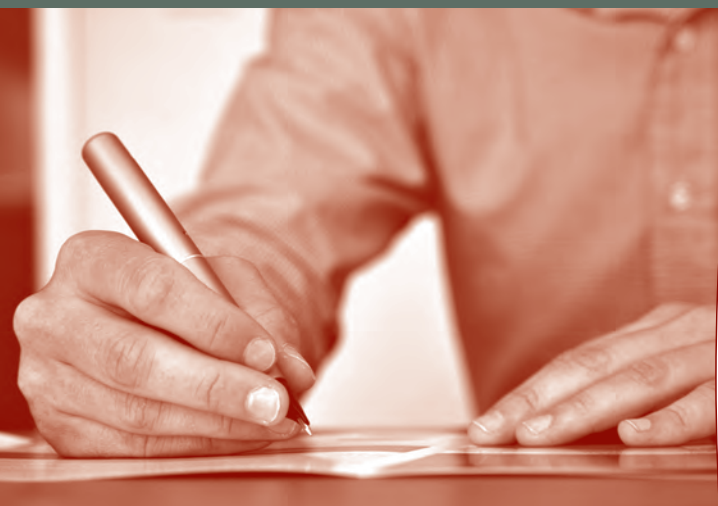


The logo for the Independent Commission Against Corruption (ICAC), featuring the letters 'I·C·A·C' in a stylized, serif font with dots between the letters.

INDEPENDENT COMMISSION
AGAINST CORRUPTION



CORRUPTION RISKS IN NSW GOVERNMENT PROCUREMENT

THE MANAGEMENT CHALLENGE

DECEMBER 2011



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Public sector organisations are welcome to refer to this publication in their own publications. References to and all quotations from this publication must be fully referenced.



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Introduction

How much procurement does your staff carry out? Do you know if what is ordered actually gets delivered? Can you find out? Do you know what tactics suppliers use to get your staff to buy their products?

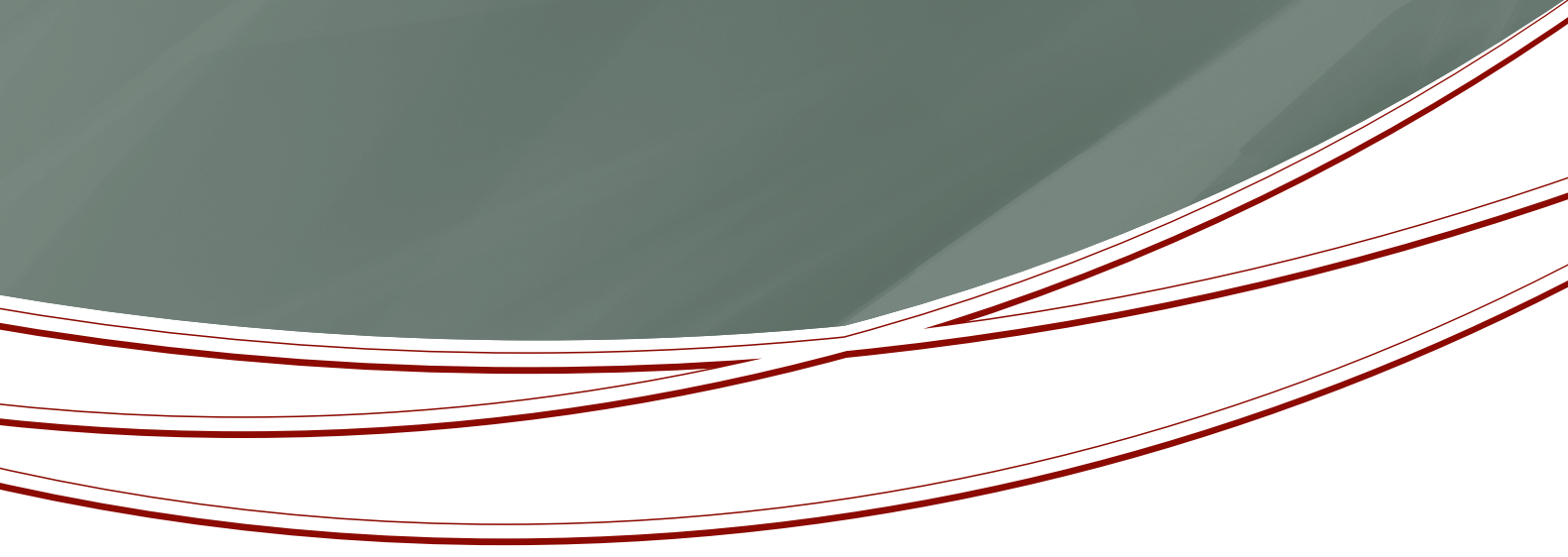
The Independent Commission Against Corruption (“the Commission”) asked public sector managers these questions as part of research¹ for this paper and as part of investigations into corruption in procurement.² At one local council, a manager who was not very enthusiastic about the need to tender or to get quotes was provoked into finding out some answers. He discovered that if he removed all capital works expenditure, his lowest paid employee (the storeman) was responsible for 60% of the value of what the council procured. At another public sector agency, a new manager discovered that it had no procurement policy at all (staff just did whatever the previous incumbent had done) and some procurement was barely touched by corruption controls. A supplier told the Commission that sales representatives were trained to offer small novelty items; the rationale being that people feel psychologically indebted to the sales representative when they accept items and are more likely to buy products.

It has become clear to the Commission that, while many public sector agencies have now put in place policies and procedures about procurement and corruption, procurement remains an activity that is vulnerable to corruption. Each year, approximately 12% of complaints received by the Commission include allegations of corruption in NSW government procurement, and approximately 30% of our public inquiries make findings of corrupt conduct related to NSW government procurement. Almost half of the 1,515 government suppliers that responded to a Commission survey³ reported that they believe corruption in public procurement in NSW is a moderate to major problem.

A key reason procurement remains vulnerable to corruption is that the corruption controls of agencies often do not extend beyond written documents and associated training. These are basic controls that help agencies achieve consistency and quality in procurement by guiding compliance with predictable requirements. The challenge for managers is to maintain control of a situation even when it is unpredictable – and procurement, and certainly corruption, can sometimes be difficult to predict. The Commission has found that public sector managers are not using the many other tools, apart from policies and training, that are available to change and influence staff behaviour in a way that enhances corruption control.

The major purpose of this report, therefore, is to illustrate the variety of tools available to managers to influence the behaviour of their staff and to improve systems. In this sense, the report constitutes a second generation of advice, the first generation being an emphasis on getting policies and procedures right.

The advice in this report is not presented as a list of formal recommendations. The one-size-fits-all approach does not work in the procurement context because managers need to use their own judgment to mix and match compliance controls depending on the unique requirements of their workplace. Prevention is not achieved only through a set of policies, procedures and checks choreographed by a governance group. It involves the very DNA of an agency: that is, the way controls are structured, the design of processes, the normative behaviour and skills of staff, and the management of staff. The report describes a range of approaches to corruption control from which managers can select to meet the unique challenges of their operating environments.



This report is divided into three sections, each focusing on a key pillar of corruption control in procurement:

1. **Strengthening procurement structures** – designing procurement structures that minimise risks for corruption but also enhance efficiency
2. **The process of procurement** – designing procurement processes that also minimise risks and enhance efficiency
3. **The people factor** – managing people and improving their performance.

