Queensland Audit Office

Fraud Management in Local Government

Report 19: 2014–15

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QUEENSLAND

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The Honourable P Wellington MP
Speaker of the Legislative Assembly
Parliament House
BRISBANE QLD 4000

Dear Mr Speaker

Report to Parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled *Fraud Management in Local Government*.

In accordance with s.67 of the Act, would you please arrange for the report to be tabled in the Legislative Assembly.

Yours sincerely

Andrew Greaves
Auditor-General

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Summary

The Australian Institute of Criminology estimates that fraud costs the Australian economy $8.5 billion a year.

Councils are exposed to high risks of fraud and corruption because of the large volume of goods and services they procure, often from local suppliers; and because of the high degree of devolved decision making vested in councils. The possibility that council employees could be linked through their personal or professional relationships to suppliers can also lead to an increased risk of fraud due to conflicts between the public interest and their private interests.

In March 2013, we reported to parliament on fraud risk management in Queensland state public sector agencies. We found that the risk of fraud occurring undetected in departments was unacceptably high. This audit extends our focus to local government.

We surveyed all 77 councils in Queensland to determine how they performed against accepted standards for fraud and corruption control. Our survey also obtained data on instances of alleged or confirmed fraud cases in councils between 1 July 2009 and November 2014. Based on this data, we identified one council that accounted for 42 per cent of the alleged and confirmed frauds reported to us. We performed detailed data analytics utilising multiple sources to identify potential indicators of other fraud and corruption at this council.

Conclusion

Most councils are not effective in managing their fraud risks—fraud and corruption is happening in councils, but few understand sufficiently how widespread it is, or what it costs them. Their responses to known and potential fraud risks are, by and large, inadequate and demonstrate a lack of leadership and a failure in governance.

The executive and senior managers in many councils do not clearly instil in their staff the importance of managing fraud risks. They do not provide sufficient guidance on how to recognise fraud and what to do if they suspect fraud.

Councils over-rely on internal and external auditors to detect fraud and this tendency further demonstrates the lack of management ownership and responsibility for fraud control within their own organisations. Passive management approaches to fraud prevention and detection are outdated in today's rapidly evolving fraud risk environment. Perpetrators of fraud and corruption are becoming more sophisticated in their approaches, but most councils' techniques for detecting fraud lack the sophistication to counter them.

Through our own data analytics and detailed analysis during this audit we identified potential fraudulent and corrupt activity in one council, demonstrating what can be achieved. We referred these matters to the Crime and Corruption Commission (CCC) in accordance with the *Crime and Corruption Act 2001*.

The extent of fraud in local government

Most councils do not have a clear understanding of the extent of alleged and proven fraud perpetrated against them over time. This is a leading indicator that as organisations, they do not treat fraud risk management as a serious issue. For many, their fraud records are episodic rather than systematic, which makes them unreliable as a comprehensive record; as is their external reporting of fraud and corruption.

The councils we surveyed responded that they had detected 324 cases of alleged and confirmed fraud between 1 July 2009 and November 2014 involving $8.6 million. Of the 194 confirmed cases, 18 (9.3 per cent) were greater than $10 000; two alleged fraud cases were more than one million dollars.

Figure 1 shows the number and value of alleged and confirmed fraud and corruption cases from all councils who participated in our survey. Councils did not provide a fraud loss value for 57 per cent of the fraud cases, and 44 per cent of councils indicated they do not have a system to manage fraud information.

Figure 1
Alleged and confirmed fraud numbers and values by council regions—Survey data 1 July 2009 to 30 June 2014

Council region—Local Government Association classifications	No. of councils in region	No. who responded to survey	No. who responded to being a victim of fraud	No. of alleged and confirmed frauds	Value of alleged and confirmed frauds
Coastal	15	14	7	123	$1 619 427
Indigenous	17	10	3	5	$4 438 685
Resources	15	13	6	10	$1 623 802
Rural/regional	9	9	4	8	$2 846
Rural/remote	13	12	2	2	$8 627
South-east Queensland	8	8	6	176	$936 306
Totals	**77**	**66**	**28**	**324**	**$8 629 693**

Note: Councils were only requested to provide data up to 30 June 2014. Some councils provided data up to the time of survey completion—October/November 2014. These exceptions are included in totals.

Source: Queensland Audit Office

To assess the completeness and reliability of the survey responses, we compared this data with that provided to us separately by the Crime and Corruption Commission (CCC) from their records. While only 28 councils reported to us that they had been a victim of alleged or confirmed fraud in the last five years, CCC records show they received fraud allegations for 67 councils in the last five years. We found that 14 of the 44 councils we surveyed who indicated to us they hadn't been a victim of fraud in the last five years, had in fact had allegations of fraud substantiated by the CCC.

This indicates the total amount lost to fraud is much higher than what was reported to us through our survey. The disparity in records also indicates to us that councils are not complying fully with their legal obligations to report suspected and proven losses from frauds.

Fraud risks and mitigation strategies

The most common types of fraud committed against councils are the misappropriation of council assets including theft, and corruption by employees who use their positional authority or their access to information for personal benefit. Corruption can involve preferential treatment in the allocation of work, receiving gifts, kickbacks or bribes from suppliers to council employees or elected officials, or unauthorised disclosure of council information to third parties.

Corruption in particular is a serious threat to councils because it is difficult to detect and can create the most financial and reputational damage. Because councils have a high inherent risk of corruption due to the large volume of goods and services they procure from local suppliers, they need to be particularly vigilant in their procurement practices and be able to identify and treat their fraud risk exposure.

In reality, however, councils are not well equipped to deal with this threat. Perpetrators of corruption often collude with other employees and suppliers to conceal information. While perpetrators are becoming more sophisticated in how they engage in corrupt acts, councils' detection counter-measures are ineffective and are not customised to detect this type of activity early. This means that corrupt behaviour may go undetected for long periods, creating serious financial and reputational risks for councils.

Key elements of fraud risk management

The elements of a fraud risk management framework we expected councils to use to assist in managing their fraud risks are:

- fraud and corruption control plans
- fraud risk assessments
- preventative actions
- controls to detect fraud.

Fraud control planning

Sixty-five per cent (or 43 of the 66 council respondents) do not have a fraud and corruption control plan or similar document. This means that most councils in Queensland have no overarching plan for preventing, detecting and responding to fraud.

The councils that do have a plan have a more structured path towards preventing, detecting and responding to fraud than those without a plan. However, of the small number of councils who have developed a fraud and corruption control plan, we found about half of them have either not implemented their fraud and corruption control plans properly or have not maintained their fraud risk management as an ongoing governance activity.

Fraud risk assessments

Councils demonstrated significant weaknesses in identifying and managing actual fraud risks. They are not targeting their fraud control and detection program to areas with emerging risks and threats, increasing the likelihood that fraudulent activity remains undetected.

Fifty-seven per cent of councils either do not document, or indicated to us they do not know if they document, the fraud risks they confront in their everyday activities.

More than half of councils do not conduct fraud risk assessments—an essential activity for ensuring that any fraud control and detection program is targeted to the areas of a council most susceptible to the risk of fraud.

Of the 28 councils that conduct fraud risk assessments, only:

- 11 councils conduct the assessments as frequently as they should—at least every two years according to the Australian Standard: AS 8001—2008 Fraud and Corruption Control
- 19 councils use the results of fraud risk assessments to prioritise efforts when developing their detection program.

Appendix C contains a fraud risk susceptibility analysis guide we developed to assist councils identify which business areas or council services are most susceptible to fraud exposure.

Preventative actions

Strong internal controls are the first line of defence to deter the occurrence of fraud and corruption. Internal control weaknesses contributed to the occurrence of fraud and corruption within the councils we surveyed. Councils were able to identify one or more weak or missing internal control process in most of their fraud cases greater than $1 000.

Lack of appropriate supervision was the most common internal control breakdown contributing to fraud between 2009 and 2014. Other contributing factors included: senior officers overriding controls; circumvention and lack of procurement controls; and undeclared conflicts of interest.

Services or business functions where it is difficult to supervise staff are more susceptible to fraud, and councils should factor this into their fraud risk assessments. Appendix C contains a list of other factors councils should consider when assessing if a business area or council service exhibits characteristics that makes it inherently more susceptible to the risk of fraud.

Detection

We found a significant discrepancy between the methods councils say they use to detect fraud, and the methods they actually used to detect fraud. They say they rely primarily on internal audit and external audit to detect fraud. However, in 57 fraud cases we reviewed, internal audit helped to detect only four of those cases. The majority were detected through tip-offs and public interest disclosures. This shows that the fraud detection techniques they purport to rely most upon are not as effective as other mechanisms. More generally, this reactive approach to fraud detection also means they are less likely to detect fraud early. The later it is detected, often the more difficult it is to recover any losses.

Fraud risk assessments and the systematic analysis of actual data in areas of high fraud risk are strong techniques that complement each other as part of an effective fraud control program. However the direct correlation between conducting fraud risk assessments and having a targeted, customised and effective fraud detection regime are not well understood by councils. Both data analytics and fraud risk assessments were outside the 'top ten' detection techniques councils use to uncover fraud—data analytics was ranked 13th and fraud risk assessments 14th.

Most councils therefore are not proactively mitigating their fraud risk by identifying factors that can lead to fraud, nor identifying the areas within council where they are most susceptible to fraud. Only 38 per cent of councils use fraud risk assessments to prioritise areas when developing their fraud detection programs and procedures. By not prioritising areas of greater risk and focusing their fraud detection systems and procedures in these areas, councils risk overlooking possible fraud within their business.

Reporting and response

There are different legislative frameworks for fraud reporting to different integrity agencies, but there is no consistent and uniform reporting approach. Each agency receiving this information records and categorises fraud information differently. Therefore, no one agency in Queensland has a complete picture of the incidence of fraud in the local government sector.

There are also differences in the legislative regimes that apply to councils and state government departments' recording and reporting of fraud related matters, including lost or missing property. The *Local Government Regulation 2012* requires councils to report 'missing' property to the Auditor-General, but there is no specific requirement for them to report fraud. It is likely that this has contributed to the situation where almost half of councils do not maintain systems to comprehensively record or report fraud.

The fraud reporting regime that applies to state government departments and to statutory bodies is more prescriptive and comprehensive than the regime that applies to local government. The *Financial and Performance Management Standard 2009* (the FMP Standard) sets out the following for state government departments which the *Local Government Regulation 2012* and the *City of Brisbane Regulation 2012* (Regulations) do not apply to local councils:

- the type of losses to which the FMP Standard applies, specifically, losses which arise from criminal offences or misconduct (which could include fraud)
- specific details about the written information that must be kept about the loss
- specific external reporting requirements where the loss is a material loss.

Councils are no less susceptible to fraud than government departments or statutory authorities; in fact, given their inherent fraud risk profile, they may face greater exposure to fraud and corruption. This places the differences between the reporting obligations of councils and of departments into starker contrast. This disparity between the regimes could be addressed through the amendment of the Regulations to more closely align with the requirements of the FMP Standard.

Recovery

Our survey data shows that once a fraud occurs, there is little recovery action; and that where recovery is initiated, the funds recouped are minimal. Based on our analysis of 14 councils who were victims of fraud over a four-year period, councils recovered less than 10 per cent of the amount they lost through fraud; and it cost them almost three times as much to recover than what they lost through the fraud. This amount could be greater still because half of those councils did not track or know what it cost them to recover their fraud losses.

Because councils' attempts to recover funds lost through fraudulent activity is often unsuccessful and can cost more to recover than the original amount lost, councils need to consider the benefits of a preventative approach to fraud management against the costs incurred in trying to recover fraud.

Recommendations

1. **The Department of Infrastructure, Local Government and Planning pursue amendment of the *Local Government Regulation 2012* and the *City of Brisbane Regulation 2012* to require:**
    - **loss as a result of fraud to be a reportable loss to the Auditor-General and to the Minister responsible for local government**
    - **councils to keep written records of alleged and proven losses arising from fraud.**
2. **All councils assess themselves against the findings in this report as a priority and where needed develop, revise or update their:**
    - **policies and procedures for fraud and corruption management**
    - **fraud and corruption control plans**
    - **fraud risk assessments**
    - **data analytics capability for fraud detection.**

Reference to comments

In accordance with section 64 of the *Auditor-General Act 2009,* a copy of this report was provided to the Department of Infrastructure Local Government and Planning, the Crime and Corruption Commission and all Queensland councils. All parties had an opportunity to comment on the proposed report.

Their views have been considered in reaching our audit conclusions and are represented to the extent relevant and warranted in preparing this report.

All comments received are included in Appendix A of this report.

1 Context

1.1 Background

Local government is a significant part of the Queensland and Australian government system. Queensland has 77 councils throughout the state, each managing the provision of everyday community services.

In 2013–14, the local government sector in Queensland collected more than $13 billion in operating revenue, spent more than $12 billion and managed more than $10 billion in assets.

The provision and management of council services (such as roads, bike paths, libraries, parks, waste management, and in some councils, housing and water) can be susceptible to fraud and corruption by employees, contractors and others external to the council, including the general public. Fraud prevention requires rigorous controls and accountability.

One of the consequences of council fraud is a reduction of funds available to benefit the community through delivery of services. This loss can multiply as ratepayer dollars may become further absorbed due to fraud-related expenses such as investigations, legal proceedings, additional information technology (IT) support, rectification of the situation, loss of revenue, and undermining of electorate confidence in council operations and services.

Fraud can also damage employee morale and relationships with stakeholders, including the community.

The terms fraud and corruption have separate meanings. They are defined by the Australian Standard for Fraud and Corruption AS8001—2008 (the standard) as:

Fraud

> *Dishonest activity causing actual or potential financial loss to any person or entity including theft of moneys or other property by employees or persons external to the entity and whether or not deception is used at the time, immediately before or immediately following the activity. This also includes the deliberate falsification, concealment, destruction or use of falsified documentation used or intended for use for a normal business purpose or the improper use of information or position.*

Corruption

> *Dishonest activity in which a director, executive, manager, employee or contractor of an entity acts contrary to the interests of the entity and abuses his/her position of trust in order to achieve some personal gain or advantage for him or herself or for another person or entity.*

1.2 Previous reports to parliament

Our past reports to parliament on the results of audits of local government entities indicate that management of fraud risks has not been subject to strong governance practices based on robust fraud risk assessments.

In March 2013, we reported to parliament on fraud risk management in Queensland public sector agencies (exclusive of local government). That report highlighted that the risk of fraud occurring and going undetected is unacceptably high.

In that report we recommended that:

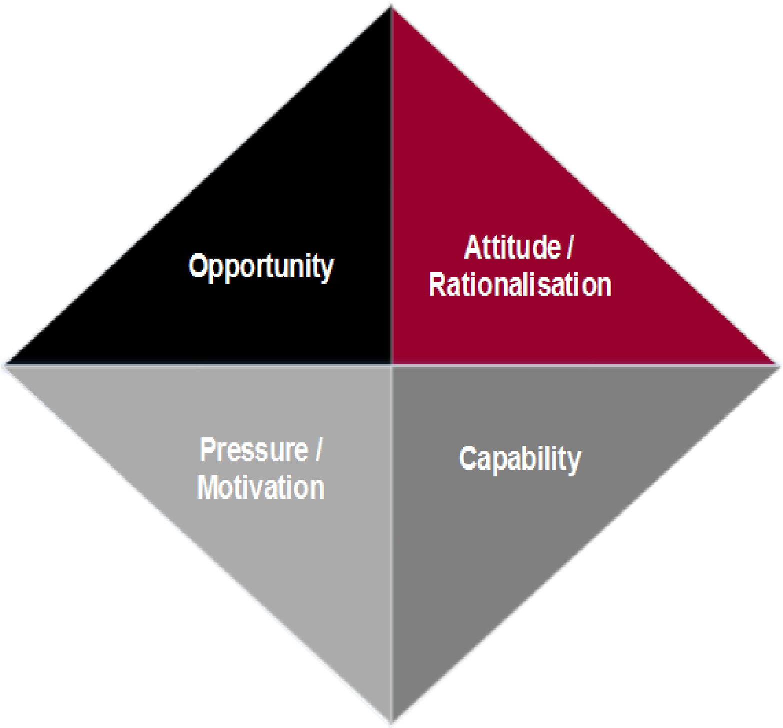
- all public sector agencies assess their fraud control program against the better practice principles highlighted in our report and, as required, implement a plan to address deficiencies identified by this self-assessment
- where the following are not in place, agencies should:
    - conduct and regularly update their fraud risk assessments
    - implement routine data analytics over areas identified as inherently susceptible to fraud
    - use their fraud data to inform ongoing development of fraud control programs.

This audit report extends the focus of our work on fraud risk management to local government.

1.3 Elements for fraudulent behaviour

It is generally accepted that various elements are required to work simultaneously for fraud to occur—pressure/motivation, opportunity, attitude/rationalisation and capability, as shown in the fraud diamond depicted in Figure 1A.

