Cleanest public sector in the world: Keeping fraud at bay

An overview from the Auditor-General on the results of a survey on fraud awareness, prevention, and detection in New Zealand's public sector

New Zealand generally has a "clean" image when it comes to fraud. We consistently rank well in international and domestic surveys that measure public trust in government and the effectiveness of systems and processes that deal with fraud and corruption.[1] Our general absence of systemic large-scale corruption in both the private and public sectors is attributed to the integrity of our system, underpinned by strong and shared common values within a small and cohesive society.

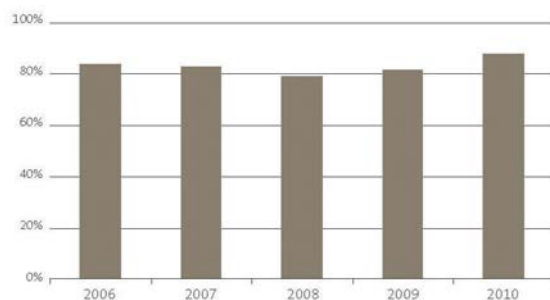To date, most of the New Zealand-based surveys on fraud have focused on the private sector. To gain better insight into fraud awareness, prevention, and detection in our public sector, my Office commissioned PricewaterhouseCoopers (PwC) to carry out a survey of almost 1500 people working in the public sector. The survey response rate of 74% places the results among the most reliable information sources about perceptions and practices in detecting and preventing fraud in the public sector.

Strong commitment to protecting public resources

Overall, our survey confirms a strong commitment within the public sector to protecting public resources. This is pleasing and not surprising. However, we cannot afford to be complacent if we are to maintain our good record of keeping fraud at bay.

Despite our generally "clean" image, fraud is a fact of business life in New Zealand. According to a 2009 survey, 42% of New Zealand organisations (public and private)

New Zealand's score on the Transparency International Corruption Index for the five years from 2006 to 2010

In 2010, New Zealand was rated first equal with Denmark and Singapore. New Zealand has achieved a high place on the index since it started in 1995.

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1   For example, in 2010, we again ranked first (equal with Denmark and Singapore) on the Transparency International Corruption Index and achieved 99.5% on the Worldwide Governance Indicator for Control of Corruption.

have suffered from an economic crime in the previous 12 months (August 2008 to August 2009), with an average loss of almost $492,000.[2]

Ongoing vigilance is particularly important in the current global economic climate, which increases the risk of fraud as many people struggle to make ends meet.

Keeping up our good record

Our survey showed that the incidence of fraud is lowest where a public entity's culture is receptive to talking about and dealing openly with fraud, where the entity communicates about fraud policies and risk, and where incidents of fraud are reported.

Anyone who has been part of an organisation that been defrauded knows that the financial loss is only part of the effect of fraud. Additional costs include loss of trust in workmates and colleagues, the loss in productivity when assessing and repairing internal systems, and the sense of betrayal.

The results of our survey show that there are some simple steps that we can all take to actively protect organisations and the public sector from fraud.

Within organisations, I encourage public entities to talk to their employees to promote fraud awareness and existing policies and procedures – and to do so regularly. I also want public entities to actively consider reporting each case of suspected fraud to enforcement agencies. Not every case will result in prosecution but reporting allows the system to work as intended and sends a strong message about an organisation's zero tolerance for fraud. This also helps protect the public sector as a whole.

Sharing our knowledge about fraud risks can protect the public purse

Everyone working in the public sector is responsible for protecting our entities and public resources. Therefore, we need to recognise that preventing fraud means focusing on fraud risks. We can learn just as much, if not more, about these risks from our detected frauds as we can from the smaller number of cases that are reported.

At present, as part of every audit, my auditors ask public entities about fraud. They do this to make sure they are carrying out a professional audit. It is important to note that fraud prevention and detection is the responsibility of the governing body and management of each entity – not of the auditor.

In future, using the information that auditors receive from public entities, my Office will be regularly updating and sharing information about the fraud advised to us, similar to the way we've collected and set out the results of this survey.

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2   The results of the 2009 PwC Global Economic Crime Survey were based on responses from more than 3000 companies in 54 countries. In New Zealand, 85 organisations from the private and public sectors took part in the survey. Full results can be found on the PwC website – www.pwc.com.