Throughout the report, case studies of real investigations are used to illustrate weaknesses related to structures, processes and people that allowed corruption in procurement to occur.



Strengthening procurement structures

Structural arrangements have the potential to provide the most powerful controls over procurement. By assigning accountabilities, coordination mechanisms and chains of command, structural arrangements are a key contributor to organisational performance and, by extension, are one of the most powerful levers of corruption control available to managers.

Centralised, decentralised or hybrid?

Structural control is generally greatest where activities, including procurement, are the basis of an agency's divisional arrangements, and where procurement decisions are relatively centralised within such structure.

Where procurement is standardised and predictable, it makes sense to centralise the function. Approaches, such as centralised category management, work best when agencies know what they need to procure in advance. Under these conditions, centralised procurement is usually easier to control and more efficient than decentralised procurement.

A centralised structural arrangement is less efficient when an organisation is procuring under conditions of speed and uncertainty. Rigid, long lines of communication and lack of knowledge of conditions on the ground, especially in large organisations, slow the response and limit the effectiveness of the procurement. Procurement in conditions of uncertainty or urgency is more appropriately decentralised.

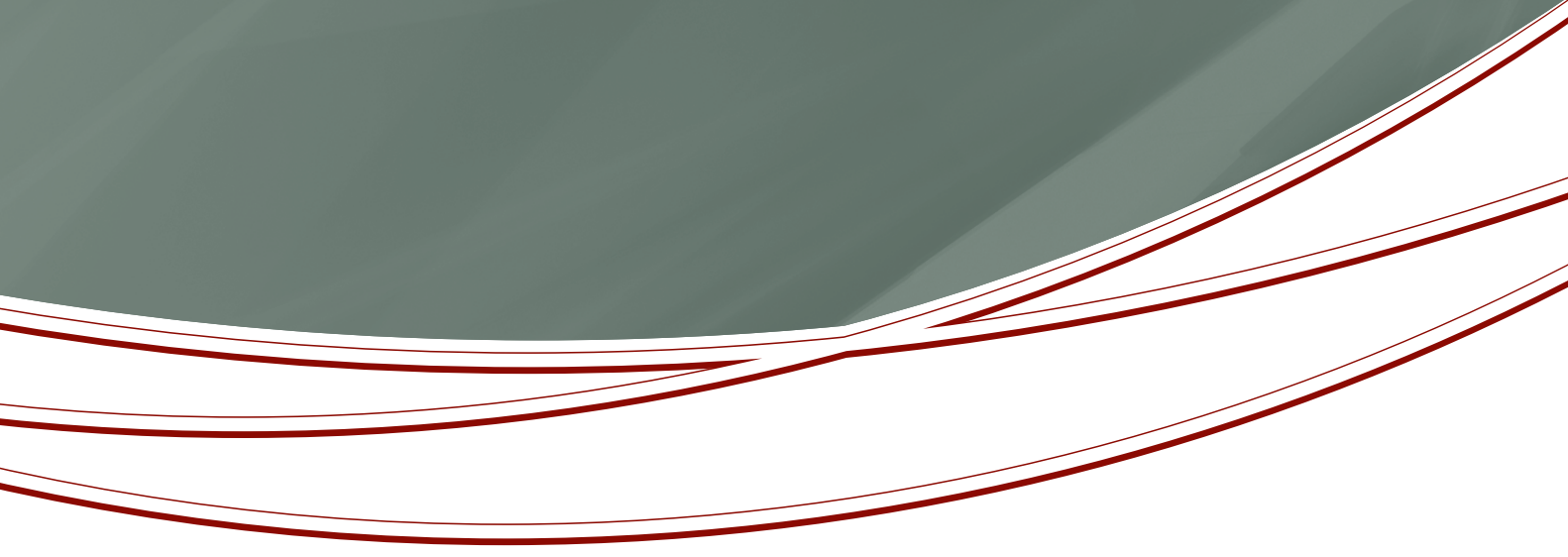
Control becomes much more difficult once an activity is decentralised; expertise levels are generally lower, and the distance between the manager and the procurement is greater. Towards the front line, procurement decisions are often spread horizontally across many positions, making monitoring difficult.

In most cases, decentralisation does not occur within a procurement division because few agencies are structured around activities such as procurement. They are more likely to structure around other areas they need to control, such as geography (with the creation of regional offices) or by the type of function they perform (with the creation of departments such as planning or licensing). If a decision is made to use structural arrangements to control a geographical issue such as regional coordination, then it implicitly is being decided not to use structural arrangements to control an activity such as procurement.

Control of procurement, therefore, becomes more difficult; not only because it is decentralised but also because the structure is not arranged to control procurement. It is under these conditions that the bulk of the procurement corruption investigated by the Commission occurs.

Such an arrangement was exposed by the Commission's investigation of cleaning contracts at a major university. The cleaning manager was responsible for procuring cleaning services, which were contracted out to private providers. In July 2007, the existing cleaner of the vice chancellor's offices became unavailable at short notice, creating an urgent need for a new cleaner. The cleaning manager recognised that this emergency presented an opportunity; she created a request to raise a purchase order for \$12,946 (plus GST) in favour of a company she jointly owned with her ex-husband. She then submitted the requisition to her supervisor, who subsequently approved it. This was the first time her company had ever been used by the university. Between 2007 and 2009, the cleaning manager awarded contracts worth more than \$355,843 to the company. She never disclosed to the university her ownership of the company.

The cleaning manager was able to engage her company because of the way procurement was structured at the university. It had a centralised procurement unit that dealt



with major procurement over \$200,000, including a major contract for university-wide cleaning services. Procurement of major cleaning services over \$200,000 is commonly planned and specified, and was centralised within the structure of the university. Lower-value procurement was devolved. The university routinely contracted smaller companies to provide cleaning services outside of the major contract, partly because it was expected to respond with speed to unexpected events on the ground. This structure was designed to allow the university to procure and control services to internal university customers (such as the vice chancellor).

Once decentralised and out of the influence of an agency's structural arrangements, managing the procurement function relies heavily on the controls described elsewhere in this paper, such as process design, manager competence, procurement expertise, various checks, firewalls, prohibitions on secondary employment and gifts, and staff rotation.

It is a challenge to ensure that these controls of procurement exist and operate effectively when they are not the focus of structural control. Over time, the expertise, reporting lines, measurement, safeguards, coordination mechanisms and accountabilities are likely to become aligned with whatever structure is in place, usually weakening the impact of these controls.

With a need to decentralise the procurement function into operational units that are not structurally arranged around procurement, some agencies are using a hybrid model that reintroduces some structural control into the procurement arrangements.

One NSW public sector agency uses such a model. It has a central procurement unit that "outplaces" staff into operational units where they act as procurement managers for that unit. Procurement is passed up the procurement chain of command for sign off by the director

of procurement, rather than the director of the unit within which the procurement has occurred.