Figure 1A
Fraud diamond—four elements of fraud



Source: Queensland Audit Office adapted from The Fraud Diamond: Considering the Four Elements of Fraud, David T Wolfe and Dana Hermanson (2004)

1.3.1 Pressure/motivation

A person can become motivated to commit fraud through pressure, which can be driven by a financial need or personal factors such as:

- financial need (for example, medical bills, or a partner who has lost a job)
- addictions (for example, drugs, alcohol, gambling)
- expensive tastes—the need to keep up with appearances and impress
- greed
- a desire to outsmart an employer
- a desire for revenge
- peer pressure.

1.3.2 Opportunity

Fraud is rarely a spur-of-the-moment offence. It takes time for the perpetrator to identify the opportunities, calculate the risks and rewards and determine that the risk is worth taking. Perpetrators seek windows of opportunity that are created by:

- weak system controls
- poor governance/management oversight
- use of their position or authority.

Fraud can occur when an individual has been in an organisation for a long time and has the ability to recognise a weakness in the processes and take advantage of the opportunity. Of the four elements in the fraud diamond, opportunity is the element that an organisation can have the most control over. They can implement controls on identified areas of risk and promote fraud awareness to all staff.

1.3.3 Attitude/rationalisation

Attitude/rationalisation is an element which involves a person justifying in their own mind why their unethical behaviour is acceptable. Common fraud rationalisation includes believing:

- that they are 'borrowing' money to assist with their personal problem—with the intention of returning the funds later
- that their behaviour is to save a family member
- through job dissatisfaction (that is, wages, job environment, or treatment by management), that they are owed something.

Rationalisation is in many cases isolated to a perpetrator's thought process and is kept secret. It rarely becomes visible.

1.3.4 Capability

Perpetrators often exhibit certain characteristics and personality traits which help them to exploit a foreseeable opportunity and execute fraud. The following is a summary of six traits associated with the capability element identified in the fraud diamond.

- **Position**—a person’s position or role can provide a clear insight to the business and the controls which can allow them to exploit a fraud opportunity.
- **Intelligence**—this is an astute person who is able to identify internal control weakness and is creative and intelligent enough to exploit the weakness in the system.
- **Ego**—this is a person who has a very high confidence level and self-esteem, with a belief they can talk their way out of any ordeal if necessary. They convince themselves and others that they will not be detected.
- **Coercion**—this person can be very persuasive and can convince others to participate in the fraud or to overlook their actions. They could also have a bullying attitude to make subordinates deviate from routine procedures.
- **Deceit**—this person is very good at concealing the truth. They speak convincingly with people at all business levels and have a good memory to track all lies to cover all fraud actions.
- **Stress**—this person has the ability to continually remain calm to conceal any related stress and avoid detection.

A properly defined and integrated fraud and corruption control strategy is required to address each of the four fraud elements and to reduce the incidence of fraud.

1.4 Roles and responsibilities

All local councils are responsible for preventing, detecting and responding to fraud in order to protect revenue, expenditure and property. Therefore, councils must identify and monitor fraud risk and implement rigour and controls around their identified risks through an active fraud and corruption control framework.

Council employees are the front line of defence. They are responsible for fraud prevention and detection, as they are most likely to witness fraudulent activity.

While all employees are responsible for preventing, detecting and reporting fraud, an oversight function is imperative to effectively manage practices and to set the tone from the top. Oversight functions set strategic directions for management and ensure adequate resources are dedicated to preventing and detecting fraudulent activities.

Figure 1B describes the oversight functions and responsibilities required of council employees performing strategic or management roles.

Figure 1B
Oversight functions and responsibilities

Oversight function	Responsibilities
Mayors and councillors	Mayors and councillors are responsible for effective fraud governance. They set the strategic direction and the tolerance levels (generally zero for fraud) and monitor management actions for fraud risk.
Audit committee	The audit committee's role is to monitor and review the integrity of financial documents, the internal audit function and the effectiveness and objectivity of the internal auditors. From a fraud perspective, they ensure the fraud and corruption control plan is implemented, evaluate management's identification of fraud risk, and oversee the efficiency of internal controls to prevent and detect fraud.
Management	Management is responsible for establishing and maintaining an effective internal control system at a reasonable cost to the council and providing oversight of staff compliance with it. Their role is also to promote ethical standards and fraud awareness, as well as develop policies and procedures for fraud investigations, reporting and communications.
Internal audit	A requirement of the *Local Government Act 2009* is for each council to establish an efficient and effective internal audit function. Results from the audits may help to deter fraud activity with the root cause analysis of an issue identified and effective recommendations to improve internal controls.
External audit	The *Australian Auditing Standard ASA 240—The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report* states that the primary responsibility for the prevention and detection of fraud rests with those charged with governance of the entity and with management. External audits for Queensland councils are conducted by the Queensland Audit Office in accordance with the Auditor-General of Queensland Auditing Standards, which incorporate the Australian Auditing Standards. External auditors focus on material misstatement in the financial statements and determine if it is caused by error or fraud.

Source: Queensland Audit Office

1.5 Fraud risk management

A fraud risk management framework guides councils through a range of activities to assist in the effective management of fraud risk and helps minimise the occurrence of fraud. The implementation of an effective fraud risk management framework includes:

- establishing a council's fraud control objectives and values
- defining anti-fraud policies
- developing a fraud and corruption control plan
- conducting fraud risk assessments
- implementing preventative actions
- implementing controls to detect fraud
- establishing methods for employees to report suspicions of fraud or unethical behaviour
- defining clear escalation procedures, including referral to external authorities, once suspicion of fraud arises
- responding to reported fraud through investigations, disciplinary procedures, external reporting and review of internal controls.

A well-developed fraud and corruption control plan provides the direction to implement and manage fraud control activities in a coordinated way. A good fraud and corruption control plan is tailored to individual business requirements and services, based on management understanding specific risk exposures within its operations.

The plan guides council management and employees in developing, implementing and monitoring action items in relation to fraud prevention, detection, response and reporting. It should also outline the frequency and resourcing of such tasks.

1.5.1 Identifying fraud risk

Adopting a risk management approach helps councils to assess the susceptibility of their programs, services and business areas to fraud. Some areas may require tighter controls, scrutiny and monitoring techniques than others. *The AS8001-2008 Fraud and Corruption Control* advises that an important outcome of a fraud risk assessment process is the development of an effective anti-fraud treatment program that addresses the risks faced by the entity. It also advises that the measures should be monitored regularly to ensure they remain relevant and address emerging fraud elements.

By virtue of their functions and the services they deliver, councils are susceptible to a variety of fraud risks, key examples are identified in Figure 1C.

Figure 1C
Types of council services susceptible to fraud risk

Type of fraud	Examples of related risks
Rate revenue fraud— Fraudulent manipulation of rates to receive a self-benefit	• incorrectly claiming discounts (such as pensioner discounts) to benefit employees, friends, family and colleagues • making changes to rates details to benefit employees, friends, family and colleagues.
Development applications and rezoning— Frauds relating to development applications and rezoning of land for commercial and residential purposes	• misuse of commercially sensitive information • providing kickbacks to councillors or council staff for favourable decisions • undeclared conflicts of interest involving councillors and/or council staff.
Service delivery fraud— Frauds relating to the use of council-provided services to which the citizen would not normally be entitled	• selling a resident's parking permit to a non-resident • oversupplying goods or services to benefit third parties • undersupplying to 'skim' goods or services (or time that would normally be devoted to the service).
Compensation fraud— Frauds relating to falsely claiming council responsibility for incidents and accidents and attempting to falsely claim compensation	• falsely claiming pedestrian accidents on footpaths or council premises • falsely claiming road quality-related accidents • falsely claiming storm water or drainage-related accidents.
Grants fraud— Frauds relating to grant funds not being used for the intended service delivery objective	• overpaying of grants, duplicating payments of grants or having grants claimed multiple times • redirecting grant funds to personal accounts • poor record keeping for grants, resulting in misstatement.

Source: Queensland Audit Office

Particular functions and activities in councils, which span various business units and services in a council, are also inherently risky. For example, procurement fraud is a significant risk in the local government context. This is in part because of the volume of services councils procure from businesses in their local communities, and the possibility that council employees could be linked through either personal or professional relationships to those businesses. This can often lead to an increased risk of conflicts of interest arising.

The Corruption and Crime Commission of Western Australia stated in a February 2015 report:

> *It is recognised world-wide that procurement by government authorities, including local governments, is an activity with a high risk of serious misconduct. In its Principles for integrity in Public Procurement report the Organisation for Economic Co-operation and Development (OECD) stated, "…of all government activities, public procurement is also one of the most vulnerable to fraud and corruption."*

Figure 1D shows examples of the types of council functions or activities that are susceptible to the risk of fraud.

Figure 1D
Types of council business functions susceptible to fraud risk

Type of fraud	Examples of related risks
Procurement fraud— Frauds relating to the process of acquisition of goods, services and project delivery from third parties	• unauthorised use of corporate credit or fuel cards • paying claims for goods or services that were not delivered • receiving of kickbacks or being involved in bribery, corruption or coercion related to manipulation of the procurement process.
Travel and allowances fraud— Frauds relating to falsely claiming reimbursement of costs or allowances for which there is no entitlement	• making claims for journeys not made or overstating the distance • reimbursing expenses not related to council business.
Payroll and salary fraud— Frauds relating to claiming pay that doesn't match work performed or conditions of employment	• creating 'ghost' employees to receive additional pay • falsely claiming overtime payments.
Employment fraud— Fraud relating to applicants falsely claiming qualifications and skills above their ability	• misrepresenting skills, capabilities or qualifications to obtain employment • forgery of reference documentation.
Asset fraud— Using council assets for other than official purposes or gaining other personal benefits	• manipulation of asset value or fraudulent asset divestment process for personal gain • stealing assets • using council assets without authorisation.
Exploiting council information— Using confidential or commercially sensitive information for personal gain	• falsifying official records • providing confidential and sensitive information to others for personal gain • using confidential and sensitive information for personal benefit.

Source: Queensland Audit Office

Red flag indicators

Red flag indicators are warning signs that can alert councils to potential fraud. They do not immediately indicate either guilt or innocence. Instead, they may be a lead to early fraud detection. There are two types of red flag indicators:

- behavioural—unusual actions or behaviour traits exhibited by people
- transactional—unusual transactions related to common business activities.

Appendix E shows examples of the types of red flags councils should be alert to as indicators of potential fraud.

1.5.2 Fraud controls

Controls are steps taken to mitigate inherent risks. Control (and internal control), as defined by The *Australian Standard on Fraud and Corruption Control AS 8001–2008* is:

> *…an existing process, policy, device, practice or other action that acts to minimise negative risks or enhance positive opportunities.*

Fraud controls can be classified into four categories—preventative, detective, corrective and directive. Figure 1E shows examples of key fraud controls for each of the four categories.

Figure 1E
Key fraud controls by control groups

Fraud control category	Examples of controls
Preventative— the first line of defence to deter the occurrence of unwanted events	• maintaining a current conflict of interests register • using checklists for processing grant applications • checking rates notices before issuing them • segregating duties between purchasing, invoice processing, payment of invoices, accounting and bank reconciliation • having cheques signed by two or more people according to delegations • ensuring the creation of vendor master files is authorised and performed by officers independent of purchasing and payments • storing unused cheques securely • having job rotation and managing excessive leave.
Detective— identify an incident after an unwanted event and alert the people responsible for the activity within the area of concern	• having acquittals reviewed by appropriate staff, and investigating anomalies • conducting proactive data analysis e.g. by internal audit • carrying out third party due diligence for suppliers and vendors • having all council credit card transactions validated by an independent officer for appropriateness based on original receipts.
Corrective— correct the negative effects of unwanted events	• periodically reviewing user access to systems to ensure access is only provided to those who need it • reconciling EFT transactions with invoices and receipts at least monthly • regularly cleansing vendor master file data to ensure vendor details are current, and no duplicates or dormant vendors exist.
Directive— cause or encourage the occurrence of a desirable event	• documenting the acquittal process and communicating it to all applicants • ensuring all policies and procedures about fraud prevention are current and communicated to staff • having clear tender processes in place for seeking quotations and tenders • having a current policy in place for confidentiality and misuse of council information.

Source: Queensland Audit Office

1.5.3 Fraud response

Fraud response refers to the necessary actions undertaken by selected council officers once fraud has been detected within a council.

Under section 307A of the *Local Government Regulation 2012*, councils must immediately report missing property with a total value of $1 000 or greater to the Auditor-General. If the council suspects the property was stolen, it must also immediately report the matter to a police officer.

If a chief executive officer of a council reasonably suspects that corrupt conduct may have occurred, they have an obligation to report the matter to the Crime and Corruption Commission as prescribed under the *Crime and Corruption Act 2001.*

To meet minimum acceptable compliance with the standard, a council must implement each of the response elements in a way that is appropriate to its size, diversity, geographic spread and risk profile. This includes:

- **Policy and procedures**—policy and procedures should be developed to assist staff in dealing with suspected fraud incidents.
- **Investigation**—an investigation into suspected fraud should be conducted by skilled and experienced personnel, independent of the business unit/service area in which the fraud conduct allegedly occurred. Investigations can also be conducted by an engaged external party.
- **Internal reporting and escalation**—councils should develop and implement processes for capturing, reporting, analysing and escalating all suspected and detected fraud incidents.
- **Disciplinary procedures**—councils should document particulars on how disciplinary procedures should be conducted including implementing a disciplinary procedures policy and separating the investigation and determination processes.
- **External reporting**—councils should have a policy on whether and how fraud allegations should be reported to the police and other external authorities such as the Crime and Corruption Commission and the Auditor-General.
- **Civil action for recovery of losses**—councils should have documented processes for recovery action when there is clear evidence of fraud and the likely benefits of such recovery will exceed the funds and resources invested in the recovery action.
- **Review of internal controls**—where fraud had been detected, councils should review the adequacy of relevant internal controls and modify them if a weakness is identified, to prevent reoccurrence of the fraud incident.

1.6 Audit objective, method and cost

The objective of the audit was to determine whether local government councils effectively manage the risk of fraud occurring and remaining undetected.

The audit examined whether:

- councils identify, analyse and assess their fraud risks, and monitor these risks for continuing relevance
- controls put in place by councils to prevent frauds, or to detect them, are effective
- councils investigate suspected or alleged fraud and use the results to improve their fraud risk management framework.

To determine how councils performed against better practice on fraud and corruption controls, we surveyed all 77 councils in Queensland. Our survey allowed us to obtain data on council fraud management practices and to provide us with instances of alleged or confirmed fraud cases in councils between 1 July 2009 and November 2014. Appendix D provides a list of all councils categorised into six regions.

For the purpose of analysing the survey results, we categorised each council by region based on categories used by the Local Government Association of Queensland—coastal, Indigenous, resources, rural regional, rural remote and south east Queensland (SEQ).

Of 77 councils, 55 responded fully to our survey, 11 partially responded and a further 11 councils did not respond. We compared the survey results on council fraud management practices against the standard to determine if they had implemented the standard's requirements to reduce the risk of fraud occurring within their councils.

The cost of the audit was $660 000.

1.7 Report structure

The remainder of the report is structured as follows:

- Chapter 2—extent and types of fraud in local councils
- Chapter 3—fraud management—planning and prevention
- Chapter 4—fraud management—detection and response
- Appendix A contains responses received
- Appendix B contains our audit method
- Appendix C contains characteristics of business areas or council services susceptible to fraud risk
- Appendix D contains a list of all councils categorised by region
- Appendix E contains a list of red flags that can help with early fraud detection.

2 Fraud in local councils

In brief

Background

More complete and accurate information on the extent and types of fraud occurring in the local government sector could help councils develop targeted strategies to mitigate the risk of fraud being undetected and causing financial and reputational damage.

Conclusions

The local government sector experiences a significant level of fraudulent and corrupt activity, but it is difficult to accurately quantity the extent of the problem. This is because councils keep poor records and there are inconsistencies in how, and to which authorities, fraud matters must be reported. One consequence is that councils are not complying with their legal obligations to report suspected and proven fraud externally. It is also unlikely any agency has a complete view of all fraudulent activity that occurs in local government councils.

Corruption is a significant threat to councils, but it is becoming harder to detect because of collusive behaviour between employees and suppliers. Councils have not developed the techniques they need to detect such activities early.

