

# PROCUREMENT AND FRAUD CONTROL: WHAT ARE THE ISSUES AND WHAT CAN YOU DO ABOUT THEM?

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## INTRODUCTION

Procurement has become an issue of concern in recent years. A recent series of major papers by the NSW Independent Commission Against Corruption have highlighted this issue. The question therefore becomes “what can be done to improve procurement now?” This paper attempts to provide practical guidance about what might be done to improve the situation, now.

This paper represents my individual views: it does not necessarily represent the views of the IAB.

## 1. THE CURRENT SITUATION

There are three particular issues that I would draw to your attention:

- The results of the NSW ICAC 2010/11 survey of suppliers to the NSW government
- The ICAC has just commenced hearings into its largest investigation ever, and that this investigation concerns procurement
- Businesses is wanting to build constructive relationships with government so they can sell more goods and services.

### 1.1. The Results of the NSW ICAC 2010/11 Survey of Suppliers

The NSW ICAC has recently released the results of a survey into the views of suppliers to the NSW government[1]. The ICAC sent out around 3,200 surveys and received 1,515 responses.

Specifically, the ICAC reports that suppliers held the following views:

- 55% believed that there was improper favouritism
- 48% reported they offered gifts and benefits over \$20
- 36% reported the acceptance of gifts or benefits over \$20
- 39% believed that there was provision of unequal information to different bidders
- 25% believed that there was leaking of confidential supplier information prior to close of tender.

The ICAC, in summary, has indicated “About two-fifths of suppliers to NSW state and local government perceive corruption in public sector procurement to be a moderate problem or worse. Such perceptions may lead to suppliers pricing corruption into their bids or not bidding at all, and almost one-third of suppliers indicated that they had declined to bid on a government contract because of corruption concerns”.

There are limitations to the above research: it is based on perceptions and those perceptions may or may not reflect actuality.

None the less, it is the effect that these beliefs have on supplier behaviours that is of concern.

### **1.2. NSW ICAC Operation Jarek**

In October 2011, the ICAC commenced public hearings into the largest investigation that it has undertaken and that investigation is centred on procurement [2]. At the heart of this investigation and public hearings are the behaviours of 3 companies. These suppliers to the NSW government are essentially using a business model that can be summarised as:

- Sales staff are encouraged to build relationships with the buyer (the employee responsible for procurement) rather than the customer (the organisation);
- Obtaining a sale/securing further orders the driving force; and
- Gifts are stepped in a sliding scale: the bigger the order, the bigger the gift.

The ICAC notes that the companies concerned claimed to have no knowledge that they were breaking NSW government approaches to procurement/agency codes of conduct.

Worryingly, the investigation covers 110 public authorities. The vast bulk of these are local Councils. However, there are a number of major NSW government departments caught up in this, including the Department of Finance and Services (which is responsible for the NSW government approach to procurement), Sydney Water, TAFE, Police, Fire and Rescue, Railcorp etc.

Despite the efforts of the ICAC over an extended period, the sheer scale of these events across government is surprising. It means that government agencies, despite having in place all sorts of policies and procedures, have allowed inappropriate business practices by the private sector to occur over an extended period.

### **1.3. Business Wants To Build Closer Relationships With Purchasers to Sell More Goods and Services**

Business is keen to sell more goods and services to government. It has become aware of just how big a purchaser the government is and can see real opportunities for growth and profits in this business.

A series of key philosophies underpin business activity:

- The best customers are your existing customers;
- It is much easier/less costly to sell more of your goods and services to existing customers; and
- Getting new customers is costly, time consuming and fraught with difficulties.

However, business is confused about how to build and manage these relationships with government.

Suppliers find the government approach to procurement sometimes quite baffling. Different agencies can have different approaches to procurement that can be further confusing to outsiders.

Business finds it difficult to communicate new products/technical developments to purchasers: these efforts are sometimes welcomed and at other times shunned. Business is more than happy to stage events such as breakfasts and lunches to bring potential purchasers up to speed, but finds it difficult to get public sector staff to attend these briefings.

