

The Auditor-General  
Audit Report No.5 2000–2001  
Performance Audit

# **Fraud Control Arrangements in the Department of Industry, Science and Resources**

**Department of Industry, Science  
and Resources**

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Canberra ACT  
23 August 2000

Dear Madam President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Industry, Science and Resources in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Fraud Control in the Department of Industry, Science and Resources*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—  
<http://www.anao.gov.au>.

Yours sincerely



P. J. Barrett  
Auditor-General

The Honourable the President of the Senate  
The Honourable the Speaker of the House of Representatives  
Parliament House  
Canberra ACT

## **AUDITING FOR AUSTRALIA**

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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**Fax (02) 6203 7798**  
**Email [webmaster@anao.gov.au](mailto:webmaster@anao.gov.au)**

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### **Audit Team**

Ann Thurley  
Bill Danaher  
Natalie Cooke  
Steven Lack

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# Abbreviations/Glossary

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AFP	Australian Federal Police
ANAO	Australian National Audit Office
APS	Australian Public Service
ATO	Australian Tax Office
CEIs	Chief Executive's Instructions
CEO	Chief Executive Officers
CLEB	Commonwealth Law Enforcement Board
CPG	Corporate Performance Group
DPP	Director of Public Prosecutions
FMA Act	<i>Financial Management and Accountability Act 1997</i>
IR&D	Industry Research and Development
ISR	(Department of) Industry, Science and Resources





# **Summary and Recommendations**



# Summary

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1. The Commonwealth Government demonstrated its on-going commitment to the protection of its revenue, expenditure and property from fraudulent activity through the release of its first Fraud Control Policy in 1987. This Policy was updated to its present form in 1994 (hereinafter referred to as the Policy).<sup>1</sup> An expected outcome of this Policy was that agencies would develop fraud control mechanisms aimed at the prevention, detection and investigation of fraud. Fraud is defined in the Policy as:

*inducing a course of action by deceit or other dishonest conduct, involving acts or omissions or the making of false statements, orally or in writing, with the object of obtaining money or benefits from, or evading liability to, the Commonwealth.*<sup>2</sup>

2. The Policy has been given legislative support through provisions in the *Financial Management and Accountability Act 1997* (FMA Act). Under the FMA Act, Chief Executive Officers (CEOs) are responsible for the implementation of a Fraud Control Plan and reporting to their Portfolio Minister on fraud control within their agencies.

3. A recent review of the Policy led to the release of a Consultation Draft in 1999<sup>3</sup> by the Attorney-General's Department. This draft seeks to update the current Policy and, among other things, encourages agencies to integrate the management of fraud risks into general risk management processes. The draft is currently being circulated for comment.

4. The changing role of the public sector in the delivery of services, including the growing use of outsourcing and electronic service delivery, is introducing different risks for agencies in the management and protection of Commonwealth funds and resources. With the emphasis on public sector performance and accountability, an effective framework to protect public property, revenue, expenditure, rights and privileges from losses arising as a result of fraudulent activity is essential if agencies are to meet their responsibilities as stewards of the public purse. As previous audit reports on the subject have indicated, there should be a strong focus on prevention involving ongoing vigilance at all levels of an organisation.

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<sup>1</sup> Fraud Control Policy of the Commonwealth in *Best Practice for Fraud Control*, Commonwealth Law Enforcement Board (CLEB), AGPS, Canberra, 1994.

<sup>2</sup> Taken from the Interim Ministerial Direction on Fraud Control issued in 1994 which is included in the Commonwealth Law Enforcement Board (CLEB) Guide, *Best Practice for Fraud Control*, Canberra, 1994.

<sup>3</sup> The Fraud Control Policy of the Commonwealth, Consultation Draft No. 1 (21 June 1999).

5. This audit of fraud control arrangements in the Department of Industry, Science and Resources forms part of a series of performance audits on the management of fraud control in Commonwealth agencies. Fraud audits were completed in the then Department of Employment, Education, Training and Youth Affairs in 1999 and the Department of Health and Aged Care in 2000<sup>4</sup>. Audits are currently underway in the Department of Family and Community Services, Department of Defence, Centrelink and the Australian Taxation Office. At the completion of the detailed audits, the ANAO plans to prepare a guide setting out practical examples to assist agencies to achieve better practice in fraud control.

6. To complement these audits, the ANAO conducted a survey of Australian Public Sector (APS) agencies to assess fraud control arrangements that had been implemented by these agencies. The survey provided an overall view of arrangements across the APS to manage fraud.<sup>5</sup>

### **Audit objective, scope and criteria**

7. The objective of the audit was to assess the framework and systems that Industry, Science and Resources (ISR) had in place to prevent, control, monitor, detect and investigate fraud and the effectiveness of these arrangements in relation to administrative functions and program operations.

8. The audit criteria were developed from the Commonwealth Policy, the Australian Standards/New Zealand Standards (AS/NZS) 4360:1999 standard on risk management and general better practice that has been identified.

### **Audit methodology**

9. The audit fieldwork was carried out in Canberra between December 1999 and April 2000. This included interviews with relevant staff as well as reviews of files and documents to test the effectiveness of fraud prevention and control. By using a case study approach, compliance issues were addressed in relation to administrative functions to determine whether the arrangements in place were consistent with the fraud control arrangements detailed in the Chief Executive Instructions (CEIs). As well, compliance testing was undertaken in AusIndustry to determine whether its divisional arrangements to support fraud control and fraud control mechanisms for specific AusIndustry programs were operating effectively in practice.

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<sup>4</sup> Auditor General's Reports No.4, 1999–2000 and No.6, 2000–01 respectively.

<sup>5</sup> Audit Report No.47, *Survey of Fraud Control Arrangements in APS Agencies*, ANAO, Canberra, 20 June 2000.

## Overall audit conclusion

10. The ANAO concluded that ISR had only some elements of a suitable fraud control framework in place at the time of the audit. As a basis for fraud prevention and control, ISR had an overall departmental policy that clearly articulated its commitment to fraud control and outlined the roles and responsibilities of the relevant groups with operational and review responsibilities.

11. However, the fraud risk assessment undertaken by ISR in 1998 is no longer as relevant in the current conditions, for example, because ISR's information technology operations have been outsourced and the use of electronic commerce has become more widespread. In addition, the methodology used did not appropriately determine the inherent fraud risk factors. This means that ISR's Fraud Control Plan was not underpinned by an appropriate risk assessment. As well, the Fraud Control Plan did not address protective security or include firm timetables for action plans as required in the Government's Policy.

12. ISR's performance indicators should, where ever possible, include more robust benchmarks and targets to enable it to monitor fraud control effectively. Furthermore, while the CEIs provided information on some administrative processes, procedures did not exist for operational aspects of fraud investigations including the management of investigations, reporting, recovery and disciplinary action.

13. ISR had informal arrangements in place to assist officers working in areas of higher fraud risk to obtain the skills necessary to prevent and control fraud. However, these arrangements were not guided by clearly formulated strategies. In addition, no fraud awareness induction or ongoing training had been provided to staff over the last year even though training is a pre-requisite for staff involved in fraud investigations.

14. At the operational level, the ANAO concluded that ISR had developed adequate CEIs detailing the fraud control procedures associated with compliance activities such as cabcharge, credit cards, travel and petty cash and the fraud control procedures in the CEIs for these functions were followed. As well, AusIndustry had implemented suitable fraud control arrangements that reflected a strong risk management culture in that division.

## Agency's response

15. ISR agreed with all the recommendations. Further, ISR indicated that progress had been made on implementing the recommendations. For example, the Department's fraud control policy has been reviewed and a strategic approach to risk management, including fraud control, is being developed.

# Key Findings

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## **Fraud control policies, risk assessments and plans**

16. ISR had developed a departmental policy on fraud prevention and control that clearly articulated its commitment to fraud control and outlined the roles and responsibilities of the relevant groups with operational and review responsibilities. As well, ISR's fraud control plan was appropriately linked to its Corporate Plan.

17. The fraud risk assessment undertaken by ISR in 1998 is no longer relevant to current conditions. As well, the methodology used in 1998 did not appropriately determine the inherent risk<sup>6</sup> and some significant fraud risks factors would not have been considered and, where appropriate, addressed in ISR's fraud control plan. The ANAO also found that the associated fraud control plan only partially met the requirements of the Fraud Control Policy of the Commonwealth. However, during the course of the audit, ISR advised that it would use a suitable fraud risk assessment methodology and redress ANAO concerns in relation to the fraud control plan in the next round of assessments.