Key findings

- Our survey data and data provided by the Crime and Corruption Commission show that the extent of fraud occurring in local government is significant enough to question how well equipped councils are to manage their fraud risks—but councils' records on how much has occurred and at what cost, is incomplete.
- Forty-two per cent of alleged frauds reported to us in our survey came from one council. Based on further analysis we conducted at this council, we formed a view that corrupt conduct may have occurred, and therefore, in accordance with section 38 of the *Crime and Corruption Act 2001*, we referred our findings to the Crime and Corruption Commission.
- The most common types of fraud committed against councils are misappropriation of council assets, including theft, and corruption by employees who use their position's authority or their access to information for personal benefit.
- There are different legislative frameworks for fraud reporting to different integrity agencies, but there is no consistent and uniform reporting approach. Each agency receiving this information records and categorises fraud information differently. Therefore, no one agency in Queensland has a complete picture of the incidence of fraud in the local government sector.
- The *Local Government Regulation 2012* requires councils (except the Brisbane City Council) to report missing property to the Auditor-General, but there is no requirement for them to report fraud. This has contributed to the worrying situation where almost half of councils do not maintain systems to record fraud. The Brisbane City Council has its own regulation which has no provision for reporting missing property or fraud.
- Councils did not report confirmed fraudulent activity worth $0.8 million and alleged fraudulent activity worth $6.3 million to the Auditor-General over a five year period, some of which would satisfy the missing property definition of the *Local Government Regulation 2012*.

Recommendations

1. **It is recommended that the Department of Infrastructure, Local Government and Planning pursue changes to the *Local Government Regulation 2012* and the *City of Brisbane Regulation 2012* to require: loss as a result of fraud to be a reportable loss to the Auditor-General and to the Minister responsible for local government, and councils to keep written records of alleged and proven losses arising from fraud.**

2.1 Background

An understanding of the extent and types of fraud occurring in the local government sector can inform targeted strategies to mitigate the risk of fraud being undetected and causing financial and reputational damage. It can also serve as the basis for developing preventative strategies and may act as a deterrent to potential perpetrators if the extent and types of fraud are well known and monitored.

Under section 307A of the *Local Government Regulation 2012*, councils must immediately report missing property with a total value of $1 000 or greater to the Auditor-General. If the council suspects the property was stolen, it must also immediately report the matter to a police officer. However, there is no specific requirement for councils to report fraud to the Auditor-General.

If chief executive officers of councils reasonably suspect that corrupt conduct, which includes fraud, may have occurred, they have an obligation to report the matter to the Crime and Corruption Commission (CCC) as prescribed under the *Crime and Corruption Act 2001.*

2.2 Conclusions

The local government sector experiences a significant level of fraudulent and corrupt activity but, under Queensland's current fraud reporting framework, it is difficult to accurately quantify the extent of the problem. This is because it is not mandatory for councils to specifically keep records on fraud matters. One consequence is that their recordkeeping and their reporting to external agencies is inadequate and incomplete.

In addition, different legislative fraud reporting regimes to various responsible authorities, including the Auditor-General, the CCC and Queensland Police, has led to inconsistencies in how fraud information is reported, what is reported, and to which agency.

It is therefore unlikely any central agency has a clear view of all fraudulent activity that occurs in Queensland councils. This impedes the ability to analyse fraud trends and emerging risks and issues in the Queensland local government sector.

The most common types of fraud committed against local councils are misappropriation of council assets and corruption involving employees using their authority and access to information for personal gain. Corruption is becoming harder to detect because of collusive behaviour between employees and suppliers, and councils have not been vigilant enough to develop the strategic detection techniques they need to counteract this increasing sophistication. Without proper attention to emerging threat areas, councils expose themselves to fraud and corruption that can remain undetected for long periods of time and cause substantial financial and reputational damage.

2.3 The extent of fraud in local government

To understand the extent and types of fraud that have affected local councils over a five year period from 1 July 2009 to 30 June 2014, we:

- surveyed all Queensland councils to identify all alleged and confirmed frauds perpetrated against them
- requested data from the Crime and Corruption Commission (CCC) showing frauds against councils reported to the CCC
- analysed missing property data reported to us as per the *Local Government Regulation 2012*
- requested data from the Queensland Police Service showing fraud offenses committed against local councils.

Figure 2A shows the fraud information reported to the Auditor-General, the CCC and the Queensland Police Service. It shows there is a significant volume of fraudulent activity affecting local councils over a five year period, with no one entity having complete visibility over fraudulent activity that occurred in local councils during that period.

Figure 2A
for the period 1 July 2009 to 30 June 2014

Responsible authority	Reporting requirement	No. of incidents of alleged fraud reported
Auditor-General	Section 307A of the *Local Government Regulation 2012 requires* councils to report missing property with a total value $1 000 or more to the Auditor-General.	741
Crime and Corruption Commission	Under section 38 of the *Crime and Corruption Act 2001* a council Chief Executive Officer must notify the Crime and Corruption Commission if they reasonably suspect corrupt conduct (fraud).	1 834
Queensland Police Service	Section 307A of *the Local Government Regulation 2012* requires a council to notify a police officer where suspected stolen property has a total value of $1 000 or more.	3 935

Source: Queensland Audit Office from council survey and data provided by the Crime and Corruption Commission and the Queensland Police Service.

The extent of fraud in local government is significant enough to warrant concern over how well councils manage their fraud risks. Our survey data and data provided by the CCC shows that fraud in the local government sector occurs, but councils' records on how much has occurred and at what cost, are incomplete.

Council survey results show councils have detected more than $8.6 million in alleged and confirmed fraud between 1 July 2009 and November 2014. Of the confirmed cases, 9.3 per cent were greater than ten thousand dollars; two alleged fraud cases were more than one million dollars.

We found that 42 per cent of alleged and confirmed frauds reported to us came from one council. We performed detailed data analytics to identify potential indicators of other fraud and corruption at this council. Based on fraud indicators, we assessed the potential for further fraud and corruption at this council and formed a view that corrupt conduct may have occurred. In accordance with section 38 of the *Crime and Corruption Act 2001*, we referred our findings to the Crime and Corruption Commission.

Figure 2B shows the number and value of alleged and confirmed fraud and corruption cases from all councils who participated in the survey.

Figure 2B
Alleged and confirmed fraud numbers and values by council regions—Survey data 1 July 2009 to 30 June 2014

Council region	No. of councils in region	No. who responded to survey	No. who responded to being a victim of fraud	No. of alleged frauds	Value of alleged frauds	Number of confirmed frauds	Value of confirmed frauds
Coastal	15	14	7	25	$1 493 751	98	$125 676
Indigenous	17	10	3	2	$4 237 236	3	$201 449
Resources	15	13	6	5	$1 298 000	5	$325 802
Rural/regional	9	9	4	1	$835	7	$2 011
Rural/remote	13	12	2	1	$1 000	1	$7 627
South-east Queensland	8	8	6	96	$318 006	80	$618 300
Totals	**77**	**66**	**28**	**130**	**$7 348 828**	**194**	**$1 280 865**

Note: Councils were only requested to provide data up to 30 June 2014. Some councils provided data up to the time of survey completion—October/November 2014. These exceptions are included in totals.

Source: Queensland Audit Office from council survey

Councils within the coastal and south-east Queensland regions experienced more incidents of fraud and corruption than the other regions. This higher rate is expected given these councils employ 77 per cent of all employees engaged by the local government sector.

Almost two-thirds of councils surveyed (63 per cent) claimed to have had no confirmed cases of fraud over the past five-years. This is inconsistent with global research undertaken in 2014 which identified 41 per cent of government organisations experienced at least one instance of economic crime, including fraud, in the past two years.

Councils did not provide us with a fraud loss value for 57 per cent of their fraud cases; and 44 per cent of councils indicated they do not have a system to manage their fraud information.

To assess the completeness of our survey data, we compared our data with that provided by the CCC. Figure 2C shows the number of councils by region who had fraud allegations referred to the CCC and how many of these allegations were substantiated.

Figure 2C
Alleged fraud numbers by council regions—CCC data 1 July 2009 to 30 June 2014

Council region	Number of councils	Number of alleged frauds reported to CCC*	Number of CCC substantiated fraud allegations
Coastal	13	296	48
Indigenous	15	182	11
Resources	13	182	17
Rural/regional	8	85	13
Rural/remote	10	68	6
South-east Queensland	8	1 021	336
Total	**67**	**1 834**	**431**

*Note: 916 fraud cases included in the 1834 fraud allegations

Source: Queensland Audit Office from data provided by the Crime and Corruption Commission

We identified through a comparison of our survey data with the CCC data that:

- **Councils victim to fraud**—the number of councils who responded that they have been a victim of fraud in the last five-years, 28, is substantially less than the number of councils who had fraud allegations with the CCC, 67.
- **Councils not a victim to fraud**—of the 44 councils who advised us they had no confirmed fraud cases in the last five-years, we identified 14 of these councils had one or more substantiated fraud allegations. Nine of these 14 councils did not have a system to manage information gathered about fraud; the five councils that did have a system to record fraud did not use it well, as they had no record of the CCC substantiated frauds.
- **Councils under-reporting fraud to the CCC**—six councils reported more cases of alleged and confirmed fraud to us than the number of cases the CCC had records of alleged fraud on. In particular, there were two large councils who respectively, did not report 39 and 40 cases to the CCC.

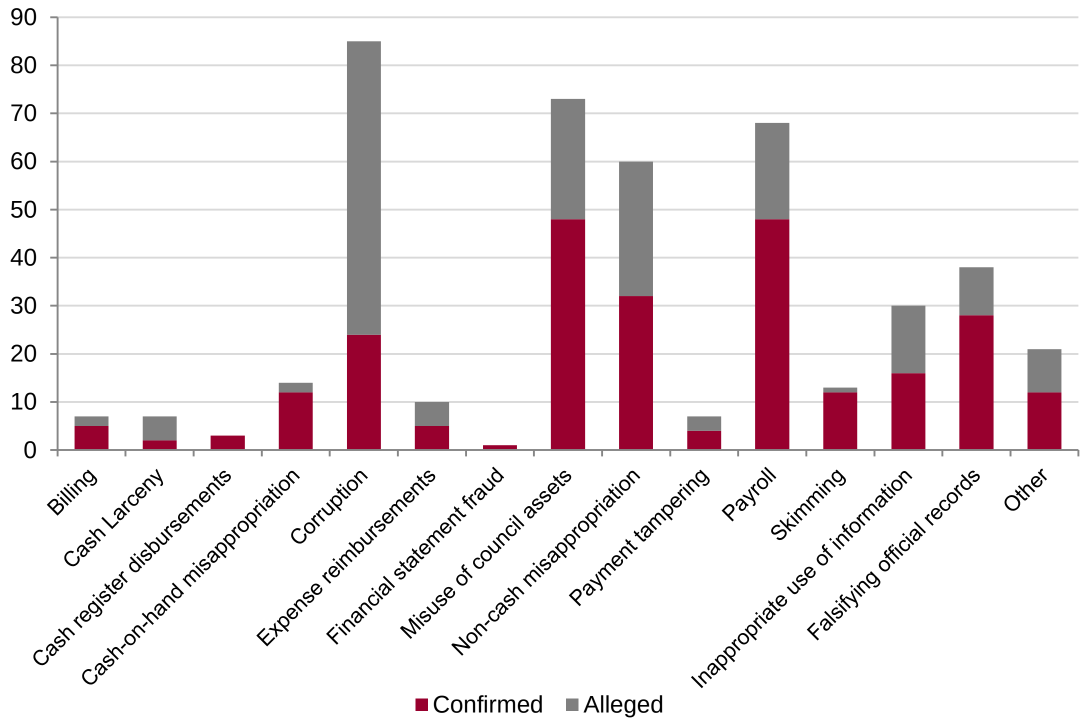
The significant discrepancies highlighted in this comparison demonstrate that councils have poor records on fraud in their organisations that omit a substantial volume of frauds that have been perpetrated against them. They also inconsistently report their frauds.

2.4 Types of frauds occurring in local councils

The most common types of fraud committed against councils over a five-year period from 1 July 2009 to 30 June 2014 were the misappropriation of council assets, including theft; and corruption by employees who use their position's authority or their access to information for personal benefit.

Figure 2D shows the types of frauds councils reported in our survey.

Figure 2D
Fraud types in local councils—alleged and confirmed 1 July 2009 to 30 June 2014



Source: Queensland Audit Office from council survey

Our research confirms that corruption, in particular, is a serious threat to councils because it is difficult to detect and can create the most financial and reputational damage. An industry survey conducted in 2012 on fraud, bribery and corruption in Australia and New Zealand identified that, while corruption accounted for four per cent of fraud incidents, it accounted for almost 30 per cent of the total value of fraud. Corruption can involve preferential treatment in the allocation of work, receiving gifts, kickbacks or bribes from suppliers to council employees or elected officials, or unauthorised disclosure of council information to third parties.

Councils have a high inherent risk of corruption because of the high volume of goods and services they procure from local suppliers and their proximity to those suppliers. This means that councils need to be particularly vigilant in their procurement practices, including tender processes, contract management, and allocation of works to suppliers, to minimise the risk of fraudulent or corrupt activity occurring.

Corruption was the most common alleged fraud type councils reported in our survey, but not the most common confirmed fraud type. Corruption can be difficult to prove because perpetrators do not often act alone, they collude with other employees and suppliers to conceal information.

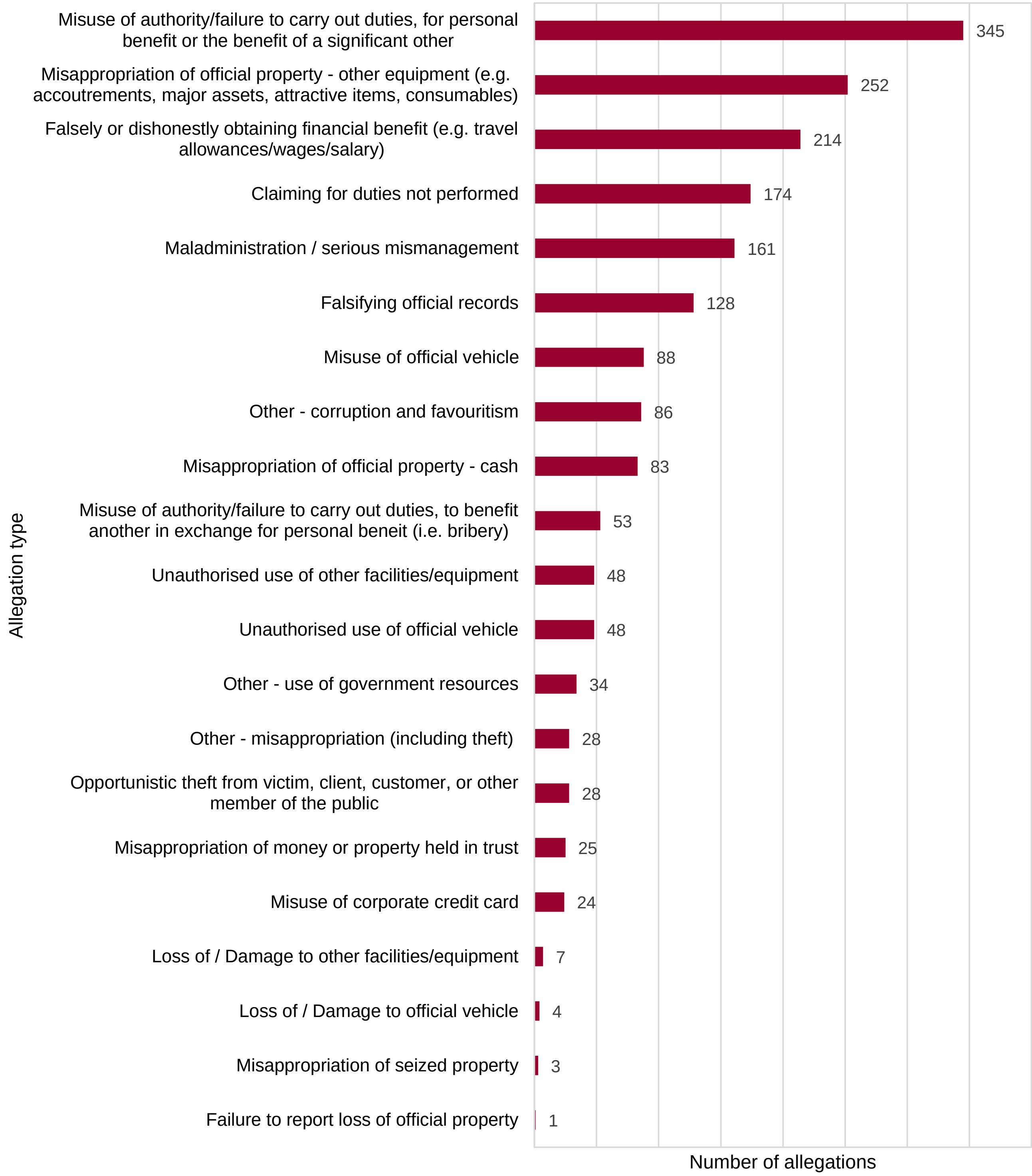
The CCC provided us with non-identifiable records of fraud occurrences in local government of which it was aware over a five–year period, 2009 to 2014. During this period, 1 834 fraud and corruption allegations in local government were referred to the CCC.

The most common allegations were misappropriation, which accounted for 44 per cent of allegations, and corruption which accounted for 26 per cent of allegations. The most common fraud type within these broad categories was corruption which involves 'inappropriate use of authority to carry out duties for personal benefit or the benefit of a significant other' which accounted for 18.8 per cent of all cases referred to the CCC from the 2009 to 2014 financial years.

