Identifying, Assessing and Understanding the Risk of Exposure to Fraud and Corruption.

As a lawyer, one of the things that struck me when I came to the field of corruption prevention was the absence of an organised body of work and clearly identifiable and settled principles.

That is perhaps because in common law jurisdictions at least historically the control of corruption was left to the criminal law, which provided sanctions for such offences as theft and bribery.

It is not possible therefore to simply direct your attention to the orthodoxy of corruption prevention, but rather I will refer to a variety of sources and different ideas concerning the problem surrounding the control of fraud and corruption in an organisation.
The Sellenger Centre for research in law, justice and social change in Edith Cowan University has done some work for the Commission in this area.

They suggest that the absence of a theoretical framework implies that corruption prevention practices are not informed by theory or grounded on an evidence base, so that researchers are now adopting a variety of approaches to facilitate the development of corruption prevention theories.

The centre further points out that one approach has been to consider the strategies of regulators in other fields that deal with similar issues, whilst another has been to extrapolate underlying principles from those strategies.

The present state of endeavour can perhaps be seen from the objectives of the Trans National Research Institute on Corruption in the Australian National University, which include the development of "a newly coherent area of study bringing together scholars who might not previously have seen synergy in their work".

The Sellenger Center identified a number of strategies:
• The identification of clusters of offences or "hotspots", which can be ameliorated by crime prevention initiatives which concentrate on those areas.

• Routine Activity Theory (RAT), which places emphasis on the combined existence of a motivated offender, suitable targets and a lack of adequate guardianship or control.

• Situational Crime Prevention Theory (SCP), which postulates that crime occurs where there is considerable opportunity, as assessed in effect on a risk analysis.

The adoption of crime prevention theory is also proposed by Professor Graycar and Dr Aiden Sidebottom in a 2012 article "Corruption and control; a corruption reduction approach". (Journal of Financial Crime Vol. 19 No. 4, 2012 pp.384-399)

The paper is apposite, as it is specifically designed to officials working in public institutions.

The authors point out that SCP focusses on the crime event, as opposed to individual criminality, and suggest that a consensus has emerged on how opportunities in the immediate environment are causal influences of such events.

Reference is made to Professor Robert Klitgaard's 1988 formula: "Corruption equals monopoly plus discretion minus accountability".
SCP, it is said, categorises the crime event across four dimensions: Type, Activities, Sectors and Places (TASP), and that enables better identification of ways to:

- increase the effort on the part of the potential miscreant to behave corruptly
- increase his risk
- reduce the reward
- remove excuses and
- perhaps reduce relevant provocations.

The authors also break the notion of opportunity into two: systemic and localised.

On the assumption that your organisation has in place a relatively strong framework of ethics, including codes of conduct and a culture of ethical conduct it is the latter which is more relevant, and the authors categorise localised opportunities as including situations where supervision and oversight are not taken seriously, the actor has specialised knowledge or high discretion, the activity is remote from supervision, there is no capable guardian, there is low decision monitoring, low salaries, a low risk of being caught, a conflict of interest is disregarded, or whistle-blowers are not heard.
An aspect of risk is perhaps deterrence.

In a 2012 paper to a Thai conference Professor Matthew Stephenson of the Harvard Law School suggested there was a great deal of evidence from a variety of countries and contexts that revealed straightforward investigation and enforcement could significantly reduce corruption levels and that simple measures in a public corruption context such as increasing the number of prosecutors had been shown in the US to significantly reduce corruption levels.

Investigations, audits and the imposition of sanctions could therefore have a real effect, he said.

Professor Stephenson also argued there was an additional lesson emerging from research on anti-corruption and the criminal law generally that although it was important to have meaningful penalties, it was much more important to have "regular, consistent, timely and predictable enforcement of anti-corruption rules", and those "factors seem to matter much more than the magnitude of the penalty, so long as the penalties are sufficiently high to be meaningful".

