NEW SOUTH WALES AUDITOR-GENERAL'S REPORT
PERFORMANCE AUDIT

Fraud Control:
Current Progress and Future Directions

THE AUDIT OFFICE
OF NEW SOUTH WALES

THE ROLE OF THE AUDITOR-GENERAL

The roles and responsibilities of the Auditor-General, and hence the Audit Office, are set out in the Public Finance and Audit Act 1983.

Our major responsibility is to conduct financial or 'attest' audits of State public sector agencies' financial reports. We also audit the Total State Sector Accounts - consolidation of all agencies' accounts.

Financial audits are designed to add credibility to financial reports, enhancing their value to end-users. Also, the existence of such audits provides a constant stimulus to agencies to ensure sound financial management.

Following a financial audit the Office issues a variety of reports to agencies and reports periodically to Parliament. In combination these reports give opinions on the truth and fairness of financial reports, and comment on agency compliance with certain laws, regulations and Government directives. They may comment on financial prudence, probity and waste, and recommend operational improvements.

We also conduct performance audits. These examine whether an agency is carrying out its activities effectively and doing so economically and efficiently and in compliance with relevant laws. Audits may cover all or part of an agency's operations, or consider particular issues across a number of agencies.
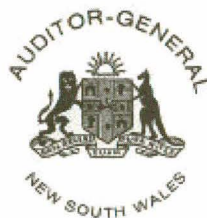
Performance audits are reported separately, with all other audits included in one of the regular volumes of the Auditor-General's Reports to Parliament - Financial Audits.

AUDITOR-GENERAL'S REPORT

PERFORMANCE AUDIT

Fraud Control:

Current Progress and Future Directions

The Legislative Assembly
Parliament House
SYDNEY NSW 2000

The Legislative Council
Parliament House
SYDNEY NSW 2000

In accordance with section 38E of the *Public Finance and Audit Act 1983*, I present a report titled **Fraud Control: Current Progress and Future Directions.**

R J Sendt
Auditor-General

Sydney
February 2005

Contents

Foreword

Periodically we review the extent to which agencies have implemented the recommendations they accept from our earlier audits. This gives Parliament and the public an update on the extent of progress made.

Given the size of the NSW public sector, the potential for fraud could run into billions of dollars if not properly managed. It is an area of risk that warrants close and ongoing attention. Over the last decade, we have responded by issuing three performance audits and a comprehensive guide to better practice on this topic.

In conducting my financial audits, there is now an Auditing Standard that requires me to seek annual assurances from every agency concerning the adequacy of their arrangements for fraud control. This latest performance audit provides a further report card on the extent to which the NSW public sector is managing its fraud risks.

This Report also provides updated guidance on improving arrangements for fraud control both at a whole-of-government level and at the agency level.

I commend the Report for close and careful attention by every agency.

Bob Sendt
Auditor-General

February 2005

Executive Summary

Executive Summary

Independent studies continue to quantify the potential risk of fraud for organisations to be between 2% and 5% of turnover. If that materialised for the NSW public sector it would equate to between $1.2 billion and $3 billion annually.

Since 1990 NSW agencies have operated under a policy requirement, issued by Premier's Department, to take action to address their risks of fraud (both internal and external).

Because of its significance, we have conducted three performance audits of this issue over an eleven-year period.

Our first performance audit (1993) examined progress in implementing the 1990 policy directive, and led to us publishing detailed guidance material to assist agencies improve their performance (1994).

Our second performance audit (1998) provided a status report on progress, which was rated as mixed, and made recommendations to facilitate improvement.

Now, in 2004, we have again determined the extent to which agencies have given effect to the 1990 policy directive.

Audit Opinion

There is both encouragement, and disappointment, in the results.

On the positive side, things have been improving. Some agencies have developed strong profiles for their fraud control work. Compared to our previous audits, the level of poor performance has reduced. Meaning, that the proportion of agencies with poor to moderately-effective fraud control strategies has declined.

However, only half of the agencies have "effective" or "highly effective" fraud control strategies. Of concern, the proportion of agencies with a highly effective strategy has decreased from 1993 to 2004. And looking more closely, the specific attributes of fraud control that are lagging across the sector are core, not peripheral, aspects.

While there are encouraging signs, we believe that the current result is not good enough. The NSW public sector needs to consolidate upon its slow but steady progress in addressing this issue and to raise its performance to the level required to combat the risk that fraud presents.

Findings

When we last audited progress in 1998, we found a mixed result with considerable room for improvement. At that time our sense was that the issue was fading from the management agenda in a considerable number of NSW agencies. Recommendations were framed to address this situation. Little sector-wide reform has been apparent. Our recommendation for fraud control strategies to be given legislative backing was not actioned, and no further directives have been issued on the subject since the original in 1990.

Given that the current approach, policy, strategy, and guidance material has been in effect for over a decade, it seems fair to conclude that the results we now see are as good as current tactics are going to provide.

To determine how things stand, and what directions for change may be most relevant and effective, the results of this current audit require close analysis and careful interpretation.

There are some positive signs. Some agencies have developed a strong external reputation in this area, and our survey indicates good news in a number of ways:

- a large increase in the number of agencies reporting an "effective" strategy (from 13% in 1993 to 37% in 2004)

- a large increase in the number of agencies reporting a "fairly effective" strategy (from 17% in 1993 to 26% in 2004)

- a decrease in the number of agencies reporting "generally ineffective" (from 10% in 1993 to 6% in 2004) and

- a large decrease in the number of agencies reporting "ineffective" strategies in place (from 25% in 1993 to 2% in 2004).

On the negative side, agencies are telling us that over time fewer of them have "highly effective" strategies in place. The proportion of agencies reporting that they have a highly effective fraud control strategy has decreased from 20% in 1993 to 13% in 2004. This decline is not in line with either policy requirements or the expectations of the Government.

Interpreting the adequacy of these results requires a judgement of what level of performance is necessary to address the risk. Studies globally of fraud indicate that it is not reducing as a key risk issue. The incidence of fraud within the Australian economy is increasing and the average financial loss associated with fraudulent conduct is increasing. The resilience and adaptability of those who commit fraud is a matter of record. Without a serious commitment by management and a holistic approach, efforts to control fraud will not be sufficient.

Given that policies have been in place for the sector since 1990, our view is that all agencies should have reached the stage of having at least an "effective", if not "highly effective", fraud control strategy in place. For many years we have argued that if standards are not set at this level, fraud will not be controlled.

Current results show that only 50% of agencies have achieved this standard of performance. We do not think this is good enough.

Breaking the overall results down allows us to consider where emphasis for improvement may be most beneficial. We did this in several ways.

First, we broke the sector down into various groupings to compare performance. Secondly, we dissected performance against each of the ten best practice elements for fraud control.

Looking at fraud control performance by agency groupings we found that:

- the universities sector is lagging and needs to do considerably more
- the health sector still has more work to do
- the budget sector has outperformed the non-budget sector, an unexpected result given the stronger focus on managing risk in the non-budget sector. It means that the non-budget sector needs to do more.

Looking at fraud control performance by each of the ten specific fraud control elements we found that:

- the best results were obtained for agencies meeting the requirements for implementing mandatory requirements for protected disclosures and external reporting, and developing conduct standards
- good performance was also apparent for the relatively simple aspects (yet still important) of consolidating and harmonising relevant agency policies and defining organisational arrangements and responsibilities

- the poorest results were for the attributes of:
  - customer, community and employee awareness (of the agency's anti-fraud focus)
  - fraud risk assessment
  - investigation standards.

These are not minor chinks in the armour. They represent very significant areas for a fraud control strategy to have weakness, and must be a priority area for attention.

Whilst there is some encouragement in the results from our survey, and the positive efforts of NSW agencies need to be recognised, the facts cannot be glossed over.

This report provides both recommendations for reform, and updated guidance material with specific suggestions for action, tailored to addresses the specific challenges that the results of the audit have identified.

Summary of Recommendations

Recommendation 1:
Sector-wide reform

To support improved fraud control across the NSW public sector generally, we recommend that **NSW Treasury**:

- initiate a minor amendment to the *Public Finance and Audit Act 1983* to provide a specific legislative basis for fraud control by NSW agencies (repeat recommendation) [page 23]

- clearly extend application of fraud control requirements to non-budget sector agencies through the most appropriate mechanism/s for this purpose [page 22]

- formally encourage all public sector organisations to address the recommendation of this report directed to Audit Committees and the improvement of detailed aspects of fraud control at the agency level (below) [page 22].

Recommendation 2:
Action by each agency

To support improved fraud control at the individual agency level recommend that **the audit committee of each agency**:

- review the adequacy of processes supporting the agency's required management representations concerning its fraud control systems and procedures (AUS 210) [page 24]

- review the agency's fraud control strategy against the 2004 revision of the Audit Office's ten attributes of best practice for fraud control [page 38]. In so doing, we strongly encourage agencies to adopt or enhance:

  □ pre-employment screening practices [page 31]

  □ strategies to make staff, customers and the community aware of the agency's commitment to fraud control [pages 18, 38]

  □ the use of data mining as a routine element of line management review of operations [page 32]

  □ the use of relevant data mining and forensic investigation tools by audit and investigation teams [page 32]

  □ processes for receiving reports from staff, contractors, suppliers, customers and stakeholders [page 32]

  □ the regularity and robustness of fraud risk assessments [pages 18, 38]

  □ recognised standards for investigation activities [pages 18, 33]

  □ appropriate quality assurance arrangements for fraud investigations [page 33].

Response from Treasury

I refer to your letter of 23 December 2004 regarding the performance audit of fraud control.

It is pleasing to note that there are positive signs of agencies improving the effectiveness of their management strategies to control fraud, notwithstanding an apparent decline in the number of agencies which now regard their strategies as being "highly effective."

Treasury is very supportive of initiatives to improve fraud control and other financial management practices of agencies. In our dealings with agencies particular emphasis is given to enhancing risk management practices.

When the Public Finance and Audit Act was drafted in 1983, specific provisions were included (section 11) placing responsibility on the Chief Executive Officers of agencies to ensure there is in place an effective system of internal control over the financial and related operations of the agency. The Act also provides that the system of internal control is to be reinforced through an effective internal audit function.