Business is also concerned about how to manage its Intellectual Property: it fears that this information will be given to its competitors.

In short, business is looking for new ways to engage with government.

## **2. HOW DID WE REACH THIS SITUATION?**

Observing the public sector closely from a variety of organisations (the NSW Premier's Department,

the Audit Office of NSW, the Internal Audit Bureau), it has become clear to me that the use of outsourcing has grown considerably.

In the mid 1990s, I was responsible in the Premier's Department for developing and promoting the use of outsourcing to the public sector. In those days, there was relatively little use made of outsourcing. Most activities were undertaken in house. The last 10-12 years have seen dramatic change in this regard. Even front line service delivery (e.g. the care of wards of the state) has now been outsourced and the NSW government is committed in this particular case to increasing use of this.

A series of key developments have led us to the current situation:

- The value of projects outsourced has risen;
- The volume of projects outsourced has risen; and
- The complexity of projects outsourced has increased.

### **2.1. The Value of Projects Outsourced Has Risen**

A good example of this is the work currently being undertaken by RailCorp NSW. Traditionally, RailCorp has used outside providers to construct the trains that it uses. RailCorp has now moved well beyond this and is currently finalising a project that will result in 76 rail car sets being owned and operated by a private sector provider for a 20-year period.

While the value of this contract is, of course, commercial in confidence, it is clear that this will be significantly more expensive than just having the railcars constructed by the private sector.

Other major projects outsourced in recent times include:

- The ATO's acquisition of a new core computer system, which cost around \$500m;
- The Defence Department acquisition of the new Joint Strike Fighter, the most expensive aeroplane ever produced.

### **2.2. The Volume of Projects Has Grown**

It is difficult to get information about this. However, some indications are available. The Auditor General of NSW recently examined the use of consultants in NSW [3].

To cut a long story short, this examination showed that the NSW government has essentially made it easier to engage consultants. The performance audit mentioned above considers that since the commencement of a new scheme (which is the joint responsibility of the Department of Premier and Cabinet and the Department of Finance and Services) some \$300 million worth of consulting work has been undertaken since 2008.

It is my view that if you make things simpler and easier, then agencies will respond. Accordingly, it is sensible to conclude that the amount of consulting work carried out in NSW has risen.

### **2.3. The Complexity of Projects Has Grown**

While some examples have already been mentioned of projects that might also fall into this category, there are a large number of other examples that could be cited.

Two examples in particular merit brief discussion: the NSW Integrated Ticketing System and the Federal Government Jobs Network.

NSW tried (unsuccessfully as it happens) to develop and implement an Integrated Ticketing System. The aim of this system was to replace all existing ticket systems for public transport in metropolitan

NSW. The system was designed to allow a customer to make a single ticket purchase to cover all forms of public transport – bus, rail, ferry, light rail. Further, the system was to cover both publicly and privately owned transport. However, one of the constraints that was imposed on the project was that no existing fare structures were to be changed. What was something that might have assisted in keeping the project simple in reality turned out to be the single largest problem – at least in my mind – that led to its demise.

The Federal Government (successfully) aimed to move the provision of assistance in seeking work from the government to the private sector. To do so, they created an entirely new market for services and over time increased the expectations of service provision so that best outcomes were achieved for job seekers. (There are many lessons in both what was done and the way in which it was done). This approach has recently been adopted by the British Government as part of its efforts to both get better results for job seekers while at the same time saving money.

#### **2.4. The Overseas Experience**

There are clear examples from overseas that tend to support the above trends.

The National Health Service in the United Kingdom is midway into the implementation of its Patient Information System. The aim of this system is to have all patient information in a single, central electronic location that will allow more informed treatment of patients. Due to the structure of the Health System in the UK, at the present time, these records have all been at the local level. Should patients be treated elsewhere, move, travel etc enormous time and energy has to be put into collecting all relevant patient information again. When the project is complete, it will cover all the patients registered for the NHS. At the present time, 8.5 million people are on the system and there are another 33.5 million people to go. The project has generated great controversy. During a recent vacation to England, this story appeared in national newspapers a number of times. According to the London Times, 6 billion pound has already been spent on this system and it is expected that a total of 11 billion pound will eventually be spend.