## **ISR management arrangements for fraud control**

### *Performance assessment*

18. The key performance indicator for fraud used within ISR was a qualitative review for each fraud investigation. However, no standards existed to ensure that these reviews met ISR's information needs. While the reviews provided useful information on the circumstances surrounding each case, they did not provide a perspective on other aspects of fraud control such as the investigation process or the implementation of fraud control treatments in action plans. As well as establishing the performance indicators needed to assess fraud control activities, ISR should identify suitable benchmarks and establish targets so that the agency has an effective basis for performance monitoring.

19. Where ever possible ISR should enhance its monitoring of fraud so that it is in a better position to improve the effectiveness of audit and fraud control activities. For example, assessing the fraud investigation process and the impact of fraud control treatment strategies set out in the fraud control plan. The enhancement of monitoring arrangements would also require more timely reports on specific fraud investigations to be submitted to the ISR Audit Committee (from annually to quarterly).

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<sup>6</sup> The inherent or 'greenfields' fraud risk is the fraud risk if no controls were in place.

20. Mandatory external reporting was satisfactory with the Commonwealth Law Enforcement Board (CLEB) being provided with regular reports and the ISR Annual Report providing details on the number of fraud allegations and Australian Federal Police (AFP) investigations during the year.

### *Manuals and procedures*

21. The CEIs provided ISR staff with suitable guidelines on issues and procedures relevant to fraud control. These guidelines are updated as required and are readily available to all staff. However, the CEIs and other ISR manuals did not address operational aspects of fraud investigations including the management of fraud investigations, reporting, recovery and disciplinary action.

### *Reporting and recording investigations*

22. Arrangements within ISR to report suspected cases of fraud were appropriate, in that, staff have access to alternative reporting channels should they be concerned about the integrity of one of the reporting channels. However, although investigation records were stored in a secure location, the amount of information recorded for individual investigations varied significantly, as did the way in which the information was stored. It was, therefore, difficult to determine if all investigations had been reported to the Audit Committee.

### *Fraud investigations*

23. ISR's fraud investigations were undertaken in a timely manner. However, the transparency of the investigations was inadequate because the records associated with the five (most recent) investigations did not contain sufficient detail to support the documented decisions. In addition, ISR fraud investigations had not been subject to a quality assurance review and, therefore, ISR has no assurance that investigations were undertaken appropriately.

### *Fraud control awareness, skills and training*

24. The ANAO found that ISR does not have an agency-wide code of ethics/conduct. While the general Australian Public Service code of conduct is available, an ISR-based code would better assist staff deal with the agency specific issues that they encounter. The ANAO also found that no fraud awareness induction or ongoing training had been conducted in the Department over the last year. ISR is, however, arranging for training to be provided.

25. While informal arrangements assist officers in areas of higher fraud risk to obtain the skills necessary to control fraud, the ANAO found that there was no clearly formulated strategy to guide these arrangements and, consequently, some training needs may not be met. Staff directly involved in fraud investigations have not had specific investigative training. ISR has, however, recognised this problem and will recruit an officer with relevant skills and provide existing staff with training in fraud management and investigations.

## **Fraud control for administrative and program activities**

26. Compliance activities associated with fraud control for cabcharge, credit cards, travel and petty cash were examined in ISR's Corporate Services Division, the Petroleum and Energy Division and AusIndustry and were considered to be sound.

27. Fraud prevention and control in AusIndustry was examined in detail and the ANAO found that the arrangements reflected a strong risk management culture. The AusIndustry business plan satisfactorily addressed fraud control. In addition, comprehensive conflict of interest guidelines existed and these were being followed. AusIndustry also had suitable arrangements to manage fraud control in the three programs examined by the ANAO—the Research and Development (R&D) Tax Concession Program, the Innovation and Investment Fund and the R&D Start Program. Each of these programs had a current fraud/risk assessment, appropriate guidelines and arrangements to address the identified risks. The ANAO noted that AusIndustry files acknowledge the ANAO audit of the R&D Tax Concession Program in 1993–94 as being the catalyst for AusIndustry's approach to risk management.



# Recommendations

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**Recommendation No.1**  
**Para. 3.15**

The ANAO recommends that, to allow the Department to assess its performance in relation to fraud control, ISR establish an appropriate performance assessment framework that includes suitable key performance indicators, benchmarks and targets.

*DISR response:* Agreed

**Recommendation No.2**  
**Para. 3.31**

The ANAO recommends that, to ensure fraud investigations are recorded, reported and investigated appropriately, ISR should:

- establish and implement formal guidelines and standards for the recording, reporting and handling of fraud investigations, including a requirement that case file reports detail the specific reasons for concluding or continuing investigations and, if relevant, prosecutions; and
- implement a quality assurance program for fraud investigations.

*DISR response:* Agreed

**Recommendation No.3**  
**Para. 3.43**

The ANAO recommends that, to promote staff knowledge and awareness of fraud, ISR should:

- develop and disseminate an agency-wide code of ethics; and
- determine staff fraud prevention and control awareness raising and training needs and implement strategies to meet these needs.

*DISR response:* Agreed



# **Audit Findings and Conclusions**



# 1. Introduction

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*This chapter describes the background to the audit, sets out the ANAO's objectives and methodology and provides information on the general fraud control framework in the Department of Industry, Science and Resources. A brief overview of the three Commonwealth agencies that have specific roles in relation to fraud is also provided.*

## Background

**1.1** The Commonwealth Government demonstrated its on-going commitment to the protection of its revenue, expenditure and property from fraudulent activity through the release of its first Fraud Control Policy in 1987. This Policy was updated to its present form in 1994 (hereinafter referred to as the Policy).<sup>7</sup> An expected outcome of this Policy was that agencies would develop fraud control mechanisms aimed at the prevention, detection and investigation of fraud. Fraud is defined in the Policy as:

*inducing a course of action by deceit or other dishonest conduct, involving acts or omissions or the making of false statements, orally or in writing, with the object of obtaining money or benefits from, or evading liability to, the Commonwealth.*<sup>8</sup>

**1.2** Fraud was defined very broadly in the Policy to encompass, among other things, theft and corruption. In its broadest sense, fraud can vary from minor matters to serious issues such as large scale revenue and welfare fraud.

**1.3** The Policy has been given legislative support through provisions in the *Financial Management and Accountability Act 1997* (FMA Act). Under the FMA Act, Chief Executive Officers (CEOs) are responsible for the implementation of a Fraud Control Plan and reporting to the Portfolio Minister on fraud control within their agencies.

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<sup>7</sup> Fraud Control Policy of the Commonwealth in *Best Practice for Fraud Control*, Commonwealth Law Enforcement Board (CLEB), AGPS, Canberra, 1994.

<sup>8</sup> Taken from the Interim Ministerial Direction on Fraud Control issued in 1994, which is included in the Commonwealth Law Enforcement Board (CLEB) Guide, *Best Practice for Fraud Control*, Canberra, 1994.

1.4 A recent review of the Policy led to the release of a Consultation Draft in 1999<sup>9</sup> by the Attorney-General's Department. The new *Consultation Draft* is a more principles-based policy that is designed to:

- encourage agencies to manage fraud risks alongside other risks they face;
- assist agencies to better deal with both the existing and new risks of fraud facing the public sector; and
- provide agencies with greater flexibility to choose and develop the fraud control arrangements best suited to them.

1.5 The changing role of the public sector in the delivery of services, including the growing use of outsourcing and electronic service delivery, is introducing different risks for agencies in the management and protection of Commonwealth funds and resources. With the emphasis on public sector performance and accountability, an effective framework to protect public property, revenue, expenditure, rights and privileges from losses arising as a result of fraudulent activity is essential if agencies are to meet their responsibilities as stewards of the public purse. As previous audit reports on the subject have indicated, there should be a strong focus on prevention involving ongoing vigilance at all levels of an organisation.

1.6 This audit of fraud control arrangements in the Department of Industry, Science and Resources (ISR) forms part of a series of performance audits on the management of fraud control in Commonwealth agencies. Fraud audits were completed in the then Department of Employment, Education, Training and Youth Affairs in 1999 and the Department of Health and Aged Care in 2000<sup>10</sup>. Audits are currently underway in the Department of Family and Community Services, Department of Defence, Centrelink and the Australian Taxation Office. At the completion of the detailed audits, the ANAO plans to prepare a guide setting out practical examples to assist agencies to achieve better practice in fraud control.