In addition NSW Treasury has also issued the "Statement of Best Practice, Internal Control and Internal Audit" (1995) and the Risk Management Toolkit.

It is Treasury's view that the existing provisions of the Act and these publication place an onus on Chief Executives to establish robust internal control procedures over all areas of their agencies. Fraud control should be an integral part of this framework.

However, in light of the Audit Office's finding, the Treasury will work with the Audit Office to develop proposals to reinforce the adoption of better fraud control practices.

(signed)

Kevin Cosgriff
Acting Secretary

13 January 2005

1. Current Progress in Managing Fraud Control

What Is Required of Agencies?

Policy requirement since 1990

In June 1990, Premier's Department advised agencies of "the need to ensure that appropriate measures were in place to combat the level and nature of fraud risk relevant to each organisation".[1] Under this policy, "responsibility for determining appropriate controls against internal and external fraud would rest with chief executives, in preference to more formal and centralised arrangements such as are used in the Commonwealth".[2] A highly devolved approach was adopted.

Audit Office involvement

We have maintained a significant involvement in fraud control over an extended period:

- a performance audit into the area was undertaken in 1993
- we wrote detailed Fraud Control Guide (1994) to assist agencies implement the policy requirement
- a second performance audit was undertaken in 1998
- this third performance audit follows ten years since the launch of the Fraud Control Guide.

Fraud control guidelines since 1994

The Fraud Control Guide that we developed in 1994 was endorsed by Premier's Department for use across the sector.

The Guide set out a model for agencies to develop a holistic and strategic approach to fraud control, instead of the disconnected and reactive actions that were occurring across the sector in attempting to implement the policy requirement.

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[1] Memo to all Chief Executives from the Director-General, NSW Premier's Department.
[2] ibid

The model that we developed featured "10 attributes of best practice" which all agencies needed to address. This would provide sector-wide consistency to a sector-wide problem. However, a one-size-fits-all approach was not advocated. The extent to which each attribute would be an issue for each agency would vary according to the nature of the business and risk profile of the agency.

Ten-point model

Integrated Macro Policy	Fraud Reporting systems
Responsibility Structures	Protected Disclosures
Fraud Risk Assessment	External Notification
Employee Awareness	Investigation Standards
Customer and Community Awareness	Conduct and Disciplinary Standards

Detailed guidance material on applying the model was published jointly by the Audit Office and Premier's Department in 1994. Over three thousand sets of the 3-volume guidance material have been distributed, with requests for copies continued for many years. As the internet grew to become a key channel for information distribution, this material was provided online through the Audit Office's website.

The original guidance material included a detailed review workbook, with checklists that agencies could use to carry out ongoing reviews of their performance in implementing the model. The review tool was updated following our second audit in 1998, and an online self-assessment tool was made available to all agencies to enable them to regularly review and rate (score) themselves against the model.

Assessing Fraud Control Performance for NSW Agencies

Audits over an eleven-year period

Our first performance audit (1993) examined progress in implementing the 1990 policy directive, and led to the development of the detailed guidance material (1994). Our second performance audit (1998) provided a status report on progress. Now, in 2004, we have again determined the extent to which agencies have given effect to the 1990 policy directive. Agencies have had fourteen years to do so, with detailed guidance having been available for ten years and follow-up action also undertaken by us during that time.

What should agencies be aiming to achieve?

Given that policies have been in place for the sector since 1990, our view is that all agencies should have reached the stage of having at least an "effective", if not "highly effective", fraud control strategy in place. For many years we have argued that if standards are not set at this level, fraud will not be controlled.

How was agency performance assessed?

In our latest audit, we again requested agencies to undertake a self assessment against the "10 Attributes of Fraud Control" in the 1994 Guide, using the assessment tool that has been available from our website since March 1998.

Our performance audit team was assisted by our financial audit teams for each agency, who reviewed the responses received for reasonableness against their educated perceptions of risk and control at the agencies. Our overall performance audit methodology also included a range of other elements, as described in the Appendix.

What questions does this audit address for Parliament and the community?

Our last survey, in 1998, found a mixed result with considerable room for improvement. Recommendations were framed to address this situation. Little sector-wide reform or action against our specific recommendations for reform has been apparent. Even so, through a range of means (including our financial audit work with agencies) we have continued to encourage agencies to address this issue.

There are three key issues of interest for Parliament and the community of NSW taxpayers in this area:

- has fraud control improved in NSW?
- it is adequate to address the issue?
- do the fraud control practices in action at NSW agencies reflect best practice?

Our report answers these questions, and based on the results proposes relevant directions for change and specific actions for agencies to take.

Progress Over the Last Decade

Is progress encouraging?

To consider how best to move forward we need to assess the progress that existing approaches have generated over time.

How have things been changing over time, given the benefit of this issue receiving regular attention in the media, management journals and at conferences, and with detailed guidance material having been available for many years?

1993 audit results

Effective 13%

Highly effective 20%

Fairly effective 17%

Partly effective 15%

Ineffective 25%

Generally ineffective 10%

1998 audit results

Highly effective 8%

Effective 23%

Ineffective 16%

Fairly effective 18%

Generally ineffective 16%

Partly effective 19%

2004 audit results

Highly effective 13%

Effective 37%

Ineffective 2%

Generally ineffective 6%

Partly effective 16%

Fairly effective 26%
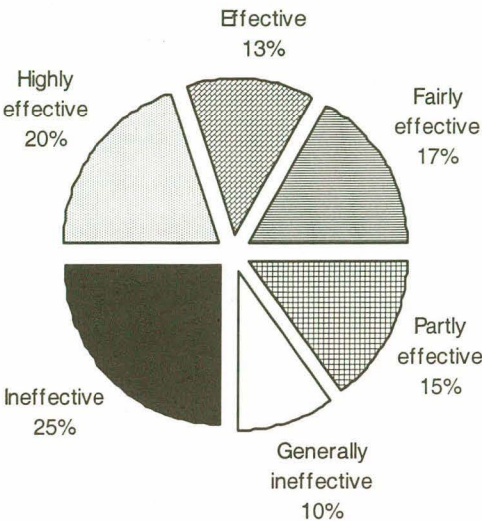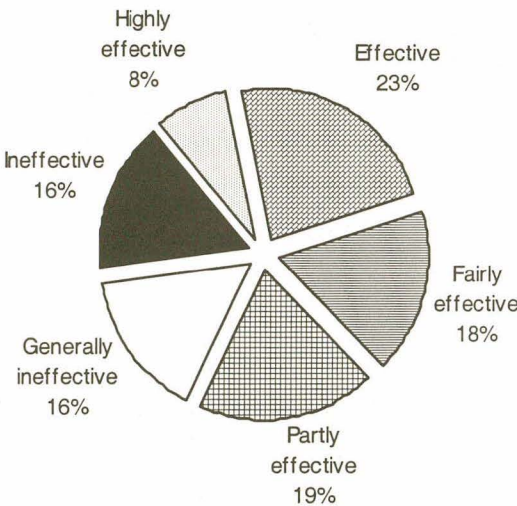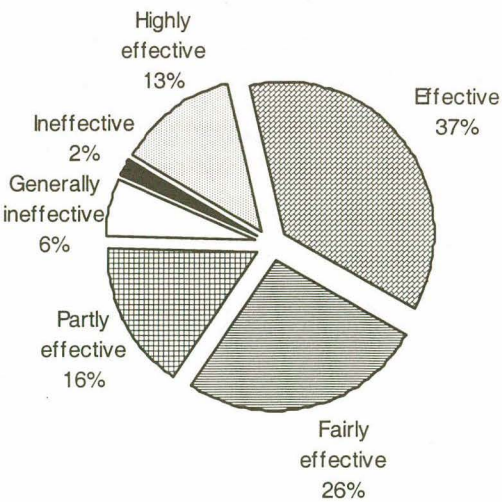
Overall progress On the positive side, things have been improving. While the proportion of agencies with an "effective" or "highly effective" strategy remained largely the same between 1993 and 1998, there has been a significant improvement from 1998 (31%) to 2004 (50%).

The good news in greater detail Breaking the good news about overall performance down in other ways, other more detailed improvements that we identified include:

- a large increase in the number of agencies reporting an "effective" strategy (from 13% in 1993 to 37% in 2004)

- a large increase in the number of agencies reporting a "fairly effective" strategy (from 17% in 1993 to 26% in 2004)

- a decrease in the number of agencies reporting "generally ineffective" (from 10% in 1993 to 6% in 2004)
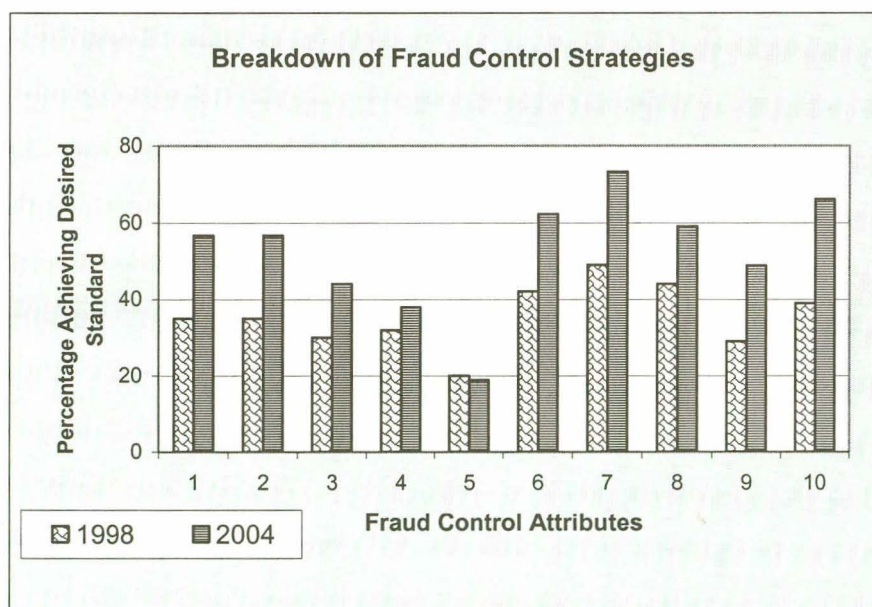
- a large decrease in the number of agencies reporting "ineffective" strategies in place (from 25% in 1993 to 2% in 2004).