In other words he said "that although the severity of the punishment does matter it doesn’t matter nearly as much as the probability that a punishment will actually be imposed in a timely fashion".
Apart from the risk aspect Professor Stephenson referred to the effect punishment had on reinforcing social norms against corruption. There was therefore a corresponding need to sustain an anti-corruption effort steadily over time.

An interesting example of the effectiveness of deterrence relates to the New York Police Department (NYPD) (provided by Messrs Kevin Ford, Michael Taylor and Max Irwing and brought to my attention by Dr Denis Osborne) which thirty years ago had a poor reputation for honesty.

However in 1994 a New York City mayor instituted change which included integrity testing of the police for bribery, with the aid of undercover personnel. The tests were carried out at a reasonable level - up to 2000 tests per year for a police force of 40,000, but the rumour effect magnified their impact.

As a result of the testing some of those susceptible were exposed and removed from the force, but more significantly the overall occurrence of the acceptance of bribes dropped by about 75%, as other officers became afraid of being caught out.

That result would appear to reinforce the proposition that it is enforcement that matters or, to use SCP terminology, the risk benefit
analysis produced a less favourable result, so the decision became one not to offend.

Another concept I have referred to which would appear related is that of "hotspots".

As part of the changed approach to policing in New York there was a shift in focus from individuals likely to commit crime to places where offences occurred.

According to the New York Times (25 January 2013) there was research which indicated that in many American cities half of crimes occurred within about 5% of the city area.

Police in New York then concentrated their efforts on such areas and, seemingly to everyone's surprise, when crime reduced in those areas it did not shift to other areas, but simply reduced.

The result was ultimately a prison population far less than the national average.

It was interesting to see in the West Australian media a recent report that WA Police have just adopted a "hotspot" strategy to target crime in Perth.
No discussion about the theoretical approaches to corruption control would be complete without reference to the work of Professor Malcolm Sparrow, who was an English police officer but left to become professor of the Practice of Public Management at Harvard University.

In "The Character of Harms. Operational Challenges in Control" (2008, CUP) he utilises as a generic term "harms" to cover events that are adverse to an organisation or society.

Professor Sparrow's views cannot be shortly or easily stated, but amongst the things he says are:

- In essence his approach is "Pick Important Problems, and Fix Them".
- The control of bad things can usefully be differentiated from the construction of good things.
- It is a mistake to regard broad preventive programs as a preferred approach to harms reduction, and such are merely means to an end, and not ends in themselves.
- To focus on process rather than a problem produces a different result to a focus on the problem itself.
- The essential thing is to identify the harm and that is done by identifying patterns of risk or incidents, called by him "knots", and by gaining as complete an understanding of them as possible. It is...
only then that the most appropriate method of control can be ascertained, whether that be a preventive program or direct action.

- A prolonged period of analysis and inspection is sometimes necessary to determine precisely what the problem is.
- It is important to have greater regard to the harm itself than to existing control structures, and an innovative approach to control might be necessary.

One example given by Professor Sparrow was an operation which became known as the Boston Gun Control Project.

Youthful homicide was occurring at an alarming rate in the City of Boston, and a project team was formed to try to do something about it. Early assumptions as to the cause were examined and rejected and it was eventually established most deaths resulted from "gang beefs", there being 61 gangs operating in the city.

It was realised gang members who committed an act of violence gained respect amongst their peers, so a strategy was developed to counter that. Gangs were told that if any member of a gang committed an act of violence the whole gang would receive the concerted attention of federal, state and city police agencies, so as to remove the gang from the streets completely.
Once the warning was given, two gangs had to be targeted.

Gang violence then dropped dramatically, and the homicide rate for young victims fell by 68% in the first year, and then continued to decline.

This particular example I think demonstrates the need for very careful analysis and selection of the most appropriate approach to control, as it is easy to see that many other strategies could have been adopted that would have been far less successful.