1.7 To complement these audits, the ANAO conducted a survey of Australian Public Sector (APS) agencies to assess fraud control arrangements that had been implemented by these agencies. The survey provided an overall view of arrangements across the APS to manage fraud.<sup>11</sup>

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<sup>9</sup> The Fraud Control Policy of the Commonwealth, Consultation Draft No.1 (21 June 1999). Following the receipt of comments from Commonwealth agencies, another Consultation Draft is expected to be released shortly.

<sup>10</sup> Auditor General's Report No.4, 1999–2000 and No.6, 2000–01 respectively.

<sup>11</sup> Audit Report No.47, *Survey of Fraud Control in APS Agencies*, ANAO, 20 June 2000.

## Audit objective, scope and criteria

**1.8** The objective of the audit was to assess the framework and systems that ISR had in place to prevent, control, monitor, detect and investigate fraud and the effectiveness of arrangements in place in relation to administrative functions and program operations.

**1.9** The audit criteria were developed from the Commonwealth Policy, the Australian Standards/New Zealand Standards (AS/NZS) 4360:1999 standard on risk management and general better practice that has been identified.

## Audit methodology

**1.10** The audit fieldwork was carried out in Canberra between December 1999 and April 2000. This included interviews with relevant staff in Canberra as well as reviews of files and documents to test the effectiveness of fraud prevention and control. Compliance issues were addressed in relation to administrative functions to determine whether the arrangements in place were consistent with the fraud control arrangements detailed in the Chief Executive Instructions (CEIs). As well, compliance testing was undertaken in AusIndustry to determine whether its divisional arrangements to support fraud control and fraud control mechanisms for specific AusIndustry programs were operating effectively in practice. This division was selected because it administers a number of programs with high financial materiality and has a significant potential exposure to external fraud.

## Industry, Science and Resources

**1.11** The primary role of ISR is to *‘foster economic advances and scientific achievements that continue to strengthen Australia’s international competitiveness’*<sup>12</sup>. To achieve this the Department has established a structure consistent with the need to undertake policy analysis, offer policy advice and provide business and scientific services. AusIndustry has the primary responsibility for the delivery of scientific services to businesses and the management of relevant State offices. The Department has its National office in Canberra and offices in Adelaide, Brisbane, Hobart, Melbourne, Perth and Sydney. Appendix 2 provides information on the structure of ISR.

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<sup>12</sup> Portfolio Budget Statements 2000–01, Industry, Science and Resources Portfolio.

**1.12** ISR has an administered appropriation for 2000–01 of \$725 million and a departmental appropriation of \$218 million<sup>13</sup>. Besides these direct expenditures, programs provide support for specific activities through tax concessions. For example, the Commonwealth expects that forgone revenue through the Research and Development Tax Concession Program will amount to \$600 million in 2000–2001.

### **Departmental arrangements for fraud control**

**1.13** The CEIs place responsibility for the oversight and monitoring of fraud prevention and control with the ISR Audit Committee. The committee is chaired by the Chief Executive or, as an alternate, the Deputy Chief Executive. The Chief Executive appoints other members from ISR's senior executive. The Committee, among other things, receives reports on ongoing fraud investigations and the outcomes of such investigations.

**1.14** The CEIs vest the Corporate Performance Group (CPG) with the responsibility for the management of corporate activities related to fraud prevention and control. Division heads and State managers are responsible for ensuring that areas under their control have adequate fraud control systems in place.

**1.15** Specific responsibilities of the CPG include:

- maintaining the currency of the fraud control plan and monitoring its implementation;
- the provision of a contact point for the reporting of all fraud allegations;
- conducting inquiries into fraud allegations and liaising with contractors engaged to conduct fraud investigations;
- liaison with the Director of Public Prosecutions (DPP) and Australian Federal Police (AFP);
- collating and submitting annual statistical returns to the Commonwealth Law Enforcement Board (CLEB);
- reporting to the Audit Committee on fraud allegations and investigations; and
- improving staff awareness of fraud prevention and control issues.

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<sup>13</sup> Administered items are items, such as grants and subsidies, that are controlled by the Government and managed by the Department. Departmental items are items, such as assets, liabilities and employee entitlements, that are controlled by the Department.



## External operational arrangements for fraud prevention and control

**1.16** CLEB, AFP and DPP are the three external agencies that have specific roles and responsibilities in relation to fraud. CLEB is a non-statutory body that was established in 1994 to improve the quality of policy for law enforcement, provide standards, facilitate coordination and provide information and related advice to government.

**1.17** The AFP is the Commonwealth's primary law enforcement agency and has responsibility for, among other things, the investigation of serious fraud against the Commonwealth.

**1.18** The DPP is responsible for the prosecution of people who commit offences against Commonwealth law, including the Corporations Law and activities related to the recovery of criminal assets.

## The Report

**1.19** Chapter 2 discusses ISR's fraud control policy, risk assessments and planning. Chapter 3 reviews ISR's management arrangements for fraud control including: performance assessment; manuals; investigation procedures, reporting and recording; and awareness-raising, skills and training. Fraud control for administrative and program activities is examined in Chapter 4.

**1.20** The audit was conducted in accordance with Australian National Audit Office (ANAO) auditing standards at a cost of \$158 000.

## 2. Industry, Science and Resources' Fraud Control Policies, Risk Assessments and Plans

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*Fraud control policies, risk assessments and control plans are considered in this chapter. The links between ISR's fraud control plan and other corporate planning processes is also assessed.*

### Introduction

**2.1** Fraud control is integral to internal control, which in turn is central to corporate governance. The Commonwealth Fraud Control Policy requires Chief Executives to be responsible for:

*fostering an environment within their agencies which makes active fraud control a major responsibility for all public sector staff, for articulating clear standards and procedures to encourage minimisation and deterrence of fraud, and for the detection and prosecution of offences should they occur<sup>14</sup>.*

**2.2** Fraud control policies should reflect an agency's wider operating environment and be an integral part of the organisational planning regime. Fraud control plans should, in turn, be linked to the broader objectives of an agency as outlined in its corporate plan, the directions specified in its business plan and the activities of individual work areas. Fraud control plans should be based on an assessment of the fraud risk and include strategies and action plans for the treatment of identified risks.

**2.3** The ANAO therefore examined whether ISR had:

- a statement of overall departmental policy on fraud prevention and control;
- undertaken a fraud risk assessment;
- an appropriate fraud control plan in place; and
- linked the fraud control plan to other relevant corporate planning processes.

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<sup>14</sup> Commonwealth Law Enforcement Board, 1994, *Best Practice for Fraud Control—Fraud Control Policy of the Commonwealth*.

## Fraud policy statement

**2.4** An agency's policy on fraud prevention and control should clearly articulate its commitment to fraud control, including ethical behaviour, and establish suitable organisational arrangements.

**2.5** The ANAO found that ISR had a fraud control policy that clearly articulated its commitment to fraud control and outlined the roles and responsibilities of the relevant groups with operational and review responsibilities. ISR's fraud control policy is defined in the CEIs and this statement is supported by a booklet that sets out the Department's approach to fraud, including responsibilities, reporting and monitoring.

**2.6** As detailed in Chapter 1, the CEIs establish organisational arrangements to support the Instructions. The CEIs are available to all staff on the ISR Intranet and establish procedural arrangements to handle suspected and proven cases of fraud. A separate booklet, developed in 1997, was recently reviewed to reflect current Commonwealth policy. To ensure that it is a ready source of advice, the ANAO suggests that information in the booklet also be made available on the ISR Intranet as part of overall arrangements.

## Fraud risk assessment

**2.7** An agency's fraud risk assessment process should be sufficiently robust to enable all key fraud risks to be identified. Risk assessments should address both the internal and external environment of the agency and cover all functions and operations to establish the level, nature and form of exposure to fraud.

**2.8** The process of risk assessment should be ongoing, iterative and be:

- undertaken on a regular basis as necessitated by changing conditions and, at a minimum, be reviewed biannually; and
- based on a sound methodology.

**2.9** The ANAO examined ISR's risk assessment against these criteria.

## Timing and changing conditions

**2.10** A risk assessment was undertaken by ISR in February 1998 and, as required by the Policy, the risk assessment (and an associated fraud control plan) were forwarded to CLEB for review. CLEB raised a number of concerns in relation to the fraud risk assessment and plan and (in December 1998) recommended that ISR immediately undertake another fraud risk assessment and prepare another fraud control plan. This was not done at that time because of reorganisation and personnel constraints.

**2.11** The ANAO noted that many significant changes have occurred in ISR's operating environment since the last fraud risk assessment. For example, the structure and responsibilities of ISR's Divisions have changed significantly, information technology operations have been outsourced and the use of electronic commerce has become more widespread. ISR is addressing these issues by undertaking work on a new round of fraud risk assessments.