This aligns with our fraud survey data which demonstrates that corruption fraud is the most common fraud type in local councils.

Figure 2E shows the allegation types referred to the CCC.

Figure 2E
Fraud allegation types referred to the CCC—1 July 2009 to 30 June 2014



Source: Queensland Audit Office from data provided by the Crime and Corruption Commission

2.5 Reporting fraud in local government

Councils may report fraud information to the Crime and Corruption Commission (CCC), Queensland Police Service and Queensland Audit Office under different legislative requirements. However, there is no consistent reporting approach that provides a complete picture of the incidence and total cost of fraud in local government.

Differences in how each receiving agency records and categorises fraud information referred to them under the relevant legislations makes it impossible presently to readily match the data to accurately identify the extent of fraudulent activity across the local government sector.

Consequently, there is no central record of frauds in local government. The lack of collective knowledge impedes analysis of fraud trends and emerging issues in the local government sector. In turn this limits the capacity to provide useful information back to councils about fraud prevention, detection and response.

2.5.1 Reporting to the Auditor-General

The *Local Government Regulation 2012* requires a council report to the Auditor-General where it becomes aware that property with a value of $1 000 or more is missing. If the council suspects that the property has been stolen, it must also give written notice to a police officer. The *City of Brisbane Regulation 2012* has no requirement for the Brisbane City Council to report missing property. Neither regulation requires councils to report loss through fraud; however, five per cent of the total amount councils' reported to the Auditor-General over a five-year period was related to loss resulting from fraud.

Figure 2F shows the breakdown of missing property reports councils submitted to the Auditor-General over the period 1 July 2009 to 30 June 2014.

Figure 2F
Missing property reported to the Auditor-General by local councils for the period 1 July 2009 to 30 June 2014

Missing property type	No of reports	Missing property value $	% of total value
Damage	83	5 348 913*	65.76
Theft	542	2 279 529	28.03
Fraud	19	430 711	5.30
Missing	80	64 409	0.79
Loss	17	9 830	0.12
Grand Total	**741**	**8 133 392**	

* Of 83 damage reports, one incident accounted for $5 million due to a fire at a council's depot that destroyed its building and contents. Excluding this incident, $3.13 million of missing property was reported to the Auditor-General over a five year period, with theft accounting for 73 per cent of this.

Source: Queensland Audit Office

Of the 19 frauds reported to the Auditor-General, amounting to $430 711, under the requirements of the *Local Government Regulation 2012*, a single timesheet fraud accounted for $305 318. The remaining frauds were for misappropriation of cash and goods and credit/fuel card fraud, including one instance where a former council employee continued to use their fuel card after their employment terminated. The council estimated that the former employee incurred private expenses of between $4 000 and $18 000.

The regime that applies to state government departments and to statutory bodies is established in the *Financial and Performance Management Standard 2009* (the FPM Standard). Its requirements are more prescriptive and comprehensive than those that apply to local government, as set out in *the Local Government Regulation 2012 and the City of Brisbane Regulation 2012*. Section 21 of the FPM Standard sets out:

- the type of losses to which the FMP Standard applies, specifically, losses which arise from criminal offences or misconduct (which could include fraud)
- specific details about the written information that must be kept about the loss
- specific external reporting requirements where the loss is a material loss.

Figure 2G illustrates the requirements of the *Financial and Performance Management Standard 2009* are more prescriptive than the *Local Government Regulation 2012* in relation to fraud reporting.

Figure 2G
Fraud reporting comparison between the *Financial and Performance Management Standard 2009* and the *Local Government Regulation 2012*

Financial Management Performance Standard 2009	Local Government Regulation 2012
Section 21 Loss from offense or misconduct (1) This section applies if the accountable officer of a department or statutory body— (a) becomes aware of a loss of the department's or statutory body's property; and (c) considers the loss may be the result of— (i) an offense under the Criminal Code or another Act; (ii) the official misconduct of an officer of the department or statutory body; or (iii) the conduct of a consultant or contractor engaged by the department or statutory body that would amount to official misconduct if it were the conduct of an officer of the department or statutory body	**307A Reporting missing local government property** (1) This section applies if— (a) a local government becomes aware that property of, or received by, the local government is missing; and (b) the property has a total value of $1 000 or more.
(2) The accountable officer or statutory body must keep a written record of the following details about the loss— (a) a description of the property, including its value; (b) the reason for the loss; (c) the action taken about the loss, including, for example the following— (i) action to remedy any weakness in the internal control of the department or statutory body; (ii) action taken to obtain reimbursement; (d) details about approval for writing off the loss.	(2) The local government must immediately give written notice to the auditor-general.
(3) If the loss is a material loss, the accountable officer or statutory body must, as soon as practicable but not later than 6 months after the accountable officer or statutory body becomes aware of the loss, notify— (a) the appropriate Minister for the department or statutory body; and (b) the auditor-general; and (c) for a loss mentioned in subsection (1)(b)(i)—a police officer; and (d) for a loss mentioned in subsection (1)(b)(ii)—the Crime and Misconduct Commission.	(3) Also, if the local government suspects the property may have been stolen, the local government must immediately give written notice to a police officer.

Source: Queensland Audit Office

Some consequence of the less prescriptive approach taken by *the Local Government Regulation 2012* and the *City of Brisbane Regulation 2012* are:

- Councils report mainly lost physical items such as mobile phones, and most do not report 'losses' associated with fraudulent behaviour such as timesheet fraud and instances where information is lost or deliberately leaked that has a commercial value.
- Councils report matters to the Auditor-General below the reporting threshold. Of 741 missing property incidents councils reported to the Auditor-General for the period 1 July 2009 to 30 June 2014, 542 were categorised as theft, but 205 of these were valued at less than $1 000. Councils did not know the value of a further 60 items.
- Councils did not report confirmed fraudulent activity worth $802 309 and alleged fraudulent activity worth $6.3 million to the Auditor-General over the period 1 July 2009 to 30 June 2014.

Figure 2H provides examples of frauds councils did not report to the Auditor-General which we identified by comparing our local government missing property data to the results of our fraud survey covering the same period.

Figure 2H
Examples of individual frauds not reported to Auditor-General

Description	Amount
Alleged that fraudulent invoices were presented to a council for goods that were not supplied	$4 191 447
Alleged misuse of financial delegations to process payment to a contractor as a variation as opposed to contract termination	$997 691
Alleged misappropriation of official property	$300 000
Confirmed undeclared conflict of interest; employee used delegation to direct work for personal gain	$250 000
Confirmed falsification of mandatory qualification requirements by a preferred applicant	$124 015
Confirmed timesheet fraud and use of contractor relationship for personal gain	$65 000
Confirmed misuse of facilities and equipment for personal gain, and use of knowledge of council systems to modify software	$64 000
Confirmed timesheet fraud	$47 960
Confirmed timesheet fraud	$37 000

Source: Queensland Audit Office

The gap in the *Local Government Regulation 2012* and the *City of Brisbane Regulation 2012*, in terms of both what councils are required to record and report on, in relation to potential fraud, may have contributed to the lack of systematic documentation and longitudinal information they hold on fraud. This lack of comprehensive documentation in their own records impedes their ability to analyse fraud trends and emerging risks and issues.

2.6 Recommendation

1. **The Department of Infrastructure, Local Government and Planning pursue changes the *Local Government Regulation 2012* and the *City of Brisbane Regulation 2012* to require:**
    - **loss as a result of fraud to be a reportable loss to the Auditor-General and to the Minister responsible for local government**
    - **councils to keep written records of alleged and proven losses arising from fraud.**

3 Fraud planning and prevention

In brief

Background

The Australian Standard: AS 8001—2008 Fraud and Corruption Control (the standard) outlines a suggested approach to controlling fraud and corruption. It emphasises the advantages of a fraud and corruption control plan to help prevent, detect and respond to fraud.

Conclusions

Most councils are not managing fraud risks well. They don't have a plan to provide structure and direction to their activities to help prevent, detect and respond to fraud. Council CEOs have not placed sufficient priority on fraud risk management and this, combined with weaknesses in internal controls, unnecessarily exposes councils to greater fraud risk than is otherwise acceptable.

Key findings

- Sixty-five per cent of councils do not have a structured approach to prevent, detect and respond to fraud because they have not documented a fraud and corruption control plan.
- The councils who do have a fraud and corruption control plan are more likely to meet better practice elements outlined in the standard, such as:
  - having a CEO-issued policy statement of fraud and council definition of fraud
  - conducting fraud risk assessments
  - establishing internal fraud reporting processes.
- The councils with a fraud and corruption control plan still did not follow through and implement the prevention and detection elements required by the standard.
- Fifty-seven per cent of councils have not conducted fraud risk assessments and of those that have, less than a third conduct them as often as they should.
- Sixty-one per cent of councils cannot demonstrate a strong fraud control culture to help with the prevention and detection of fraud because they have no definition of fraud or their CEO has not issued a policy statement on fraud.
- Lack of supervision was the most common internal control breakdown that contributed to fraud instances in local councils between 2009 and 2014. Other internal control breakdowns we observed were: senior officers overriding controls; lack of procurement controls, or people circumventing the controls; and undeclared conflicts of interest.
- Almost all councils have a code of conduct; however, more than half of councils have not developed additional fraud guidance material to support their code of conduct. Only 49 per cent of councils cover fraud and corruption control guidelines as part of induction or other training.

3.1 Background

The Australian Standard: AS 8001—2008 *Fraud and Corruption Control* (the Standard) provides all entities and government with tested methods to control fraud and corruption within their business and daily activities. A key element of better practice is to develop and implement a fraud and corruption control plan.

A fraud and corruption control plan details councils' intended actions in implementing and monitoring fraud and corruption prevention, detection and response initiatives. It provides a structured approach for management and staff to combat fraud and corruption risk. It should:

- include a definition of fraud and corruption
- have full commitment from the chief executive officer and management
- be an integral part of an overall risk management plan
- be reviewed at least every two years
- determine resources for monitoring the plan
- determine accountabilities for fraud control activities
- determine implementation and frequency of fraud and corruption risk assessments
- determine implementation of prevention methods
- determine implementation of detection methods
- determine response methods.

A council that develops a fraud and corruption control plan at strategic and operational levels, and implements, communicates and monitors it well, can reduce the threat of fraud and corruption within its organisation.

3.2 Conclusions

The majority of councils are not managing fraud risk well because they don't have a plan to prevent, detect and respond to fraud. Most councils that do have a plan are not following through with control activities to manage fraud.

The lack of planning and follow-through is a consequence of chief executives not setting an appropriate 'tone at the top', failing to place sufficient priority on fraud risk management. Because 61 per cent of councils have not defined fraud and issued a policy statement on fraud, most councils lack a strong fraud control culture and do not practice preventative measures to mitigate fraud risk. This means employees may not understand what fraud or corrupt behaviour is; nor do they know what to do if they suspect fraudulent or corrupt activity.

Because councils don't have a plan to manage their fraud risks, or fully implement a plan if they have one, they are unnecessarily exposed to incidents of fraud and corruption that could have been prevented or detected earlier.

3.3 Fraud prevention

For councils to effectively manage fraud and comply with the Standard, they need to resource and implement each of the minimum acceptable compliance planning initiatives outlined within the Standard. Initiatives should be implemented in ways appropriate to their council, having regard to its size, diversity, geographical spread and risk profile. Figure 3A outlines some prevention initiatives.

Figure 3A
AS8001—2008 Fraud and Corruption Control standards

Prevention initiatives required to meet fraud and corruption control standards
• Develop and implement a fraud and corruption control plan. • Build an ethical culture. • Show senior managers are determined to control the risks of fraud and corruption. • Implement an effective system of internal control. • Assess fraud and corruption risk. • Foster fraud and corruption awareness. • Implement a robust employment screening program. • Ensure due diligence of suppliers and customers.

Source: AS 8001–2008 Fraud and Corruption Control

We used data from our fraud survey to analyse council fraud processes against elements of the Standard. Responses to our survey show that most councils outside the SEQ region are not implementing the most fundamental and critical fraud prevention practices.

Figure 3B shows the council regions, the number of councils in each region, the number of councils who responded to our survey, and the number of councils in each region that had:

- a fraud and corruption control plan
- conducted a fraud risk assessment
- defined fraud and issued a policy statement on fraud
- screened all new employees with a criminal history check
- implemented fraud-specific awareness training.

Figure 3B
Council key fraud management practices—response to survey

Council Region	Number of councils	Number of responses	Fraud and corruption control plan	Fraud risk assessment	Define fraud and issued policy statement on fraud	New employee screening —criminal history *	Fraud-specific awareness training
Coastal	15	14	7	6	7	1	6
Indigenous	17	10	1	2	2	1	0
Resources	15	13	4	7	5	1	8
Rural regional	9	9	2	5	3	0	4
Rural remote	13	12	1	2	2	2	7
SEQ	8	8	8	6	7	0	7
Totals	**77**	**66**	**23**	**28**	**26**	**5**	**32**

* Note: Queensland criminal history checks for all new staff

Source: Queensland Audit Office

The following sections provide further detailed analysis of how councils perform against key fraud management planning and prevention practices, based on our survey results and detailed field work we performed at selected councils.

3.3.1 Fraud management planning

Australian Standard AS 8001—2008 Fraud and Corruption Control states:

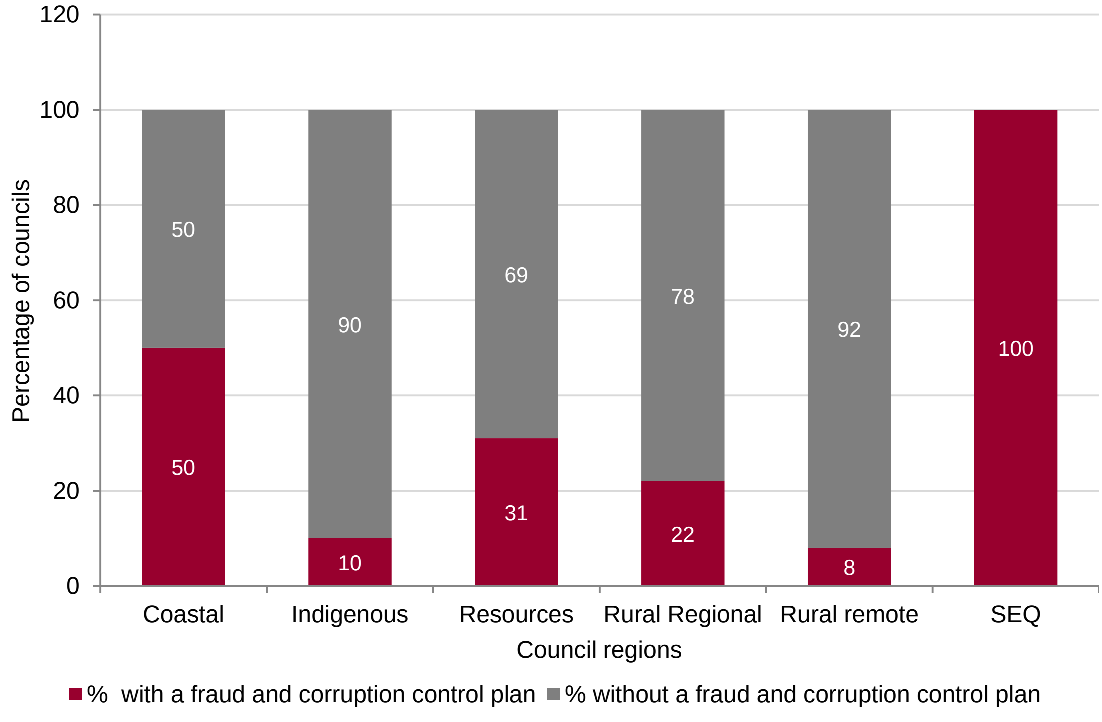
> *Entities should develop and implement a Fraud and Corruption Control Plan documenting the entity's approach to controlling fraud and corruption exposure at strategic, tactical and operational levels. The Fraud and Corruption Control Plan should detail the entity's intended action in implementing and monitoring the entity's fraud and corruption prevention, detection and response initiatives.*

Sixty-five per cent (or 43 of the 66 council respondents) do not have a fraud and corruption control plan or similar document. This means that most councils in Queensland have no plan for preventing, detecting and responding to fraud.

The SEQ region was the only region where all councils developed a fraud and corruption control plan. In all other regions, 74 per cent of councils did not have a fraud and corruption control plan. In particular, of 31 councils within the Indigenous, rural regional and rural remote regions only four councils developed a fraud and corruption control plan.

Figure 3C illustrates the proportion of fraud and corruption control plans developed within councils regions.