Progress at the sub-component level In assessing progress, another important perspective to consider is performance against each of the ten separate best practice attributes for fraud control as set out in our 1994 Guide.

Breakdown of Fraud Control Strategies

Percentage Achieving Desired Standard

Fraud Control Attributes

☒ 1998   ▦ 2004

This also shows a positive trend and is encouraging. However, not all important trends are positive.

Not all important trends are positive On the negative side, agencies are telling us that over time fewer of them have "highly effective" strategies in place.

Percentage of Agencies Having a Highly Effective Fraud Control Strategy in Place
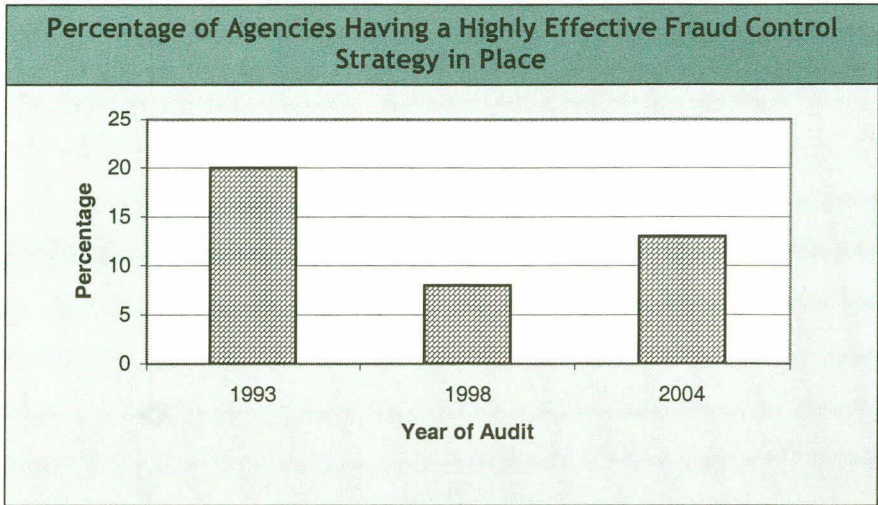
The proportion of agencies reporting that they have a highly effective fraud control strategy has decreased from 20% in 1993 to 13% in 2004. This decline is not in line with either policy requirements or the expectations of the Government.

The Overall Situation in 2004

What is the overall standard of performance in fraud control for NSW?

While some trends are positive, the overall level of performance warrants closer examination. Fourteen years since the policy requirement for fraud control strategies was issued by Premier's Department, what standard of performance in fraud control is being achieved?

We know of some good stories, and we know of concerted efforts over a prolonged period by a number of agencies.

Our survey asked all NSW agencies to rate the effectiveness of their fraud control strategy against the best practice criteria that they have been working with now for ten years.

Effectiveness of NSW Fraud Control Strategies in 2004

Legend:
- ■ Ineffective
- ☐ Generally Ineffective
- ▦ Partly Effective
- ▤ Fairly Effective
- ▨ Effective
- ☐ Highly Effective

Percentage
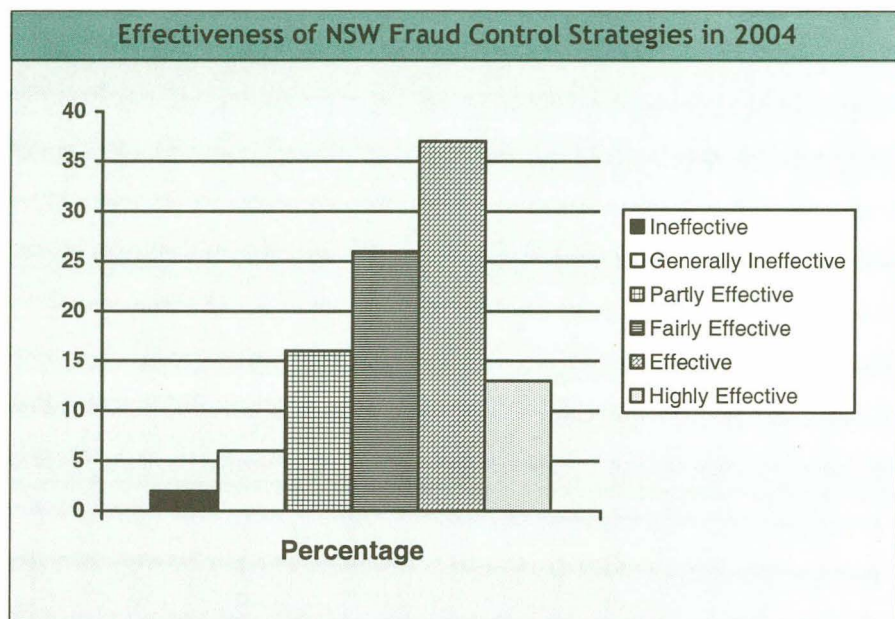
What do the overall results mean?

There is both encouragement, and disappointment, in the results. This is especially so considering that the assessment is not made by us (who, being external and independent, might tend to judge more strictly), but by the agencies themselves. Agencies have self-declared that 37% have "effective" strategies in place, but only 13% consider that they have highly effective strategies.

This means that only 50% of agencies have in place "effective" or "highly effective" strategies. We do not think this is good enough.

A closer look, by sub-groups across the NSW public sector

Breaking the overall sector down allows us to consider where emphasis for improvement may be most beneficial.

We analysed the performance of various "sub groups" of agencies across the sector, including:
- universities
- Area Health Services
- budget sector agencies (those funded from the Consolidated Fund)
- non-budget sector agencies (those that largely self-fund).

In comparing universities and the sector overall, we found:
- both have similar levels of "highly effective" fraud control strategies in place, but
- universities have a significantly larger proportion of "generally ineffective" strategies.

This means that, overall, the universities sector is lagging and needs to do considerably more.

In comparing Area Health Services and the sector overall, we found:

- both have similar levels of "highly effective" fraud control strategies in place, but

- the overall sector has strategies that are more towards the "effective" end of the scale than the Area Health Services.

This means that **the health sector still has more work to do.**

In comparing the Budget and Non-Budget sectors, we found:

- both have similar levels of "highly effective" fraud control strategies in place, but

- Budget sector agencies have strategies that are more towards the "effective" end of the scale than their non-budget sector counterparts.

This means that the budget sector has outperformed the non-budget sector. This was an unexpected result, given the stronger focus on managing risk in the non-budget sector. It means that **the non-budget sector needs to do more.**

Performance at the sub-component level

Another way to consider what approaches to improvement may be most beneficial is to dissect performance against each of the ten best practice elements.
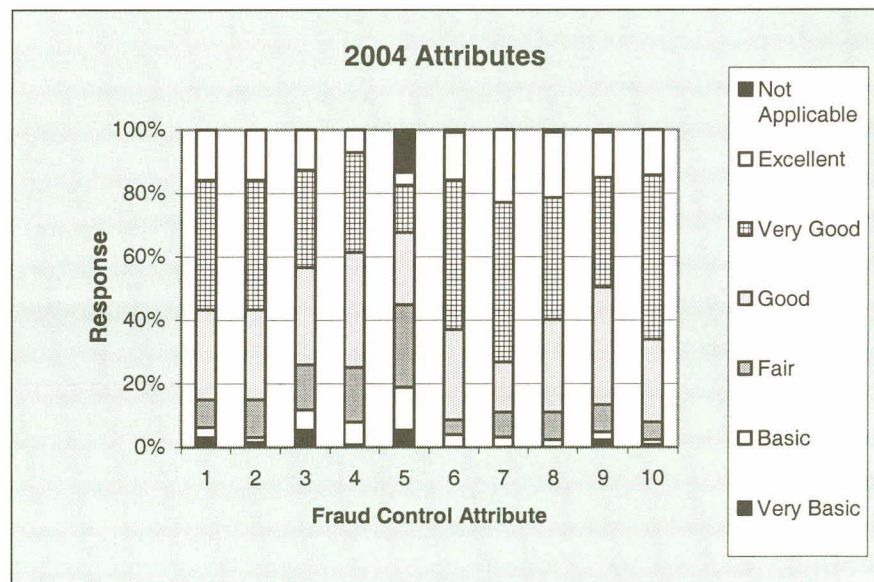
The best results were obtained for agencies meeting the requirements for implementing mandatory requirements for [attribute 7] protected disclosures, [8] external reporting, and [10] conduct standards. Good performance was also apparent for the relatively simple (yet still important) aspects of [1] consolidating and harmonising relevant agency policies and [2] defining organisational arrangements and responsibilities.

The poorest results were for the attributes of:

- [5] customer and community awareness (of the agency's anti-fraud focus)
- [4] employee awareness
- [3] fraud risk assessment
- [9] investigation standards.

These are not minor chinks in the armour. They represent very significant areas for a fraud control strategy to have weakness, and must be a priority area for attention.

Fraud Control Performance in 2004 - the Bottom Line

Global trends in fraud

Studies globally of fraud indicate that it is not reducing as a key risk issue. In fact, the incidence of fraud within the Australian economy is increasing and the average financial loss associated with fraudulent conduct is increasing. The most recent Forensic Fraud Survey by KPMG puts it plainly when it says that the principal conclusion to be drawn from its 2004 survey is that "fraud in Australia and New Zealand is alive and well."[3]

The reasons for the continued growth in fraud are complex, but include:[4]

- the continual striving for greater efficiencies in business
- the increasing use and reliance on technology and the associated changes in payment systems and channels. Of particular concern is the ease with which commercial crime can operate globally, access accounts in countries on the other side of the globe and then transfer funds very quickly between accounts in a different jurisdiction with the intention of making it impossible to follow the trail let alone recover any of the proceeds of the crime
- the 'flattening' of organisational structures
- rapid and continuous changes to business operations
- the increasing pace of business
- the inability of the criminal justice system, the police, the Australian Securities and Investments Commission and other law enforcement agencies and the Courts, to keep pace with the ever-increasing workload and greater complexity of matters reported to them
- the accessibility of gambling which has become a significant motivator for employees to commit fraud against their employer
- greater complexity of business relationships
- changing remuneration and incentive structures and arrangements.