Scotland has recently seen difficulties emerge with the construction of a new borders railway. The difficulties that were encountered in the acquisition process – tenderers dropping out for instance – eventually led to a decision to abandon this process and to (as I understand it) essentially have the government take over the project.

#### **2.5. The Consequences of the Above**

There are a series of consequences arising. These include:

- Our ability to deliver government services has become very dependent on the private sector;
- The difficulty of managing outsourced projects has increased; and
- Business is wanting to build closer relationships with purchasers to win more business.

### **3. IMPROVEMENTS THAT HAVE BEEN MADE TO PROCUREMENT POLICIES AND PROCESSES**

The recent years have seen a number of significant improvements made to procurement policies and processes. They include, but are not limited to:

- Increasing use of risk management methodologies;
- Increasing use of project management methodologies;
- Increasing use of probity auditors;
- Increasing use of specialist contractors/specialist advisors for the process as a whole/at particular points in process;
- Ensuring that staff are formally trained in procurement methodologies; and
- Putting in new purchasing systems that are more transparent and robust than ever before.

The efforts of undertaking these improvement projects should not be underestimated. RailCorp NSW has designed and implemented a new purchasing system called ARIBA. While in some ways a response to the concerns expressed by the ICAC over an extended period, none the less this system has significantly improved accountability and transparency for procurement right across RailCorp.

Equally, there is evidence of increasing interest of so called “watchdog” agencies in the area of procurement: the Auditor General, the ICAC, Public Accounts Committee and so forth.

Central agencies are also increasingly focussed on this issue: the Department of Treasury has its “gateway” screening process for capital works proposals. The Department of Finance and Services has made significant efforts in this regard as well.

Despite these efforts, problems clearly remain.

#### **4. THE VIEW FROM THE FIELD**

It is timely to consider the positions that Senior Executive and Managers find themselves in. Despite the many and varied changes of recent times, issues remain.

##### **4.1. The Senior Executive View**

There is no doubt in my mind that Senior Executive/Chief Executive Officers are genuinely committed to ensuring that procurement in their organisation is at best practice standards. However, the reality is that issues remain:

- Procurement is competing for the attention of Senior Executive staff;
- They receive endless reports on everything under the sun;
- The reports can be very detailed and complex;
- Improvements have been made to procurement policy and process which provide some comfort to executives; but
- Senior executive also know that organisations have a tendency to cover up bad news.

The effect of this is that Senior Executive/Chief Executive Officers remain – in their hearts – unsure just how well procurement is really going in their own organisation.

##### **4.2. The Manager View**

Just as Senior Executive/Chief Executive Officers are genuinely committed to the highest of standards in regard to procurement, Managers are equally committed to this. None the less, issues remain:

- Organisations are leaner than they have ever been before;
- This “thinning out” has affected mid level management in particular. These were traditionally the people that did the checking;
- Managers are overseeing projects where they have limited technical expertise in house;
- More and more organisations are becoming dependent on contractors to provide technical input and oversight;
- Managers have also become increasingly risk adverse; and
- Procurement takes Managers longer, costs more and can be so overly controlled as to be inefficient/ineffective.

Managers are, then, well over this !

##### **4.3. A Summary of the Current Situation**

**Senior Executive** still nervous about procurement. They keep seeing stories in the press about the

many and varied bad things that can happen in regard to procurement. They are looking for further tools and assistance to help them understand what the risks are/how to manage them

**Managers** are still nervous about this too. They are increasingly being held accountable and responsible for projects that are sometimes beyond their technical competence. They are increasingly reliant on outside assistance that also makes them nervous. They also read all the stories in the press and worry. They too are looking for further tools and assistance to help them understand what the risks are/how to manage them.

Both parties require further information: what risks do they need to be alert for. And once these risks are well understood, then the steps that they might take now to improve things.