It locates procurement expertise throughout the structure to maximise the agency's procurement capabilities. Such an approach reintroduces a structural control through what is effectively a matrix structural arrangement. The arrangement draws on the procurement expertise of the centrally linked professionals across the operational units. Such arrangements can, however, add a burden of additional staff and coordination costs within operational units. Staff control problems may also occur with such a violation of the principle of unity of command; for example, staff may have one manager for most work and another manager for procurement.

Centralisation is not a realistic solution to all procurement risks.

The degree to which procurement of predictable and standardised items can be centrally controlled may reduce corruption risks. Where urgency or uncertainty require procurement to be decentralised, a matrix approach or conscious emphasis on controls – such as expertise, reporting lines, measurement, safeguards, coordination mechanisms and accountabilities – will remain effective.

Locate clear responsibilities and accountabilities in the structure.

It is not always practical to hire an expert if procurement occurs only occasionally. But even for positions that only occasionally perform procurement, it is useful to set out these responsibilities in position descriptions and performance agreements. This is because (1) the person in the position will understand this is a part of their job, and (2) this will improve an organisation's ability to hold occasional procurers accountable for their procurement.

Designated procurement officers improve consistency.

If procurement is not under line control structurally, an agency will benefit from designating a single position accountable for procurement. The primary purpose of having a designated procurement officer is for that officer to oversee procurement and to be a source of knowledge for other staff. This person will probably also need to do some requisitioning and/or approving, although separation of duties should be maintained. Designated procurement officers can help to control corruption both in agencies that do a lot of procurement and agencies that do very little.

Fragmentation of structures

Procurement controls are weakened when agency accountabilities are fragmented or unclear as a result of either poor organisational design or structural confusion following organisational change. Fragmentation of structures has been featured in many investigations undertaken by the Commission.

In 2009, the Commission investigated corruption in relation to the training provided to the security industry, such as that provided to security guards and nightclub bouncers. In NSW, the training of security industry workers and issuing of certificates of competency when candidates have attained an acceptable level of skills is outsourced to registered training organisations (RTOs). The Commission found that some RTOs had accepted bribes from students in return for providing certificates of competency without proper assessment of their competency. In some cases, students had received certification despite having received only the most rudimentary training or no training at all.

The main reason RTOs were able to carry out this practice was that oversight of this outsourced function was fragmented between two different organisations. Both agencies had some accountability for security industry training but neither was sure whether it was responsible for controlling corruption associated with the outsourcing. This meant that despite a decade of reviews, reports and investigations concerning the corruption risks in security training and certification and widespread noncompliance among RTOs providing security training, neither agency actually took responsibility for doing something about these problems.

In other investigations, the Commission found that corrupt individuals took advantage of structures that were characterised by multiple lines of authority and multiple points of accountability. Such structures are usually put together to ensure an inclusive approach of all interested parties. For example, oversight of IT

procurement is structured so it involves IT managers and end user managers, giving the person responsible for the procurement two lines of authority. A common way corruption occurs in such structures is for the corrupt individual to seek sign off for a corrupt procurement decision from different managers in the structure. This strategy for corruption is successful when no single manager is fully aware of the subordinate's activities, usually because he or she assumes that some other manager knows what the employee is doing.

Superficial changes are unlikely to improve structure.

If lines of authority and location of accountabilities in an organisational structure are unclear, compensating with committees, complex procedures, coordinating groups, and so on will generally produce a second-best solution to both corruption control and efficiency. A redesign of the structure may be required.

Corrupt individuals often deliberately seek out managers known to be lax or managers with authority but little knowledge to sign paperwork associated with corrupt payments. In 2008, the Commission investigated allegations of corrupt conduct involving two project managers at a public agency, which had many premises and offices located throughout NSW, and the tendering and payments for the building, repair and renovation of these properties. The investigation was primarily concerned with the conduct of these two individuals, who were recruited and contracted by the public sector agency via a recruitment agency.

As project managers, they were responsible for carrying out building projects for the agency within an allocated budget. Between September 2005 and early 2007, they manipulated the contract selection process in relation to 39 projects worth \$6 million. The project managers ensured that contracts were awarded to eight companies controlled by one of them. The work was actually carried out by subcontractors arranged by the project managers (the subcontractors were unaware of the corruption).

The project managers could not directly authorise the awarding of contracts. They were supposed to make a recommendation to their manager, who then signed off on the recommendation. In practice, they got four different managers (including their immediate supervisor) to sign off on their recommendations in relation to selected tenderers or progress payments. The managers all knew that other managers also occasionally signed off on tenders or progress payments. Being able to "signature shop" for a manager made it easier for the project managers to conceal their activities because no one was quite sure which manager was checking that

a contract or a progress payment was correct. Apart from questioning the project managers, none of these managers conducted any objective checks on any aspects of their recommendations before authorising them.

Clear procurement reporting lines. Blurred reporting lines and multiple accountabilities for the same approvals allow for signature shopping. By limiting procurement approvals to a single or small number of roles, the opportunity to split orders or favour certain suppliers is reduced as a small number of accountable managers are aware of all the procurement being undertaken by any one individual.



The process of procurement

The design and management of the process of procurement is the second pillar of corruption control. Procurement processes work in conjunction with the expertise and motivation of staff, and structural arrangements of the organisation, to reduce corruption risks and enhance efficiency and effectiveness of the entire procurement system.

This section focuses on the three key challenges for managers relating to procurement processes: (1) designing a process that both reduces opportunities for corruption and enhances efficiency, (2) limiting staff noncompliance with the process that is in place, and (3) controlling out-of-process procurement.

Reducing opportunities for corruption in the process

In theory, the most efficient and effective approach to procurement is to assign high levels of discretion to a single public official who is responsible for taking procurement through the entire process. Supplier and customer knowledge within the public agency exists at a single point – the public official – with internal coordination costs and double-handling reduced to a minimum.

In practice, this level of discretion introduces unacceptable risk into most procurement activities. For those designing the procurement process, the goal is to find methods of reducing risk to an acceptable level without seriously damaging efficiency and effectiveness through loss of flexibility and responsiveness or inefficient hand-offs and doubling up.

One method of understanding process and the vulnerabilities created by discretion is to map the procurement process. Rather than being designed, in many organisations the processes have evolved over time, as issues occur and in response to need. The steps,

complexities and alternate process paths are often “hidden” in position descriptions, multiple policies and organisation charts. Process maps are less about what a policy states but more a map of the actual process that staff follow.

Such process mapping helps control risks to an acceptable level, with minimum loss of efficiency and effectiveness through unnecessary controls. If complexities and unnecessary safeguards are identified, the overall system performance may improve. With the process laid out clearly, supervision can be tightened and out-of-process procurement reduced.

Process maps

A process map is a useful tool for quickly showing where a person has control over an entire process (what is usually called end-to-end control) or control over two points in the process that could allow corrupt behaviour, such as ordering and verifying delivery. Such maps may also identify single points where high levels of discretion could be misused, such as collecting quotes and selecting a supplier.

Standard sets of symbols represent a start or end point, a step in the process, a decision point, a document, and a sub-process, which are then connected using lines with arrows to demonstrate the direction the process flows (see Box 1). The benefit of mapping out a process is that it sets out each step involved in the policy or procedure and allows close analysis of each step to identify those underlying causes or loopholes that may allow corruption to occur.