We consider that sharing information more quickly about fraud will help all public entities learn about fraud incidents and risks, without compromising the principle of fairness. Public entities can support this by taking the simple step of informing their auditor quickly when they suspect that fraud has occurred. By sharing information quickly, we can identify and minimise our risks, limiting possible losses while working in ways that play to the strengths that continue to protect us – our sense of community and values.

This survey is a first step in what I hope will become an ongoing conversation about how we can all protect the public purse to get better value for every dollar used by the public sector. We're putting together results by sector and entity size to help public entities get more insight. We'll be sending out these sector results between now and Christmas, and my auditors are looking forward to discussing them with you.

Lyn Provost
Controller and Auditor-General

2 November 2011

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Headline results – what our survey revealed

Without doubt, the best way for us to keep fraud at bay is to treat the risk of fraud seriously. Although an organisation will never be able to reduce its fraud risks to zero, it can have in place the attitude and controls to prevent, detect, and respond decisively to fraud. Broadly, this includes:

- a clear and visible commitment from senior management towards fraud prevention and a zero tolerance to fraud;
- a sound policy framework, with policies that provide clear and concise guidance to staff on fraud and fraud-associated matters and outline clear roles and responsibilities for fraud prevention;
- established and well-controlled management processes and systems; and
- fraud-specific procedures that allow an organisation to identify and report incidents of fraud and monitor the remedial actions.

Low incidence of fraud in public sector

Overall, the incidence of fraud in our public sector appears to be relatively low. Less than a quarter of survey respondents (22.5%) were aware of any fraud occurring in their organisation in the last two years. What the respondents told us shows clearly that having a receptive culture that informs employees about the risks of fraud, how to protect the organisation from fraud, and what to do if a fraud has been detected is crucial in minimising incidents of fraud.

Trusting staff is not a fraud control

Respondents pointed out that they trusted their staff and colleagues to do the right thing – we want to be able to trust each other. However, trust alone is not a fraud control. Although many organisations take comfort from the fact that they are not aware of having been defrauded in the past and many public entities rely on "trusted employees", nearly 80% of known frauds were committed by an internal person acting alone.

Good internal controls are important

The survey results show that public entities with effective management controls in place do well in minimising fraud risk. This is supported by the survey finding that 45.0% of all known incidents of fraud were detected by internal controls.

We need to be more aware of emerging fraud risks

Respondents told us that the main perpetrator in known incidents of fraud was an operational (46.3%) or administration/support service person (22.2%). However, in the current challenging economic environment, international data shows that fraud is increasingly committed by those at managerial level or above. This is a concern because people in these positions can often override controls and potentially better conceal their offending. The results of our survey suggest that people working in the public sector are not necessarily aware of the emerging fraud risks and challenges. Nearly 70% of respondents did not believe that the current economic climate increased their level of fraud risk.

The "fraud triangle" – the three common factors when fraud occurs

Incentive/ Pressure

Fraud risk

Opportunity

Attitude/ Rationalism

Three crucial elements

The results of our survey show that certain elements are crucial if organisations want to successfully minimise the risk and occurrence of fraud. These can be summed up as:

- having a receptive culture;
- communicating regularly about fraud policies and risk; and
- reporting suspected fraud to the Police.

Having a receptive culture is strongly linked to fewer incidents of fraud

Our survey showed a strong correlation between the culture of an organisation and incidents of fraud. Organisations where respondents felt they could raise concerns about fraud and felt that these concerns would be treated seriously had fewer incidents of fraud compared to those where staff felt there was a less receptive culture. Strong confidence in leadership and tone at the top also had a significant influence in building a culture against fraud.

It is vital to have an environment that encourages staff to come forward if they suspect fraud. Pleasingly, 95% of survey respondents felt that they would be willing to raise any concerns that they may have about fraud and that their concerns would be taken seriously.

Overall, our survey also shows that, although staff awareness and understanding of policies and management processes and systems is less than that of senior managers, public entities have the frameworks and, in many instances, processes that are necessary to prevent fraud. These include

having and communicating a fraud policy and Code of Conduct, and ensuring that employees at every level of the organisation understand their responsibilities in relation to fraud.

Communicating regularly about fraud keeps fraud at bay

The results of the survey also show how important communication is in preventing fraud. For example, organisations that had a specific fraud policy that was regularly communicated to staff generally suffered fewer incidents of fraud.