## **Risk assessment methodology**

**2.12** The ANAO examined the methodology used for the fraud risk assessment in 1998 and found that the general approach required by Commonwealth Policy was followed, in that:

- fraud risk was determined quantitatively using the 'greenfields' approach<sup>15</sup>;
- the methodology could be applied consistently across all the programs that were assessed; and
- staff with knowledge of the programs that were being assessed were involved in the fraud risk assessment process.

**2.13** As mentioned above (paragraph 2.10), the fraud risk assessment was not fully endorsed by CLEB because of, for example, concerns about how the effectiveness of the controls was determined. As well, the ANAO is concerned that, among other things, the model used by ISR:

- consistently underestimated the fraud risk; and
- incorrectly determined the 'greenfields' risk because the contributing factors were not weighted correctly.

**2.14** As a consequence, some significant fraud risks would not have been considered and, where appropriate, addressed in the fraud control plan.

**2.15** During the course of the audit, ISR acknowledged ANAO concerns regarding this methodology and advised that its next round of assessments would use the fraud risk assessment methodology as detailed in the *Consultation Draft No.1* and incorporate the fraud risk assessment in the risk management framework. Specifically, ISR would develop a framework that would enable fraud risks to be assessed and managed alongside other business risks faced by the Department rather than in isolation. The ANAO found that this approach had already been successfully applied in AusIndustry.

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<sup>15</sup> The greenfields approach involves the quantitative determination of the:

- fraud risk with no controls in place (the 'greenfields' or 'inherent' level of risk);
- effectiveness of controls; and
- residual risk, this being the difference between the greenfields risk and control effectiveness.

**2.16** The management arrangements to incorporate fraud risk assessment into the risk management framework across the Department have yet to be established. However, once they have been developed, this broader risk management strategy will better suit the needs of the Department and assist it to overcome the shortcomings identified in paragraph 2.14.

## Fraud Control Plan

**2.17** A Fraud Control Plan is a specific requirement of both the Fraud Control Policy of the Commonwealth and the FMA Act<sup>16</sup>. The Fraud Control Plan provides a mechanism for outlining an agency's overall approach to fraud control and should<sup>17</sup>:

- reflect the risks identified in the fraud risk assessment;
- include strategies to rectify shortcomings identified in the risk assessment;
- provide a timetable for implementation of the strategies;
- nominate action areas responsible for implementing each strategy; and
- address corporate issues such as protective security detailed in the Commonwealth Fraud Control Policy.

**2.18** The results of the ANAO assessment of ISR's Fraud Control Plan against these criteria are contained in Table 1.

**Table 1**

Assessment of ISR's Fraud Control Plan

Criteria	Assessment	ANAO comment
<i>Reflects the risks identified in the fraud risk assessment</i>	✓	<i>The fraud control plan was appropriately linked to the results detailed in the fraud risk assessment</i>
<i>Includes strategies to rectify shortcomings identified in the risk assessment action plans</i>	✓	<i>Strategies for all the activities assessed as having a residual fraud risk equal to or greater than 'medium'</i>
<i>Includes timetables for implementation of the strategies timetables</i>	✗	<i>The timetable for action items was not determined precisely. It was defined as being a certain period (say three months) 'of this plan'</i>
<i>Nominates action areas responsible for implementing each strategy action officer</i>	✓	<i>Action areas nominated</i>
<i>Addresses corporate issues required by the Commonwealth Fraud Control Policy<sup>18</sup></i>	✗	<i>Corporate issues such as computer and protective security that must be covered were not addressed in the plan</i>

<sup>16</sup> Section 45 of the FMA Act requires CEOs to implement an agency wide Fraud Control Plan that includes and addresses fraud by external parties as well as internal fraud.

<sup>17</sup> Taken from Best Practice for Fraud Control, Fraud Control Policy of the Commonwealth, CLEB, 1994., p. 21–22.

<sup>18</sup> The Commonwealth Fraud Control Policy requires agencies to address: the encouragement of ethical behaviour; staff training in fraud awareness and prevention; arrangements for financial authorisations; computer and protective security; and guidance to staff on how to handle fraud cases.

**2.19** The ANAO found that the Fraud Control Plan only partially met the requirements of the Fraud Control Policy of the Commonwealth. The plan had been submitted to CLEB and endorsed subject to a subsequent plan addressing concerns in relation to timetables and corporate issues such as computer and protective security. During the course of the audit, the ANAO was advised that these concerns would be addressed in the forthcoming fraud control plan.

## **Links to the Corporate Plan**

**2.20** To maximise the effectiveness of the fraud control planning framework an agency should have a coordinated approach to fraud control across the agency. In particular, the Fraud Control Plan should link with the Corporate Plan.

**2.21** The ANAO found that ISR's Corporate Plan establishes a sound basis for fraud control activities by including references to risk management and ethical behaviour. These issues relate directly to fraud control and provide an appropriate link between the Fraud Control and Corporate Plans.

## **ANAO conclusion**

**2.22** The ANAO concluded that ISR had developed a departmental policy on fraud prevention and control that clearly articulated its commitment to fraud control and outlined the roles and responsibilities of the relevant groups with operational and review responsibilities.

**2.23** The ANAO found that the fraud risk assessment undertaken by ISR in 1998 is no longer relevant to current conditions. As well, the methodology used in 1998 did not appropriately determine the inherent risk and some significant fraud risks factors may not have been considered and, where appropriate, addressed in the Fraud Control Plan. The ANAO also found that the associated Fraud Control Plan only partially met the requirements of the Fraud Control Policy of the Commonwealth. However, during the course of the audit, ISR advised that it would use a suitable fraud risk assessment methodology and redress ANAO concerns in relation to the Fraud Control Plan in the next round of assessments.

**2.24** The ANAO considered that the Fraud Control Plan was appropriately linked to the Corporate Plan.

### 3. Industry, Science and Resources' Management Arrangements for Fraud Control

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*This chapter discusses the corporate management arrangements for fraud control used by ISR to assist in the effective implementation of its fraud control plans. The ANAO examined performance assessment; manuals and procedures; the reporting and recording of allegations; investigations; awareness-raising; skills and training.*

#### Introduction

**3.1** Within agencies it is important to have arrangements in place that assist in the effective implementation of fraud control plans. This includes performance assessment and supporting practices so that the day-to-day operations are focused on preventing and managing fraud effectively.

**3.2** The ANAO, therefore, examined whether ISR had appropriate:

- performance assessment mechanisms including performance information, monitoring and reporting;
- manuals and procedures;
- arrangements for reporting and recording allegations;
- fraud investigation procedures; and
- fraud control awareness-raising, skills and training.

**3.3** Each of these issues is discussed under separate headings below.

#### Performance assessment

**3.4** Performance assessment of fraud control activities is a key accountability measure for stakeholders such as the Minister, clients and the public. As well, CEOs have particular responsibilities in relation to fraud under the FMA Act, which serves to increase the importance of assessing and monitoring performance on fraud-related matters.

**3.5** The ANAO, therefore, examined whether ISR had established mechanisms to assess the effectiveness of the fraud control function, including:

- a balanced range of performance indicators with benchmarks and targets, where appropriate, that can be used to assess fraud control activities, including the implementation of fraud control treatments in action plans;

- monitoring arrangements covering the implementation of fraud control plans and fraud investigations. The arrangements should include standards and benchmarks to aid the evaluation process; and
- reporting arrangements for fraud control activities, including the provision of reports consistent with the requirements specified in the Fraud Control Policy of the Commonwealth.

## **Performance indicators**

**3.6** The ANAO found that the key performance indicator used for fraud within ISR was a qualitative review for each fraud investigation. However, there were no benchmarks, targets or standards detailing the requirements for these qualitative reviews.

**3.7** The investigation reports reviewed by the ANAO detailed the:

- ISR program involved and financial materiality;
- circumstances surrounding the investigation; and
- status of investigations.

**3.8** The ANAO found that, while the reviews provided useful information on the circumstances surrounding each case, they did not provide a perspective on other aspects of fraud control or the investigation process. Other information that could assist includes advice on the:

- implementation of the fraud control plan including, for example, whether target dates in the action plans (previously referred to in paragraph 2.17) have been met;
- quality of the fraud investigation process;
- timeliness of investigations including, for example, whether target dates (that should be set) have been met; and
- level of service, for example, information on how satisfied the Audit Committee is with the investigative process.