Development of process maps generally involves a team discussion. An individual, such as a technical expert working in isolation, rarely understands practices on the ground. Creating a map with team involvement leads to a more accurate representation of the process as it is understood and as it works in practice, and a more open discussion and criticism of the process.

Process mapping was established in the corporate world following several corruption scandals in the US in the late 1990s and early 2000s. In 2002, the US government introduced the *Sarbanes-Oxley Act 2002*, which requires key compliance processes to be documented, as well as documentary proof as to whether staff are complying with those processes. One idea behind this requirement is that staff are more likely to follow processes when they are mapped, rather than reading through lengthy policy documents.

Such maps are not ends in themselves. They are an analytical tool to identify corruption risks, as well as to improve business practices. In terms of corruption risks, they can show the following:

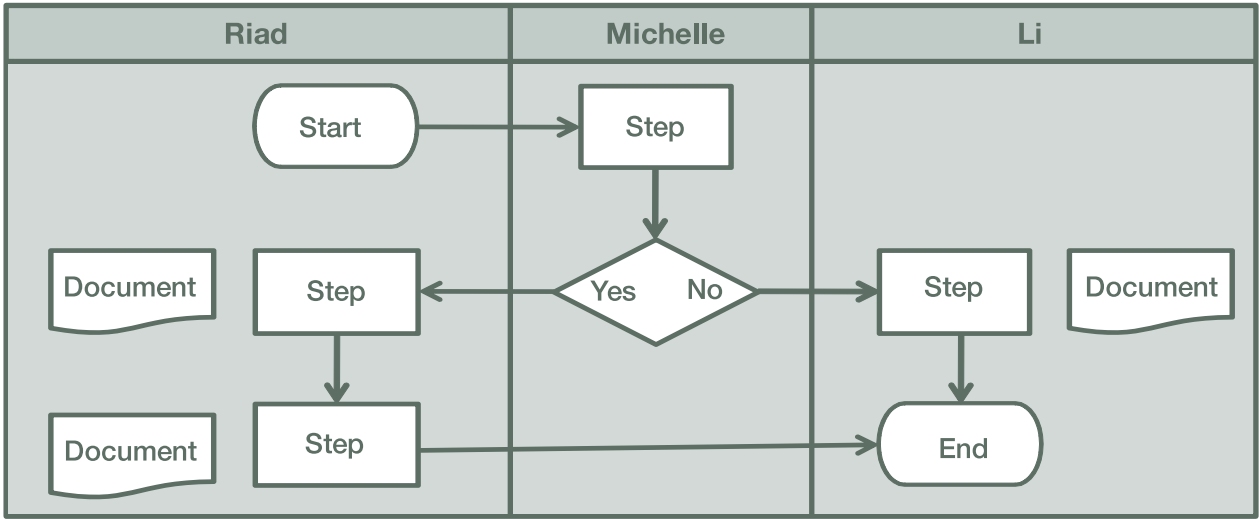
- flaws in a process
- points where policy diverges from practice or where work-arounds (that is, where staff work around the process and safeguards in place) have been instigated

- points where decision-making is unchecked or concentrated with one person
- occasions where there are very few handover points and therefore end-to-end control might be a factor.

The best process maps for corruption control purposes show which staff members are involved in each step. Knowing who is responsible for each step or decision is crucial, as opportunities for corrupt conduct often emerge when one person has control of two points of a process that create a conflict. To reduce the opportunity for corrupt conduct, the points of potential conflict must be separated. For example, when a single person controls both ordering and verification of delivery for a certain product, this creates a risk of both over-ordering and under-delivery.

For the purposes of corruption control in procurement, a robust corruption risk assessment cannot be undertaken

Box 1: Example of a basic deployment process map



until the procurement process has been fully mapped and understood. A detailed process map can depict the steps that should be followed according to an agency's policy, and identify points where policy diverges from practice or where work-arounds have been instigated.

Process maps can also examine points where a new person or team becomes involved in a process, and where the previous person or team dealing with the process comes to the end of their role. These points of handover are particularly prone to error and confusion that can be deliberately manipulated by a person intent on corruption; for example, confusion around who, precisely, assumes responsibility and when. Process maps can, therefore, indicate where there are few handover points (indicating that end-to-end control might be a factor) and where the hand-off is verbal rather than based on a document (indicating reduced accountability and transparency).

Process maps reveal weaknesses, such as:

- **Conflicts of duty.** When the people who perform functions are added to a process map, this immediately reveals if there is an individual (or more than one) who has a conflict of duty. In the case of procurement, this includes whether this person has end-to-end control, or control over two or more points in the process that, for the purposes of corruption control, are best controlled by separate individuals.
- **Points where undeclared external associations pose greatest risk.** Undeclared external interests will create opportunities for corruption at some points in the process that contain discretion, but not at other points. A process map allows the discretion at any point to be compared with a reasonable, potential external interest to determine whether the discretion creates an opportunity to behave corruptly. In fields such as IT contracting and construction, for example, it might be reasonable to assume a staff member has friends in the industry, may even own a supplier, or is looking for future employment with a supplier. If this is a reasonable assumption, then discretion at a point of the process that influences allocation of work to suppliers may be considered too risky.
- **If no one is in charge.** Process maps can also help identify if anyone is accountable for making sure the entire process functions properly. Managers can use a map to identify what would happen if there was a problem with a process; for example, who would notice that there was a problem and who should be alerted.

- **If more than one person is in charge.** When two or more people are able to authorise a decision ambiguity about authority and variation in decision-making can be created that corrupt persons may be able to exploit.

- **Who is *not* involved in a process.** Key senior executives and managers are sometimes not aware that there is no senior input into decisions about procurement (although employees are usually fully aware of this). A process map helps identify those senior managers who are not involved in decision-making, but possibly should be. This includes whether there is no senior manager checking the person actually making the decisions.

Teams that perform the process draw the best process maps. Process maps are most accurate (that is, truly reflect actual process) when they are developed by a team of people made up of those who actually perform the process, and not a technical expert who does not use the process.

Process mapping exposes confusion. Analysing the mapping process can quickly demonstrate whether a process is well understood. For example, if those drawing the process map are unclear about who performs a particular role, this shows there is a weakness in how the process is being communicated.

Process maps help strengthen accountability. A thorough process map indicates what documents and other paperwork are required at each decision-making point in a process. If no paperwork is required, this indicates that managers' accountability is weakened because they cannot demonstrate through records the basis on which they made a decision. A process map can also show if the paperwork is ever double-checked by management, either on a routine or random basis, demonstrating whether monitoring is occurring.

Discretion

The design of a procurement process has to allow for discretion because all managers and staff require some discretion to perform their jobs. But the process also needs to minimise risks for corruption created by this discretion.

Discretion is typically controlled in two main ways. First, by creating limits on discretion at any point in the process, often through financial delegations, which permit a manager (or employee) to authorise the expenditure of public money. Ideally, financial delegations are only allocated to staff with

sound judgment and knowledge about an organisation's procurement needs. Delegations are then capped at a certain financial level, allowing more senior staff to authorise the expenditure of larger sums of public money.

An investigation conducted by the Commission focused on the sale between 1999 and 2005 of surplus public buildings by a property sales manager in a large NSW public sector agency. One of the sales manager's responsibilities was to maximise the value of property sales for the government.