**Developing and Implementing Treatment Strategies that Prevent and Mitigate Identified Risks**

Clearly every organisation is different and an assessment of risk areas must depend on the particular features of the relevant organisation. Nonetheless, I think a consideration of the above is of assistance when one comes to make that assessment.

Whatever the theoretical state of corruption prevention, there do exist practical aids which an organisation can turn to to assist in the development of treatment strategies.

One resource is the Australian Standard AS8001-2008 "Fraud and Corruption Control".
The Standards Australia people had a concern about copyright if any part of the standard was reproduced, whether validly or not, so beyond pointing out that the usual areas are covered by it and that it contains a suggested framework for a fraud and corruption control plan, I do not propose to speak further about it, other than to note that federal organisations are obliged to have regard to it.

The Western Australia Auditor General has recently tabled a report (Report 7-June 2013) "Fraud Prevention and Detection in the Public Sector". Under the heading: "What should be done?" the following are listed:

- "organisational commitment to and awareness of fraud and corruption issues"
- specific consideration of fraud and corruption risks as part of their risk management processes
- concise policies and procedures covering fraud and corruption management with consideration of the need for a specific fraud and corruption control plan
- allocation of sufficient resources to manage fraud and corruption
- effective employee, supplier and customer vetting
- fraud and corruption training and awareness programs
alignment of the internal audit program with agency fraud and corruption risks

post incident reviews of controls”.

There are of course many case studies, or if you like cautionary tales, and some guidance can be obtained from them.

Two examples that stand out are my own Commission’s report in relation to alleged misconduct by public servants in relation to the purchase of toner cartridges from one company in exchange for gifts (report tabled in WA Parliament 24 November 2011) and the NSW ICAC report (October 2012) of an investigation into allegations that staff from local government and other public bodies accepted secret benefits from suppliers.

My Commission found in relation to the purchase of toner cartridges that in addition to high pressure sales strategies, gifts were offered to the procuring officers, including such things as GPS navigators, television sets and coffee makers.

One public officer received about $3,000 worth of gifts over a year, and purchased about $23,000 worth of cartridges. Purchased from a supplier on the government approved list the cost would have been about $5,000.

Another spent $111,000 on cartridges over a three year period.
A further officer said he had accumulated a four to five year supply of cartridges although the shelf life has only about two years.

Another result of the Commission’s investigation was that it was ascertained there were similar practices in regard to the purchase of toner cartridges from the company in other states.

Here in Victoria the Ombudsman found one government officer had purchased enough to supply his department for forty years.

In regard to the NSW ICAC investigation, findings of corruption were made against 41 people. A total of 15 recommendations were made in the report, and included the need for the communication to suppliers of a clear set of supplier behaviour expectations and the consequences for non-compliance, inclusion in any gift policy of a provision that any staff member who holds a financial delegation be prohibited from receiving any gift, that there be an assessment of which staff operate in an environment where relational selling is commonplace that consideration be given to e-procurement, and the provision of appropriate training for those people, and that councils analyse their procurement processes to identify points of corruption risk and take steps to improve the design of such. The following finding in relation to one sales technique used maybe of interest.
"Many of the salespeople whose conduct was investigated by the Commission were specifically trained in a selling process called 'Gears of Selling'. This process encouraged salespeople to pretend to have a friendship with the buyers. They were trained to ask questions about a buyer's family, interests and health, and to portray an interest in these matters that they did not really have. This is apparent from the fact that once a buyer left his or her position, the interest and concern disappeared.

In most cases, the process started with gifts worth modest amounts, but the size of the gifts increased with the value of orders placed by buyers on behalf of their agencies. Once the values of the gifts increased, salespeople would suggest that the gifts should be sent to the buyers' homes, rather than their work. Concealing the receipt of gifts in this way inculcated a greater feeling of gratitude in the recipients, and also a fear of being found out. Buyers then fell further into the grip of the salespeople and, in some cases began placing larger and larger orders to achieve more valuable gifts."