Having appropriate policies and procedures is a good first step. However, for any of these to be effective, management needs to ensure that employees know about them and know how to use them.

Communicating previous incidents of fraud has also been shown to be an effective way to reduce fraud. Currently, communication of fraud incidents to staff is poor – with only 29.2% of respondents saying that management communicates incidents of fraud. However, the survey indicates that those organisations that had communicated previous incidents of fraud to staff had generally fewer incidents of fraud. This, again, highlights the importance of sharing information and communicating with staff to minimise the risk of more fraud occurring.

Reporting prevents more fraud occurring

Understandably, given New Zealand's high values, our survey shows that most people (78.0%) were confident that if fraud were discovered in their organisation, it would be reported. For many, action by enforcement agencies is the confirmation that a fraud has occurred. However, only 39.5% of the frauds known to have occurred were actually reported to enforcement agencies.

Importantly, our survey shows how effective reporting to the Police is in preventing more fraud from occurring. Organisations that had reported previous matters to the Police had fewer known incidents of fraud. Of those who said that fraud was reported to the Police, 21.0% told us that fraud had occurred in the last two years. Of those who didn't report previous matters to the Police, 49.0% told us that fraud had occurred in the last two years.

Where fraud has occurred but goes unpunished, staff confidence in management can be seriously eroded. This may have an adverse effect on staff who would otherwise report their suspicions of fraud.

Results for fraud management strategies – prevention, detection, incidents of fraud, and fraud response

Our survey focused on four main areas – fraud prevention, fraud detection, incidents of fraud, and fraud response. Other findings in each area were:

Preventing fraud – robust frameworks minimise the risk of fraud occurring

The elements that are generally recognised as helping an organisation to successfully prevent fraud are shown here with the percentage of "yes" answers, ordered from highest to lowest:

- have a staff Code of Conduct (91.6%);
- have managers who understand their responsibilities for preventing and detecting the risk of fraud (89.4%);
- have a fraud policy (79.0%);
- take a proactive approach to preventing fraud (77.2%);
- have employees who understand their responsibilities for preventing and detecting the risks of fraud (73.2%);
- have a clear policy on accepting gifts or services (71.2%);
- screen new employees, including criminal history checks (71.0%);
- communicate their staff Code of Conduct regularly – annually or biannually (69.7%);
- designate a person to be responsible for fraud risks, including investigation (67.7%);
- review fraud controls regularly – annually or biannually (67.0%);
- communicate their fraud policy regularly – annually or biannually (64.3%);
- carry out due diligence on new suppliers, including credit checks and checks for conflicts of interest (47.5%); and
- offer fraud awareness training (23.6%).

The results show that public entities are highly aware of fraud. Larger organisations, in particular, have mature and connected policies and approaches to mitigating the risk of fraud.

It is important to understand that policies and procedures alone won't protect public entities from fraud. It is crucial to clearly communicate those policies and procedures to staff, and for management to be consistent with their messages and actions. The results show that although a large number of public entities have a Code of Conduct and a fraud policy, fewer communicate these to their staff regularly.

Only 23.6% of respondents have had fraud awareness training at their organisation. Fraud awareness training can teach staff what fraud is, how to recognise incidences of fraud, and how to act if they detect a fraud. Organisations with fraud training reported higher occurrences of fraud

in the last two years than those that did not have such training (32.0% compared with 20.0%). This could be attributed to staff knowing how to recognise fraud and what to do when they suspect or observe fraud occurring, rather than more fraud actually having been committed in those organisations.

Detecting fraud – having the right environment

Detecting fraud generally relies on a range of actions, from providing awareness of ways in which staff can report suspicions to specific process checkpoints. Elements are shown here with the percentage of "yes" answers, ordered from highest to lowest.

To be able to detect fraud, public entities should:
- closely monitor staff expenses (96.8%);
- have a culture where staff would be willing to raise any concerns that they may have regarding fraud or corruption and know that their concerns will be taken seriously and that they would not suffer any retaliation (95.0%);
- closely monitor credit card expenditure (89.8%);
- encourage staff to come forward if they see or suspect fraud or corruption (88%);
- when fraud or corruption risks are raised, take proactive steps to reduce the risk (86.6%);
- have a whistleblower hotline (23.5%); and
- have a Protected Disclosure Policy (71.2%).