The sales manager had almost total discretion over the sales process. Although certain critical decisions had to be approved by his superiors, he had authority to make most key decisions. These included appointing a valuer and agent for properties identified for disposal, recommending and organising any necessary repairs prior to sale, overseeing the marketing of properties, assessing any offers made for the purchase of properties, accepting, rejecting or recommending the acceptance of any such offers, and maintaining files and databases.

The sales manager colluded with two real estate agents to sell them 10 properties at a deliberately undervalued price. A short time later, the real estate agents resold the properties to companies that were controlled by friends of the sales manager or by the real estate agent himself. The total resale value of the 10 properties was \$608,900 more than the amount the real estate agents had paid the government. The sales manager received a share of these profits, and one of the real estate agents also gave him two paid interstate holidays.

Discretion can create particular risks for some types of procurement, including:

- low value-high volume transactions
- restricted tenders
- tenders involving negotiations post-tender
- maintenance
- disposal of surplus goods
- ICT hardware and consultants
- procurements promoted by elected councillors, with little input by council staff
- procurements that have been in place for a long time
- "pet projects", which result in discretion being concentrated in the hands of a single individual.

In all of these situations management interest and attention is often low. These types of procurement are seen as mundane, low status, someone else's pet project, or in the case of IT, too hard for most managers to understand. One way this lack of management interest exhibits itself is

through the evolution of high levels of discretion in these tasks. As long as there are no problems, managers can spend their time on other matters.

Limiting financial delegations contains potential damage of corrupt or incompetent behaviour.

Limiting financial delegations until managers have achieved a certain competence can help reduce corruption risks. If limitations are not possible because certain operations would be adversely affected, regularly check managers exercise of delegations until competence is assured. Later, these checks can be replaced by random checks and regular audits.

Segregating duties helps control discretion.

Segregating duties is a tried-and-tested control for reducing risks of corruption associated with individuals having discretion over the procurement process. Segregation comes at a cost of increased handoffs and coordination costs, and loss of expertise, and the individual employee can lose sight of the bigger picture. Separating every point of potential conflict in a process may create an unacceptable burden but analysis of the process can identify points of such high risk that segregation is necessary. Analysis of process can also identify other points of conflict that may more efficiently be dealt with through checks by managers or random audits. In cases where the corruption risks of an employee being involved in different points of conflict are low, monitoring an employee's involvement at different points might be more cost effective than total segregation of duties.

Managers benefit from knowing who has discretion.

Some managers are not aware of how much discretion their staff have and, therefore, are not aware of the opportunities for corruption that exist. Lack of awareness may be caused by managers not approving procurements or not paying attention when they approve them, spending little time on a day-to-day basis with the employee, never having carried out the task themselves or inheriting the situation when they take on the job. Identifying the size and scope of discretion available to individuals in key roles allows risk to be more accurately assessed.

Discretion within the process

Even with an efficient and controlled process that separates points of conflict (that is, eliminates end-to-end control) and uses discretion carefully, some individuals will still find opportunities for misconduct. A second protection that a process can offer is minimisation of opportunities for corruption by tightening the parameters within which the process can move. Accurate identification of needs, price determination and verification of delivery can improve value for money and, like delegation limits, can contain the size of the damage resulting from misconduct.

Determining need

Determining what goods and services an agency actually requires is the first step of procurement. For many managers being satisfied that a proposed purchase is meeting an organisational need can be challenging. For example, an IT recommendation that without a certain update the computer system will cease to perform adequately is a difficult need to verify for a non-specialist manager. It can be similarly difficult for non-specialist managers to verify the need for a building structure upgrade or for additional counsellors in a remote area. An agency may know it has a problem but not what is needed to solve it, and this gives considerable power to contractors, consultants and sales staff to determine need. If one person has a major say in what an agency needs to buy, this person can make sure that what is “needed” are goods or services supplied by a mate or a family company.

In other cases, the supplier determines the need, not the agency. A contracted maintenance firm, for example, that finds and fixes problems in buildings, such as replacing light bulbs or clearing overgrown areas, is also determining the need for the service that generates profit for the maintenance firm.

The scope for corruption in how need is determined is significant. If corruption at the “needs determination” stage is not detected, the rest of the procurement can follow proper process and appear compliant when, in fact, the whole process has been corrupted from the start.

An example from Victoria illustrates how needs determination can be manipulated for corrupt purposes. In 2011, the Victorian Ombudsman investigated a project officer in Arts Victoria who was responsible for ordering toner cartridges. Over four years, she purchased 129 toner cartridges, including 24 black toner cartridges for one particular printer, which was enough to last 40 years (as the life of a toner cartridge is only two years, almost all of these cartridges were going to expire before they could be used). The project officer also split orders to prevent the order

going to someone with higher financial delegation who might question the order. She did this to obtain gift cards that were given by the supplier to individuals who placed orders with them. In total, she received gift cards worth \$8,300. The project officer caused Arts Victoria to spend \$80,773 more on toner cartridges than it needed to.

In 2006, the Commission investigated the procurement of traffic management services by a manager at a large infrastructure agency. Amongst other tasks, the manager was in charge of procuring, managing and monitoring the delivery of “tidal flow” traffic services, that is, the changing and delineating of vehicle lanes on key roads and bridges around Sydney so that more lanes are available for dominant flow direction during peak hours. He also had the authority to order and purchase new traffic “candy bars” (plastic, orange poles sometimes used to delineate traffic lanes).

The manager procured tidal flow services worth \$214,000 from a company owned by his friend. The Commission found that the manager’s awarding of tidal flow contracts and continuation of payments for one of the tidal flow sites occurred long after work had ceased at that site. Similarly, the manager procured new candy bars worth \$92,000 from his friend, but these candy bars were never delivered and did not exist, demonstrating that they were never needed in the first place.

Price discovery

Like determining need, determining what price an agency should pay for goods and services is essential to obtaining good value for money from procurement. Where price is not well known, there is a risk of both poor value for money as well as a risk that corrupt overcharging cannot be detected. Determining price also has specific risks for corruption. The obvious risk is that an agency will pay too much for something. While it is in a supplier’s interests to maximise the price they get paid for a good or a service, collusion between a public official and a supplier over price, collusion between suppliers to raise prices, and the release of confidential pricing information by a public official to a supplier so it can adjust its price, are corrupt practices that can result in inflated prices being paid.

Inaccurate price determination contributed to the corruption in the building maintenance and renovation case described earlier, in which two project managers for a NSW public sector agency allocated capital works contracts worth \$6 million to companies they controlled. Soon after commencing work at the agency, they realised that its budgets had been inflated far beyond reasonable costs because of management’s ignorance about the market price of capital works projects. Of the \$6 million paid for

39 projects, the project managers used \$3.6 million to pay subcontractors and kept the remaining \$2.4 million for themselves.

The project managers' immediate manager gave evidence that he took no proactive steps to verify any aspects of their work, including their recommended prices for capital works contracts. The manager told the Commission he was unable to think of anything he did to supervise them that did not rely on their word or on trust.

Budget details help verify accuracy. It is reasonable for managers to insist on seeing the detail of how price estimates were obtained before signing off on budgets.