KPMG also do some useful work in this area with their annual survey of fraud, bribery and corruption in Australia and New Zealand. Amongst the points they made in the 2012 edition were:

- Beware of third party influence, as over the previous 12 years external parties were responsible for up to 74% of fraud by value in the finance sector, and 42% in the public sector.
- Responding to early indicators of fraud is essential, such being "red flags".
- Collusion is a growing problem, and data analytics, including predictive analytics, continuous auditing, rules based testing and
trend and benchmark analysis is one method of combating it, along with whistle-blower programs and a focus on key risk indicators.

In regard to individual officers and ongoing supervision and appraisal of them, in a report on occupational fraud and abuse (2012) the Association of Certified Fraud Examiners identified 16 danger signals:

- control issues
- a wheeler-dealer attitude
- financial difficulties
- living beyond means
- excessive pressure
- close associations with vendors or customers
- irritability or defensiveness
- refusal to take holidays
- past employment problems
- addiction problems
- excessive family/peer pressure
- divorce/family pressure
- past legal problems
- complaints about pay
- unstable life circumstances.
The most significant was said to be living beyond means, close association with vendors, divorce/domestic problems, control issues and a wheeler-dealer attitude.

In summary, to develop and implement treatment strategies that prevent and mitigate identified risks requires first, that the organisation establishes corruption prevention as a core part of its business, and, as with the central aims, a plan is developed, based on a thorough risk assessment of the organisation.

Some areas of function naturally lend themselves to corrupt or fraudulent activity.

Chief amongst those areas of function are:

- procurement, including by tender
- dispensing of licences, permits or other discretionary consents
- any activity where there is a conflict of interest.

Again, every organisation is different and has its own knots, as Professor Sparrow would say.

When talking about the development of treatment strategies I should mention one more theory, that of "Broken Windows", which was
developed, I assume, from the approach to policing in the same area in New York as that already talked about.

The theory is that communities experiencing lots of minor crimes become vulnerable to serious crimes over time. For example, when graffiti is left unattended, community members become generally less motivated to address crime. This facilitates, in turn, an escalation of social disorder and more serious crime. The lesson is that serious crime can be avoided if minor crimes are targeted.

The broken windows theory has some appeal for a number of reasons. First, it seems to fit with human experience. Second, and much more compellingly than intuition, is that it has been practically applied and proven to work.

In a work place setting that could include having a dress code or uniform requirement and enforcing it, the maintenance of discipline in regard to such things as punctuality and temporary absences from work areas, and the monitoring of internet use, and personal emails sent from work computers.

Enforcement in a diligent and consistent way of codes of conduct is another facet, particularly in relation to conflicts of interest.
Returning to risk assessment and monitoring such ought to relate to procurement in particular and fraud generally and needs to be incorporated into the risk management framework of the organisation. An analysis of relevant matters including the following would need to take place, followed by all necessary changes where vulnerability was revealed.

- Who is authorised to purchase goods or contract services, whether all such persons need to have that authority, whether any of them have other duties that are not compatible with that authority, in particular goods receipt or contract work approval, or authority to make payments.

- Whether the procurement regime requires a sufficient number of separate quotations, with documentation of such, managerial checking of the selection process and documentation of that.

- Supplier and contractor registers.

- CEO approval of sole supplier purchases or contracts.

- For tenders a requirement for signed evaluation reports and the choice of appropriate tender panel members.
- Recorded checking of goods received and service contracts carried out.

- Is there a corporate credit card register, who is authorised to hold a corporate credit card and what controls are there over its use.

- Other adequate payment controls.

- A stocktake policy with other adequate inventory assessments, and a system to record all stock movement with stocktakes to be conducted by independent officers.

- Secondary employment controls.

- A procedure to check ABNs and ABRs of suppliers and contractors.

- A conflict of interest policy and register.

- A whistle blower policy and a procedure to facilitate people coming forward when they have a concern.

