance. They can be as simple as locking an office to discourage theft, or more complex, such as reviewing monthly statements or accounts to verify transactions.

Internal controls can be preventive or detective. Preventive controls include such things as a computer application that validates user names and account numbers to prevent unauthorised access, while a detective control would be the regular checking of cash receipts against monthly financial statements to detect deposits to wrong accounts.

Management of the risks associated with an agency's physical resources forms only part of the total ambit of a comprehensive fraud and corruption control plan. At the heart of most agencies is the secure management of information resources involving the interaction of staff with a multitude of external organisations and clients. Information management is also one of the fastest growing areas at risk from fraud and corruption.

The Auditor-General has emphasised the necessity for improving controls in relation to access to information and the critical importance of ensuring that information assets are not lost, amended, misused, inappropriately disclosed or damaged.[11] Agency management and control processes must ensure that the application of information in decision-making and other activities is always legitimate, objective and impartial in serving the public interest.

An agency's accountability structures are an integral part of its internal controls. Where accountability is vague or uncertain, fraud and corruption can flourish. Clear lines of accountability must be established to ensure operational integrity. This will also ensure that all aspects of the control plan are implemented.

Through careful design, a system of internal controls can help an agency operate more efficiently and provide reasonable assurance that the activities or outcomes for which it is responsible are adequately protected.

4. Public interest disclosures

A public interest disclosure refers to any disclosure made by a public officer to a supervisor, internal auditor or investigator, their chief executive, or an external investigation agency that contains information about:

- official misconduct
- maladministration — illegal, arbitrary, oppressive or improper public sector administrative action
- negligent or improper management involving a substantial waste of public funds by any public officer or public sector agency or anyone contracting to supply goods or services to a public sector agency.

Concerned and motivated staff who act as whistleblowers (or 'disclosers') are a powerful tool against fraud and corruption. Their role should be recognised by agencies.

The reporting of serious wrongdoing using appropriate internal and external channels is covered by the:

- *Whistleblowers Protection Act 1994* (Qld)
- *Public Sector Ethics Act 1994* (Qld)
- *Public Service Act 1996* (Qld)
- *Crime and Misconduct Act 2001* (Qld).

There are three primary objectives of whistleblower legislation — to ensure the protection of the discloser; to ensure that disclosures are properly dealt with; and to facilitate the making of disclosures.[12]

To achieve these objectives, agencies need clearly defined policies and procedures that place a responsibility on management to foster effective reporting and to adopt measures that protect the discloser. These policies and procedures should focus on staff training and development, management of investigations, internal controls, and systems of support or protection.

5. Internal reporting

Good channels of internal communication encourage a steady flow of information that can result in better ways of doing things.[13] They should incorporate an effective internal reporting system that will lead to the early identification of fraud and corruption risks.

The range of matters that should be covered by internal reporting will need to be much wider than for public interest disclosures (covered by the Whistleblowers Protection Act). Internal reporting mechanisms need to be able to capture suggestions for system improvements and identification of risk areas, as well as allegations of misconduct.

Staff may feel uncomfortable about reporting suspected fraud and corruption if there are no obvious reporting mechanisms. A well-publicised and documented system that clarifies staff responsibilities will foster confidence and minimise delays in reporting untoward situations.

To overcome any personal inhibitions about internal reporting, agencies should implement highly visible reporting systems and robust support mechanisms that encourage staff to take appropriate action when they recognise or suspect fraud or corruption. These systems must enable the reporting of fraud and corruption committed against the agency by employees, and by parties external to the agency.

6. External reporting

While internal reporting systems should always be available, in some cases staff members who wish to report suspected fraud and corruption may feel more comfortable reporting to an external body. There may be a statutory reporting obligation such as the Crime and Misconduct Act, which requires CEOs to report all cases of suspected official misconduct within their agency to the CMC. Internal management systems should ensure that the CEO is kept fully informed of such matters so this reporting takes place.

The requirements for external reporting will depend on the circumstances and seriousness of the suspected matter. The available reporting avenues are the CMC for suspected official misconduct and the Queensland Police Service (QPS) for criminal matters. In addition, any criminal offence that involves material loss of more than $500 must be reported to the Queensland Auditor-General. Acts of suspected fraud or corruption committed against an agency by an external party should be reported directly to the QPS.

Sometimes a matter falls into more than one category, and so must be reported to more than one of these external bodies. Agencies therefore must ensure that their policies and procedures, and staff development and awareness training adequately cater for these various reporting requirements.

The CMC has produced brochures for the general public on how to make a complaint to the CMC about public officials, and recently published a comprehensive document, *Facing the facts: a CMC guide for dealing with allegations of official misconduct in public sector agencies*, to assist agencies in satisfying their reporting obligations. These materials are available on the CMC website at <www.cmc.qld.gov.au>.

7. Investigation

When fraud and corruption is detected or suspected, a comprehensive approach to the subsequent investigation must follow. The Crime and Misconduct Act stipulates that, wherever possible, agencies must resolve internal matters themselves. This approach recognises that CEOs and managers are the people best placed to deal with any misconduct that occurs within their own agency.

In cases where suspected fraud and corruption is committed against the agency by an external party, preliminary investigation should be undertaken to determine its substance prior to reporting the matter to the QPS.

In all cases, investigations must be carried out objectively, thoroughly and without prejudice. Management must ensure high standards of investigation that preserve due process and protect the dignity and rights of the alleged perpetrator.

The *Facing the facts* guidelines mentioned above are designed to help agencies with the investigation process.[14] They provide practical advice on planning an investigation, maintaining the integrity of the process, and ensuring confidentiality and fairness during the process.