Figure 3C
Fraud and Corruption plans identified by council region



Source: Queensland Audit Office council survey

Councils without a fraud and corruption control plan

Councils without a fraud and corruption control plan are less likely to:

- define fraud and set the tone from the top
- develop supporting fraud control materials (other than the code of conduct) and conduct regular code of conduct/fraud control training to their staff
- develop and implement measures to prevent and detect fraud
- implement screening and due diligence processes for prospective employees and third parties who are working with the councils
- detect fraud when it occurs
- rely on fraud risk assessments to prioritise fraud detection methods
- have policies and procedures in relation to:
    - managing information gathered about fraud
    - investigation
    - fraud register
    - disciplinary procedures
    - external reporting
- use intelligence to challenge internal controls.

Councils with a fraud and corruption control plan

Of those councils with a plan, we found gaps in essential activities required for effective fraud management:

- providing regular training to all staff on the code of conduct and other related fraud training—only 55 per cent of councils with a plan provided code of conduct training to their staff every two-years
- conducting fraud risk assessments and using them to prioritise areas for the development of fraud prevention and detection methods—only 50 per cent of councils conduct fraud risk assessments at least once every two-years.

This indicates that, of the small number of councils who have developed a fraud and corruption control plan, about half have either not implemented their fraud and corruption control plans properly or have not treated fraud risk management as an ongoing activity.

Figure 3D demonstrates the contrast in compliance of selected fraud elements between councils that have implemented a fraud and corruption control plan and those that haven't.

Figure 3D
Council compliance results against selected elements of a fraud and corruption control plan

Standard Initiatives	Councils with a fraud and corruption control plan %	Councils without a Fraud and corruption control plan %	Variance %
Planning			
Fraud and corruption definition	96	51	45
Fraud statement policy issued by the CEO	78	26	52
Prevention			
Council code of conduct	100	95	5
Code of conduct training at least every two years	55	21	34
Development of other fraud materials other than code of conduct	61	30	31
Conduct checks on prospective employees	100	91	9
Due diligence on third parties (e.g. contractors)	83	74	9
Conduct fraud risk assessments	74	26	48
Fraud risk assessments conducted at least once every two years	50	20	30
Detection			
Fraud detection program prioritised on fraud risk assessments	65	24	41
Established and promoted internal fraud reporting processes	87	24	63
Response			
Reports prepared on findings of fraud investigations	100	80	20
Council has a system to manage information gathered about fraud and allegations	78	44	34

Source: Queensland Audit Office

We identified variances of up to 63 per cent for implementation of elements of the standard between councils with a plan and councils without a plan.

Planning and prevention elements with variances greater than 40 per cent were:

- defining fraud and corruption
- a fraud and corruption statement policy issued by the Chief Executive Officer (CEO)
- conducting fraud risk assessments

It is evident that councils with a plan have a more structured path towards preventing, detecting and responding to fraud than those without a plan. It is also more likely that council employees and third parties working for councils with a plan will have greater awareness of fraud and corruption control.

3.3.2 Fraud risk assessment

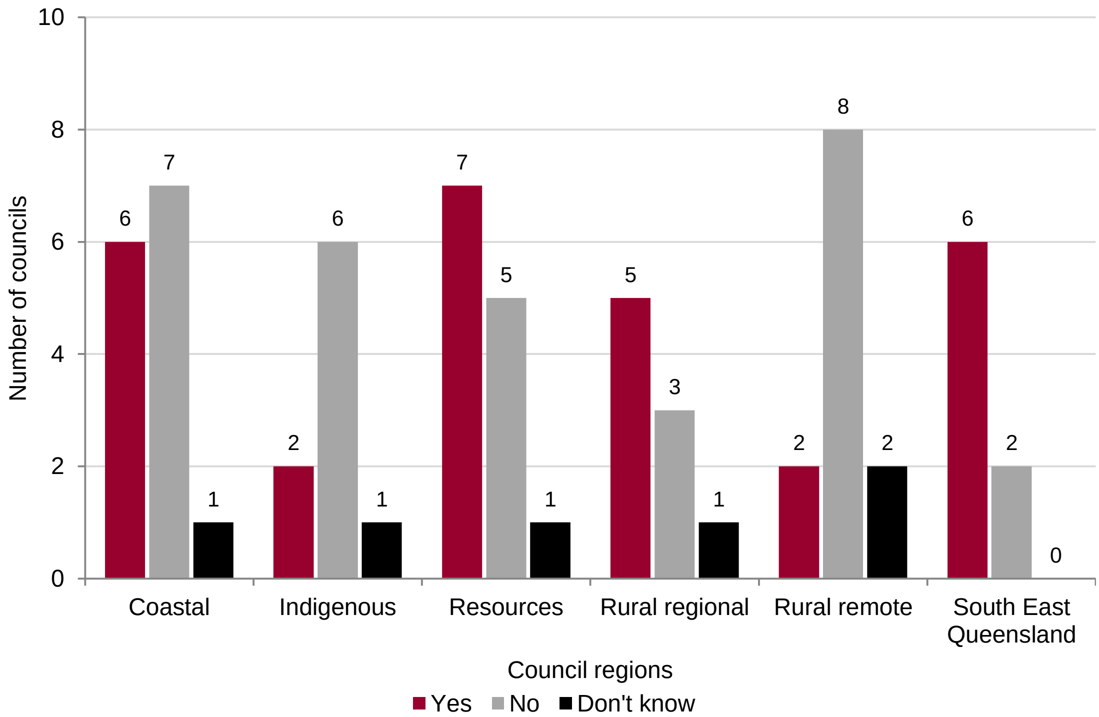
Periodic fraud risk assessments are an essential component of the fraud and corruption control plan. They assist councils to identify, understand, document and mitigate risks across all business levels and services.

More than half of councils, 57 per cent, do not conduct fraud risk assessments— a key activity for ensuring that any fraud control and detection program is targeted to the areas of a council most susceptible to the risk of fraud.

While the uptake of conducting fraud risk assessments is poor across all council regions, it is particularly absent in the indigenous and rural remote regions. This may mean that councils in these regions have greater exposure to potential fraud, and are unlikely to be identifying any potential new risks in line with changing business plans, behaviours and the councils' changing risk profiles.

Figure 3E shows the breakdown of the number of councils within each council region that conduct fraud risk assessments.

Figure 3E
Number of councils that conduct fraud risk assessments—by council regions



Source: Queensland Audit Office council fraud survey

Of the 28 councils that conduct fraud risk assessments, only:

- eleven councils conduct the assessments as frequently as they should—at least every two years according to the standard
- nineteen councils use the results of fraud risk assessments to prioritise areas when developing their detection program.

This indicates that councils are not targeting their fraud control and detection programs to areas with emerging risks and threats. This increases the likelihood that fraudulent activity remains undetected.

Case Study 1 shows weaknesses we identified at one council where we reviewed its fraud risk assessment process.

Case Study 1

Fraud risk assessment

We observed major shortcomings and weaknesses with the methodology one council used to conduct fraud risk assessments:

- The council did not identify which of its business units and services were more inherently susceptible to fraud risk to enable a more detailed assessment in those areas to occur. The council only assessed organisational fraud risks based on self-assessments performed by each business unit, some of which did not complete an assessment.
- There was inadequate governance over the completion and verification of the fraud risk assessments completed by the business units. The business units were inconsistent in their approach to completing the assessments, but this was not corrected to ensure the council had records of fraud risk assessments for all business units.
- The council used a methodology that assumed its business units had the capability to undertake fraud risk assessments; however, the council did not assure itself that the staff who completed self-assessments were capable of conducting fraud risk assessments. Nor did it offer training to assist those responsible for their completion. The assessments were open to individual interpretation.
- The council did not assess any risks that business units did not score. This means that if a business unit had a significant fraud risk, but did not note it in its self-assessment, this fraud risk remained unidentified from a corporate perspective.

We reviewed in further detail the fraud risk assessments completed by two of the council's business units. Our findings indicate that these two business units did not place importance on the fraud risk assessment process nor were they capable of making the assessments accurately. For example, the fraud risk assessment of one business unit at this council was incomplete and inadequate for its inherent fraud risk profile. The fraud risk assessment contained no detail of the controls the business unit had implemented to address fraud risks. This undermined the integrity of the data used for the council's corporate fraud risk assessment which relied on business units performing self-assessments accurately and completely.

Source: Queensland Audit Office

3.3.3 Ethical culture

The establishment of an ethical culture is a critical element of sound governance and plays an important role in preventing fraud and helping to detect it once it occurs. Senior executives should ensure that internal control systems, such as internal audit, fraud control strategies and risk assessments, are functioning and effective.

A strong and visible commitment to internal controls and ethical practices from senior management is fundamental to a successful fraud and corruption control program.

Less than 40 per cent of councils have a definition of fraud and a CEO-issued policy statement on fraud. This indicates most councils are not sending clear messages to their employees and third parties and cannot demonstrate that they provide ethical leadership that underpins the fraud control effort.

Our survey shows that of the 66 councils that responded:

- twenty-six councils define fraud and have a CEO-issued policy statement on fraud
- three councils have a CEO-issued policy statement on fraud but have not defined fraud
- eighteen councils defined fraud but do not have a CEO-issued policy statement on fraud
- nineteen councils have not defined fraud nor have their CEOs issued a policy statement on fraud.

If council management does not communicate its expectations and continue to reinforce its anti-fraud and corruption message, those in a position to perpetrate fraud may seek opportunities to do so. They could rationalise their decision by a perceived lack of interest by management.

3.3.4 Employment and third party screening

All councils should undertake employment and third party screening because it verifies the bona fides of an individual/company's identity, integrity and credentials. Pre-employment or contract checks verify the accuracy of an applicant's claims as well as discover any possible criminal history, or other sanctions affecting the employment or contract. With this knowledge councils can make more informed decisions on whether to proceed or not.

Employee and contractor screening

Councils give low priority to conducting criminal history checks for both prospective and existing staff. This limits their ability to identify employees who have previously committed fraud or corruption.

Our survey shows that only five out of 66 councils conduct either a Queensland or national criminal history check for **all** prospective staff and less than 20 per cent of councils conduct criminal history checks for senior executive positions. Not conducting criminal history checks on applicants applying for senior executive positions may heighten fraud risk. Senior executives, by virtue of their position, often have discretionary control and the ability to circumvent internal controls.

Figure 3F shows the type of screening checks the 66 councils surveyed conduct on prospective employees and which ones they more likely use depending on employment positions.

Figure 3F
Number of councils that conduct pre-employment screening checks

Type of check	All staff	Contractors	Financial staff	Senior Executives	Other key staff
Criminal history—Queensland	5	1	7	12	13
Criminal history—National	5	1	8	12	20
Criminal history—International	2	1	1	2	4
Disciplinary history	7	2	1	2	2
Qualifications	32	8	9	14	5
Reference	58	12	12	13	3
Past employment	44	8	9	10	3

Source: Queensland Audit Office

Of 66 councils, 44 councils do not conduct any criminal history checks on existing staff. In 45 alleged/confirmed fraud cases (all in excess of $1 000 and from 19 individual councils), relevant councils did not know if the perpetrators had previous criminal history for 39 of those cases.

Councils conduct even fewer 'personal checks' for contractors than for their employees. We identified that:

- only one council conducts all three levels of criminal history checks (state, national and international) for contractors
- two councils review disciplinary history for contractors
- six councils review contractors' qualifications
- nine councils obtain references
- six review past employment history.

Supplier screening

Of 66 councils, 51 councils have a process in place for risk assessment and due diligence before entering into contracts with third parties. The most common checks performed by councils were insurance, reference and finance checks. Case Study 2 shows that it is important that councils also perform vetting of supplier and company director details as it can alert them to potentially fraudulent or corrupt activity by their suppliers.

Case Study 2

Supplier vetting
A council invited tenders for a preferred supplier arrangement. Seven companies submitted a tender in response to the council's invitation. Two of seven companies which submitted tender documentation are owned by the same individuals. Both companies were selected as the two highest scoring applicants for the tender, and were selected to progress to the final stage of assessment—a value for money assessment of their bids. The bids of both companies for the work were within 0.4 per cent of each other; no other companies were selected for a value for money assessment of their bids. This could indicate that the two companies, owned by the same individuals, submitted bids in order to create false competition. If so, this compromised the council's ability to determine an accurate value for money proposition when it progressed to the final assessment stage involving only these two companies. Council officers should have been aware that both companies were owned by the same individuals and, if not, a simple check would have alerted them to this fact. If the council officers did know, then this is an indicator of potential corruption.

Source: Queensland Audit Office

3.3.5 Fraud awareness training

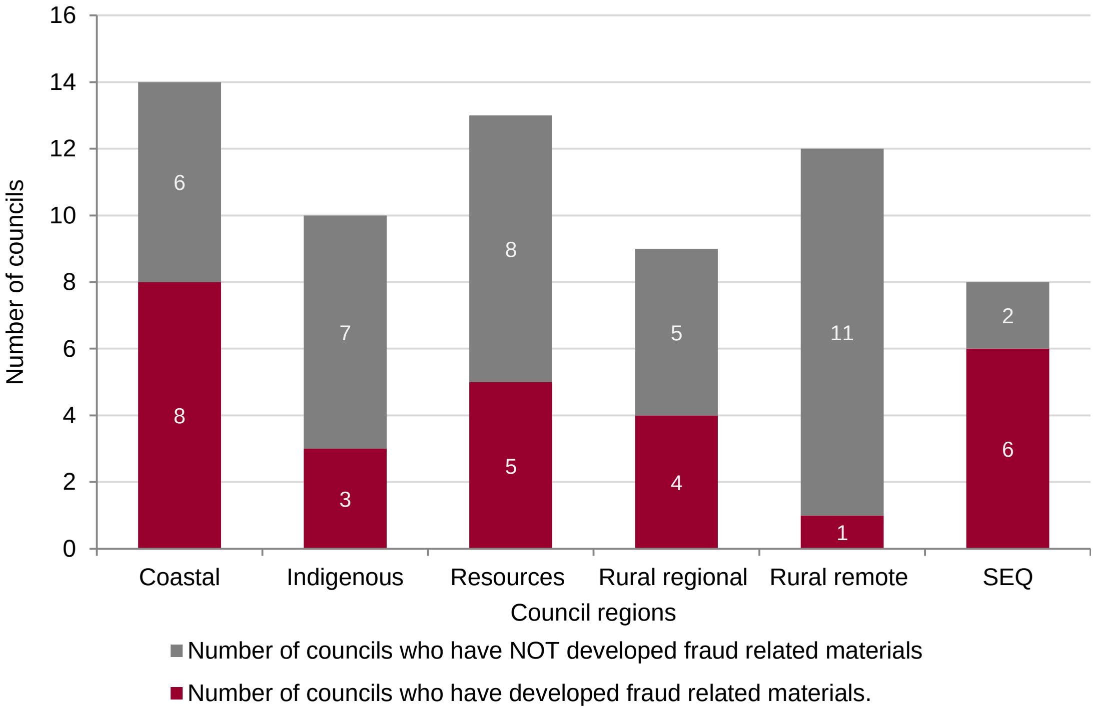
Fraud education and awareness strategies can create and strengthen an environment that discourages fraud and honours integrity. The code of conduct is a good starting point for fraud training as it sets standards and rules of desired behaviour required by all employees. Councils should not, however, solely rely on the code of conduct as the only means of providing fraud awareness training. Developing a broader range of relevant documents and tools to complement frequent fraud awareness communication is critical in preventing fraud.

We found that 97 per cent of the council survey respondents have a code of conduct and 89 per cent per cent make it available to all employees via their intranet or website. However, only 23 councils provide regular code of conduct training (at least once every two years) to their staff. More than half of councils have not developed additional fraud guidance material to support their code of conduct.

If staff are not provided with guidance on fraud related matters outside the code of conduct, it may limit their knowledge of fraud risks and related issues. This leaves councils at risk that employees may not recognise or overlook occurrences of fraud or, if they suspect or detect fraudulent activity, they may be unsure of how to respond to it.

Figure 3G shows the number of councils by region that have and have not developed fraud awareness materials for their staff other than the code of conduct.