Verification of price can indicate performance. Agencies can usefully apply performance indicators related to price to both procurement staff and their managers. Indicators could include reducing costs or accuracy in budget forecasting or expenditure.

Separate contingency funds from normal expenditure. Keeping contingency funds separate from normal operating expenditure and capital expenditure makes it easier to establish when additional funding has been required to complete a job. The use of these funds could automatically trigger a review, helping to bring scrutiny to their use.

Determining both price and need is particularly difficult for public agencies when markets are uncompetitive. Competitive markets allow public sector agencies to compare different products and prices, ultimately ensuring better value for money is obtained. Competitive markets are characterised by the availability of multiple, similar products, buyers and sellers having access to the same information, the presence of many buyers and sellers, and few costs associated with doing business (that is, other than the cost of the product itself, buyers and sellers do not have to pay much to actually compete in the market or to conduct transactions).

When markets do not have these characteristics, identifying a reasonable product and/or price is increasingly difficult, and the transaction costs of determining price increase. Procuring a product without properly researching the market – especially when a market is weak – results in the public sector agency knowing much less about the product than the supplier. The supplier will have far more knowledge of the technical details and cost, creating opportunities for collusion between suppliers or with a corrupt public official.

Weak markets are a particular problem outside metropolitan areas, especially for some rural councils. For example, while services such as office supplies or cleaning are widely found throughout NSW, there may be limited availability of refrigeration mechanics or computer programmers in remote areas.

There are several flags that can reveal a market is weak:

- a low number of bids is received in response to an open tender
- no tenders offer acceptable value for money
- no tenders conform to minimum requirements
- tender responses demonstrate a general lack of supplier capacity
- only one service provider has the required capability and experience
- only one supplier holds the required patent, copyright or proprietary information
- no single supplier has the capacity to deliver the full service.

Weaker markets create opportunities for a public official and a supplier, or a small number of suppliers, to collude over price. For example, the public official, knowing that the manager authorising the procurement will find it difficult to establish what should be a reasonable price, agrees that a supplier will charge a high price and then receives a kickback.

Methods of determining price in a weak market.

Price determination becomes increasingly expensive as the market becomes weaker. Simply “going to market” is not an adequate method of determining price in some cases. Agencies can compensate for a weak market by:

- developing an internal quote against which to measure the prices tendered by a sole supplier by identifying how much it would cost the agency itself to provide the services or build the structure
- using independent experts to determine price
- requiring sole suppliers to conduct an “open book” regime where there is transparency around the suppliers’ costs and profits
- creating a “shadow operator” where the agency goes through the motions of providing the service or building a facility to gain an understanding of costs and problems.

These options can be expensive, but may be required only in circumstances assessed as risky.

Experts can reduce the risks by determining need and price.

An agency can reduce the risk for corruption, and increase the effectiveness of procurement, if it uses specialist procurement staff, especially when markets are uncompetitive. Specialist staff can research and advise on what products are needed, how much they should cost, and whether a competitive market actually exists or not.

Decide what needs to be purchased and what can be produced internally.

If a strong market does not exist, in some cases, an agency may decide that the best option – given both the risks and the costs – is to produce the good or service in-house. This will probably not be feasible for one-off procurements or complex goods and services, but it may be feasible for some ongoing services.

Alternatively, outsourcing more of the process may shift procurement to a point where the market is more favourable. In the provision of transport services, rather than procure at a point in the delivery process where there are large numbers of transactions in weak markets, Victoria has outsourced larger portions of operations allowing controlled negotiation with a smaller number of large suppliers.

Verifying delivery

The Commission has conducted several investigations where public sector agencies paid hundreds of thousands of dollars for goods and services that were not delivered or were under-delivered. In the Commission's experience, corruption risks around verification of delivery is a perennial issue. There are also specific risks around verification of delivery when a function is outsourced.

One investigation conducted by the Commission focused on a fraud committed by a supplier in collaboration with the storeman at a large regional council (both men are now serving gaol sentences for their role in the fraud). The investigation exposed how, in return for gifts and payments of cash from the supplier, the storeman placed fraudulent orders for consumable items that were never actually delivered. It also exposed how the storeman evaded detection. Through these orders, the council was defrauded at least \$757,000.

This corrupt scheme was not detected earlier because no one other than the storeman was responsible for monitoring delivery of the items involved and, therefore, no one noticed that the council store contained less stock than it should. The council conducted stocktakes, but the storeman participated in this process and misled the rest of the stocktake team about the actual levels of stock. The

storeman knew that delivery of stores was not monitored and took advantage of this situation.

If a supplier providing a good or service has a strong track record in delivering the desired quality on time, fewer controls on delivery are required. If a supplier does not have an established track record, or if there are particular opportunities for non-delivery or under-delivery due to geographic distance or difficulty ascertaining delivery, then managers need to take action to verify delivery.

Independent assessment reduces risk of under-delivery.

By randomly or continuously reviewing and evaluating delivery of goods and services, managers can reassure themselves that their organisation is obtaining what it paid for. The fact that checks are carried out can also be a deterrent to corrupt conduct.

Verifying delivery to an agreed standard is particularly challenging in the case of outsourced services. The risks for corruption in outsourcing were highlighted in the 2009 Commission investigation into security industry workers, and in its 2004 investigation into outsourced assessors employed by a regulatory agency to assess the competency of operators of certain heavy plant and equipment.

Following the introduction of new legislation in 1996, the regulatory agency (in the latter investigation) introduced a system of certifying operators of heavy plant and equipment. Under this new system, the role of testing applicants and the issuing of notices of satisfactory assessment to operators of machinery was outsourced.

The investigation conducted by the Commission found that six assessors issued tens of thousands of notices of satisfactory assessment to plant and equipment operators without having properly conducted the specified assessment procedures. In some cases, newly assessed operators were provided with notices of satisfactory assessment without any testing at all of their actual competence in operating the specified equipment. Assessors received bribes from candidate operators in return for issuing these notices. One assessor received an estimated \$470,000 in bribes over a seven-year period, and another received \$1.2 million in bribes over an eight-year period.

The Commission identified a number of factors that should have alerted the regulatory agency to the extensive risks in outsourced assessment. First, there is a strong and profitable market for the provision of competency assessments in the building and construction sector. Second, certificates of competency are a valuable commodity, issued for life, and valid in other states. Finally, the outsourced nature of the function contained inherently weak centralised controls over assessors' activities.

Prior to the Commission's investigation, the regulatory agency relied almost exclusively on its audit program to ensure compliance by assessors. The audits included an audit of the assessor's records (records audit) and observation of the assessor's conduct of assessments (performance audit). These audits were always held at prearranged times known to the assessors. A compliance audit was also occasionally conducted to check that an assessor had implemented any recommendations for improvements contained in a previous performance or records audit. These audits failed to detect nearly all of the corrupt conduct exposed by the Commission's investigation. In terms of quality control, there were no mechanisms in place to measure assessment outcomes and validate the claims of competency made by the assessors through notices of satisfactory assessment.