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[3] Forensic Fraud Survey 2004, KPMG, page 4.
[4] AS 8001-2003, Australian Standard, Fraud and Corruption Control, Standards Australia, pages 5-6

The potential dollars at stake are substantial

Independent studies continue to estimate the extent of fraud risk for organisations (based on experience about fraud losses) to be in the range of 2-5% of turnover.

For the NSW public sector, if this materialised this puts potential fraud risk at as much as $3 billion annually. This translates into $1,142 for each taxpayer in NSW.

NSW is not yet where it needs to be

While there is some encouragement in the results from our survey, and the positive efforts of NSW agencies need to be recognised, the facts cannot be glossed over.

We believe that the current result is not good enough to address the nature of risk that fraud presents. The resilience and adaptability of those who commit fraud is a matter of record. Without a serious commitment by management and an holistic approach, efforts to control fraud will not be sufficient.

The NSW public sector needs to consolidate upon its slow but steady progress in addressing this issue over the past fourteen years and to raise its performance to the level required to combat the risk.

Since in our view current results are not good enough, we believe that actions are required at a range of levels to revisit and refresh the issue of fraud control, and to provide updated guidance to assist agencies better discharge their responsibilities in this regard.

This report addresses those challenges.

2. Future Directions: Strengthened Leadership and Governance Requirements

Providing Leadership in Fraud Control to the NSW Public Sector

Formal requirements

Requirements upon agencies to respond to fraud control are chiefly driven by a Premier's Department memo of 1990. Requirements of the *Public Finance and Audit Act* for effective internal control are also relevant, as are requirements from NSW Treasury in terms of risk management. However, there is currently no specific legislative requirement for fraud control, a key feature of the fraud control framework in the Commonwealth public sector.

In NSW there is no routine or formal monitoring of progress with implementation of the policy directive for fraud control. This was another key feature of the approach originally taken in the Commonwealth. Once compliance had been progressed to a satisfactory point, the Commonwealth also moved to a highly devolved approach: but with legislative underpinnings and support and quality assurance elements provided through agencies such as the Australian Federal Police. NSW agencies examine their own operating environment and needs to determine the most appropriate course of action for them.

When we audited progress in 1998, our sense was that the issue was fading from the management agenda in a considerable number of NSW agencies. Our 1998 recommendation for fraud control strategies to be given legislative backing was not actioned, and no further directives have been issued on the subject since the original in 1990.

In our current audit we have found that many of the relevant officers in agencies are not aware of the original directive, and when we mention it they ask us if we can provide a copy for them. In any case, the original directive was only a memorandum, not an official Circular, and as such some officials have queried with us its status. And officers have indicated to us that applicability of these important requirements to non-budget sector agencies is unclear.

Recommendation

We recommend that Treasury refresh the issue of fraud control with all agencies in all sectors. A Treasury Circular, supporting the actions for audit committees which this report also recommends, would achieve this purpose. Additional steps may be needed to ensure that non-budget sector agencies also address the issue.

Even with refreshed and clearer administrative directions in place, we believe that legislative support is a necessary step to elevate the issue of fraud control above that which been achieved over a fourteen-year period using the current approach.

If agencies were mostly reporting that highly effective fraud control strategies were in place, then we would support the current approach. However, our survey clearly shows that this approach is not delivering the required results, with only 13% rating their strategies as highly effective.

Given that the current approach, policy, strategy, and guidance material have been in effect for over a decade, it seems fair to conclude that the results we now see are as good as current tactics are going to provide.

We think that it is necessary to again recommend establishing a legislative basis for fraud control in NSW. We recognise that more is needed than legislation alone. This is discussed shortly. But we believe that there is now evidence that a legislative basis for fraud control in NSW is a necessary enhancement to reinforce efforts from the central agencies and watchdog bodies (including external audit). We consider that legislation is a necessary component of providing leadership on this key issue for the State.

Recommendation It is (again) recommended that a specific legislative basis be provided for fraud control by NSW agencies.

A simple, minor amendment to the *Public Finance and Audit Act 1983* would achieve this purpose.

Strategic Management Frameworks for Fraud Control

Corporate governance standards
In 2003, fraud control became formally recognised as a central element to good governance with the release of a suite of governance standards by Standards Australia.

The AS 8000 series of Standards represents a single set of standards for governance that, for the first time, covers all sectors and most types of organisations. They provide common elements, and also allow for specific areas of difference: for example for public sector bodies, listed companies or not-for-profits. We regard this as a significant breakthrough.

It can now be said with authority that, regardless of what sector or jurisdiction we are in, best practice governance necessarily includes:

- a core set of governance principles (features) (AS 8000)
- fraud control and corruption prevention (AS 8001)
- codes of conduct (AS 8002)
- corporate social responsibility (AS 8003)
- whistleblower systems (AS 8004).

Being able to define, with the authority of a Standard, that fraud control is one of the key building blocks of good governance is a major step forward. It places the issue where it should be: not as a compliance requirement, but as a key feature of good governance for all organisations.

Auditing standards

Auditing standards have also changed in recent times, in a way that substantially increases the focus on fraud control. Auditing Standard AUS 210 now requires the external auditor (including the Audit Office) to obtain a written representation from agency management (the Chief Executive Officer and Chief Financial Officer) that they have in place the systems and procedures to deal effectively with fraud.

In our role as the external auditor for the NSW public sector, we now require such formal assurances from the heads of NSW agencies. This has the (desirable) effect of encouraging chief executives to raise the priority of fraud control on the executive and governance agendas of their agencies.

We see this as another significant breakthrough. Just as the Corporate Governance Standards set a general direction for the ethical and transparent management of organisations, the new auditing standards probe more deeply into organisational systems and day to day actions taken to manage fraud.

Assurance and compliance through the Audit Committee

With both governance and auditing standards now formally giving dedicated attention to fraud control, we believe that the management and governance mechanisms within all agencies need to do likewise.

To enable agency management to be able to provide the required representation required by external audit under AUS210 concerning their fraud control systems and procedures, we believe that fraud control must become a key item for attention by every agency's audit committee.

Recommendation

The audit committee in each agency review the adequacy of processes supporting the agency's required management representations concerning its fraud control systems and procedures (AUS 210).

New approaches, actions and tools

The audit committee would likely seek to address the adequacy of the agency's efforts through various means, including:

- the internal audit program
- the risk management program
- interactions with relevant expert external bodies
- dialogue with the Audit Office as the external auditor.

The audit committee needs a simple means through which it can do this. And in turn, line management and internal audit need more detailed tools to examine their agency's performance in managing fraud control.

This suggests to us that different tools are required to suit the needs of these different users with different purposes.

From our research we have developed material that we think will address these differing requirements. Material for the audit committee and for fraud control practitioners is provided separately in the following two Chapters.

3. Directions for Change: Assistance for the Audit Committee

A Simplified Strategic Management Framework for Fraud Control for Use by Audit Committees

In our 1994 Guide, one of the 10 key attributes for an effective fraud control strategy was "responsibility structures" (Attribute 2). We gave this a very high level of importance because there were indications that, at that time, responsibility for fraud control was not clear in many agencies.

This is not an unusual problem. There are many issues in organisations for which this can be said. Risk management in general, for example. With issues such as this, that are principally line management responsibilities, the challenge is a classic governance one: how to provide assurance that vital aspects of how the organisation operates are working as required?

In our 1994 Guide we said "a comprehensive responsibility structure must be developed to implement and give effect to the agency's fraud control strategy." We recognised the responsibilities of line management, and provided guidance on how agencies could approach clarifying and reinforcing this.

In the case of issues such as fraud control and risk management (amongst others), experience has led to a widely-held view that there is also a need to allocate some specific responsibilities for oversight. This can be organised in a number of ways, but in 1994 we suggested a fraud control committee as a potentially useful means. At that time, audit committees were not widespread in NSW agencies. Today, audit committees are regarded as a key component of governance for all forms of organisations.

In obtaining feedback from expert practitioners about their practical experience with implementing fraud control, this evolution in the extent and role of audit committees was raised. Most agencies have chosen to include a responsibility for their audit committee to periodically review the effectiveness of the agency's fraud control strategy. We support this approach.

However, practical experience appears to suggest that in undertaking their review role, audit committees find the current guidance material too detailed. This makes sense, since the material was written for fraud control practitioners. Even the checklist material (Volume 3 of the 1994 Guide), and Self-Assessment Audit Guide (1998), was pitched to support the detailed development, and detailed internal/external audit, of fraud control strategies. It is clear that we need to find a better way to assist audit committees to perform their crucial review role.

The competency standards for fraud control developed in the Commonwealth public sector refer to elements of prevention, detection and investigation. Such a classification framework appears to have taken favour with management, as it simplifies the many elements in a common-sense way.

It provides a useful classification system for applying the notion of an holistic integrity-system approach (a concept developed by Transparency International) to the specific area of fraud control.

This simple framework provides a high-level frame of reference to discuss and evaluate fraud control efforts that we think is ideally suited for use by audit committees.

A simple way for Audit Committees to question and examine their agency's fraud control performance and to support the agency representations required by AUS210
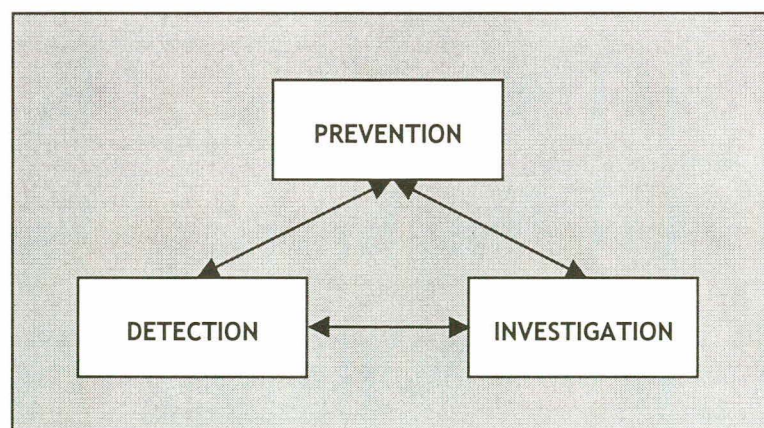
As a test of using this framework, we applied it during this audit. It provides a simple way of organising and focusing thinking, questioning and research material. What follows is the product of our use of this method to identify, on a whole-of-government basis, areas of comparative weakness and areas of lag in adopting best-practice initiatives.