## **5. RISKS THAT NEED TO BE BETTER MANAGED**

This comes to the heart of this paper: discussing the risks that need to be effectively managed and then what might be done with this information in your organisation.

### **5.1. Procurement Risks**

The NSW ICAC has identified a series of key procurement risks. These are laid out in considerable detail in their 2010 consultation paper "Corruption Risks In NSW Public Sector Procurement. "

This research focussed on 4 major areas:

- People – the human factor;
- Systems and processes;
- Markets – where to buy and what to pay; and
- Structures – the way procurement is organised.

Each major area was then broken up and, as a result, 12 key risks have been identified:

- Expertise of procurement staff;
- Relationships;
- Management of staff;
- Public/private sector differences;
- Information about procurement policy;
- Tight timeframes;
- Direct negotiations;
- Use of subcontractors;
- Lack of genuine markets;
- Outsourcing;
- Bypassing the DSTA (Department of Services, Technology and Administration); and
- Discretion.

Rather than going into the detail of the above risks, can I recommend this as a paper that you need to be familiar with? It provides much food for thought and will allow you to start thinking about your agency and the work that needs to be done to improve things.

### **5.2. What You Can Do With This Information, Now**

Being aware of the risks above is genuinely useful. However, information of itself is insufficient: action is called for.

Accordingly, there are a series of actions that you can take in regard to the above information:

- Draw the attention of your procurement staff to the ICAC discussion paper;
- Summarise the paper/parts of the paper and circulate to relevant managers/their staff;
- Workshop the risks identified by the ICAC with key staff in your agency;
- Review procurement policy and practice so that it better deals with the risks identified by the ICAC;
- Develop a dedicated approach to procurement risk management; and
- Develop specialist tools to help your agency better manage procurement risk.

### **5.3. Discussion Point: Relationships**

This section of the conference is dedicated to the theme of “improper influences”. Clearly our relationships with business are very much at the heart of this. However

- We have become dependent on our suppliers to deliver a vast range of government goods and services to the community;
- We in government are very wary about improper influences from business, so try to keep suppliers very much at arm’s length;
- This causes problems for both parties.

So what might be done to overcome some of these problems? As noted earlier, business is keen to build better relationships with us but is uncertain about how to do this, so why not give them guidance?

A series of options exist which include:

- Do you have a Statement of Business Ethics?
- Are suppliers required to sign the Statement of Business Ethics before commencing work for you?
- Are contractors and suppliers individually inducted into your expectations and requirements?
- Do suppliers have an independent avenue of appeal so they can report concerns?
- Do suppliers have an approved and easy means of getting feedback about their goods and services?
- Do suppliers have an approved & easy means of showing you their new goods and services?
- Do potential suppliers find it easy to access your approaches to procurement?

### **5.4. What the IAB Has Done With This Information**

As an agency committed to improving public sector performance, we recognised that our clients needed further assistance with procurement.

Accordingly, we used the ICAC categories and expanded them to form a facilitated self-assessment. For example, we took the category “expertise of procurement staff” and expanded it into 5 questions based on our experience in the field of the issues of concern:

- Staff have a detailed knowledge of all aspects of the Agency procurement process;
- Staff have all the required technical/subject expertise to make well informed purchasing decisions;
- Staff are well informed about the goods and services that are available in the marketplace;
- Staff have all the necessary skills to manage and monitor contracts; and
- Staff involved in procurement are provided with regular training to ensure that their expertise remains relevant.

In total, then, we have a 60 question Procurement Health Check. We use this tool in a number of ways to:

- Facilitate self assessment of individual procurement projects;

- Facilitate self assessment of entire procurement functions; and
- Benchmark improvements over time.

In the workshop we

- Work through each of the ICAC 12 risks and their accompanying 60 questions;
- Staff discuss each of the risk categories and use the 5 questions per risk to guide discussion;
- Give performance in each risk a score from 1 to 5;
- Make a list of the things that are going well and those that need improving, for each risk; and
- At the end, develop the 5 priority actions to be taken now.

We have successfully used this tool with a client to assess a \$500million procurement project.