Figure 3G
Councils who have developed fraud related materials for dissemination to their staff



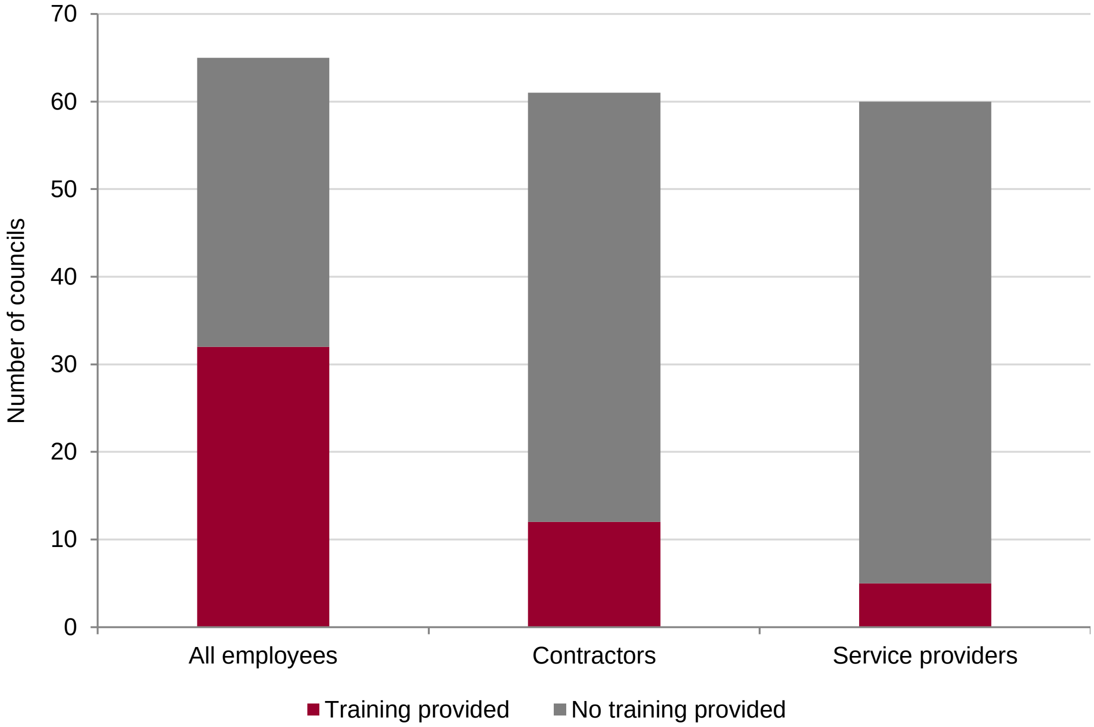
Source: Queensland Audit Office council survey

While the most common delivery method councils use to raise fraud awareness to staff is induction or other training programs; only 49 per cent of councils actually cover fraud and corruption control guidelines as part of this training. This means that new employees in more than half the councils are unlikely to be aware of their council's position on fraud and what to do if they suspect fraud.

Councils place significantly less emphasis on raising fraud awareness with contractors and external service providers than on current employees. Councils who do not provide contractors and external service providers with a copy of their code of conduct and deliver fraud related guidance including requirements to disclose conflicts of interest are missing an opportunity to minimise their external exposure to fraud.

Figure 3H shows how many councils provide fraud and corruption control guidelines training sessions to employees, contractors and external service providers.

Figure 3H
Inclusion of fraud and corruption guidelines for induction or other training



Source: Queensland Audit Office Council survey

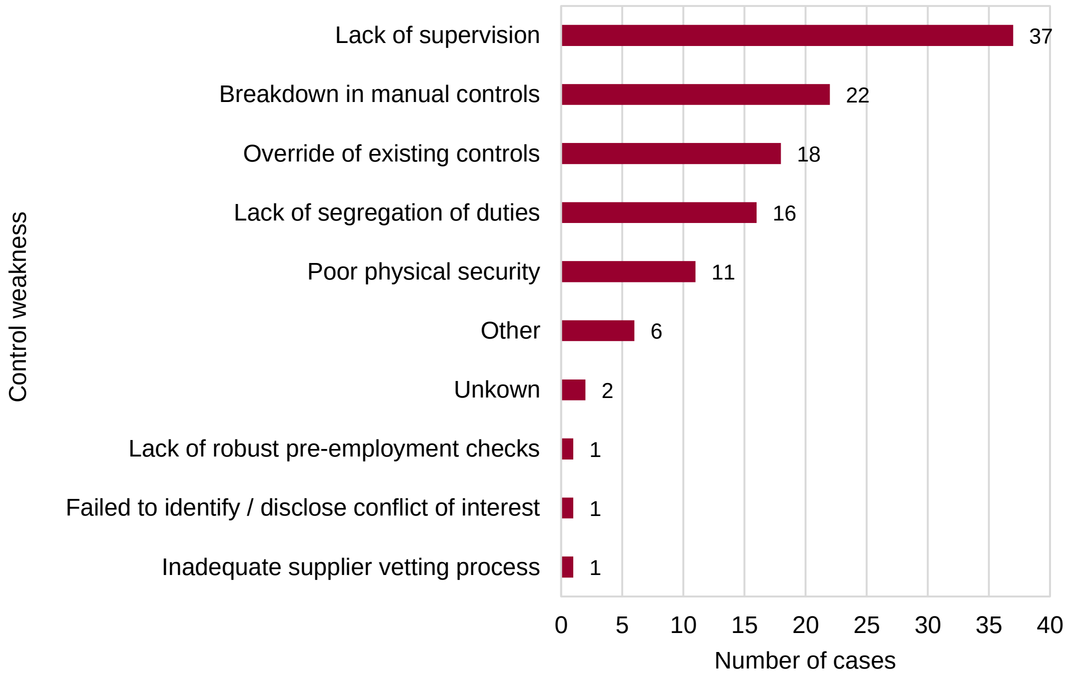
3.4 Internal controls

An effective system of internal control is critical to protect an organisation from the risk of fraud. It can assist with both the prevention and detection of fraudulent activity and ensures that opportunities for fraud are minimised. Weak internal controls provide potential perpetrators with opportunities to exploit the system and commit fraud or corruption. A review of the operating effectiveness of internal controls can provide a trigger for further investigation of potentially fraudulent activity.

Internal control weaknesses contributed to the occurrence of fraud and corruption within councils we surveyed. Councils were able to identify one or more weak internal control processes in most of the fraud cases greater than $1 000.

Figure 3I shows control weaknesses identified from council fraud cases, highlighting lack of supervision as the most common control breakdown.

Figure 3I
Control weaknesses causing council fraud cases



Source: Queensland Audit Office

Figure 3J provides examples of confirmed fraud cases committed by council employees or third parties and the weakness in internal control which enabled the frauds to occur.

Figure 3J
Confirmed fraud cases and related control weaknesses

Fraud description	Approx. Amount	1	2	3	4	5	6	7	8	9
Employee and a contractor misappropriated funds by setting up a 'ghost employment agency worker' for labour work and timesheets to obtain ordinary and overtime hours, unlawful use of a council vehicle and falsification of council mobile telephone calls in an attempt to avoid a debt to the council.	$300k	X	X		X	X				
Undeclared conflict of interest. Inappropriate use of delegation to direct work for personal gain	$250K		X		X	X		X		
Falsification of mandatory qualification requirements by preferred applicant	$124K								X	
Theft of cash stored in unlocked filing cabinet	$54K	X	X			X	X			
Removal and on-selling of water meters and scrap material from council depots	$19K	X	X							
Overtime claim for weekend work for hours not worked	$15K		X							
Lodging fraudulent expense claims	$15K		X							
Theft of cash during banking process	$7 600	X	X							
Submitting dummy quotes to award maintenance work to a company co-owned by employee	$7 000	X			X					
Failure to declare a conflict of interest in awarding work to wife's business	$5 000									X
Misuse of financial delegations / position of authority to modify own pay records as to increase leave loading	$3 900	X				X				

Legend:

1 – Breakdown in manual controls
2 – Lack of supervision
3 – Lack of IT controls
4 – Lack of segregation of duties
5 – Override of existing controls
6 – Poor physical security
7 – Inadequate supplier vetting process
8 – Lack of robust pre-employment checks
9 – Failure to identify/disclose conflict of interest.

Source: Queensland Audit Office

Strong and enforced internal controls cannot eliminate fraud and corruption, however they do provide an effective prevention measure.

The following case studies from our detailed fieldwork provide examples of the risks created by lack of oversight of controls by senior officers, circumvention or procurement controls and undeclared conflicts of interest.

Oversight of controls

Case Study 3 provides an example of a fraud committed by a senior employee at a local council and demonstrates the importance of councils implementing and monitoring strong internal controls to minimise opportunities for staff to commit fraud.

Case Study 3

Senior officer overriding controls
A council reported it was defrauded of approximately $1 million by a former senior employee. A history of poor control consciousness from management, weak governance and ineffective oversight and monitoring of controls within this council created an environment conducive to fraudulent behaviour. It was alleged that the former senior employee made a number of erroneous payments to council suppliers. The same employee subsequently requested refunds from the supplier. The refunds were directed to be deposited to a private bank account in the name of the former employee rather than a council bank account. Factors which contributed were: • all functions in the accounts payable process could be performed by one officer • the second delegated officer approved EFT payments without sighting supporting documentation • invoices not reconciled to monthly supplier statements • changes made to vendor masterfile data not checked by a second officer • poor internal monthly financial reporting with variations between actual and budget results not fully explained • failure by council to follow up action taken by management to address control weaknesses identified by internal and external audit • ineffective fraud risk assessment processes with no formal risk registers being maintained.

Source: Queensland Audit Office

Procurement practices

In two other councils, we revealed a number of weaknesses and risks to the integrity of their procurement practices. Case Study 4 provides two examples of weaknesses in procurement practices that can increase the risk of fraud.

Case Study 4

Circumvention and lack of procurement controls
Example 1 The execution of tender processes and lack of supporting documentation to justify the decision-making process exposed one council to queries about probity in its procurement process. Significant internal control weaknesses highlighted during the audit included: • limited documentation to support procurement decisions made by management, specifically in relation to the appointment of suppliers through the tender process and preferred supplier arrangements • inconsistent communication with suppliers during the tender process • purchase orders raised subsequent to the issue of the related invoice • engagement of long-term suppliers with no evidence of regular, comprehensive performance reviews • consultants and contractors given the authority to approve payments, recommend purchase requisitions, sign off on goods/services received, and act as a contract manager (contact officer) for projects where in some cases they had a direct connection with the supplier appointed. **Example 2** At another council, we observed the following internal control weaknesses in relation to procurement which increase the risk of fraudulent or corrupt activity: • the risk of undeclared conflicts of interest is not properly assessed by business units • vendors are not required to declare conflicts of interest upon tender application • contract administration anomalies occur. These include the creation of contracts and variations without a scope definition of work, and allocation of high volumes of work beneath the competitive threshold and procurement policy • system functionality weakened the council's evidence trail of purchasing activity of its officers. That is, it is not clear who is buying what • lack of segregation of duties in purchasing has created a risk of goods being receipted and paid for that may not have been delivered • lack of vetting supplier details upon tender application.

Source: Queensland Audit Office

Conflicts of interest

Undeclared conflicts of interest present a significant fraud risk in relation to procurement of goods and services in local government. If conflicts of interest are undeclared or undetected, individuals, or even a group of individuals, can use their purchasing and contract management authority to direct work and payments to companies with which they have an interest. Personal relationships with suppliers can also result in kickbacks and bribery in order to obtain work.

Case Study 5 shows weaknesses in the management of conflicts of interest increases the risk of fraud and corrupt activity.

Case Study 5

Undeclared conflicts of interest
A council requires employees involved in a tender to declare any conflict of interests during the tender process. However, this does not identify instances where employees not involved in the tender process, but involved in the subsequent allocation and awarding of work, may assist companies with which they have a conflict of interest to submit a tender application. During our analysis, we identified instances where council employees operated companies during their time of employment, but there was no record of a conflict of interest being declared. We also found an instance where a council employee had the same address details as a council vendor, but there was no evidence that a conflict of interest was declared. We reviewed the fraud risk assessments for two areas within this council and found that neither performed a realistic assessment of the risk of conflicts of interest. One did not even assess the risk of conflicts of interest. The other assessed that the risk was low and required no further mitigating actions because they had limited controls requiring staff involved in tenders and contract administration to declare conflicts of interest. When vendors submit a tender application, they are not required to declare any relationships they have with current council employees or whether any of their directors are former employees of the council. There is no easy way to know the relationships these entities may have with staff they previously worked with. Identification of such conflicts of interest would help the council to identify the controls it has in place to manage those conflicts.

Source: Queensland Audit Office

4 Fraud detection and response

In brief

Background

A fraud plan is essential, but it is not enough. Councils need to be constantly alert for fraud and corruption and equipped to detect early or long-term cases of fraud. Effective detection methods can help councils identify and minimise fraud and corruption.

Conclusions

Councils' fraud detection approaches are, at best, reactive but outdated in today's increasingly sophisticated and evolving fraud control environment. Management are not owning the challenge of fraud control within their organisations—they leave the problem of detecting fraud to internal and external audit teams.

Detected fraud is costing councils more to recover than the amount they lose through fraudulent activity. Having good preventative and detection controls reduces the risk of fraud happening and therefore reduces the cost of managing fraud.

Key findings

- Councils mostly rely on internal and external auditors to help them detect fraud, and do not use risk assessments and data analytics to help them detect fraud. This indicates a passive approach to fraud detection.
- In more than half of cases, councils detect fraud through tip-offs and public interest disclosure. The over-reliance on tip-offs to detect fraud, and the lack of advanced fraud detection methods, means there is likely to be a significant volume of fraudulent activity going undetected.
- Councils are not placing sufficient emphasis on data analytics to anticipate and efficiently detect fraud—our survey shows data analytics ranked thirteenth in detection tools councils use to detect fraud. Councils may therefore be oblivious to unusual transactions and trends, and miss opportunities to uncover fraudulent activity.
- Our survey data shows that, once a fraud occurs, there is little recovery action. Where recovery is initiated the funds recouped are minimal. Based on our analysis of 14 councils who were victims of fraud over a four year period, councils recovered less than 10 per cent of the amount they lost through fraud, and it cost them almost three times as much to recover fraud than what they lost through fraud. This amount could be greater because half of those councils did not know what it cost them to recover fraud.

4.1 Background

As the incidence of fraud continues to rise and millions of dollars are lost by public sector entities to fraud every year, councils need to be proactive in their approach to detection.

Fraudulent activities can remain undetected for many years, but various fraud detection methods can help councils to identify fraud, decrease the chance of financial loss, and shield them from reputational damage.

Collusion presents ongoing challenges for councils. An industry survey in 2012 found it takes organisations much longer to discover fraud perpetrated by more than one individual than when there is a single perpetrator. The average time taken to detect fraud involving collusion was 665 days, which increased from an average of 410 days in its 2010 survey.

Perpetrators are becoming more sophisticated which makes detection more difficult. Councils may also lack the advanced detection techniques they need to detect this type of fraud early.

For a council to comply with fraud detection standards in the Australian Standard: AS 8001-2008 Fraud and Corruption Control (the Standard), it needs to implement the following detection elements:

- fraud detection systems
  - post-transactional review
  - data mining and real-time computer system analysis to identify suspected fraudulent transactions
  - analysis of management accounting reports
- role of the external auditor
- avenues for reporting suspected incidents
- whistleblower protection programs.

To comply with the Standard, councils also need to establish policies for recovery action.

4.2 Conclusion

Most councils do not appreciate the importance of fraud detection tools and how they need to be tailored to address specific fraud risks. Councils' management teams over-rely on internal and external audit to detect fraud, rather than taking ownership of fraud detection within their organisations. This passive approach to fraud detection is outdated in today's increasingly sophisticated and evolving fraud control environment.

Fraud costs councils more to recover than the amount they lose through fraudulent activity. This is because of the additional costs they incur to attempt recovery. However, councils do not consistently capture these additional costs to record how much fraud costs them. The minimal amount councils have successfully recovered from fraud demonstrates that having good preventative and detection controls reduces the risk of fraud happening and therefore reduces the cost of managing fraud.

4.3 Fraud detection methods

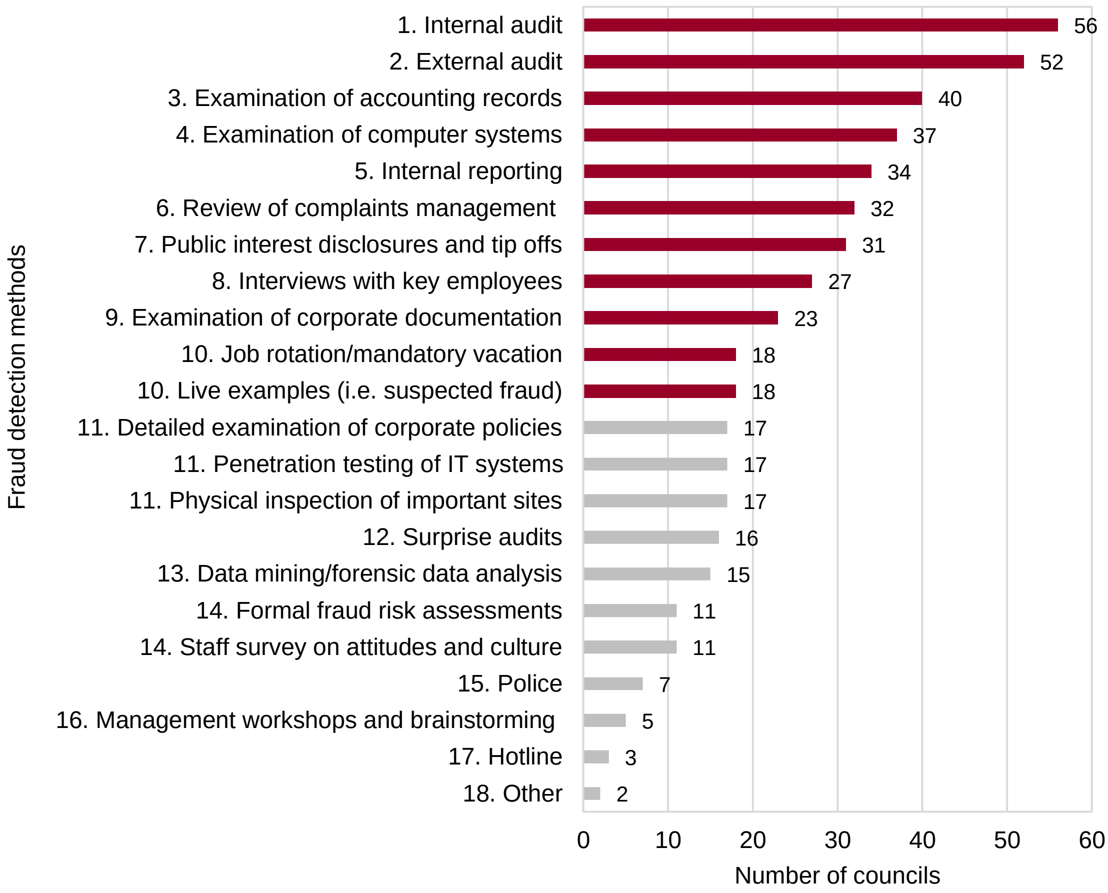
Fraud risk assessments and data analytics are complementary tools that are essential for an effective fraud control program.