## **Monitoring**

**3.9** The ANAO considers that if ISR is to implement a successful fraud control monitoring program it should ensure that it has:

- sufficient performance information, including benchmarks and targets, where possible, against which to adequately monitor fraud control (discussed in paragraphs 3.6 to 3.8); and
- guidelines on the nature and frequency of monitoring (discussed later in this chapter in paragraphs 3.17 to 3.20).



**3.10** As mentioned previously (paragraph 1.13), the CEIs devolve to the Audit Committee the responsibility for monitoring fraud control. The ANAO found that the Audit Committee received the qualitative reports on fraud investigations mentioned in paragraphs 3.6 to 3.8. Neither the implementation of fraud control action plans nor the fraud investigative process was monitored.

**3.11** Internal audit staff within ISR<sup>19</sup> monitor aspects of fraud control at the program level while fulfilling wider internal audit obligations. For example, in the current internal audit program, the ANAO identified approximately 15 audits with fraud control implications. However, while internal audit activities meet some of the agency's monitoring needs and address some of the issues raised in the Fraud Control Plan, it is still necessary to monitor the implementation of strategies in the Fraud Control Plan and the effectiveness of these fraud control strategies.

**3.12** This situation has now been recognised by ISR and it is currently recruiting an officer who, among other things, will monitor the implementation of treatment strategies in the Fraud Control Plan.

## **Reporting**

**3.13** The Audit Committee receives reports on specific fraud investigations. However, the reports have not been timely as they have only been submitted annually to the Audit Committee over the last two years. It is suggested that fraud control reporting be an agenda item at each quarterly meeting of the Audit Committee so that ISR has, for example, an assurance that prompt action has been taken to progress fraud investigations and implement fraud control treatments in action plans. As well, progress towards the establishment of an appropriate set of performance indicators should be reported to the Audit Committee.

**3.14** The ANAO found that annual reports have been provided in a timely manner to CLEB. These reports involve the completion of a pro-forma and indicate whether, for example, particular activities had or had not been undertaken and the extent of fraud and losses. In addition, the ISR Annual Report provides details on the number of fraud allegations and AFP investigations during the year.

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<sup>19</sup> Both the internal audit and fraud control functions are in the same area in ISR.

## Recommendation No.1

**3.15** The ANAO recommends that, to allow the Department to assess its performance in relation to fraud control, ISR establish an appropriate performance assessment framework that includes suitable key performance indicators, benchmarks and targets.

### *ISR's response*

**3.16** Agreed. A risk assessment, incorporating fraud risk, is scheduled for late 2000 from which a revised Fraud Control plan will be developed, together with a performance assessment framework that includes key performance indicators. These performance indicators will be reported regularly to the Audit Committee.

## Manuals and procedures

**3.17** A manual or a set of procedures is necessary to provide specific detailed guidance on fraud management responsibilities and practices and to raise staff awareness of fraud matters.

**3.18** The ANAO examined whether ISR has a manual that:

- provided ISR staff with guidance on fraud control and investigation procedures;
- was readily available to relevant staff; and
- was reviewed and updated as necessary.

**3.19** The ANAO found that the CEIs provided ISR staff with guidelines on issues and procedures relevant to fraud control. These guidelines were updated as required and were readily available to all staff on the Intranet. The CEIs:

- clearly directed ISR staff to report all suspected cases of fraud to their supervisor or the CPG;
- made the CPG responsible for operational aspects of fraud control;
- gave the Audit Committee responsibility for oversighting fraud control; and
- established procedures for generic corporate activities such as credit card use, travel, cabcharge and petty cash handling that, among other things, assist with fraud control. Appendix 3 provides details of some of the specific arrangements.

**3.20** However, the CEIs and other ISR manuals did not address operational aspects of investigations, the management of investigations, reporting, recovery and disciplinary action. Therefore, ISR did not have

a basis for the consistent management, monitoring or reporting of fraud investigations. These particular issues are discussed in more detail in paragraphs 3.21 to 3.30.

## Reporting and recording fraud investigations

**3.21** Agencies should have mechanisms to facilitate the reporting and recording of fraud investigations. These mechanisms should be visible and accessible so that people will use them. Alternative reporting channels should exist and people wishing to report fraud should be assured that information provided will be treated in strict confidence, otherwise they are less likely to report suspected fraud. As well, information on investigations should be collected in a systematic manner so that it can be reported.

**3.22** The ANAO, therefore, examined whether ISR had:

- established a central reporting system with alternative reporting channels for officers; and
- consistent recording arrangements.

### Reporting arrangements

**3.23** The ANAO found that the CEIs require staff to report all suspected cases of fraud to the CPG or their supervisor. These arrangements are appropriate in that the staff member has an alternative reporting channel should one of those two parties be involved in the suspected fraud. All the ISR staff interviewed during the course of the audit were aware of these reporting arrangements.

### Recording arrangements

**3.24** The ANAO found that, although investigation records were stored at one secure location, record structure and content varied significantly and there was no formal register of investigations. It was therefore difficult to determine:

- if all investigations had been recorded and reported to the Audit Committee; and
- the status and progress on investigations.

**3.25** The ANAO considers that the ad hoc nature of the files is the probable reason that one of the investigations examined by the ANAO was not reported by the CPG to the Audit Committee as required by the CEIs.

**3.26** As a limited number of investigations are proceeding at any point of time, a simple management information system would meet ISR's needs. However, ISR still requires a clearly formulated strategy.

## Fraud investigations

**3.27** The Fraud Control Policy of the Commonwealth requires investigations to be undertaken in a timely and professional manner. The arrangements for fraud investigations should include a quality assurance system to ensure appropriate and timely action is taken in relation to investigations.

**3.28** The ANAO examined the investigation files for the eight fraud investigations undertaken in ISR over the last two years. It was difficult for the ANAO to determine the timeliness for three of the eight investigations because of the disorganised nature of the records. However, the other five cases were investigated in a timely manner.

**3.29** A successful investigation requires the collection of sufficient information to determine if there is reasonable cause to believe that an offence has been committed. Based on this information the decision-maker must assess the materiality of the offence and decide whether to prosecute the suspected offender<sup>20</sup> or implement other penalties. However, the ANAO considers that the records associated with the five (most recent) investigations did not contain sufficient detail to support the documented decision not to proceed with investigations or prosecutions. Typically, the ANAO noted that reports stated that *'there was no prima facie case of fraud'*. The ANAO considers that, for transparency and accountability purposes, it is important that reports clearly detail the specific reasons for concluding or continuing investigations.

**3.30** The ANAO also found that, over the last two years, the ISR fraud investigations had not been subject to a quality assurance review. As a consequence, ISR has no assurance that investigations were undertaken appropriately, or that problems in the fraud control framework, identified during investigations, will be addressed in a formal way.

## Recommendation No.2

**3.31** The ANAO recommends that, to ensure fraud investigations are recorded, reported and investigated appropriately, ISR should:

- establish and implement formal guidelines and standards for the recording, reporting and handling of fraud investigations, including

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<sup>20</sup> Criteria for the referral of investigations to the AFP and in relation to decisions on whether or not to prosecute are found in the CLEB guidelines and Prosecution Policy of the Commonwealth (1990) respectively.

a requirement that case file reports detail the specific reasons for concluding or continuing investigations and, if relevant, prosecutions; and

- implement a quality assurance program for fraud investigations.

#### *ISR's response*

**3.32** Agreed. While the Department outsources its fraud investigations to qualified fraud investigators, it is planning to send some Departmental staff on fraud management/investigation training. A strategic approach to Risk Management, including Fraud Control as a key risk, is being further developed. This will culminate in guidelines and manuals associated with fraud investigations, management and reporting.

### **Fraud control awareness, skills and training**

**3.33** One of the key elements in assisting staff to understand, prevent and identify fraud is by encouraging awareness of fraud and ethical behaviour throughout an agency. As well as ensuring that staff are aware of their broad responsibilities in relation to fraud prevention and control, agencies should provide appropriate training, particularly for those staff who work in higher risk areas. Specific training is also necessary for those staff directly involved in investigating fraud.

**3.34** The ANAO therefore examined the following issues:

- fraud and ethics awareness-raising;
- general fraud training; and
- training for investigations staff.

### **Fraud and ethics awareness-raising**

**3.35** The ANAO found that ISR did not have an agency-wide code of ethics/conduct<sup>21</sup>. In the absence of a specific agency code, ISR staff can use (and are bound by) the general Australian Public Service (APS) code of conduct. However, this code was designed to be applicable to all APS agencies and employees and does not specifically address issues that ISR staff may frequently encounter. For example, because ISR provides services and assistance to private enterprise, its staff have access to confidential information and it is highly desirable, for the creation of an ethical climate, that ISR produce and distribute a specific code of ethics/conduct that sets corporate values and standards of behaviour for staff.

