3.3
Managing Employee Fraud

Employee fraud in government departments is relatively rare. However, it does happen and we were surprised that fewer than half of the departments we surveyed had formal policies and procedures specifically for minimising the likelihood of employee fraud or dealing with it when it happened.

Why We Looked At the Subject

3.301 Information that had come to our attention led us to the view that the quality of departmental policies and procedures for managing employee fraud was mixed. Therefore, we decided to survey departments for current practice.

What We Looked At

3.302 Our auditors examined each department to:

- establish whether it had formal written policies and procedures for minimising the likelihood of employee fraud and identifying the action to be taken once the department had determined that it had occurred; and

- assess how the department had managed any employee fraud that had occurred.

3.303 In those departments in which employee fraud had occurred in the past three years, the auditor examined whether the department had:

- documented policies and procedures;

- regularly reviewed transactions, activities or locations that may be susceptible to fraud;

THREE

- treated employees suspected of fraud consistently, regardless of seniority or position; and

- reviewed and (if necessary) amended internal control procedures and related practices following determination that fraud had occurred.

Incidence of Employee Fraud

3.304   Over the past three years (that is, 1997-98 to 1999-2000), there were 136 identified instances of employee fraud in 22 departments. The total established loss from the frauds was $1,568,034.[1] Not all of the 136 instances involved loss of money; nor was it always possible to establish the exact amount of money lost.

3.305   Of the $1,568,034 lost, $320,243 had been recovered and $417,239 was still the subject of investigation. The balance was regarded as not recoverable for a number of reasons, including:

- the perpetrator was not known or the perpetrator's identity could not be proved;

- it was not possible to quantify the amount lost; and

- the amount involved was considered too small to justify the additional expense of recovery action.

Policies and Procedures

3.306   Of the 43 departments we surveyed, only 16 had formal policies and procedures for managing employee fraud. One department said a policy was being developed; 18 departments relied instead on the provisions of an employee code of conduct; and six departments said that employee fraud was either identified as not being a risk or considered not to be a priority.

THREE

---

1   That represents 0.0009% of the total government expenditure of approximately $106,000 million over the three-year period.

How Employee Fraud Was Dealt With

3.307 Of the 22 departments in which employee fraud had occurred in the past three years, 10 had formal policies and procedures for managing it. And of the 136 instances of employee fraud, 106 occurred in those 10 departments.[2]

3.308 Also, of those 22 departments:

- 18 undertook regular reviews of transactions, activities or locations susceptible to fraud;

- 18 treated employees suspected of fraud consistently, regardless of seniority or position; and

- 19 reviewed and amended internal control procedures and related practices following the occurrence of fraud.

3.309 Analysis of the 136 instances of employee fraud shows that individuals perpetrated 129, staff acting in collusion perpetrated 3, and a person or persons unknown perpetrated 4. As for the consequences:

74 cases resulted in staff being dismissed

18 cases resulted in staff resigning

44 cases were still under investigation

in 44 of the 92 cases finalised staff were prosecuted.[3]

THREE

---
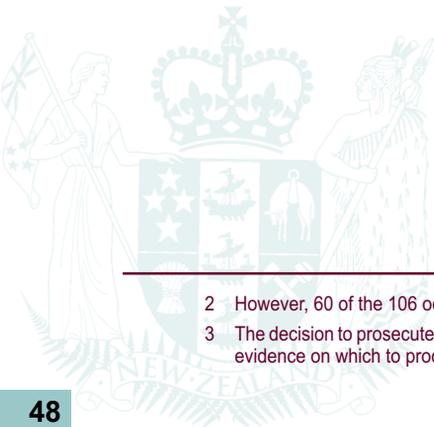
2   However, 60 of the 106 occurred in two large departments.

3   The decision to prosecute rests with the police, who may decide that there is insufficient evidence on which to proceed.

The Quality of Employee Fraud Management

3.310 For each of the 22 departments in which employee fraud had occurred, we assessed the quality of the department's management of the fraud. The criteria that we used were broadly similar to those we use to assess departments' financial management (see paragraph 2.011 on page 22). The results of our assessment are:

Standard	Number of Departments
Not adequate	–
Just adequate	8
Satisfactory	7
Good	6
Excellent	1

Conclusions

3.311 We are disappointed at the small proportion of departments that had formal policies and procedures for managing employee fraud. We acknowledge that the risk of employee fraud will vary according to the size of the department, the complexity of its operations, and other factors. But we do not believe that there is never any risk. Indeed, smaller departments – in which internal controls could be harder to apply – could be at greater risk than larger departments.

3.312 In our view, every department should formally address the matter of employee fraud, and formulate an appropriate policy on how to minimise it and (in the event that it occurs) how it will be dealt with.

THREE
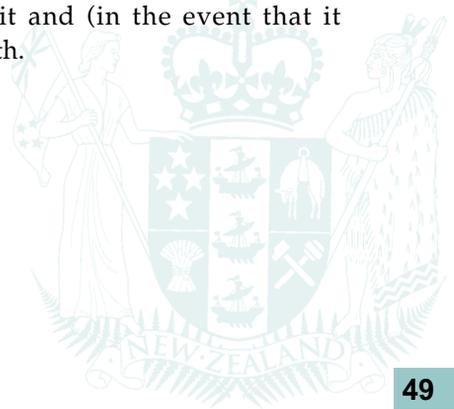
3.313   A code of conduct – or, perhaps, an individual employment contract – may identify employee fraud as constituting serious misconduct and specify the action that follows if serious misconduct is considered to have occurred. However, neither of those documents is likely to include a detailed and comprehensive statement of the department's policies and procedures for managing all aspects of employee fraud. For example, the absence of standardised procedures and documentation could lead to inconsistencies in how individual cases are dealt with.

3.314   In our view, the benefits of detailed and comprehensive policies and procedures are that:

- the response to employee fraud is both considered and appropriate;

- the same course of action is taken in every case; and

- the particulars of a fraud and the action taken is better documented, increasing the ability to refer the case to the police for prosecution.

3.315   **We recommend that an employee fraud policy should include, as a minimum, these key elements:**

- **a system for undertaking regular reviews of transactions, activities or locations that may be susceptible to employee fraud;**

- **specifications for fully documenting what happened in an employee fraud and how it is to be managed;**

- **the means for ensuring that every employee suspected of committing fraud is dealt with in the same manner, regardless of the employee's seniority or position;**

- **the principle that every effort is to be made to gather sufficient reliable evidence to support a prosecution, and that every case of fraud will be referred to the police with a view to prosecution; and**

- **the principle that recovery of the lost money or other property will be pursued wherever possible and practicable.**

3.316   The chief executive and management of every department need to be clear on their attitude towards employee fraud, and employees need to be aware of that attitude and the consequences of transgressing. The only satisfactory way of achieving those objectives is in a formal statement of policies and procedures about which everyone in the organisation is fully informed.

3.317   We will maintain our interest in the subject by keeping under review how departments are formalising their attitude to employee fraud and how they deal with any cases that occur.

THREE