Fraud risk assessments can inform data analytics by helping to identify the types of data analytics tests of most value (that is, where there is greatest fraud risk) and the potential anomalies they could highlight.

Councils' responses to our survey indicate that they rely predominantly on internal and external auditors to help them detect fraud, and do not use fraud risk assessments and data analytics, either separately or as complementary tools to help them detect fraud. Both data analytics and fraud risk assessments were outside the top 10 detection techniques councils used to detect fraud—data analytics was ranked 13th and fraud risk assessments 14th.

Figure 4A shows the top 10 detection methods councils use to detect fraud.

Figure 4A
Council's top 10 fraud detection methods



Source: Queensland Audit Office

Internal and external audit

Internal audit's role is to ensure the council's internal control framework is functioning adequately and is appropriate to its risk profile and risk appetite. Its role therefore involves assessing the effectiveness of fraud management controls. Internal auditors, by virtue of their knowledge of a council's business operations, their independence from those operations, and their analytical skills, are well positioned to use data analysis and continuous control monitoring to assist management with fraud detection.

The focus of external audit is on material misstatement in the financial statements and to determine if it is caused by error or fraud. Council managements' reliance on external audit to detect fraud indicates a passive approach to fraud detection.

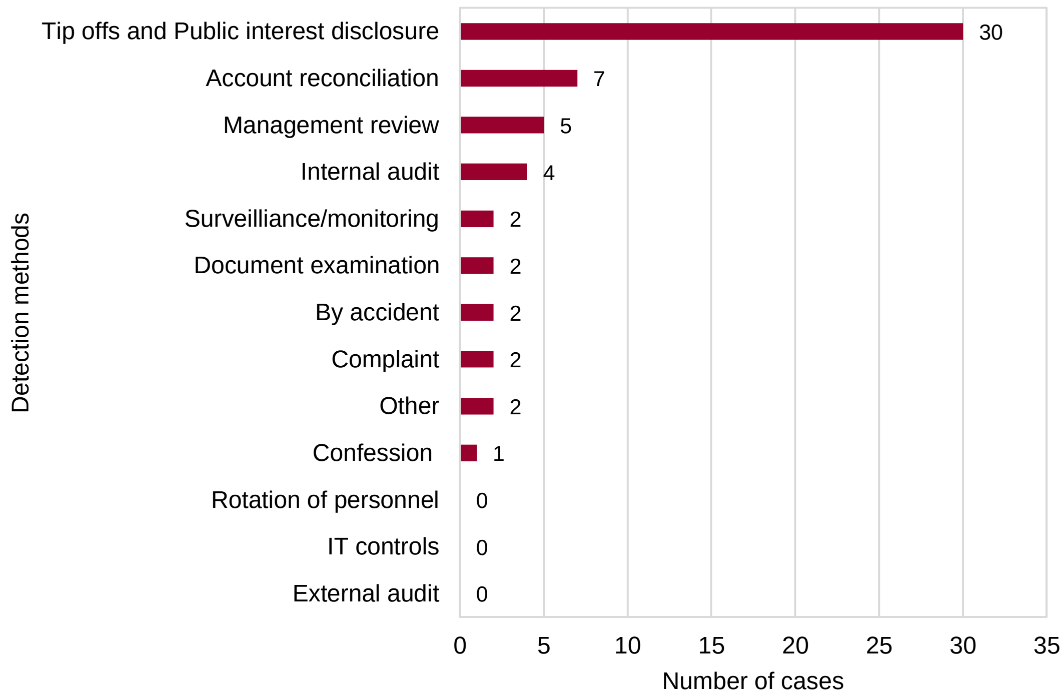
Risk assessments

Only 38 per cent of councils use fraud risk assessments to prioritise areas to focus on when developing fraud detection programs. This means most councils are not identifying factors that can lead to fraud, or areas within council that are most susceptible to fraud. By not prioritising areas of risk and focusing their fraud detection systems and procedures in these areas, councils risk overlooking possible fraud within their business.

Our survey shows there is a significant difference between the detection methods councils advised us they used, from the type of detection methods that actually assist them to identify alleged and confirmed fraud incidents. The more common detection methods councils use have not helped them to identify fraudulent activity. For example, while internal audit is the most common detection method councils use, only four of 57 fraud cases councils reported to us were detected through internal audit, while 30 were detected through tip-offs. More than half the council fraud and corrupt cases (53 per cent) were detected through tip offs or through public interest disclosure. The over-reliance on tip-offs to detect fraud, and the lack of advanced fraud detection methods, means there is likely to be a significant volume of undetected fraudulent activity.

Figure 4B shows the detection methods councils used to identify the 57 fraud and corruption cases reported in our survey.

Figure 4B
Council detection methods used to detect alleged and confirmed cases



Source: Queensland Audit Office

4.4 Data analytics

Data analytics is the science of analysing raw data in order to draw conclusions. The effective use of data analytics helps identify hidden patterns and possible anomalies in large volumes of data, which may be uneconomic or technically difficult to analyse by other means. It is commonly used in business to help make better business decisions and it can be applied very usefully to fraud detection.

Data analytics can be employed to:

- test for suspicious activities or anomalous transactions to allow for early detection of potential fraud
- identify areas where there are opportunities for efficiency improvements (e.g. rosters)
- detect overpayments and cost recovery opportunities for the agency (e.g. duplicate invoicing)
- facilitate the risk ranking of particular transactions or to target potential operational hot spots (e.g. particular business units or personnel).

Data analytics also has a preventative role as it can identify control gaps that may be vulnerable to fraudulent conduct.

Section 4.2.4 of the Standard states:

> *An entity's information systems are an important source of information of fraudulent and, to a lesser extent, corrupt conduct. By the application of sophisticated (and, in many cases, relatively unsophisticated) software applications and techniques, a series of suspect transactions can be identified and then investigated thus potentially detecting fraudulent and corrupt conduct at an early stage.*

Our survey results indicate that councils are not placing sufficient emphasis on data analytics to anticipate and efficiently detect fraud. Without the use of data analytics, councils may be oblivious to unusual transactions and trends, thereby missing opportunities to uncover fraudulent activity.

4.4.1 Procurement and vendor data analytics

Procurement fraud is a significant risk in the local government context because of the volume of services councils procure from businesses in the local community, and the possibility that council employees could be linked through either personal or professional relationships to those businesses.

To demonstrate the value of data analytics as a detection tool for this type of fraud, we performed a detailed assessment at one council. Based on the results of our data analytics and subsequent enquiries, we formed a view that corrupt conduct may have occurred at this council and therefore, in accordance with section 38 of the *Crime and Corruption Act 2001*, we referred our findings to the Crime and Corruption Commission.

Procurement

Case Study 6 provides examples of the results of data analytics we performed at the council in relation to procurement transactions with related parties. It demonstrates the value councils can obtain from data analytics in identifying red flags that fraudulent or corrupt activity may be occurring.

Case Study 6

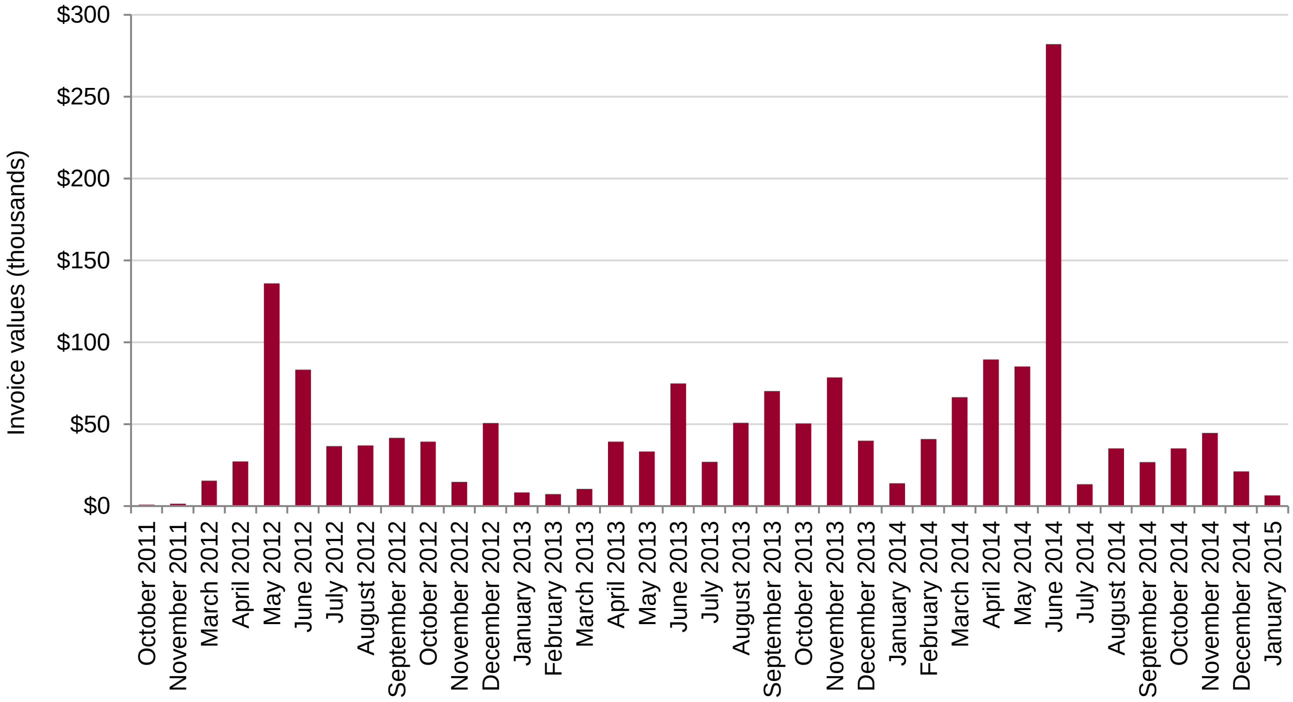
Related party procurement data analytics
To assess the risk of procurement transactions with parties related to employees of a council, we analysed the following data sets: • human resources (HR) personnel data • vendor master data • vendor payment transactions data • company directorship data. By analysing these data sets we identified: • The council paid a total of $35.2 million to 27 vendors operated by its former employees over a three year period • The council had nine vendors who were paid while one of the vendor's company directors was concurrently employed at the council. Based on further analysis of these matches, we identified four vendors which warranted further in-depth analysis • The council engaged with 15 companies whose directorship includes a current council employee. Based on our analysis of these matches, we identified four companies which in our view, warrant further in-depth analysis. There is a risk that these vendors are favoured in the allocation of work because of relationships they may have with current council employees. The exceptions we highlighted through this analysis provide indicators of potential fraud, and demonstrate the potential of data analytics to identify where opportunities for fraud exist and its power as a detective tool. The council's fraud and corruption control plan did not include any actions for developing a data analytics capability to assist with the early detection of fraud.

Source: Queensland Audit Office

Vendor activity

Transactional data analysis is a powerful tool to find anomalies in data to identify potential fraudulent activity. Figure 4C shows an example of transactional analysis of a vendor's activity at one council which shows an apparent anomaly (large volume of goods which it was unlikely the council could use at the time) with the purchase of goods or services in the last month of a financial year. Further analysis confirmed suspicions raised in relation to these transactions, and showed that the goods ordered may never have been received, despite the council paying for the goods.

Figure 4C
Example of transactional analysis of vendor activity



Source: Queensland Audit Office

Data analytics alone is not sufficient to confirm fraud, but it provides the trigger for further targeted analysis through other means that can either confirm fraud or raise the level of suspicion that fraudulent activity has occurred.

Case Study 7 shows an example of how our data analytics at a council provided a trigger for further targeted analysis, which then gave us a basis to reasonably conclude that corrupt activity may have occurred.

Case Study 7

Data analytics as a trigger for analysis of fraudulent or corrupt activity

A council vendor appeared on our list of exceptions because of a direct match between the address details of the vendor and a former employee.

Analysis of the council's HR data confirmed a close personal relationship between the former council employee and the vendor's owner.

Further analysis of transactional data relating to this vendor, found that for almost 40 per cent of purchase orders for this vendor there was a total of only two days between when the purchase orders were created to when payments were made. This could indicate that works were in progress before purchase orders were raised and approved.

We also reviewed the contract history of this vendor, and found evidence that the vendor was given a contract of works before any quote for work was requested to cover any expenditure for work that may arise from future quotes. We also confirmed that the vendor's initial contract was varied on several occasions, resulting in a 240 per cent increase on the initial contract which was based on no definition of work.

Our analysis also raised suspicion that these anomalies were systemic and bought into question probity issues relating to the integrity of the council's procurement practices.

Source: Queensland Audit Office

4.5 Reporting and response

Established reporting processes allows employees and external parties to report any suspicions of fraudulent or unethical behaviour. When councils continually promote fraud awareness, staff are aware of what constitutes fraudulent or corrupt behaviour and know who to report such behaviour to.

Less than half of the 64 council respondents promote both internal and external fraud reporting processes. Forty-four per cent of councils do not have arrangements to assist staff who have questions regarding ethical dilemmas. This means that if staff and third party employees become aware of suspected fraudulent or corrupt behaviour, they may not raise their concern, because they do not know how to report it or who to discuss it with. A reporting opportunity may be missed and suspected fraud or corruption cases may remain undetected.

4.5.1 Recovery of losses

In our survey, councils reported 42 cases of confirmed fraud over a five year period where the amount lost in each case was more than $1 000. We reviewed to what extent councils recovered losses for 33 cases detected between 1 July 2009 and 31 December 2013. Our review was based on the assumption that councils had the opportunity to recover those funds up to the time of October 2014 when the survey was conducted.

The 33 fraud cases, across 14 councils, had a total value of $979 910. Of this, councils only recovered $97 658—less than 10 per cent of the amount lost through fraud. This includes:

- full recovery—of $25 658— in four cases
- partial recovery—of $72 000 out of $365 000 in two cases
- no recovery:
  - Three councils did not know if they recovered funds for three cases where $51 477 was lost through fraud
  - In 24 cases, the 11 councils affected did not recover any funds for total losses of $537 774.

This shows councils' attempts to recover total funds lost through fraud are not effective.

Attempting to recover lost funds can often cost more than the original amount. The benefits need to be considered before undertaking recovery action upon the completion of a fraud or corruption investigation. Section 5.7 of the standard states:

> *Entities should ensure that they have a policy requiring that recovery action be undertaken where there is clear evidence of fraud or corruption and where the likely benefits of such recovery will exceed the funds and resources invested in the recovery action.*

Of the 33 cases, there were only eleven cases where councils estimated a total recovery cost for the frauds, including costs associated with resourcing the investigation of the fraud cases. Councils did not recover the full cost of the frauds in any of these cases.

Figure 4D shows the number of confirmed fraud cases per council between 1 July 2009 and October 2014. It compares the amount lost through fraud, the amount recovered and the cost to recover fraud where the council could provide an estimate. Of 33 confirmed fraud cases, councils did not identify the recovery cost for 27 cases.

Figure 4D
Fraud cost and recovery

	Number of fraud cases	Amount lost through fraud	Amount recovered	Minimum cost to recover*
Council A	3	$27 000	—	$49 000
Council B	3	$11 790	$6 076	$1 840
Council C	1	$6 302	$6 302	$5 000
Council D	1	$1 600	—	—
Council E	8	$426 728	$62 000	—
Council F	2	$32 257	$10 780	$21 477
Council G	1	$65 000	$10 000	$60 000
Council H	1	$23 000	—	—
Council I	4	$33 112	—	—
Council J	1	$79 000	—	—
Council K	1	$1 211	—	$5 000
Council L	3	$89 960	—	$117 000
Council M	2	$178 449	—	—
Council N	2	$4 500	$2 500	—
Totals	**33**	**$979 909**	**$97 658**	**$259 317**

* Note where councils advised they' did not know' or did not provide information, we completed this field with $0.00; the total cost to recover was not provided for each fraud case.

