

## SCENARIO 2

### THEME 1: INTERNAL CONTROLS, COMPLIANCE & MONITORING

#### Overview

Corruption in procurement processes can occur in any organisation. Its presence and extent depend largely on an organisation's procurement framework and the strength of its ethical supports, for example appropriate policies, procedures and other support mechanisms. Organisations can mitigate the risk of corrupt conduct being embedded, by enforcing sound policies and controls with appropriate checks and balances.

This resource is based on the conduct of a manager in a small public sector agency. It examines factors that enabled criminal conduct to occur and then continue, despite concerns being raised on numerous occasions. In this case, over a four-year period, nearly \$1 million was stolen from the agency.

This resource is designed to support a group discussion about how procurement processes can be exploited and what steps can be introduced to improve practices.

It is divided into two sections:

**Section one** describes one individual's ongoing corrupt conduct at an agency, which included serious criminal offending through fictitious invoicing. It demonstrates the cumulative effect of policy breaches, obvious red flags being ignored and insufficient action on the part of senior management in response to these concerns being raised.

**Section two** provides a range of questions to prompt group discussion on **internal controls, compliance and monitoring**, as well as background information to support the group discussion.

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The key learning goal from using this resource is to better understand the importance of a strong internal control framework to reduce the risk of corrupt conduct

#### Disclaimer:

This guidance is provided to you for training purposes only. It is not legal advice and cannot replace legal advice informed by specific circumstances. It is not binding on either the Serious Fraud Office or decision-makers who may use it, and is not intended to be enforceable against either the Serious Fraud Office or decision-makers in any way.

## The scenario

Sarah is a general manager in a relatively small public sector agency. She was initially employed as a team leader and has been at the agency for five years, over which time she has given gifts to, and done favours for, other staff on numerous occasions. Colleagues describe her as charismatic and she counts many of her workmates as personal friends.

Sarah is regarded as a high performer and has risen through the ranks quickly to become a general manager, reporting directly to the chief executive. Sarah's role as a general manager makes her a member of the senior leadership team where she is well regarded by her SLT colleagues. Sarah has financial delegation authority allowing her to authorise payments up to \$100,000.

The agency has procurement policies and procedures that require the separation of duties (distinct lanes of responsibility within an approval process) and one-up approval (obtaining the signature approval of the line manager). It is also mandatory to have written contracts with all external providers. The induction Sarah received when she started included an explanation of the agency's policies and procedures. In practice these controls are often ignored by approvers and senior people across the agency, with little or no accountability brought to bear for policy breaches.

Within three months of being appointed as a general manager, Sarah registers an entity on the NZ Companies Office website. This entity is effectively a façade. It has no operational substance, assets or employees. Sarah soon starts to create, submit and approve invoices for ambiguously described work, claimed to have been completed by her recently created company. No signed contracts exist for this work and nobody else in the agency is involved in this approval process.

Sarah's non-compliance with policies and the vague nature of the services referred to in the invoices is soon noticed by finance and legal staff. They raise their concerns with other managers. Initially these concerns are dismissed or not acted on. However, with persistence by staff, these concerns are eventually brought to the attention of senior management.

Senior management raise these concerns with Sarah. She pleads ignorance, claiming that she is not aware of the procurement policy, in particular the requirement for contracts to be signed by the Ministry and the supplier before payments can be made. In order to colour management's perceptions of the legitimacy of the complaints, Sarah suggests that they are being driven by improper motives and bias on the part of staff who have complained. Her explanation is accepted and no further action is taken.

Sarah continues her corrupt conduct but changes her modus operandi slightly. She stops submitting invoices in the name of the company at the centre of the concerns, instead creating two more fictitious companies. The two new companies have the same bank account number, the same GST number and the same postal address, but this is not identified by the agency.

Contrary to the agency's procurement policy, Sarah drafts contracts which are multi-year arrangements, with no oversight from the legal and finance teams. She continues to create, submit and approve invoices without seeking the requisite one-up approval and, in doing so, exceeds her \$100,000 financial delegation for approving payments.

Agency staff become aware of Sarah's continued non-compliance with policy and again raise concerns. Sarah again claims staff bias towards her and persuades senior management to close down any further investigation of the issue. It is not until John, the agency chief executive, receives – through informal networks – a warning about Sarah's history of similar concerning behaviour that any action is taken. John starts a full investigation into Sarah's activities. Sarah is ultimately dismissed and charged with criminal offending. During the investigation it is discovered that she was dismissed from a previous role for corrupt conduct.