## **6. OTHER IMPROVEMENTS THAT YOU CAN MAKE TO PROCUREMENT NOW**

One of the things that has become clear to us in recent years is the need to galvanise organisations into action.

So, accordingly, we present below some of the things that we believe can be used to drive change. For each of you, the action that you take will vary: it will need to, of course, take account of the circumstances in your organisation, the organisation's stage of development etc.

Consider, then, this as a series of suggestions that you may (or may not !) find useful.

### **6.1. Build the Case for Procurement Reform**

In some agencies, you will need to develop a case for procurement reform. Actions that can be taken in this regard include:

- Collect stories from the press and circulate them;
- Review the work of corruption prevention bodies: do they have information you need to circulate now?
- Review the research: what are the fraud facts? Who needs these facts now?

Good sources of information include:

- The Association of Certified Fraud Examiners;
- Major accounting companies put out regular publications/podcasts;
- The work of Auditors General;
- OECD/UN/World Bank now very active as well.

Consideration then needs to be given to who needs this information: the Head of Audit & Risk Committee? Chief Risk Officer? Who else?

### **6.2. Improve the Workplace Culture**

We are finding an increasing number of clients are starting to test their workplace culture. The absence of a strong workplace culture is a matter of great concern.

One particular course of action has been to test "employee engagement". Different patterns are emerging from across our client base. One found that the least engaged by the organisation are those that are more junior, those working in remote locations and those having worked for the agency for a long time. The issue becomes, of course, what happens when the above 3 factors coincide in the one individual? Other clients are, of course, finding different patterns.

Other actions that can be taken include:

- Encouraging exemplary behaviour from the top; and
- Rewarding managers/workplace heroes.

### **6.3. Review the Procurement Control Framework**

Research from the Certified Fraud Examiners [4] suggests that kneejerk responses to individual cases of fraud often involve putting in more controls. However, surely a more productive course of action is to first determine what controls are in place and then to determine if they are actually working.

Only after the above actions have been taken should further controls be introduced.

### **6.4. Improve procurement policy and process**

In running over 150 fraud and corruption workshops in recent years, it has become increasingly clear that staff may or may not know what the policy actually is. In fact, I talk a lot about the inverse square law: the further you are from head office, the less likely you are to know the policy. This also applies organisationally: the further you are from the top the less likely you are to know the policy.

So, a series of questions need to be considered:

- Do staff actually know what the policy is ?
- Are the policies relevant and up to date ?
- Can they be easily found ? Can they be put in a single place on your intranet ?
- Have you got an Employee Handbook which clearly sets out all employee expectations ?

### **6.5. Review your fraud and corruption prevention policy**

There is an old saying that “prevention is better than cure”. This is particularly the case in regard to fraud and corruption prevention. We know that reviewing the existing fraud and corruption prevention policy is the first thing that is often reviewed after an individual case of fraud. Why not, instead, get on the front foot?

So in reviewing your policy, what might you look for?

- Is it consistent with the Australian Standard?
- Do staff actually know what the policy is?
- Are the policies relevant and up to date?
- Can they be easily found? Can they be put in a single place on your intranet?

### **6.6. Gather supplier feedback**

Suppliers have the potential to provide you with large amounts of useful information. The question becomes “what are you doing about this?”

So some questions that you might want to consider include:

- Do you gather supplier feedback about your performance?
- Do you do this consistently and regularly?
- Is this feedback given to your agency’s executive?
- Do you change your approaches based on this information?

## **7. CONCLUSION**

I hope that this paper has given clear indications of what procurement risks you need to consider. Further, and even more importantly, it suggests that there are a series of actions that you can take now to genuinely improve things in your organisation.

## **8. REFERENCES**

- [1] NSW Independent Commission Against Corruption: Corruption Risks in NSW Public Sector Procurement: Consultation Paper, 2010.
- [2] NSW Independent Commission Against Corruption: Press Release, October 2010 .
- [3] NSW Auditor General: Performance Audit: Prequalification Scheme Performance and Management Services, September 2010.
- [4] Association of Certified Fraud Examiners: Report to the Nations, 2010.