- A watch on increases in expenditure in an area, or to a particular supplier or contractor or on increases in use of a particular supplier or contractor, or very frequent use of one supplier.
- Vetting of suppliers and contractors.

- A strict gift policy.

- Independent internal audit committee.

That is not, and is not intended to be, exhaustive.

Some of you might think these are obvious measures to take.

Let me assure you that in my time at the CCC most misconduct of this kind arises from failures to have in place, or to observe basic controls.

By way of example, a Perth local government council centred on a beachside suburb hired G, an architect, to undertake conservation and maintenance work, both personally and by contracting others. He was entrusted with the obtaining and assessing of quotations and the making of recommendations about such.

A week before G started with the council he registered a business name, which consisted of three initials, and on commencement he began issuing purchase orders for work, in favour of that business and then with his business hat on, sent invoices which the council duly paid, ostensibly to the business but in fact to G's bank account.
Once the fraud was uncovered it was found that some work had not been done at all, while some had been done by the town itself, or other paid contractors.

Some of the work actually done and paid for had been done by G himself during council working hours.

The fraud went on for over 12 months and was discovered only by chance.

A search of the Australian Business Register, freely available to local governments, would have revealed the connection between this new and frequent supplier of services to the council, and G, its employee. Spot checking of work done would have also revealed the scheme.

Another investigation involved Princess Margaret Hospital for Children in Perth, where a leading hand in the hospital café was able to steal an admitted sum of $186,000.

The circumstances included the existence of an obligation to café staff to issue receipts which was not enforced, and failure by staff to adhere to a direction to log off from cash registers after each transaction. There were other failures.
A particular cosmetics firm was the ultimate beneficiary. Over a five-year period this leading hand spent $257,000 on their products all of which was purchased from one particular shopping centre store.

It is important to ensure the development of treatment strategies does not involve the imposition of further compliance burdens on an inappropriate or inefficient business model.

A constant complaint of public sector managers is the compliance burden they face.

But these burdens are often implemented without a rational assessment of what the best business model to deliver a given service might be. ICAC have recently been proposing that these ever increasing burdens are, themselves, a source of corruption risk. For example, adding checklists to an already broken process might simply reinforce existing fraud and corruption risks.

ICAC proposes that what ought to happen is that the starting point for treatment strategies should be a best practice model for the service being delivered. As opposed, for example, to simply adding compliance burdens to the model currently being used.
For example, if you are receiving and paying invoices from multiple suppliers what is the best way to do this? What, for example, does Bunnings have to say about how this should be done?

If corruption is found among the inefficiencies in government, there is something to be said for this. Certainly, if a treatment strategy adds another burden to an already overburdened and inefficient system, there must be a good chance that the treatment strategy will be ignored.

The overriding lesson from this is, I think, that treatment strategies ought not necessarily be burdensome to work. They are unlikely to work if they are just added on to an already overburdened process.

**Monitoring Compliance and Evaluating the Effectiveness of Treatment Strategies**

A forensic audit is the first thing of importance that ought routinely be done to monitor compliance with treatment strategies. Interestingly, KPMG also suggest that stress testing ought be undertaken, in the form of controlled attempts to perpetrate fraud.

The other measure of greatest importance is adequate supervision. As shown the Corruption and Crime Commission’s experience is that the correlation between poor supervision and fraud and corruption is high.
Our experience of fraud and corruption frequently coincides with workplaces in which supervision is either poor or effectively non-existent.

I doubt that the issue of monitoring compliance goes very much beyond adequate supervision. In environments in which people are adequately supervised, part of the supervision process involves ensuring that people follow agreed stated organisational policy, procedure and process. Even in contemporary 21st century organisations this remains a core function of supervisors.

Let me use another example.

One case investigated by the Commission involved an engineer who built highly specialised medical facilities. What was interesting about this case was his ability to consistently build these highly specialised facilities on time and under budget. It is not necessary to go into the detail of the corruption, it is enough to say that it occurred. What is of most relevance is that the only way he could consistently build these facilities on time and under budget was by ignoring the tendering rules.