Source: Queensland Audit Office

Our survey results show that for the 14 councils with confirmed fraud cases between 1 July 2009 and 31 December 2013:

- seven councils did not know what additional costs they incurred to attempt recovery of the amount lost through fraud
- six councils spent more to recover fraud than the amount they were able to recover
- overall, councils spent almost three times as much on attempting to recover fraud as on the amount they were able to recover. As seven councils did not know what recovery costs they incurred, we expect this variance to be even greater.

Attempting to recover funds lost through fraudulent activity is often unsuccessful and can cost more to recover than the original amount lost. Recovery action can be complex and resource intensive. This reinforces the need for councils to consider the benefits of a preventative approach to fraud management to reduce the overall cost of managing fraud.

Outcome of confirmed fraud cases

Our survey results show that for 42 confirmed fraud cases the most common outcomes were termination of employment and employee resignation. In 22 cases the employee or contractor had their employment terminated, and in 14 cases the employee resigned. Three were convicted at trial.

Figure 4E shows outcomes for the 42 confirmed fraud cases.

Figure 4E
Fraud outcomes

Source: Queensland Audit Office

Appendices

Appendix A—Comments

In accordance with section 64 of the *Auditor-General Act 2009*, a copy of this report was provided to Department of Infrastructure Local Government and Planning, the Crime and Corruption Commission and to all Queensland councils. All parties had an opportunity to comment on the proposed report.

Responsibility for the accuracy, fairness and balance of the comments rests with the head of these agencies.

Comments received from Acting Director-General, Department of Infrastructure, Local Government and Planning

Queensland Government

Department of Infrastructure, Local Government and Planning

Our ref: DGBN15/422

Your ref: 2015-9123P

21 MAY 2015

Mr Andrew Greaves
Auditor-General
Queensland Audit Office
PO Box 15396
CITY EAST QLD 4002

Dear Mr Greaves

Thank you for your letter of 6 May 2015 providing a draft report for comment in relation to the performance audit on fraud management in local government recently undertaken by the Queensland Audit Office.

In principle, the Department of Infrastructure, Local Government and Planning supports both proposed recommendations in this report. Enclosed is the Department's response to each of the individual recommendations.

The Department has no issues or specific comment on the content of the report itself.

Although the proposed amendments to the *City of Brisbane Regulation 2012* and the *Local Government Regulation 2012* would be subject to approval by Governor in Council, the Department intends to progress proposed amendments to the regulations as soon as practicable following the tabling of the final report in Parliament.

In addition, the Department intends to promote the content of the report and its recommendations and will be seeking a report from each local government on their progress in implementing the report's recommendations within the following 12 months.

Having regard to the audit findings, the Department agrees that implementation of both recommendations would provide significant benefits to local governments in managing fraud risks.

In addition, a consistent reporting framework to capture fraud related details would enable a more coordinated approach in identifying and dealing with fraud related risks across the local government sector.

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Comments received from Acting Director-General, Department of Infrastructure, Local Government and Planning

The report further indicates local governments will continue to be at risk of ongoing fraudulent activity if gaps in their governance arrangements to support fraud identification and mitigation are not improved. This is a concern and reinforces the importance of promoting the content of the report and its recommendations to local governments and peak local government bodies once it has been tabled in Parliament.

The Department is also interested in working with your office to identify appropriate resources and training available to support local governments in addressing the report's findings.

I would like to thank you and your office for conducting this review. These performance audits continue to encourage improvements in systems and provide guidance on matters that can provide significant benefits to not only the local government sector, but the community as a whole.

If you require any further information, please contact Mr Max Barrie, Director, Program Implementation and Review on (07) 3452 6704 or max.barrie@dilgp.qld.gov.au, who will be pleased to assist.

Yours sincerely

Stephen Johnston
Acting Director-General

Enc

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Responses to recommendations

Queensland Audit Office

Department of Infrastructure, Local Government and Planning, Fraud Management in Local Government

Response to recommendations provided by Mr Stephen Johnston, Acting Director-General, Department of Infrastructure, Local Government and Planning on 21 May 2015.

Recommendation	Initial response Agree / Disagree	Timeframe for Implementation	Current Status	Additional Comments
1. The Department of Infrastructure, Local Government and Planning pursues amendment of the *Local Government Regulation 2012* and the City of *Brisbane Regulation 2012* to require: • **loss as a result of fraud to be a reportable loss to the Auditor-General and to the Minister responsible for local government** • **councils to keep written records of alleged and proven losses arising from fraud.**	Agree	As soon as practicable following tabling of final report in Parliament	TBA	
2. All councils assess themselves against the findings in this report as a priority and where needed develop, revise or update their: • **policies and procedures for fraud and corruption management** • **fraud and corruption control plans** • **fraud risk assessments** • **data analytics capability for fraud detection.**	Agree	As soon as practicable following tabling of final report in Parliament	TBA	The Department of Infrastructure, Local Government and Planning will promote this recommendation with local governments and will monitor progress of implementation across the sector.

Current status:

I – Recommendation fully implemented

P – Recommendation partially implemented

AA – Alternate action undertaken

NA – No substantial action taken

1

Appendix B—Audit method

Audit objective

The objective of the audit was to determine whether local government councils effectively manage the risk of fraud occurring and remaining undetected.

Reason for the audit

Fraudulent and corrupt conduct by public officials falls within 'corrupt conduct' under the *Crime and Corruption Act 2001* and is an indictable offence under the Queensland *Criminal Code Act 1899* and the *Criminal Code Act 1995 (Commonwealth).*

Fraud can damage an organisation's reputation, employee morale and relationships with stakeholders, including the community. In the case of local governments, fraud can involve the loss of ratepayer funds that would otherwise have been used to deliver council services or fund council business. As such, councils need to be committed to creating and sustaining an effective fraud risk management framework where opportunities for fraud and corruption are minimised, fraud is detected when it occurs, and where councils use the results of fraud investigations to improve their fraud risk management frameworks.

Our past reports to parliament on the results of audits of local government entities indicate that management of fraud risks is not subject to strong governance practices based on robust fraud risk assessments.

In March 2013, we reported to parliament on fraud risk management in Queensland public sector agencies (exclusive of local government). This performance audit extended the focus of that work to local government.

Performance audit approach

The audit was conducted between July 2014 and April 2015.

The audit consisted of:

- analysis of survey results from survey conducted of all 77 Queensland councils
- analysis of data from the Crime and Corruption Commission (CCC) and Queensland Police Service
- data analytics and further analysis at one council
- referral of relevant matters to the CCC.

Appendix C—Fraud risk susceptibility analysis

Figure C1— Characteristics of business areas or council services susceptible to fraud risk

Category	Attribute	Factors that increase fraud risk	Fraud exposure
Financial	Materiality of economic flows	High value/low volume, and/or high volume/low value transactions with third parties.	Fraud risk increases in both likelihood and consequence as the sums involved increase.
	Nature of transactions	Non-exchange/non-reciprocal where values given do not match values received, e.g. grants, subsidies, donations, rates and other involuntary transfers.	Unlike a commercial exchange, the inability to readily compare or reconcile the value of what was provided with the value of what was received increases the opportunity for fraud and the likelihood that it remains undetected.
	Susceptibility to manipulation	Accounting balances require subjective measurements involving high levels of judgement or expertise to calculate.	The manipulation of accounting balances can be used to conceal frauds, or may itself be fraudulent by concealing losses or adverse financial positions.
Relationships	Economic dependency	High supplier dependency—supplier relies on the entity for a significant proportion of its gross turnover/continued solvency. High remuneration dependency—salary at risk or other performance incentive schemes with large bonuses or earn-outs arrangements relative to base salary, contingent upon achieving targets.	Supplier dependency creates an incentive for the supplier to offer bribes and an opportunity for the purchaser to request kick-backs to retain business. Overly aggressive or unrealistic performance targets can motivate employees to commit fraud to conceal or overstate actual performance, or can be used to rationalise fraud when bonuses are not paid.
	Market depth	Limited market depth restricting competition, existence of oligopoly or monopoly suppliers.	Lack of competition creates opportunities for collusive tendering, and for predatory pricing or other cartel behaviours.
	Proximity to external parties	High degree of direct, face to face contact required. Interaction with customers and suppliers at their premises or in the field.	Ongoing personal contact away from direct supervision establishes the opportunity to cultivate inappropriate personal relationships or to groom others to unknowingly facilitate frauds.
	Related parties	Related party transactions—employees or their spouse, children, and other close relatives or associates have a direct or indirect personal pecuniary interest in transactions or confidential information. Non-commercial, non-arm's length transactions.	Personal interests inherently conflict with public interest and motivate fraudulent behaviour. Transaction values that are not set by reference to observable market inputs create the opportunity for fraud.

Category	Attribute	Factors that increase fraud risk	Fraud exposure
Attitudes	Internal controls	Failure to quickly address or remediate internal control issues identified by auditors and other parties. Corner-cutting, failure to follow due process is tolerated or encouraged. Senior leadership does not promote good governance.	Failure by management to demonstrate a commitment to strong and effective control fosters weak control consciousness and a poor control culture that increases the opportunity both for fraud to occur and for it to remain undetected.
	Transparency/accountability	Reluctance to voluntarily disclose information publicly. Limited or poor quality internal reporting to executive.	Failure to acknowledge mistakes, to accept blame and to report risks fosters a culture of secrecy which increases the risk that unusual or suspect transactions and behaviours will not be reported.
Use of assets	Intrinsic value of physical assets	Use of highly 'portable and attractive' items of equipment. Handling of cash or other assets readily convertible into cash.	Movable equipment and machinery and items of cash or negotiable instruments are inherently more susceptible to theft or misappropriation by employees.
	Intrinsic value of intangibles	Access to commercially sensitive/economically valuable information not publicly available, e.g. Intellectual Property.	The intangible nature of sensitive information makes it difficult to secure and to prevent being misused for personal gain or advantage.
Decision-making	Assignment of authority	Decision making is widely devolved to business units. Authority is highly delegated below senior management.	The further removed the approval and scrutiny of transactions are from the 'centre' and from the 'top' of the organisation the greater potential for fraud to remain undetected.
	Decentralisation of operations	Operations in locations remote from central office Span of management.	The 'tyranny of distance' makes it harder to establish consistent processes and to understand how controls are being applied.
	Discretion	Personal discretion applied in determining allocations to third parties.	Staff or elected officials with the discretion to determine how funds are allocated to third parties have the ability to over-ride standard processes and expose their organisation to fraud.
	Supervision	Span of control is high. No supervisory review before decisions. No centralised monitoring after decisions.	Lack of supervision creates the opportunity for staff to commit fraud and that it remains undetected e.g. paying for goods and services that were never received.

Source: Queensland Audit Office

Appendix D—Local Government regions

Figure D1
Council regions

Region	Councils		No.
Coastal	• Bundaberg Regional Council • Burdekin Shire Council • Cairns Regional Council • Cassowary Coast Regional Council • Douglas Shire Council • Fraser Coast Regional Council • Gladstone Regional Council	• Gympie Regional Council • Hinchinbrook Shire Council • Livingstone Shire Council • Mackay Regional Council • Noosa Shire Council • Rockhampton Regional Council • Townsville City Council • Whitsunday Regional Council	15
Indigenous	• Aurukun Shire Council • Cherbourg Aboriginal Shire Council • Doomadgee Aboriginal Shire Council • Hope Vale Aboriginal Shire Council • Kowanyama Aboriginal Shire Council • Lockhart River Aboriginal Shire Council • Mapoon Aboriginal Shire Council • Mornington Shire Council • Napranum Aboriginal Shire Council	• Northern Peninsula Area Regional Council • Palm Island Aboriginal Shire Council • Pormpuraaw Aboriginal Shire Council • Torres Shire Council • Torres Strait Island Regional Council • Woorabinda Aboriginal Shire Council • Wujal Wujal Aboriginal Shire Council • Yarrabah Aboriginal Shire Council	17
Resources	• Banana Shire Council • Barcoo Shire Council • Bulloo Shire Council • Burke Shire Council • Central Highlands Regional Council • Charters Towers Regional Council • Cloncurry Shire Council • Cook Shire Council	• Etheridge Shire Council • Isaac Regional Council • Maranoa Regional Council • McKinlay Shire Council • Mount Isa City Council • Quilpie Shire Council • Western Downs Regional Council	15

Region	Councils		No.
Rural/ Regional	• Goondiwindi Regional Council • Lockyer Valley Regional Council • Mareeba Shire Council • North Burnett Regional Council • Scenic Rim Regional Council	• Somerset Regional Council • South Burnett Regional Council • Southern Downs Regional Council • Tablelands Regional Council	9
Rural/ Remote	• Balonne Shire Council • Barcaldine Regional Council • Blackall-Tambo Regional Council • Boulia Shire Council • Carpentaria Shire Council • Croydon Shire Council • Diamantina Shire Council	• Flinders Shire Council • Longreach Regional Council • Murweh Shire Council • Paroo Shire Council • Richmond Shire Council • Winton Shire Council	13
South-east Queensland	• Brisbane City Council • Council of the City of Gold Coast • Ipswich City Council • Logan City Council	• Moreton Bay Regional Council • Redland City Council • Sunshine Coast Regional Council • Toowoomba Regional Council	8

Source: Queensland Audit Office

Appendix E—Red flag indicators

Red flag indicators are warning signs that can alert councils to potential fraud. They do not immediately indicate either guilt or innocence. Instead, they may be a lead to early fraud detection. There are two types of red flag indicators:

- Transactional—unusual transactions related to common business activities
- Behavioural—unusual actions or behaviour traits exhibited by people.

Figure E1
Transactional red flag indicators

Transactional red flags
• Transaction occurrence is unusual (too many or few) • Timing of transactions is unusual (time of day, week, month, year or season) • Number of refunds or credit notes issued appears unreasonable • Origin of transaction is unusual (e.g. invoice not usually received from a region/state/country) • Transaction amount is unusual (too high, too low, too alike or too different) • Unusual relationships between persons (related parties, perceived strange relationship between parties, management performing clerical functions) • Excessively high levels of stock based on usage patterns • Stocktakes and stock checks indicate significant discrepancies between what is supposed to be there and what is actually there. Missing assets or consumables • Staff requisition or request for purchases of items not required for their work • Frequent requests for 'emergency purchases' which bypass normal checks because the items are required urgently • Lack of segregation of duties • Missing/unavailable/altered records, files or vouchers • Lack of detailed (or ambiguous) descriptions on documents, or in text fields in databases.

Source: Queensland Audit Office adapted from fraud control plan of a Queensland public sector entity

Figure E2
Behavioural red flag indicators

Behavioural red flags
• Displaying lifestyle changes: expensive cars, jewellery, homes, clothes • Having an exorbitant/excessive lifestyle, having personal circumstances or purchases that don't match with income (e.g. significant gambling or substance addiction may increase the likelihood of committing fraud) • Creditors or collectors appearing at the workplace • Refusing recreation leave, sick leave or promotions—may have a fear of detection • Lack of a strong code of personal ethics • A strong desire to beat the system • Criminal history • Persistent and/or unnecessary taking control of records • Insisting on working unusual or non-standard business hours • Avoiding or delaying provision of documentation when requested by auditors • Making requests for use of other peoples' computer log ins • Resigning immediately prior to audit • Exhibiting excessive secrecy about work being undertaken and/or refusing assistance • Shortcutting internal controls, e.g. bypassing the chain of command.

Source: Queensland Audit Office adapted from fraud control plan of a Queensland public sector entity

Auditor-General Reports to Parliament

Reports tabled in 2014–15

Number	Title	Date tabled in Legislative Assembly
1.	Results of audit: Internal control systems 2013–14	July 2014
2.	Hospital infrastructure projects	October 2014
3.	Emergency department performance reporting	October 2014
4.	Results of audit: State public sector entities for 2013–14	November 2014
5.	Results of audit: Hospital and Health Service entities 2013–14	November 2014
6.	Results of audit: Public non-financial corporations	November 2014
7.	Results of audit: Queensland state government financial statements 2013–14	December 2014
8.	Traveltrain renewal: Sunlander 14	December 2014
9.	2018 Commonwealth Games progress	December 2014
10.	Bushfire prevention and preparedness	December 2014
11.	Maintenance of public schools	March 2015
12.	Oversight of recurrent grants to non-state schools	March 2015
13.	Procurement of youth boot camps	April 2015
14.	Follow up audit: Tourism industry growth and development	May 2015
15.	Results of audit: Education entities 2014	May 2015
16.	Results of audit: Local government entities 2013–14	May 2015
17.	Managing child safety information	May 2015
18.	WorkCover claims	June 2015
19.	Fraud Management in Local Government	June 2015