The intuitive appeal of this tool, its simplicity of use, and its effectiveness in producing an action-agenda, convinced us that it would be of great assistance to an audit committee using it for a single-agency analysis.

Fraud control practitioners will continue to use more detailed frameworks, as described in the next chapter. But this provides a tool suited for an audit committee in addressing the agency's fraud control representations required by the Auditor-General under AUS 210.

Prevention

Prevention consists of an organisation:

- determining the fraud risks to which it is exposed
- putting in place policies, systems and procedures to deal with these risks.

The results of research suggest that prevention is an area where many agencies have applied considerable effort and are doing quite well. This is very important, as prevention is a critical dimension of fraud control. We strongly encourage agencies to maintain this level of attention.

But what, if anything, more should agencies be doing for effective fraud prevention?

Hot tips for improving prevention

Examining AS 8001, our own ten-point model for fraud control, and current thinking on best practice, we have identified a key action in the area of prevention that we would recommend all agencies closely consider: pre-employment screening.

Pre-employment screening

Pre-employment screening is increasingly being used by organisations in both the public and private sectors.

We note that some public sector organisations now routinely ask prospective employees to agree to pre-employment checks, which may involve criminal records checks as well as speaking to current or former supervisors.

There have recently been high profile cases in both the public and private sectors that have drawn this issue to the attention to HR managers.

Some of these cases relate to fraudulent academic credentials, positions held and so forth. Others will conceal criminal records and other matters of significant concern to a prospective employer.

Perhaps most importantly of all, pre-employment checks effectively stop perpetrators of fraud moving from organisation to organisation and continuing their less than desirable behaviours in more than one location.

Recommendation To further improve performance in the area of fraud prevention, we recommend that agencies consider adopting, or enhancing, pre-employment screening practices.

Detection Detection consists of an organisation:

- implementing policies and systems to find out what is happening in practice. This involves receiving information (passive detection) and proactively searching for indications (active detection)

- reviewing high and medium risk activities (from a fraud control perspective) to which it is exposed to identify untoward behaviours

- sampling low risk activities to determine if they remain low risk and/or whether untoward behaviours are taking place.

The results of research suggests that of all aspects of fraud control, the area most in need of improvement is detection. In general, NSW agencies are not as strong in this area as current thinking suggests they should be.

Hot tips for improving detection Computerised accounting systems are now thoroughly embedded into the day-to-day operations of all public sector organisations in NSW. From an accounting perspective, this means that all financial transactions being undertaken by the organisation are recorded and stored for future reference. Working "around the system" is no longer an option. This provides a useful opportunity for fraud detection.

Data mining In simple terms, all that needs to be done is to ask meaningful questions of the accounting and financial systems to see what is happening. The emergence of sophisticated data mining tools has made such analysis possible at a relatively modest cost. Helpfully, some of the most effective data mining tests are very simple ones to run.

Some things will be easier to find than others. For example, checking whether invoices have been split into smaller amounts so that none exceeds public sector guidelines on expenditure has proven to be a worthwhile test. As has checking for duplicate payments and multiple vendor names (with slight variations). Other tasks will require more sophisticated approaches, which are also available through the rapidly developing area of forensic accounting and investigation.

Over time, data mining tools will become more well-known and widely available and we encourage agencies to consider where they might fit into more robust strategies to deal effectively with detecting corruption. They have a proven value-add, and are relatively inexpensive.

Data mining by line management

However, fraud detection computer analytical tools should not be seen as the domain of fraud control specialists, investigators and auditors. Such groups will certainly make highly effective use of such tools (and it should be regarded as standard practice). However, beyond that, a strong sign that an organisation has effective fraud detection in operation is the routine use of such tools as a part of everyday line management.

We strongly encourage agencies to build the capacity into their systems for detection routines that provide line management with routine reports and provide line management with simple tools.

Fraud reporting systems

Another proven detection method is the observations of staff, contractors, suppliers and customers. Experience suggests that if something untoward happens in an organisation, there is likely to be someone who knows something about it. But how likely are they to tell anyone? And how easy is it for them to do so? Unfortunately, experience also suggests that few organisations do this well, and thus fail to make effective use of one of the most potent detection tools available.

Like data mining, the development of effective corruption reporting systems has become a specialist industry with considerable research and development being undertaken. Advances have been made in systems to receive and process information about alleged improper actions, in ways that provides security and confidence to those providing such information as well as processing it efficiently.

Our survey shows that most agencies have complied with their obligations for reporting, and have instituted reporting systems, particularly for protected disclosures. However, in examining this issue more closely against best practice standards it is not apparent that this valuable channel has been developed sufficiently in most agencies to reach its potential.

There is evidence to suggest that making improvements to these systems will generate substantial value to agencies, and we encourage agencies to carefully consider this aspect of their detection regime.

Recommendation

To further improve performance in the area of fraud detection, we recommend that agencies:

- adopt, or enhance, their use of data mining as a routine element of line management review of operations
- require their audit and investigation teams to apply relevant data mining and forensic investigation tools
- enhance their processes for receiving reports from staff, contractors, suppliers, customers and stakeholders.

Investigation

Investigation consists of an organisation systematically and thoroughly reviewing to required standards, and in compliance with required rules, actions and events which are deemed to be "of concern", then subsequently:

- imposing appropriate sanctions and/or reporting the matter to other investigating agencies for action (ICAC, Police etc)
- recommending strategies and actions to overcome perceived deficiencies in policies and processes.

Investigations is a strong area of the fraud control framework in the Commonwealth which NSW does not enjoy.

When issued some years ago, the Commonwealth's Investigation Standards (and accompanying model procedures) provided best practice for investigations. The Standards apply to all forms of investigation, and outline the written procedures that each agency should have in place to perform an efficient and effective investigation. The model procedures are minimum arrangements and Commonwealth agencies must have in place procedures that are consistent with or exceed the model procedures.

In introducing the Standards, the Australian Federal Police conducted a rolling program of quality assurance reviews to examine whether agencies were conducting their investigations to an adequate standard.

Commonwealth officers working in the fraud control area must also be trained and certified to formal competency standards.

In the absence of a comparable regime in NSW, investigations are not undertaken to a uniform standard. Some agencies have outsourced investigations, however, this is not a guarantee of uniformity, or even necessarily of quality.

Hot tips for improving investigations

As part of their fraud control strategy, we encourage NSW agencies to adopt recognised standards for investigations. We also encourage agencies to consider the extent to which investigations, whether conducted in-house or outsourced, are quality assured against those standards.

Recommendation

To further improve performance in the area of fraud investigation, we recommend that in undertaking investigations (either by staff or outsourced providers) agencies:

- adopt recognised investigation standards
- include appropriate quality assurance arrangements for fraud investigations.

4. Directions for Change: Assistance for Fraud Control Practitioners

Current challenges for fraud control

The Audit Office's ten-point model for fraud control has now been available for 10 years. It is widely recognised in both the public and private sectors as an effective approach to the subject, and has formed the basis of frameworks developed for some other jurisdictions. However, the nature of fraud continues to evolve, as does it prevention, detection and investigation.

In addition to the survey, our method included a range of other research actions. One of these was to convene a focus group of experienced fraud control practitioners to undertake a number of tasks, including identifying significant issues impeding the implementation of effective fraud control strategies.

We had already identified 25 issues of concern from our own research and the survey. Our expert group extended this list to 45. Such widely varying issues indicate just how complex it is to effectively implement fraud control strategies in individual organisations.

Priority issues

The focus group ranked the "top ten" issues as:

1. Fraud risk assessment practices being poor in agencies
2. Ethical behaviours by staff
3. Responsibility in times of organisational change
4. Training for managers about how to manage the issues of fraud and corruption (equal with)
4. Lack of systematic risk assessment within agencies
5. Wide spread introduction of new technology, with greater delegation of decision making (equal with)
5. Management of confidential/commercially sensitive information (equal with)
5. Changing control structures
6. IT systems have appropriate audit trails, but auditing does not take place often enough/at the required standard (equal with)
6. Technology systems insufficiently robust
7. Early warning signs of fraud often either ignored or not acted upon quickly enough (equal with)
7. Internal control systems increasingly being "short cut" to get things done in a hurry (equal with)
7. Lack of commitment by agency senior executive to issue of fraud control
8. Training for staff in ethical behaviours (equal with)
8. Consistency in sanctions (equal with)
9. Smaller agencies need different approaches, support than the medium to larger sized agencies (equal with)
9. Difficulty of getting the message acted on "in the field" and
10. Managing the aftermath of investigations.

A series of common themes emerged from the focus group, described in the diagram below:

**Current and Emerging Issues
in Implementing Effective Fraud Control**

POOR RISK ASSESSMENT PRACTICES	ETHICAL BEHAVIOURS IN THE WORKPLACE	APPROPRIATE TRAINING FOR ALL STAFF
ORGANISATIONAL CHANGE		COMMITMENT OF SENIOR MANAGEMENT
TECHNOLOGICAL CHANGE	SHORT CUTS IN DECISION MAKING	QUALITY AND QUANTITY OF AUDITS
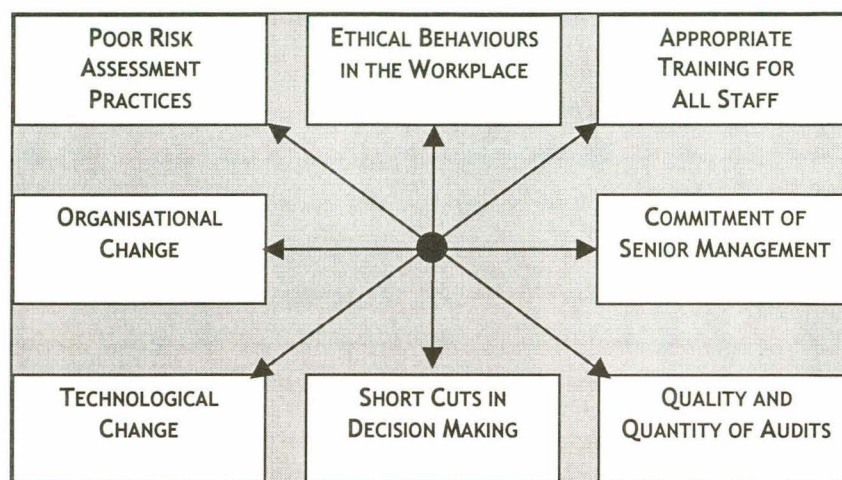
The fraud control practitioners at the focus group indicated a strong desire for us to retain the fraud control model that had been in operation since 1994, but also to update and refine it based on experience and current thinking about priority issues for fraud control. We have done so.