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<sup>21</sup> As discussed in the following chapter, AusIndustry has comprehensive conflict of interest guidelines.

**3.36** The ANAO also found that while the ISR fraud policy requires information on fraud control to be provided to new staff during induction and other staff on an ongoing basis, no fraud awareness induction activities had been conducted during the last year. However, ISR is addressing this problem and the fraud control officer who was being recruited at the time of the audit fieldwork will be responsible for conducting suitable fraud awareness-raising exercises.

### **General fraud control training**

**3.37** The ANAO found that ISR had informal arrangements that assist officers working in areas of higher fraud risk to obtain the skills necessary to control fraud. However, as these arrangements were not guided by a formal strategy, some officers training needs may not be met.

**3.38** Some of ISR's training initiatives, while not being designed to address fraud control, have provided training relevant to fraud control for officers working in areas of higher fraud risk. For example:

- the preparation and conduct of training courses in competitive tendering that, among other things, address probity and legal issues; and
- sponsoring staff attendance at risk management seminars.

**3.39** Administrative officers have networking arrangements whereby they keep each other informed of problems and issues, including those relevant to fraud.

**3.40** As well, ISR officers also have access to CEIs relevant to fraud control on the corporate Intranet. This enables the officers to readily inform themselves on, for example, the various administrative controls in place to prevent fraud.

### **Training for investigations staff**

**3.41** The ANAO found that ISR had undertaken preliminary fraud investigations in-house over the last year using staff who did not have specific investigative training. External investigators were engaged to examine any case where it was determined in the preliminary investigation that a full investigation was warranted.

**3.42** ISR has, however, recognised that preliminary investigations should be undertaken by officers with investigative skills. Therefore, to address this problem, as well as recruiting an officer with relevant skills (previously mentioned in paragraph 3.36), ISR advised that it will provide staff with training in fraud management and investigations as appropriate.

## Recommendation No.3

**3.43** The ANAO recommends that, to promote staff knowledge and awareness of fraud, ISR should:

- develop and disseminate an agency-wide code of ethics; and
- determine staff fraud prevention and control awareness raising and training needs and implement strategies to meet these needs.

### *ISR's response*

**3.44** Agreed. A staff awareness program is planned to promote staff awareness of fraud prevention and control. This program will also include emphasis on agency-wide ethics.

## ANAO conclusion

**3.45** The ANAO concluded that ISR should improve its management arrangements for fraud control to ensure that its day-to-day operations are focused on preventing and managing fraud effectively. ISR has recognised that it should improve performance indicators, monitoring and reporting relevant to fraud and is addressing concerns identified by the ANAO. The following table summarises ANAO conclusions against each of the criteria examined.

**Table 2****Corporate fraud control conclusions**

<b>Criteria</b>	<b>Assessment</b>	<b>ANAO comment</b>
<b>Performance assessment</b> <ul style="list-style-type: none"> <li>performance indicators</li> <li>monitoring</li> <li>reporting</li> </ul>	<p>partial achievement</p> <p>partial achievement</p> <p>X</p>	<p>The key performance indicator was a qualitative review for each fraud investigation. The performance assessment framework did not provide the Audit Committee with sufficient information to evaluate the fraud control function on an on-going basis.</p> <p>The Audit Committee monitored reports on fraud investigations. Neither the implementation of the Fraud Control Plan nor the fraud investigation process has been monitored.</p> <p>Reports to the Audit Committee have not been timely. Also, because information is only collected on investigations, they do not address other aspects of fraud control such as the timeliness of the investigation process. Reports to CLEB are satisfactory.</p>
<b>Manuals and procedures</b>	partial achievement	CEIs provide information on some processes. However, procedures do not exist for operational aspects of investigations, the management of investigations, reporting, recovery and disciplinary action.
<b>Arrangements for reporting and recording investigations</b> <ul style="list-style-type: none"> <li>reporting arrangements</li> <li>recording arrangements</li> </ul>	<p>✓</p> <p>X</p>	<p>Alternative reporting channels exist and ISR staff are aware of the reporting arrangements.</p> <p>Investigation records were stored at one secure location. However, the record structure and content varied significantly and there was no formal register of investigations.</p>
<b>Fraud investigation procedures</b>	partial achievement	Investigations were timely, but investigation reports did not contain sufficient detail to support the documented decisions. As well, ISR did not have a quality assurance review process.
<b>Fraud control awareness, skills and training</b> <ul style="list-style-type: none"> <li>Fraud and ethics awareness-raising</li> <li>General fraud control training</li> <li>Training for investigations staff</li> </ul>	<p>X</p> <p>X</p> <p>X</p>	<p>No fraud awareness induction or ongoing training had been provided to staff over the last year. However, ISR is addressing this problem.</p> <p>Informal arrangements assist officers in areas of higher fraud risk to obtain the skills necessary to control fraud. However, there should be a clearly formulated strategy.</p> <p>Training is necessary for investigations staff.</p>



## 4. Fraud Control for Administrative and Program Activities

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*This chapter examines operational fraud control arrangements in ISR. Specific procedures related to cabcharge, credit cards, travel and petty cash for the agency as a whole were examined in three Divisions. Fraud control was also examined in AusIndustry.*

### Introduction

**4.1** While an agency must establish a suitable framework for fraud control, operational areas are, in the main, responsible for day-to-day aspects of fraud control. There are two aspects to this, namely, fraud control arrangements associated with specific administrative activities and fraud control arrangements for particular divisional programs.

**4.2** A case study approach was used in this phase of the audit, in that compliance activities associated with fraud control for cabcharge, credit cards, travel and petty cash were examined in ISR's Corporate Services Division, the Petroleum and Energy Division and AusIndustry. As well, fraud control in relation to ISR programs was examined in AusIndustry.

### Fraud control for administrative activities

**4.3** Within ISR, each Division is responsible for initiating transactions associated with generic activities such as cabcharge, credit cards, travel and petty cash associated with their operations. The Divisions are also responsible for the fraud control associated with these transactions. The Corporate Services Division is responsible for checking that specific fraud control measures have been complied with, such as authorisations and processing these transactions.

**4.4** The ANAO examined administrative practices in the Corporate Services Division, the Petroleum and Energy Division and AusIndustry to determine whether the arrangements that these areas had in place were consistent with the fraud control arrangements detailed in the CEIs.

**4.5** The ANAO undertook compliance testing in each of the three areas referred to above to determine the level of compliance with the CEIs. For example, whether the areas satisfactorily checked that all transactions had valid authorisations and had reconciled authorised expenditures against the accounts rendered by suppliers checked. Some of the specific fraud control measures in the CEIs, for cabcharge and credit cards, travel and petty cash, are listed in Appendix 3.

4.6 The ANAO found that these fraud control practices and procedures were followed by AusIndustry and the Petroleum and Energy Division. The relevant area in the Corporate Services Division also had procedures in place consistent with the CEIs.

4.7 Compliance checks on 80 transactions in the above categories in AusIndustry and the Petroleum and Energy Division were undertaken. All of these met the requirements detailed in the CEIs. As well, all the transactions processed by the Corporate Services Division and checked by the ANAO met the requirements detailed in the CEIs.

## Fraud control in AusIndustry

4.8 Fraud prevention and control at the program level was examined in detail in AusIndustry. This Division was chosen as a case study because it administers a number of programs that have high financial materiality and has a significant potential exposure to external fraud. Within this Division the ANAO examined:

- AusIndustry divisional arrangements to support fraud control; and
- fraud control arrangements for specific AusIndustry programs.

4.9 These two issues are discussed separately below.

### **AusIndustry divisional arrangements to support fraud control**

4.10 The AusIndustry divisional business arrangements should, among other things, promote fraud control. Its business plan should, for example, encompass fraud control and conflict of interest. Conflict of interest arrangements are of particular importance as AusIndustry staff and Industry Research and Development (IR&D) Board members could have a direct or indirect interest in a group that is seeking funds or tax concessions<sup>22</sup>.

4.11 The ANAO, therefore, examined whether:

- the AusIndustry business plan included strategies that address significant fraud control issues; and
- conflict of interest guidelines gave clear, appropriate directions on conflict of interest and were supported by an appropriate operational framework.

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<sup>22</sup> The *Industry Research and Development Act* (1986), among other things, establishes a statutory requirement for Board members to disclose conflicts of interest, requires the recording of declarations in the minutes of meetings and prohibits members with a conflict of interest from being present during any related deliberation and decision-making without the approval of either the Minister or the Board.