It is almost impossible to accept that his supervisors were unaware that he was doing this, but they did nothing. He operated without any effective supervision at all. Maybe his supervisors avoided supervising
because to do so would have meant they would have to address the uncomfortable reality that he had to be ignoring the tendering rules.

His supervisors were ignoring an important fraud and corruption "red flag". He was the wheeler-dealer that the Association of Certified Fraud Examiners tell us is one of the more significant fraud danger signals.

Good supervision, and by extension appropriate compliance monitoring, involves working out what the fraud and corruption red flags are and paying attention to them. On this point I return to my earlier comments about the nature of treatment strategies. There is no "one size fits all" strategy. It follows that there are no universal "red flags". "Red flags" will necessarily reflect organisation-specific fraud and corruption issues. The hard work is working out what they are.

Again, let me use examples. I have talked quite a lot about local government procurement. It seems to me that an important "red flag" here must be the existence of multiple payments to limited suppliers which, on a payment-by-payment basis, do not meet tender thresholds but, when aggregated, exceed tender thresholds. Another is concentrations of invalid ABNs. Two issues that ought to be relatively easily identified by moderately competent supervisors.
It might also be said that it is also possible to test the effectiveness of treatment strategies by declines in the occurrence of "red flags". I think that there is truth in the observation that changes in the occurrence of "red flags" tells us something about the effectiveness of treatment strategies, but interpreting what the changes mean might be challenging, as an increase in reporting might actually result in an increase in "red flags".

Finally as the WA Auditor General points out, it is important that there be a response where fraud has occurred, by way of a post incident review and trend analysis.

**Reviewing Treatment Strategies to Maintain Relevancy and Adequacy**

So far we have identified risk, developed treatment strategies and monitored compliance and effectiveness. The next issue to arise is reviewing the relevancy of treatment strategies.

As I have already said, it seems to me that the main issue for controlling fraud and corruption is to mainstream control measures into the business life of public sector organisations. I have already talked about developing control measures, but not about mainstreaming these measures.

Public sector organisations evolve and adapt. As governments change, they make machinery of government changes according to their policy.
agendas. In other words there is a fair bit of churn in the make-up, existence and focus of public sector organisations. It follows that, as the businesses and structures of public sector organisations change, so to do their fraud and corruption risk profiles.

Public sector organisations primarily deal with change through their planning cycles and re-structuring strategies. What I propose is that mainstreaming the control of fraud and corruption simply means including fraud and corruption risk identification and treatment in the normal business planning and change cycle.

For example, most organisations review the relevance of their strategic and business plans annually. Some more often, some a bit less often. But they all have a cycle. Most organisations periodically review their codes of conduct and values statements. Perhaps not annually, but I doubt that there are too many organisations that do not review and amend these every five years or so.

As changes from these cycles emerge, so to do consequential changes to fraud and corruption risk. It follows, I think, that this planning cycle should logically include fraud and corruption risk. The same argument applies to organisational re-structures. Identifying and treating fraud and corruption risks as part of the ordinary re-structuring process ensures that it remains relevant.
Educating Employees and External Stakeholders

The final topic to tackle is education. Education is the first line of defence against fraud and corruption. But, for all the reasons I have discussed, will not, of its own, do any more than deliver modest outcomes. It is nevertheless important.

What needs to be said is the best education strategies focus on specific, identified risks and treatment strategies. People need to be educated, for example, about how to test the validity of ABNs and why this is important to control fraud and corruption. People need to know how to implement the practicalities of these things.

The Corruption and Crime Commission provides education programmes. Our experience is that it is practical education about the experiences of people, dealing with specific issues that is, by far, the most sought after. The education forums we offer in this area are consistently swamped with attendees.

What this tells me is that public officers want this practical education over and above the generic. And it makes sense that they do. After all, it is the practical application of strictures which affect what actually happens in organisations.