To provide fraud control practitioners with an updated source of guidance we have:

- fine-tuned our 1994 ten-point model's Attributes of Best Practice
- better explained the aim of each Attribute so that they are as easy as possible to implement
- provided examples of what would be seen in organisations who have successfully implemented the attribute (indicators of success)
- provided "hot tips" to help organisations take immediate actions to improve the management of fraud control.

Those familiar with the model that agencies have been using for the past ten years, will notice some change:

- there have been changes to the names of some of the current attributes to reflect a move to an "integrity systems" approach (a concept coined by Transparency International)
- two existing Attributes have been combined (Attributes 6 and 7) to form a single Attribute: "Notification Systems"
- Attribute 7 (Detection Systems) is new.

The 2004 revision of our ten attributes of best practice in fraud control follows.

Recommendation   To further improve overall performance with managing fraud control, we recommend that Audit Committees direct the agency's internal audit and/or investigations functions to review and update the agency's fraud control strategy against the 2004 revision of the Audit Office's ten attributes of best practice for fraud control. In so doing, areas identified by this audit as warranting particular attention include:

- pre-employment screening practices
- strategies to make staff, customers and the community aware of the agency's commitment to fraud control
- the use of data mining as a routine element of line management review of operations
- the use of relevant data mining and forensic investigation tools by audit and investigation teams
- processes for receiving reports from staff, contractors, suppliers, customers and stakeholders
- the regularity and robustness of fraud risk assessments
- recognised standards for investigation activities
- appropriate quality assurance arrangements for fraud investigations.
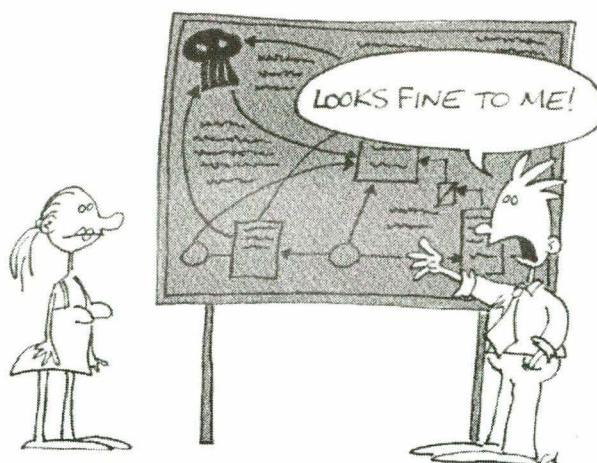
2004 Revision of the Ten Attributes of Best Practice in Fraud Control

Attribute 1	**Integrated Macro Policy**

Aim of Attribute is to ensure that:

- agencies have in place the necessary policies, systems and procedures to minimise fraud in all places, and at all levels, of an organisation
- policies, systems and procedures respond, and are proportionate, to the fraud risks faced by the organisation.

Indicators of Successful Implementation:

- Policies, systems and procedures are based on assessed fraud risks
- Policies, systems and procedures have been updated in the last 2 years.

Hot Tips

- Confidential/commercially sensitive information needs to be actively monitored
  - Does it comply with legislative standards ?
  - Does it comply with commercial standards ?
  - How secure is the commercial information ?
- One policy approach won't fit all
  - Smaller and medium size agencies will take different approaches to larger agencies
- One definition of fraud won't fit all agencies
  - Each agency needs to define what fraud means in the context of its core business activities
- There is a myth that large amounts of money need to be spent to deal effectively with fraud control:
  - In reality, agencies can take some simple steps and be confident that they are able to exercise effective management over their risks in a controlled way.

Attribute 2

Responsibility Structures

Aim of Attribute is to ensure that:

- There is clear accountability and responsibility for implementation and monitoring of the fraud management strategy
- This accountability is well known by all staff at all levels and in all places of the organisation
- There is a common understanding that everyone in the organisation has a role to play in effective fraud management.

Indicators of Successful Implementation:

- Position descriptions have appropriate fraud control elements incorporated
- Managers and staff are able to articulate their fraud control responsibilities
- Audit Committee periodically reviews the effectiveness of the agency's fraud control strategies.

Hot Tips

- Ensuring responsibilities and accountabilities remain clear in times of organisational change
  - As part of finishing any restructure, agencies need to ensure that responsibilities for fraud are considered in creating/revising position descriptions
- Widespread introduction of new technology means that there is greater delegation of decision making
  - When introducing new technology, there is a need to ensure that there are still appropriate checks and balances in decision making
- "Tone at the top" sends out important messages to managers and staff
  - Executive management need to lead fraud control in their agency by their own behaviours, driving the issue of fraud control through the organisation
- Training for managers in managing fraud
  - Managers need the knowledge and skills so they can effectively discharge their executive responsibilities for managing fraud
- Clarity in management responsibilities/actions for supporting staff
  - Managers need to be clear about their roles and responsibilities for supporting staff in dealing with the many and varied fraud related issues that emerge in the workplace
- Flattened organisational structures mean that there are fewer middle level managers to enforce internal controls
  - With fewer levels of management, and an outcomes focus, it is easy to override internal controls to "get things done". Actions such as this have been shown to be significant contributors to instances of major fraud in organisations.

Attribute 3   **Fraud Risk Assessment**

Aim of Attribute is to ensure that:

- A separate fraud risk assessment is undertaken by the organisation
- The fraud risk assessment quantifies the level, nature and form of the risks to be managed
- Actions will be taken by the organisation to mitigate the risks identified in the fraud risk assessment.

Indicators of Successful Implementation:

- Risk assessment undertaken in last 2 years
- Risk assessment covers internal and external operating environments
- Risk mitigation actions assigned to individual members of management and/or staff for action.

Hot Tips   - General risk analysis is insufficient:
  - Fraud risk assessment needs to be undertaken separately from general risk management exercises
- Get staff thinking about fraud risks in all business units
  - Quality of risk assessment processes needs to be the best possible. Staff at all levels and in all places need to be involved
- Fraud risk assessment needs to be undertaken on a regular basis
  - If your fraud risks analysis is over two years old, then it needs a fresh assessment.

Attribute 4   **Employee Awareness**

Aim of Attribute is to ensure that:

- All employees understand the ethical behaviours required of them in the workplace
- Training programs in ethical behaviours are in place across the organisation
- Training deals with the fraud risks faced by individuals in their workplaces.

Indicators of Successful Implementation:

- Ethical behaviour is included in organisation induction programs for new staff, temporary staff, contractors etc
- Employees are able to articulate the fraud risks they are required to deal with in the workplace
- Employees are able to articulate the actions that they need to take to respond to fraud in their workplace.

Hot Tips
- The term "employees" covers a lot of different people:
  - Have you thought about part-time, temporary and casual staff ? Contractors ? Consultants ?
- Ethical behaviours are a key to getting fraud control "right" in an organisation:
  - Staff need to know exactly what is expected of them in the workplace
- Training for staff in ethical behaviours:
  - Just as managers need training in ethical behaviours, so staff need training too
- Difficulty of getting the message acted on "in the field":
  - Training is not sufficient: there needs to be encouragement for appropriate workplace behaviours.

Attribute 5

Customer and Community Awareness

Aim of Attribute is to ensure that:
- Customers and the community understand that the organisation will not accept fraudulent dealings/ transactions
- Customers are aware of the consequences of fraudulent dealings/transactions
- Information is available to customers about the quantity, quality and timeliness service delivery.

Indicators of Successful Implementation:
- Customer service standards in place
- Transactions with customers audited for fraudulent behaviour, consistent with the assessed level of fraud risk of the transaction
- Regular reporting to community of actions to prevent and control in the organisation.

Hot Tips
- Publicising poor behaviours and their consequences:
  - Customers and the community need to know what will happen should attempts be made to interact fraudulently with the organisation

Attribute 6   **Notification Systems**

Aim of Attribute is to ensure that:

- Policies, systems and procedures are in place to encourage the reporting of suspect behaviours
- Fraud notification systems give the complainant the opportunity to report the suspect behaviours anonymously
- "Whistle-blowers" are protected by the organisation
- Policies, systems and procedures give equal opportunities to managers, staff, contractors, consultants, customers, suppliers etc to notify the organisation of suspect behaviours.

Indicators of Successful Implementation:

- There is regular testing of the fraud notification system to ensure that notifications are recorded and passed onto the appropriate manager for action
- Fraud notification system generates quarterly reports into both number and nature of internal and external complaints received
- Actions taken to resolve notifications of suspect behaviours reported quarterly to the executive of the organisation
- "Whistle-blowers" report satisfaction with the actions taken by the organisation to resolve their concerns about suspect behaviours.

Hot Tips
- Notification systems are tricky things to get right internally:
  - Outsourcing notification systems to third party providers may be worth considering.

Attribute 7   **Detection Systems**

Aim of Attribute is to ensure that:

- Available data is thoroughly monitored and reviewed to ensure that irregularities and warning signals are picked up at a very early stage and flagged for further detailed review
- Internal audits regularly examine samples of medium and high risk financial decision making across the organisation
- Audit Committees make decisions, based on risk, about key systems and decisions to be audited
- Outcomes of audits are reported to executive management on a quarterly basis.

Indicators of Successful Implementation:

- The organisation is routinely using data mining tools in detecting fraudulent behaviours as part of line management review
- Audit and investigation functions employ advanced data mining and forensic review tools
- Medium and high risk transactions are audited on a regular basis for probity
- Audit report recommendations are followed up
- There is clear accountability for implementation of audit report recommendations.