As mentioned above, it is critical for organisations to foster a culture where staff feel safe to come forward if they suspect that a fraud has occurred. A Protected Disclosure Policy that protects and provides ways for staff to express concerns is critical in these instances.

Although 71.2% of respondents said that their organisation had a Protected Disclosure Policy, awareness of such policies was high at management level, but relatively low at operational level. A policy can only be effective if staff are aware of it.

Incidents of fraud – how often does fraud occur in the public sector?

Overall, only 22.5% of respondents said that they were aware of at least one incident of fraud or corruption in their organisation in the last two years. These frauds tended to be of lower value, with more than 60% being less than $10,000.

Respondents who said they knew of a fraud or corruption incident in the last two years were asked for details of the most recent incident. In nearly 80% of these incidents, the perpetrator was internal and the incident was committed by one person acting alone.

Of the respondents who indicated that they were aware of at least one incident of fraud in their organisation in the last two years:

- 45.0% said that fraud was detected through internal controls;
- nearly 1% said that fraud was detected by external audit;
- 25.0% said that fraud was detected through internal tip-off;
- 12.5% said that fraud was detected through external tip-off; and
- 5.3% said that fraud was detected by accident.

The most common type of internal fraud was theft of cash, in more than a quarter of all known incidents. The following groups came in at around 10% of the incidents:

- theft of plant and equipment;
- theft of inventory;
- fraudulent expense claims;
- fraudulent misuse of a credit card;
- false invoicing; and
- payroll fraud.

The main reasons given for these incidents were that the perpetrator did not think they would be caught and that the intended controls were not followed.

Action taken in response to fraud detected

The survey shows that public entities tend to address matters of fraud internally. Only if there is sufficient materiality or evidence available do they refer the matter to the appropriate agency, usually the Police. Only 23.0% of known frauds in our survey resulted in the person being dismissed and a report being made to Police.

Organisations are often reluctant to bring criminal charges against employees because of the time and costs of developing a case, the time it takes for matters to be resolved in the Courts, and the perception that fraud is a lower priority for the Police.

However, this means that employees suspected of fraudulent activities may move on to other public sector organisations and continue their behaviour — we are aware of this having occurred. The lack of visible action may also suggest to other staff that management tolerates such behaviour, creating a sense of failure to live up to the values promoted by the organisation.

About our survey

The survey and data analysis were carried out by PwC, on behalf of the Auditor-General. PwC's full report on the research, including data analysis, is available on our website (www.oag.govt.nz).

For the survey, we used a complex sample structure because we wanted to be able to get insight from staff at different organisational levels and to be able to provide results by sectors within the public sector to get the best insight about incidents and current practices.

Using a tiered selection method sample, we approached chief executives of certain public entities within sector groups, asking that person to provide contact details for staff at different levels of the organisation as follows:

- **Tier 1**: All entities in the following sectors were asked to participate – Government Departments; Crown Entities; Local Authorities; Energy Companies; State Owned Enterprises; Ports; Airports; Rural Education Activities Programmes; Licensing and Community Trusts; Māori Trust Boards; Fish and Game Councils.
- **Tier 2**: Statistically representative samples were sought from each of the following sectors – Schools; Council-Controlled Organisations and Council-Controlled Trading Organisations; and Central Government – Other.
- **Tier 3**: A general sample was sought from Local Government Other and Subsidiaries.

We then sought participation from the individual contacts provided using an online fraud awareness survey, which was made available by email between 14 February and 3 June 2011. The survey sample comprised 1968 valid email addresses across the three tiers set out above. The number of respondents who completed the survey was 1472.

Schools account for about one-third (32.7%) of responses, followed by Local Authorities (11.7%) and Government Departments or Subsidiaries (10.2%).

The scope of the survey included all of the following categories of dishonest acts and included the following definitions:

- **Fraud** – is an intentional and dishonest act involving deception or a misrepresentation, to obtain or potentially obtain an advantage for themselves or any other person (for example, falsifying timesheets, supplying false credentials, false invoicing, making false entries in business records).
- **Theft** – to dishonestly and without claim of right, take or deal with any property with intent to deprive any owner permanently of the property or interest in it (for example, theft of IP, theft of company property).
- **Corruption** – the abuse of entrusted power for private gain, (for example, soliciting or receiving gifts or other gratuities to perform part of an official function, or omit to perform an official duty).

Notes