4.12 The ANAO also undertook compliance testing to determine if declared conflict of interests were identified in AusIndustry records.<sup>23</sup>

### *AusIndustry business plan*

4.13 The ANAO found that the 1999–2000 AusIndustry business plan was underpinned by risk management and addressed fraud control. As well, the plan covered specific strategies relevant to risk and fraud management that will be (or have already been) implemented during 1999–2000. These included the ongoing requirement that risk management principles be adopted, and specifically:

- a review of risks for all AusIndustry products and practices, including fraud;
- the appointment of a risk coordinator<sup>24</sup>; and
- the creation of an electronic risk register.

4.14 To promote the implementation of these strategies the plan includes, as necessary, action plans, milestones and nominated action officers.

4.15 The ANAO regards the consideration of fraud risk and fraud management in the business plan as being a reflection of the strong risk management culture in AusIndustry. The ANAO noted that AusIndustry files acknowledge the ANAO audit of the Research and Development Tax Concession Program in 1993–94 as being the catalyst for the development of these arrangements<sup>25</sup>.

### *Conflict of interest*

4.16 The ANAO found that AusIndustry had comprehensive conflict of interest guidelines that were developed in 1997 by the IR&D Board<sup>26</sup>. They cover a range of issues, including, impartiality, frankness and honesty amongst colleagues, bribes, and the use of public property and services. As well, they require a formal inquiry into conflict of interest

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<sup>23</sup> While undertaking fieldwork in AusIndustry, the audit team paid particular attention to conflict of interest arrangements because, as was the case with the *Magnetic Resonance Imaging* audit (Auditor General's Report No.42, 1999–2000), there was a risk that (Industry Research and Development) Board members may seek to profit through access to confidential information. Further details regarding conflict of interest are contained in that report.

<sup>24</sup> The ANAO was advised that this appointment has been made.

<sup>25</sup> Auditor General's Report No.12, 1993–94, *Administration of the 150% Taxation Incentive for Industry Research and Development*. Recommendation No.22 suggested that a risk management approach be used to identify tax concession applications that should be subject to a detailed assessment

<sup>26</sup> Based on the Bowen principles as defined by the Bowen Inquiry in 1979 (Public Duty and Private Interest).

**before** delegates receive any papers on a topic under consideration<sup>27</sup>. They also outline the process to be followed when a conflict of interest is disclosed. Once a potential conflict has been disclosed, a decision must be made on its materiality and whether that person should be permitted to participate in the decision-making process. The guidelines advise on how to determine the materiality of a conflict of interest and who should be involved in the determination.

**4.17** Board and committee members are required each year to provide a statement detailing their pecuniary interests and those of their family/spouse. This statement must be updated if their interests change. The statement is confidential and is declared to and recorded by the Secretariat of the IR&D Board. Details are available to the Secretariat staff and the Secretary of the Department.

**4.18** Consistent with the guidelines, prior to every meeting members are required to declare any conflicts of interest and these declarations are recorded in the minutes. The AusIndustry secretariat maintains the register of all declared conflicts of interest, their materiality and the outcome of the consideration on the declaration.

**4.19** The ANAO checked the conflict of interest register and the minutes of meetings and found that they clearly show declarations and decisions on the materiality of these declarations.

## **Fraud control arrangements for specific AusIndustry programs**

**4.20** To assess program fraud control arrangements the ANAO examined the:

- Research and Development Tax Concession Program;
- Innovation and Investment Fund; and
- Research and Development Start Program.

**4.21** These programs were chosen for examination because they represent three different means of promoting research and development and, therefore, a range of challenges that must be met to prevent and control fraud. Appendix 4 provides a brief outline of the features of these programs.

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<sup>27</sup> Those involved are advised in broad terms of the subject matter prior to the receipt of materials so that they can determine if they are likely to have a conflict of interest.

**4.22** Specifically, the ANAO examined whether the programs had included:

- fraud risk assessments;
- guidelines and procedures that, among other things, address fraud control; and
- monitoring of the adequacy of fraud control arrangements.

**4.23** For each of the three programs, program arrangements were examined to determine if guidelines relevant to fraud control were followed and fraud risk, identified during risk assessments, had been addressed. Some of the features of the program fraud control arrangements are listed in Appendix 4.

**4.24** The results of the ANAO assessment of AusIndustry's programs against these criteria are contained in Table 3.

**Table 3**

Assessment of the AusIndustry Program

<b>Criteria</b>	<b>Assessment</b>	<b>ANAO comment</b>
<i>Fraud risk assessments</i>	✓	<i>All AusIndustry programs were examined by consultants as part of a risk management review in July 1998. The approach detailed in the Australian and Zealand standard on risk management (AS/NZS 4360) was used. As well, since then, one of the three programs has undertaken another risk assessment and another is part way through a risk assessment. Fraud risk had been addressed.</i>
<i>Guidelines and procedures that address fraud control</i>	✓	<i>All had guidelines and procedures that address fraud control. For example, the effectiveness of fraud control is an issue that is being considered during the current review operational arrangements for the Research and Development Start Program.</i>
<i>Monitored the adequacy of fraud control arrangements</i>	✓	<i>All had monitored the adequacy of fraud control arrangements. The Research and Development Tax Concession Program has, for example, performance information on the effectiveness of the risk management process.</i>

4.25 The ANAO examined a sample of files for each of the three programs and found that, in all cases, procedures and guidelines relevant to fraud control had been followed. For example:

- thirteen applications for the Research and Development Tax Concession were correctly assessed against eligibility criteria;
- payment claims for funds from each of the five Innovation Investment Fund fund managers had been assessed and processed in accordance with program guidelines; and
- nine reports provided by recipients of Research and Development Start grants had been assessed correctly against grant monitoring and payment criteria.

4.26 Some of the specific features of fraud control programs for each of the three programs examined are listed in Appendix 4.

## ANAO conclusion

4.27 The ANAO concluded that ISR had developed sound fraud control arrangements associated with administrative activities such as cabcharge, credit cards, travel and petty cash and that the fraud control procedures detailed in the CEIs were adequately followed.

4.28 The ANAO also concluded that AusIndustry had satisfactory fraud control arrangements and that these were a reflection of a strong risk management culture in this particular ISR Division. The AusIndustry business plan also satisfactorily addressed fraud control. In addition, comprehensive conflict of interest guidelines were in place and these were being followed in the division. AusIndustry had suitable arrangements to control fraud control in the three programs examined. Each of these programs included a current fraud/risk assessment as well as appropriate guidelines and arrangements to address the identified risks.

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Canberra ACT  
23 August 2000

P. J. Barrett  
Auditor-General

# **Appendices**





## Appendix 1

### Previous ANAO performance audits on agency fraud control arrangements

Audit Report No.6, 2000–01

*Fraud Control Arrangements in the Department of Health and Aged Care*

Department of Department of Health and Aged Care

Audit Report No.47, 1999–2000

*Survey of fraud control arrangements in APS agencies*

Audit Report No.4, 1999–2000

*Fraud Control Arrangements in Employment, Education, Training and Youth Affairs*