Hot Tips

- Individual organisations have all the records they need to detect fraud:
  - □ IT systems have appropriate audit trails, but auditing does not take place often enough/at the required standard
- Agencies are increasingly relying on technology to provide the efficiency and effectiveness required of the agency:
  - □ Is the use of technology sufficiently robust from a fraud control perspective?
- Major fraud can be avoided:
  - □ Rather than ignoring early warning signs of fraud or not acting on them quickly enough, if in doubt you should act NOW
  - □ Probity audits should regularly examine a sample of medium and high risk decision processes across the organisation
- The need to achieve outcomes needs to be balanced with due process:
  - □ When you short-cut internal controls, you are exposing yourself to significantly larger risks of fraud happening
- Technology can now produce "flawless" fraudulent documents:
  - □ What has your organisation done to think through this issue ? Does it rely on "standard" third party documents ? How reliable are these now?
- Introduction of large scale technology dependent finance systems is a major risk for organisations:
  - □ Is the finance system able to produce meaningful management information at the time required?
- Existing levels of fraud unable to be easily quantified:
  - □ There is a view that "if it can't be quantified, there isn't a problem". Is this a realistic point of view?

Attribute 8	**External Notification Systems**

Aim of Attribute is to ensure that:

- Agencies have policies which clearly identify the nature of suspect actions which require reporting to the Police, the ICAC, the Ombudsman etc
- External notification takes place as required in light of the above legal and policy requirements.

Indicators of Successful Implementation:

- Agency provides information in annual report about number of suspect incidents referred to Police, ICAC, Ombudsman etc for action
- Results of those actions reported to the community.

Hot Tips

- Organisations can become embarrassed about becoming the victim of fraudsters:
  - Treating fraudsters with leniency, allows them to move from organisation to organisation. This is to be avoided at all costs.

Attribute 9	**Investigation Systems**

Aim of Attribute is to ensure that:

- Procedures and other appropriate support (including training, where required) is provided to staff undertaking investigation activity on behalf of the organisation
- Investigation actions undertaken should be consistent with commonly used investigation standards
- Where appropriate expertise is not available internally, then external assistance should be sought
- All investigations consider what improvements can be made to policies, systems and procedures within the organisation
- All investigation reports are referred to the audit committee or an equivalent, and the organisation's senior executive, for action.

Indicators of Successful Implementation:

- The agency has adopted recognised Standards for conducting investigations
- Investigations are audited for due process on a regular basis
- Investigations use appropriate data gathering and analysis mechanisms to come to valid conclusions
- Investigation results are referred to the audit committee and the organisation's senior executive for action.

Hot Tips	■ Investigations are tricky to undertake and manage:

- Don't assume that your audit staff are fully competent in this specialised area
- Perhaps you may wish to consider training relevant staff against competency standards that are available in this area?
- Investigations need to ensure that there is even-handedness for both complainant and those accused.

■ Is your organisation using an appropriate approach to investigations?

- There are investigation standards (eg. ICAC, Commonwealth) that can be used to ensure that processes are at "best practice" standards

■ Increasing reliance on external expertise:

- Outsourcing does not guarantee quality. This is still your responsibility
- What about training internal staff to undertake this most sensitive of tasks? This both builds up organisational expertise and also lessens reliance on external providers.

Attribute 10	**Conduct and Disciplinary Systems**

Aim of Attribute is to ensure that:

- Employees understand that fraud will not be tolerated and that perpetrators will face disciplinary action
- Employees have access to written information to assist them understand their ethical obligations
- Approaches will be developed that are consistent with both perceived risks and the organisation's approach to human resources management.

Indicators of Successful Implementation:

- Employees are able to articulate their obligations in regard to ethical behaviours
- Managers able to articulate the steps that need to be taken in disciplinary circumstances.

Hot Tips	■ Codes of Conduct are critical:

- Lack of one or one that is poorly implemented will lead to poor outcomes for the organisation

■ Consistency in sanctions:

- Unless everyone is treated the same way, the organisation is left vulnerable to charges of victimisation/favouritism.

Appendix

About the Audit

Audit objective The objective of the audit was to determine the extent to which agencies conformed to the 1990 Premier's Department policy requirement that they have in place appropriate measures to combat the risks of both internal and external fraud.

Audit scope The audit extended to all agencies in the NSW public sector (both the general government sector and the non-budget sector, including universities).

Agencies provided survey information to us in the period April to July 2004.

Audit criteria Since 1994, fraud control for NSW agencies has been developed and judged using our Best Practice Guide, "Fraud Control: Developing an Effective Strategy".

There are ten specific required elements for fraud control set out in that guide. Those formed the criteria for this audit. Detailed explanatory material is available online at:

www.audit.nsw.gov.au/guides-bp/fraud198/vol1.htm

www.audit.nsw.gov.au/guides-bp/fraud298/vol2.htm

Audit approach The audit approach comprised:
- a self-assessment survey of all agencies
- a focus group of expert practitioners
- research into current best practice.

Survey For this audit we again surveyed all NSW public sector agencies with a standard self-diagnosis tool that had been used before in 1992 and 1998.

Responses were received from 129 agencies.

The tool is available online at:

www.audit.nsw.gov.au/guides-bp/fraud99/selfaudit.doc

Expert focus group We convened a facilitated workshop of highly experienced practitioners in this field. The workshop aimed to review:
- the effectiveness/relevance of the fraud control framework
- the effectiveness/relevance of the existing support documents
- emerging issues in fraud control and their priority
- actions/resources that could be taken to improve the situation.

Nineteen practitioners attended the workshop. They came from a variety of current employing organisations, including:

- a private sector provider of specialist services to government and private sector agencies
- universities
- local government
- NSW general government sector agencies
- NSW non-budget sector agencies.

To ensure that expert opinion was, indeed, being utilised, an analysis was undertaken of the roles and actions that these officers had undertaken in their working experience. Results from the group showed that:

- 63% had developed a code of conduct for a workplace
- 84% had developed a code of conduct for an agency
- 63% had developed fraud control policies for a workplace
- 84% had developed fraud control policies for an agency
- 63% had implemented fraud control policies in a workplace
- 84% had implemented fraud control policies for an agency
- 84% had undertaken risk assessments in a business unit
- 79% had undertaken risk assessments across an agency
- 84% had arranged training in ethical behaviours
- 63% has been a member of an agency Audit Committee
- 16% had led/managed an Audit Committee
- 95% had undertaken internal audits
- 95% had managed internal audits
- 42% had undertaken external audits
- 26% had managed external audits
- 95% had undertaken investigations
- 84% had managed investigations
- 32% had reported fraud(s) to a manager
- 42% had reported fraud(s) to an executive manager
- 79% had reported fraud(s) to a CEO.

Literature research

A review was made of research undertaken by others into fraud control. This identified a substantial body of research material, of which the following sources were given particularly close consideration:

- KPMG Fraud Survey (six from 1993 to 2004)

- Fraud Control in Australian Government Agencies: Better Practice Guide, Australian National Audit Office (2004)

- 2004 Report to the Nation on Occupational Fraud and Abuse, Association of Certified Fraud Examiners

- Inquiry into Fraud and Electronic Commerce, the Parliament of Victoria Drugs and Crime Prevention Committee (2004)

- Examination of the report of the Independent Commission Against Corruption – Profiling the NSW Public Sector, the Parliament of NSW Committee on the Independent Committee Against Corruption (2004)

- The Adequacy of the Protected Disclosures Act to Achieve its Objectives: Issues Paper, NSW Ombudsman (2004)

- Investigating Complaints: A Manual for Investigators, NSW Ombudsman (2004)

- Model Internal Reporting Policy for State Government Agencies, NSW Ombudsman (2004)

- Fraud and Corruption Control: An Integrated Approach to Controlling Fraud and Corruption Within the Workplace, Crime and Misconduct Commission (Qld) (2004)

- Fraud Resistance, A Practical Guide, SIRCA Strategic Value Management Series (2003)

- Fraud and Corruption Control, Standards Australia, AS 8001-2003

- Profiling the NSW Public Sector - Functions, risks and corruption resistance strategies, Independent Commission Against Corruption (2003)

- Commonwealth Fraud Control Guidelines, Attorney General's Department (2002)

- Fighting Fraud: Checklists, Independent Commission Against Corruption (2002)

- Fighting Fraud: Guidelines for State and Local Government, Independent Commission Against Corruption (2002)

- Responding to Fraud: An ICAC Discussion Paper, Independent Commission Against Corruption (2002)

- Do it Yourself: Corruption Resistance Guide: Independent Commission Against Corruption (2002)

- The Need to Know: eCorruption and Unmanaged Risk, Independent Commission Against Corruption (2001)

- Exploiting Emerging Technology Corruptly in the NSW Public Sector, Independent Commission Against Corruption (2001)

- Fraud Control: A State Perspective (Queensland), Brendan Butler SC, Criminal Justice Commission (Qld) Australian Institute of Criminology Conference, Gold Coast (2000)

- The Future of Fraud Control (South Australia), Matthew Goode, Attorney-General's Department (SA), Australian Institute of Criminology Conference, Gold Coast (2000).

National trends were examined and fell into 4 major categories:

- Standards for Corporate Governance

- introduction of new accounting standards

- Introduction of new Auditing Standards

- passage of new legislation.

An analysis of international trends was also undertaken. Activities were noted at a number of levels, including at the trans-national (the OECD) and national levels (U.S.A and U.K.)

Cost   Including printing and all overheads the estimated cost of the audit is $141,500.

Audit team   Our team leader for this performance audit was John Watt who was assisted by Brian Holdsworth.

Direction and quality assurance was provided by Stephen Horne.

Performance Audits by
the Audit Office of New South Wales

Performance Auditing

What are performance audits?

Performance audits are reviews designed to determine how efficiently and effectively an agency is carrying out its functions.

Performance audits may review a government program, all or part of a government agency or consider particular issues which affect the whole public sector.

Where appropriate, performance audits make recommendations for improvements relating to those functions.

Why do we conduct performance audits?

Performance audits provide independent assurance to Parliament and the public that government funds are being spent efficiently and effectively, and in accordance with the law.

They seek to improve the efficiency and effectiveness of government agencies and ensure that the community receives value for money from government services.

Performance audits also assist the accountability process by holding agencies accountable for their performance.

What is the legislative basis for Performance Audits?

The legislative basis for performance audits is contained within the *Public Finance and Audit Act 1983, Part 3 Division 2A*, (the Act) which differentiates such work from the Office's financial statements audit function.