As is clear from the example of the regulatory agency and outsourced assessors, outsourcing a function does not make the corruption risks disappear. In fact, additional risks can be created. Regulatory "capture", where inspectors or regulators come to identify with the individuals and organisations they are supposed to regulate, can become an issue when agencies outsource a function continuously and become reliant on one or few suppliers because payment is linked to performance. Third-party providers (unlike public agencies) also have a specific financial incentive to cover up noncompliance (that is, cover-ups by the contractor of poor performance or poor handling of complaints and mistakes) or falsification of records such as performance data.

Following the Commission's investigation, the regulatory agency separated its audit and investigation roles and functions to allow for specialisation and to better ensure objectivity (that is, to avoid situations where auditors investigate cases involving their own audits). It also developed indicators of fraud and corruption to help with detection; for example, identical answers, handwriting and spelling mistakes on assessment exams, an applicant getting multiple notices of assessment on the same day, and assessors issuing large numbers of assessments on one day.

Outsourcing can create risks for corrupt under-delivery. The corruption risks created by outsourcing mean that auditing and monitoring of delivery and quality of a function may require *more* resources. This is because reviewing a third party's actions is often more difficult and, therefore, more expensive than reviewing the actions of public officials. It is the nature of transaction costs in difficult-to-monitor contracts.

Specify both quality and quantity. Verifying delivery can be difficult when a function is outsourced, especially for services that are hard to quantify, such as client well-being (for example, the health of inmates) or customer satisfaction (for example, easy to follow application processes for a service). Clauses in contracts that specify performance indicators and what records the company must create and provide to the public agency can be helpful in this regard. On the ground, independent assessors of quality may be needed.

Monitor the desired deliverable, not the process. In the case of the regulatory agency and the outsourced assessors, the organisation audited and monitored the assessors, but did not put resources into finding out whether the individuals who were assessed as competent were, actually, competent. If the agency had done this for individuals assessed by the corrupt assessors, it would have quickly discovered that many were incompetent, which would have indicated there was a problem with assessment and certification. To address this issue, the agency subsequently revised its audit program to focus on certification outcomes and commenced random re-testing of applicants to verify competency standards.

Controlling out-of-process procurement

Corruption can occur when staff are able to undertake procurement outside of the core process. This occurs most commonly as a result of a real or manufactured emergency, in negotiations and variations, or where there are opportunities to find alternate pathways or work-arounds in complex or inappropriately designed processes. Such corruption can also occur in outsourcing, whereby what is ostensibly a public function is transferred to a private company or a non-profit organisation to deliver.

Emergencies

Managers and procurement officials are in a difficult position when asked to organise procurement against short timeframes, especially if they have little information available to them. If they delay procurement, they can worsen an already urgent situation; if they do not ask questions, they can waste money on something that was never really urgent. Reporting any emergency procurement promptly to senior managers will ensure officials have authorisation to proceed. Testing (if possible) the proposed cost of the emergency procurement against existing service prices will indicate what the additional cost will be to the

agency. Experienced procurement managers will already have a good instinct for the latter.

While genuine emergencies sometimes occur, the Commission has found that corrupt persons sometimes use the excuse of an emergency or urgent timeframes as a ruse to get a manager to sign off on a procurement that is improper, outside of normal process or otherwise unusual. Sales staff understand this weakness in controls, and may create an emergency through a very short, time-limited offer or other sales technique designed to create an out-of-process procurement.

Such an emergency occurred in the case involving the cleaning manager at a major university, who awarded cleaning contracts to a company she owned with her ex-husband. As noted earlier, in July 2007, the existing cleaner of the vice chancellor's offices became unavailable at short notice, creating an urgent need for a new cleaner. The cleaning manager recognised that this "emergency" presented an opportunity and engaged her company to perform the work. It is likely that, from her supervisor's perspective, she appeared to be solving a problem. In fact, she was exploiting an opportunity created by the emergency. Having established her company as a university supplier, the cleaning manager went on to direct an additional 18 requests for cleaning services to the company.

As illustrated by this case, claims of urgency increase the risk of noncompliance with established procurement processes. Sometimes short or urgent timeframes for procurement are unavoidable, such as when a natural disaster occurs and the government has to procure goods or services as part of its emergency response. However, even if an emergency is genuine, the short timeframe within which procurement has to occur creates opportunities for corruption.

Unnecessarily short timeframes may arise for a number of reasons, including:

- unrealistic deadlines imposed for reasons of political expediency (for example, by CEOs or ministers)
- end-of-financial year pressures to spend money (as not spending it would mean that the money is returned to Treasury)
- agencies not being sufficiently organised to allow enough advance preparation time to meet a deadline.

The problem created by short timeframes is that pressure is put on public officials to make a quick decision. Urgency can make it easier for public officials to justify partiality ("I needed a supplier urgently, so went with someone I knew instead of getting quotes") and to disguise partiality ("No records were made because we didn't have time").

Suppliers may also overcharge or under-supply when there is a tight delivery timeframe as they know fewer questions will be asked.

Advance planning reduces frequency and associated risks of short timeframes.

A comprehensive risk management strategy for procurement can help avoid unplanned procurement, including reducing the likelihood that it will be required. The strategy can stipulate the time period during which a service is, or is not, considered to constitute emergency procurement, in order to assist managers in deciding what course of action to take. When urgent work is required often, establishing a panel of contractors able to supply goods or services within an agreed price range in such circumstances can reduce the risk of (1) overcharging, including as a result of collusion, and (2) public officials improperly allocating work to favoured suppliers.

Limit sales related to the emergency. An emergency is an opportunity to undertake procurement outside of the normal process. A danger is that this procurement then enters the normal process and contracts are rolled over as part of the normal process. This was the case in the corruption that occurred as a result of the university's emergency cleaning contracts, when a company never previously used was allowed into the system through an emergency, and then continued to receive non-emergency work. As a general rule, an emergency arrangement should be terminated as quickly as possible, and subsequent, ongoing procurement conducted through the normal process.

Records assist accountability. Creating records as soon as practicable during or after an emergency provides an ability to check what has happened and to control extensions of arrangements going forward. Limits on follow-on sales and sales during the contract period following an emergency can be best enforced and scrutinised if they are written down. Records also allow agencies to audit procurement decisions following an emergency.

Use reviews and audits to detect and learn from mistakes. Managers and internal audit units of agencies have a role to ensure procurement against short timeframes does not get out of hand. They can review emergency procurements after the fact and ensure that staff requesting such procurements know that these reviews will occur. Including emergency procurement on audit plans also sends a message to staff that they will be held accountable for the decisions they make.

Direct negotiations

Discussions between public officials and suppliers about a good or service that is to be procured can be described as direct negotiations. The purpose of these discussions is often to determine price, although at other times it is to decide whether a contract should be extended or whether the product supplied needs to be changed. While the term direct negotiations is sometimes used to refer only to an organisation communicating with a sole supplier, in this report it is also used to refer to negotiations with one or more suppliers regarding the awarding, variation or extension of contracts, or an invitation to tender in the first instance.

Direct negotiations can be an effective method to buy something different or at a better price. As direct negotiations contain risks for corruption, using some sort of test as to whether they are warranted can be helpful.

Reasons why direct negotiations may be required include:

- the supplier is an important source of information about industry changes
- the supplier has a monopoly on a product
- intellectual property rights form a necessary part of the project
- negotiations need to occur over a particular parcel of land or other real property
- the government is involved in a joint venture with a single partner
- the government has to deal with an existing facility or product
- discussions are required to clarify specifications.