Agencies should consider prosecution in appropriate circumstances. Criminal prosecutions act as a strong deterrent against fraud and corruption and help to educate the public generally about the ethical practices of the agency and the seriousness of fraud.[15]

8. Code of conduct

A code of conduct is an essential element of a fraud and corruption control plan. It provides a documented minimum benchmark of expected behaviour, a tool to help communicate the agency's required ethical standards and, where necessary, a reference against which disciplinary action can be taken.

Although codes of conduct deal mainly with principles, effective codes anticipate likely ethical dilemmas and provide clear direction as to what the agency allows and prohibits in particular situations.

In Queensland the development of a code of conduct is mandatory for public sector agencies under the Queensland *Public Sector Ethics Act 1994*.

The code should be communicated to all staff at induction and at regular intervals afterwards. Agencies should take all reasonable measures to ensure that staff understand the concepts embodied in the code. This understanding should be confirmed by asking each person to sign a suitable declaration form.

Additionally, by distributing the code of conduct widely to external parties, they too will develop a clear understanding of the agency's ethical stance.

Agencies should review their code of conduct periodically to ensure its continued relevance. The frequency of these reviews will vary with the changing environment in which the agency operates, together with any internal changes made to the structure and function of the agency.

9. Staff training and awareness

Well-trained staff are a key factor in creating an appropriate organisational culture and in minimising the risk of fraud and corruption from both internal and external threats. As may be seen from the KPMG survey, they play a vital role at all stages of prevention, detection, investigation and prosecution.

To foster organisational integrity, agencies should implement comprehensive training and development programs that incorporate not only the agency's policies and procedures but also training and awareness of fraud and corruption issues. This training should be given to staff as they enter the agency, and on an ongoing basis as needed.

Specific training in relation to the agency's fraud and corruption control plan should include the risk management process, the reporting process and internal support mechanisms, and the management of investigations.

Through these training and awareness programs, and by adopting management practices that empower staff in their operational roles, the agency's systems and procedures can be continually improved, and staff can develop a greater understanding of and commitment to ethical decision-making.

TEN-ELEMENT MODEL FOR FRAUD AND CORRUPTION CONTROL

1. **Agency-wide policy**
2. **Risk assessment**
3. **Internal controls**
4. **Public interest disclosures**
5. **Internal reporting**
6. **External reporting**
7. **Investigation**
8. **Code of conduct**
9. **Staff training and awareness**
10. **Client and community awareness**

10. Client and community awareness

Client and community awareness programs can be an effective way to:

- provide clear guidelines about acceptable practices
- forestall the likelihood of unacceptable approaches being made
- increase the likely detection of suspected fraud and corruption
- add value to the agency's profile and standing within the community.

Many agencies conduct business with a wide range of external parties that have different ethical standards. Agencies should identify areas of risk in external dealings where the boundaries between acceptable and unacceptable practices may become blurred, and design appropriate ways of communicating the correct procedures to the external parties. This may include providing explanatory statements on tender documents and contracts, and issuing codes of conduct and/or ethical practices and values statements, along with other material.

In providing this information, an agency can avoid situations where unacceptable offers might be made, and send a clear message to their business partners regarding the agency's ethical values and business principles. Informed individuals

SUMMARY

- **The incidence and cost of fraud and corruption continue to increase across private and public sector agencies. New areas of fraud and corruption are evolving, especially in the area of electronic commerce and identity fraud.**
- **Agencies must develop appropriate responses to the threats posed by fraud and corruption from both internal and external sources.**
- **The implementation of an effective fraud and corruption control plan will require an integrated approach, bringing together a range of policies and procedures, including risk management, internal controls, reporting systems and practices, investigations, a code of conduct, and staff training and awareness.**
- **To assist agencies in assessing the adequacy of their current fraud and corruption control arrangements, the CMC is currently developing a comprehensive set of fraud and corruption control guidelines and associated toolkit materials.**
- **This paper outlines the basic structure of the forthcoming guidelines.**

are better able to recognise and report inappropriate practices. By drawing attention to acceptable practices, the agency can help expose suspected fraud and corruption by providing a sound basis for individuals to assess the agency practices in matters that concern them.

Finally, client and community awareness campaigns can provide leadership and improve the agency's standing among clients and the community generally.

Awareness programs, therefore, should target client groups, contractors, suppliers, consultants, part-time staff, and the community generally. They should demonstrate that the agency is committed to providing honest and ethical services to its clients, and that it has established policies and controls to prevent and detect internal corruption and to rebuff external threats.

Notes

1 Standards Australia 2003, AS 8001–2003 *Fraud and corruption control*, Standards Australia International, Sydney.

2 Queensland Audit Office, *Auditor-General's Report No. 10, 2002–03*.

3 Standards Australia 2003, AS 8001–2003 *Fraud and corruption control*, Standards Australia International, Sydney, p. 4.

4 WA Ministry of Premier and Cabinet, *Fraud prevention in the WA public sector*,1999.

5 KPMG, *Fraud Survey 2002*, KPMG Forensic, Sydney, April 2002, p. 5.

6 Attorney-General's Department, *Commonwealth fraud control guidelines 2002*, May 2002.

7 Standards Australia, op cit., pp. 26–27.

8 Financial Management Standard 1997, s. 84.

9 Standards Australia, op cit., p. 20.

10 ibid., p. 14.

11 Queensland Audit Office, *Auditor-General's Report No. 10, 2002–03*.

12 NSW Ombudsman, *Issues paper: Adequacy of the Protected Disclosures Act to meet its objectives*, April 2004, p. 8.

13 ICAC, *Fighting fraud: guidelines*, 2002, p. 20.

14 <www.cmc.qld.gov.au/library/CMCWEBSITE/FacingtheFacts.pdf>.

15 Attorney-General's Department, *Commonwealth fraud control guidelines 2002*, May 2002, p. 12.