Performance audits are not entitled to question the merits of policy objectives of the Government.

Who conducts performance audits?

Performance audits are conducted by specialist performance auditors who are drawn from a wide range of professional disciplines.

How do we choose our topics?

Topics for performance audits are chosen from a variety of sources including:
- our own research on emerging issues
- suggestions from Parliamentarians, agency Chief Executive Officers (CEO) and member of the public
- complaints about waste of public money
- referrals from Parliament.

Each potential audit topic is considered and evaluated in terms of possible benefits including cost savings, impact and improvements in public administration.

The Audit Office has no jurisdiction over local government and cannot review issues relating to council activities.

If you wish to find out what performance audits are currently in progress just visit our website at www.audit@nsw.gov.au.

How do we conduct performance audits?

Performance audits are conducted in compliance with relevant Australian standards for performance auditing and operate under a quality management system certified under international quality standard ISO 9001.

Our policy is to conduct these audits on a "no surprise" basis.

Operational managers, and where necessary executive officers, are informed of the progress with the audit on a continuous basis.

What are the phases in performance auditing?

Performance audits have three key phases: planning, fieldwork and report writing.

During the planning phase, the audit team will develop audit criteria and define the audit field work.

At the completion of field work an exit interview is held with agency management to discuss all significant matters arising out of the audit. The basis for the exit interview is generally a draft performance audit report.

The exit interview serves to ensure that facts presented in the report are accurate and that recommendations are appropriate. Following the exit interview, a formal draft report is provided to the CEO for comment. The relevant Minister is also provided with a copy of the draft report. The final report, which is tabled in Parliament, includes any comment made by the CEO on the conclusion and the recommendations of the audit.

Depending on the scope of an audit, performance audits can take from several months to a year to complete.

Copies of our performance audit reports can be obtained from our website or by contacting our publications unit.

How do we measure an agency's performance?

During the planning stage of an audit the team develops the audit criteria. These are standards of performance against which an agency is assessed. Criteria may be based on government targets or benchmarks, comparative data, published guidelines, agencies corporate objectives or examples of best practice.

Performance audits look at:
- processes
- results
- costs
- due process and accountability.

Do we check to see if recommendations have been implemented?

Every few years we conduct a follow-up audit of past performance audit reports. These follow-up audits look at the extent to which recommendations have been implemented and whether problems have been addressed.

The Public Accounts Committee (PAC) may also conduct reviews or hold inquiries into matters raised in performance audit reports. Agencies are also required to report actions taken against each recommendation in their annual report.

To assist agencies to monitor and report on the implementation of recommendations, the Audit Office has prepared a Guide for that purpose. The Guide, *Monitoring and Reporting on Performance Audits Recommendations,* is on the Internet at www.audit.nsw.gov.au/guides-bp/bpglist.htm

Who audits the auditors?

Our performance audits are subject to internal and external quality reviews against relevant Australian and international standards. This includes ongoing independent certification of our ISO 9001 quality management system.

The PAC is also responsible for overseeing the activities of the Audit Office and conducts reviews of our operations every three years.

Who pays for performance audits?

No fee is charged for performance audits. Our performance audit services are funded by the NSW Parliament and from internal sources.

For further information relating to performance auditing contact:

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Assistant Auditor-General
Performance Audit
(02) 9275 7278
email: stephen.horne@audit.nsw.gov.au

Performance Audit Reports

No.	Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
65	Attorney General's Department	*Management of Court Waiting Times*	3 September 1999
66	Office of the Protective Commissioner Office of the Public Guardian	*Complaints and Review Processes*	28 September 1999
67	University of Western Sydney	*Administrative Arrangements*	17 November 1999
68	NSW Police Service	*Enforcement of Street Parking*	24 November 1999
69	Roads and Traffic Authority of NSW	*Planning for Road Maintenance*	1 December 1999
70	NSW Police Service	*Staff Rostering, Tasking and Allocation*	31 January 2000
71*	Academics' Paid Outside Work	*Administrative Procedures Protection of Intellectual Property Minimum Standard Checklists Better Practice Examples*	7 February 2000
72	Hospital Emergency Departments	*Delivering Services to Patients*	15 March 2000
73	Department of Education and Training	*Using Computers in Schools for Teaching and Learning*	7 June 2000
74	Ageing and Disability Department	*Group Homes for people with disabilities in NSW*	27 June 2000
75	NSW Department of Transport	*Management of Road Passenger Transport Regulation*	6 September 2000
76	Judging Performance from Annual Reports	*Review of Eight Agencies' Annual Reports*	29 November 2000
77*	Reporting Performance	*Better Practice Guide A guide to preparing performance information for annual reports*	29 November 2000
78	State Rail Authority (CityRail) State Transit Authority	*Fare Evasion on Public Transport*	6 December 2000
79	TAFE NSW	*Review of Administration*	6 February 2001
80	Ambulance Service of New South Wales	*Readiness to Respond*	7 March 2001
81	Department of Housing	*Maintenance of Public Housing*	11 April 2001
82	Environment Protection Authority	*Controlling and Reducing Pollution from Industry*	18 April 2001

No.	Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
83	Department of Corrective Services	*NSW Correctional Industries*	13 June 2001
84	Follow-up of Performance Audits	*Police Response to Calls for Assistance The Levying and Collection of Land Tax Coordination of Bushfire Fighting Activities*	20 June 2001
85*	Internal Financial Reporting	*Internal Financial Reporting including a Better Practice Guide*	27 June 2001
86	Follow-up of Performance Audits	*The School Accountability and Improvement Model (May 1999) The Management of Court Waiting Times (September 1999)*	14 September 2001
87	E-government	*Use of the Internet and Related Technologies to Improve Public Sector Performance*	19 September 2001
88*	E-government	*e-ready, e-steady, e-government: e-government readiness assessment guide*	19 September 2001
89	Intellectual Property	*Management of Intellectual Property*	17 October 2001
90*	Intellectual Property	*Better Practice Guide Management of Intellectual Property*	17 October 2001
91	University of New South Wales	*Educational Testing Centre*	21 November 2001
92	Department of Urban Affairs and Planning	*Environmental Impact Assessment of Major Projects*	28 November 2001
93	Department of Information Technology and Management	*Government Property Register*	31 January 2002
94	State Debt Recovery Office	*Collecting Outstanding Fines and Penalties*	17 April 2002
95	Roads and Traffic Authority	*Managing Environmental Issues*	29 April 2002
96	NSW Agriculture	*Managing Animal Disease Emergencies*	8 May 2002
97	State Transit Authority Department of Transport	*Bus Maintenance and Bus Contracts*	29 May 2002
98	Risk Management	*Managing Risk in the NSW Public Sector*	19 June 2002
99	E-government	*User-friendliness of Websites*	26 June 2002
100	NSW Police Department of Corrective Services	*Managing Sick Leave*	23 July 2002
101	Department of Land and Water Conservation	*Regulating the Clearing of Native Vegetation*	20 August 2002

No.	Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
102	E-government	*Electronic Procurement of Hospital Supplies*	25 September 2002
103	NSW Public Sector	*Outsourcing Information Technology*	23 October 2002
104	Ministry for the Arts Department of Community Services Department of Sport and Recreation	*Managing Grants*	4 December 2002
105	Department of Health Including Area Health Services and Hospitals	*Managing Hospital Waste*	10 December 2002
106	State Rail Authority	*CityRail Passenger Security*	12 February 2003
107	NSW Agriculture	*Implementing the Ovine Johne's Disease Program*	26 February 2003
108	Department of Sustainable Natural Resources Environment Protection Authority	*Protecting Our Rivers*	7 May 2003
109	Department of Education and Training	*Managing Teacher Performance*	14 May 2003
110	NSW Police	*The Police Assistance Line*	5 June 2003
111	E-Government	*Roads and Traffic Authority Delivering Services Online*	11 June 2003
112	State Rail Authority	*The Millennium Train Project*	17 June 2003
113	Sydney Water Corporation	*Northside Storage Tunnel Project*	24 July 2003
114	Ministry of Transport Premier's Department Department of Education and Training	*Freedom of Information*	28 August 2003
115	NSW Police NSW Roads and Traffic Authority	*Dealing with Unlicensed and Unregistered Driving*	4 September 2003
116	NSW Department of Health	*Waiting Times for Elective Surgery in Public Hospitals*	18 September 2003
117	Follow-up of Performance Audits	*Complaints and Review Processes (September 1999) Provision of Industry Assistance (December 1998)*	24 September 2003
118	Judging Performance from Annual Reports	*Review of Eight Agencies' Annual Reports*	1 October 2003
119	Asset Disposal	*Disposal of Sydney Harbour Foreshore Land*	26 November 2003

No.	Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
120	Follow-up of Performance Audits NSW Police	*Enforcement of Street Parking (1999) Staff Rostering, Tasking and Allocation (2000)*	10 December 2003
121	Department of Health NSW Ambulance Service	*Code Red: Hospital Emergency Departments*	15 December 2003
122	Follow-up of Performance Audit	*Controlling and Reducing Pollution from Industry (April 2001)*	12 May 2004
123	National Parks and Wildlife Service	*Managing Natural and Cultural Heritage in Parks and Reserves*	16 June 2004
124	Fleet Management	*Meeting Business Needs*	30 June 2004
125	Department of Health NSW Ambulance service	*Transporting and Treating Emergency Patients*	28 July 2004
126	Department of Education and Training	*School Annual Reports*	15 September 2004
127	Department of Ageing, Disability and Home Care	*Home Care Service*	13 October 2004
128	Department of Commerce	*Shared Corporate Services: Realising the Benefits, including guidance on better practice*	3 November 2004
129	Follow-up Performance Audit	*Environmental Impact Assessment of Major Projects (2001)*	February 2005
130	Fraud Control	*Current Progress and Future Directions*	February 2005

* Better Practice Guides

Performance Audits on our website

A list of performance audits tabled or published since March 1997, as well as those currently in progress, can be found on our website www.audit.nsw.gov.au

If you have any problems accessing these Reports, or are seeking older Reports, please contact our Governance and Communications Section on 9275 7100.

THE AUDIT OFFICE
OF NEW SOUTH WALES

THE AUDIT OFFICE MISSION

Assisting Parliament improve
the accountability and
performance of the State

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