## QUESTIONS FOR GROUP DISCUSSION

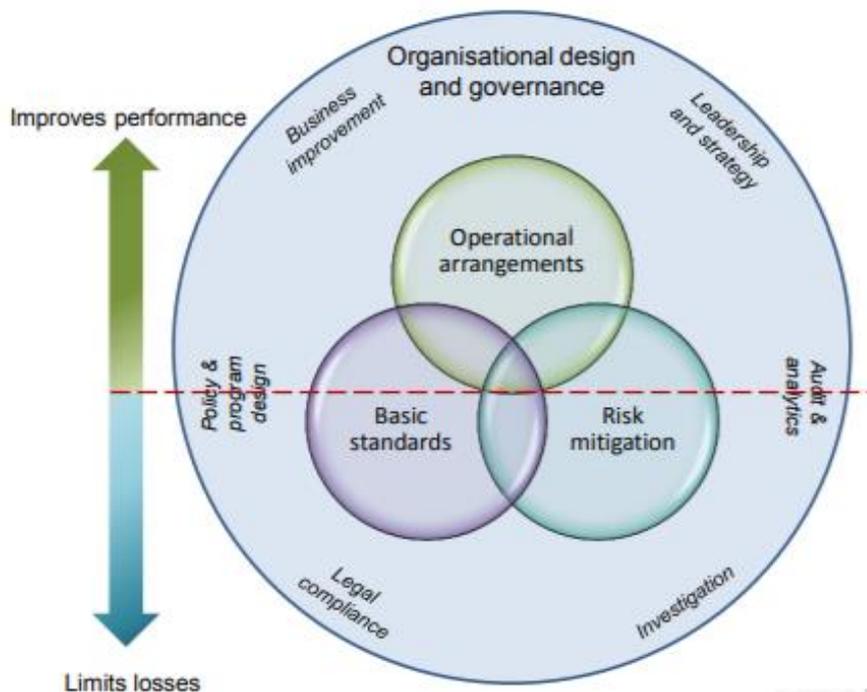
***How was it possible for Sarah to act independently and contrary to the agency's procurement policy on repeated occasions over a four-year period?***

- There were limitations with internal audit and controls were not robust – Sarah was able to exceed her delegations repeatedly because controls were not enforced early in the process and monitoring was weak or absent.
- Sarah adapted her behaviour over time when red flags were raised – she created new companies through which invoices were raised, and she paid invoices without contracts being in place.
- Sarah formed close relationships with key people who assisted her in her corrupt behaviour.
- When staff spoke up nothing was done – explanations given by Sarah for the breaches of policy were accepted by senior management.

***Which controls should have been reflected in the agency's policies?***

The four basic elements of organisational control that should be reflected in policies are:

1. **Operations** - e.g. correct people and skills in the relevant units (incentives, process design, information and metrics, accountability and decision location, structural or team arrangements, boundaries)
2. **Risk mitigation** - necessary to manage opportunities that can't be designed out (segregation, discretion reduction, delegations, management oversight, audit)
3. **Basic standards** - of behaviour, disciplinary options (code of conduct, gift policy, register, training)
4. **Design and oversight** - requires clear understanding of operational realities (design, governance, management, audit, investigation, business improvement, legal)



A standard set of preventive controls includes:

- a policy and procedure framework that considers the potential for corrupt conduct (where appropriate, anti-corruption policies and procedures should also bind suppliers and other external parties)
- segregation of duties to prevent an individual from exercising end-to-end control over risky processes
- training and awareness-raising activities targeted at the risk of serious misconduct
- setting and enforcing delegations and permissions
- supervision of high-risk functions and systems that impose joint decision-making
- key performance indicators that encourage ethical conduct
- transparency mechanisms that give internal and external parties access to the decision-making processes
- accountability mechanisms that oblige decision-makers to explain the reasons for their actions (for example, appeal processes)
- physical and information technology security controls to either prevent access to valuable assets/information or at least create an audit trail
- a screening process for new/existing employees and due diligence measures for suppliers and business partners.

***In terms of controls and monitoring, what could the agency do to prevent this happening again?***

- Ensure its internal control framework considers the potential for corrupt conduct.
- Strengthen supervision of high-risk functions and systems that require joint decision-making.
- Include transparency mechanisms that give internal and external parties access to the decision-making processes and allow greater oversight of the procurement function.
- Implement accountability mechanisms that require decision-makers explain the reasons for their actions at various stages in the procurement process.
- Implement physical and information technology security controls to either prevent access to valuable assets/information or at least create an audit trail.
- Ensure effective segregation of duties to prevent an individual from exercising end-to-end control over a procurement process.

***What other things might the agency consider doing to prevent inappropriate behaviour?***

- Undertake regular training and awareness-raising activities for all staff.
- Take a proactive approach to ethical culture by undertaking regular training on good procurement practices.
- Provide regular communications to staff about fraud and corruption.
- Take swift action on policy breaches and conduct appropriate inquiries whenever staff raise concerns.
- Undertake random compliance checks and regularly report to all staff on the findings.
- Ensure staff fully understand the organisation's procurement policy and how it applies to their role.
- Embed measures such as compliance inspections, evaluations, and investigations - including review of contracts, permits, data, and other documentation.
- Ensure that there is a well-publicised and confidential pathway for protected disclosures to occur.

***What are the risks associated with the procurement process?***

- Controls may be absent or not enforced.
- Individuals may take advantage of weaknesses in systems and processes or bypass policy and procedures for personal gain.
- Goods or services are procured but not received or not needed, or value for money is not delivered (i.e. an organisation pays too much for goods or services).
- Reputational damage to the organisation can occur if poor decisions are made.
- Public money may be inappropriately spent.