Department of Employment, Education, Training and Youth Affairs

Audit Report No.11, 1992–93

*Procedures for Dealing with Fraud on the Commonwealth*

Department of Administrative Services

Audit Report No.40, 1991–92

*Systems for the Detection of Overpayments and the Investigation of Fraud*

Department of Social Security

Audit Report No.15, 1991–92

*Procedures for Dealing with Fraud on the Commonwealth*

Department of Defence

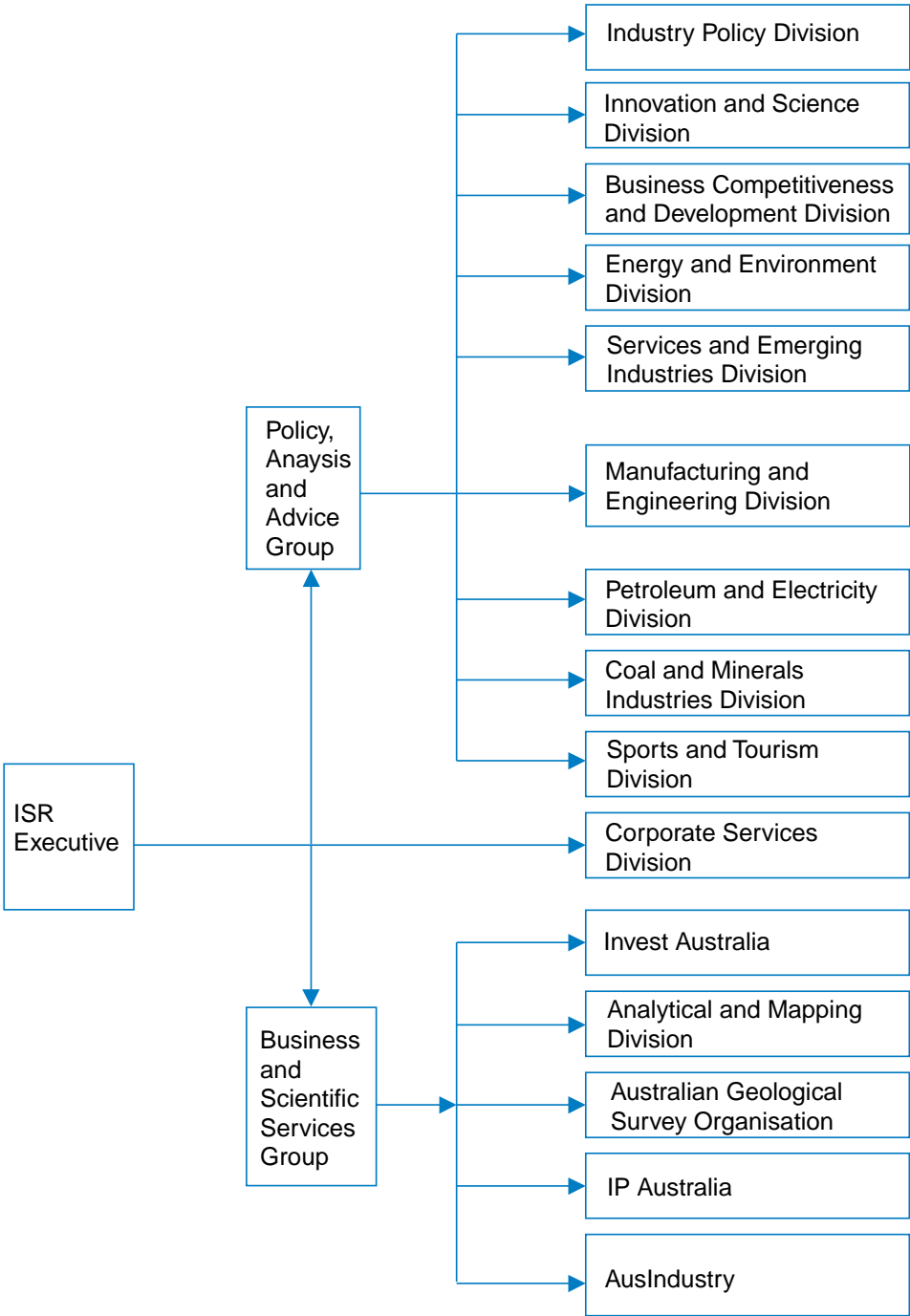
Audit Report No.25, 1990–91

*Efficiency and Effectiveness of Fraud Investigations*

Australian Federal Police

Appendix 2

ISR Organisational Structure



## Appendix 3

### Fraud control arrangements for administrative activities

Following are some of the controls established in the CEIs for generic corporate activities such as credit card use, travel, cabcharge and petty cash handling and associated administrative arrangements to control fraud:

<b>Administrative activity</b>	<b>Control feature</b>
<i>Cabcharge (cards and vouchers)</i>	<ul style="list-style-type: none"> <li>• access and use controlled by holding unused vouchers at a central location and limiting the number of cards issued</li> <li>• reason for travel etc. must be recorded</li> <li>• vouchers must be signed</li> <li>• cabcharge service fees checked (eg. to detect double billing)</li> <li>• reconciliation of use of cabs at a central point in the division</li> <li>• travel summary reports printed and checked to identify overuse by divisional staff</li> </ul>
<i>Travel</i>	<ul style="list-style-type: none"> <li>• appropriate authorisation required</li> <li>• travel must be acquitted</li> <li>• summary records of travel maintained</li> </ul>
<i>Credit card</i>	<ul style="list-style-type: none"> <li>• the number of cards issued is limited to specific officers who require them</li> <li>• requests for purchase must be completed and correctly authorised</li> <li>• cards must be stored in a B class safe when not being held by the nominated card user</li> <li>• all transaction notices reviewed and reconciled with requisitions at a central point in the division</li> </ul>
<i>Petty cash</i>	<ul style="list-style-type: none"> <li>• three signatures normally required (receiver, collector, authorising delegate)</li> <li>• receivers can not authorise their own expenditures and generally the receiver is not the collector</li> <li>• receipts required to demonstrate purchases</li> </ul>

## Appendix 4

### AusIndustry program and fraud control details

#### Research and Development Tax Concession Program

1. The Research and Development Tax Concession Program is designed to encourage research and development in Australia by allowing organisations to take a 125 per cent tax deduction for eligible expenditure for R&D activities that comply with the program guidelines. The program is run under the *Industry Research and Development Act* (1986) and the *Income Tax Assessment Act* (1936). ISR (through AusIndustry) and the Australian Tax Office (ATO) jointly administer the program and a Memorandum of Understanding between the two agencies explains their respective roles. AusIndustry is responsible for registration and assessment of eligibility of research activities and ATO is responsible for compliance with the tax concession expenditure provisions of the Income Tax Assessment Act. Annually, about 3000 to 4000 companies register for the tax concession.

2. This program was selected for examination because tax concession activities and expenditure allowed under the Act could be claimed fraudulently. As well, applicants may submit 'aggressive' claims for the tax concession that stretch qualification criteria close to or beyond the intended limits. Therefore, risk/fraud management should be an important part of program management. Examples of some of the features of risk/fraud management are:

- close liaison and complementary fraud control activities between AusIndustry and ATO staff;
- detailed performance information on, for example, assessment time and cost and the effectiveness of the risk/fraud management process; and
- the revision of the compliance monitoring arrangements to, among other things, improve fraud control. These changes will lead to improved liaison with, and education of, companies to reduce the adversarial nature of monitoring.

#### Innovation Investment Fund

3. The Innovation Investment Fund provides venture capital for technology-based companies that are commercialising research and development. Funds are directed to industry through fund managers.

4. Fund managers have the full responsibility for investment decisions, subject to eligibility criteria. They must identify eligible companies that they wish to promote and then apply to AusIndustry for Commonwealth funds to invest in these companies. Commonwealth funds are allocated on the basis of \$2 for every \$1 of private capital provided by the fund manager. At least 30 per cent of the private capital must come from persons not associated with the fund manager. Five fund managers administer funds totaling \$195 million with \$130 million of this being provided by the Commonwealth. Each fund manager must create a portfolio of 10 companies. After 10 years, the fund manager must return all the funds provided by the Commonwealth and, overall, achieve a minimum return. Additional monies are divided between the fund managers (18 per cent), the investors (72 per cent) and the Commonwealth (10 per cent).

5. This program was selected for examination because, unlike the other two programs examined, it involves a third party. This raises different issues relevant to fraud control, such as the need to undertake probity checks on prospective fund managers.

6. Examples of some of the features of risk/fraud management are:

- comprehensive probity checks on prospective fund managers. This required the engagement of experienced investment managers and the checking of primary and secondary references;
- the regular provision of annual audited and half-yearly unaudited statements by fund managers; and
- clear audit trails for payments to fund managers.

### **Research and Development Start Program**

7. The Research and Development Start Program is a grant and loan program that assists a diverse range innovative projects. Because of technical risk and/or risk associated with the commercialisation of the 'product', projects funded under this program can not readily obtain funds through normal commercial sources.

8. Typically, AusIndustry provides Research and Development Start funds over about three years to a maximum of 50 per cent of the eligible project cost with five per cent of the funding being withheld until project acquittal. Prior to AusIndustry finalising applications for funding, critical project milestones are identified and agreed upon by AusIndustry and the group seeking funding. Payments are made quarterly after AusIndustry has reviewed reports provided by the grant recipients. The reports must, among other things, address the milestones that fall in that quarter and include a financial budget. Monitoring of progress against the milestones is the responsibility of AusIndustry officers.

9. The ANAO selected this program for examination because it raises issues relevant to fraud control not examined in the reviews of the Research and Development Tax Concession Program of the Innovation Investment Fund. Specifically, issues relevant to the establishment of milestones and monitoring project progress against milestones.

10. Examples of some of the features of risk/fraud management are:

- identification of clear, unambiguous project milestones to guide payments; and
- monitoring and comprehensive reports on project progress against milestones.

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