Direct negotiations are inherently out-of-process in that they involve negotiations between individuals. When poorly managed, they give a public official undertaking negotiations the opportunity to make improper extensions or variations, with few incentives to stick to a lower price or narrower scope. The fact that negotiations are occurring may indicate that an agency does not have adequate market intelligence, does not assess need accurately or does not determine price independently, indicating these factors have not played a role in the process up to this point.

Corruption that occurs in direct negotiations might involve the public official agreeing to give the supplier additional work in the hope of a kickback, splitting an excessive profit margin or obtaining work for a favoured subcontractor.

In 2009, the Commission investigated allegations that a civil engineer for a large infrastructure agency improperly arranged for a contractor to the agency to subcontract

work to a certain engineering firm. The contractor was a specialist fencing contractor and engaged by the agency to erect palisade fencing. The subcontracted engineering firm was owned by a friend of the civil engineer.

At one location, the agency determined that some roadworks were also required around the property that was being fenced. The civil engineer directed the fencing contractor to organise the completion of the necessary roadworks. The contractor told the Commission that he was concerned about this, as he had no experience in performing roadworks and would have preferred that the agency organise this work. As such, he asked the civil engineer if he knew anyone who could do the work. He suggested the engineering firm owned by his friend. The civil engineer sent cost and scope information to his friend, who used this as the basis for a quote of \$153,300, which he submitted to the contractor.

The contractor eventually invoiced the agency for \$185,930 (inclusive of GST) for the additional roadworks, which included \$153,300 for the engineering firm plus a 10% profit margin of \$15,330 for the contractor – a substantial profit for the contractor and an amount that the agency would have saved had it put the works out to tender. The agency's threshold at the time to go to a public tender was \$100,000, and this is what should have happened with the roadworks. Instead, the agency allowed the civil engineer to directly negotiate with a contractor about scope, which resulted in the inclusion of roadworks into what should have been only a fencing contract. While the civil engineer's manager did some research to establish whether the quoted price for the roadworks was reasonable, his negotiations with the contractor were never scrutinised, controlled or otherwise scripted by his manager or procurement professionals.

The Commission's publication, *Direct negotiations: guidelines for managing risks in direct negotiations* (2006), contains advice on how to conduct direct negotiations in a way that minimises risks for corruption. However, ensuring accountability, transparency and establishing records that allow proper evaluation to occur, are also important for managing risks for corruption.

Two negotiators are sometimes better than one.

One-on-one negotiations between an officer and a supplier are a very high corruption risk. The attendance of a second officer, chosen by the manager rather than the lead negotiator, greatly limits the scope for secret arrangements being made.

Requiring authority to negotiate improves

agency control. An agency reduces the incidence of unauthorised contract variations and extensions when it makes it clear to employees and suppliers that negotiations are allowed only when explicitly approved in writing and that any unauthorised negotiations will be non-binding.

Limits on scale and scope of negotiations contain the size of potential damage.

Setting clear, agreed limits around what can be negotiated is a check on the discretion of the negotiating public official. If significant changes in price or specifications are mooted during negotiations, a new tender process is probably required. A predetermined percentage of the original contract value can be used as the trigger point for deciding to go back out to tender. In most cases, a change in scope should go back to tender, as it may indicate the original need assessment was inadequate.

Recordkeeping facilitates accountability and

evaluation. Staff involved in negotiations are likely to be more considered about what they propose to suppliers when records of their negotiations are created. These can be written records but, in some cases, especially for contentious negotiations or high value negotiations, agencies may choose to video or audio record the negotiations. The existence of records improves the ability of managers to evaluate the negotiations or use them to train other staff.

This is, however, little protection against informal arrangements that are reached prior to the formal negotiations.

Work-arounds

In 2011, the Commission exposed corrupt conduct by a person posing as a researcher that resulted in two hospitals losing \$665,300. One reason the “researcher” got away with her scheme was because of a work-around (where staff work around the process and safeguards in place) that developed in the accounts payable units that served these two hospitals. The work-around was a response to a formal process for paying invoices that did not allow staff to fulfil a key performance indicator – that all invoices be paid within 45 days. Managers were fully aware of, and even encouraged, the work-around.

The researcher convinced clinical and administrative staff at the hospitals that she was a postgraduate university student undertaking clinical trials on the use of a new device as part of her medical research. In fact, she was neither

a postgraduate student nor a medical researcher. She prepared requisitions and orders that falsely purported to be signed by various doctors in order to procure payment to three companies controlled by her or her sister (she did not disclose these interests). The requisitions and orders were for services related to a clinical trial but no work was ever performed. She then submitted false invoices from the three companies, claiming payment for the work.

The formal process for handling invoices in the accounts payable units that served the hospitals stipulated that the oldest invoices, determined by the date written on the top of the invoice, were paid first. This practice supported the key performance indicator relating to a 45-day period for vendors to receive payment.

The first element of the work-around came into play when a complaint was made about a delayed payment – regardless of whether the 45-day limit had been exceeded or not. When a complaint was received about non-payment of an invoice, processing of that invoice was made a priority. Vendors that were hostile were also given payment priority; effectively, they were allowed to jump the queue.

The second element related to clerk checks on paperwork for requisitions and purchase orders. According to the formal process, requisitions and purchase orders at the hospitals required the authorising signature of managers or doctors, with the appropriate financial delegation, with the name of the person and a date written next to the signature. Since accounts payable clerks could not possibly know what the signatures of all hospital staff with financial delegations looked like or the names of all managers and doctors, they simply checked that something was scrawled in the right place. Delegation manuals listing the financial delegations of senior department positions could have been used to establish some of the position titles and names. But some clerks gave evidence that they were not aware that these manuals existed, and the time required to check a manual would have worked against the 45-day payment target. Again, managers were aware that the manuals were not used when clerks processed payments.

Both elements of this work-around facilitated the corrupt scheme, as it allowed emergencies to be created and checks bypassed. The “researcher” convinced accounts clerks that her payments were overdue by telephoning a clerk in the accounts payable unit and pretending to be a hospital researcher. She complained in a manner that was described as “pushy”, that the vendors supplying critical materials or services for her research had not received payment and that her research would have to cease if the vendors were not paid. In fact, she backdated invoices from the three companies to give the impression that payment was long overdue, even though most of the invoices were likely to have been created only a few days before she faxed

them through to accounts payable. In doing so, she was able to take advantage of the accounts clerks' practice of prioritising the payment of invoices believed to be overdue or belonging to a grumpy vendor. While most of the requisitions and purchase orders submitted contained signatures, names and dates in the required places (some of these were falsified), in keeping with the second element of the work-around, these were never checked.

The Commission advised the department that it was a corruption risk to allow a complainant vendor or an employee to have direct contact with accounts payable clerks responsible for processing claims for payment in which the vendor or employee has an interest. Exposing accounts staff to this pressure increases the possibility that clerks will be less rigorous when checking financial paperwork. The department advised the Commission that it was introducing a web-based electronic requisitioning procurement system. This system allows users to request, approve or authorise a purchase only if they are given access and have a password, which dispenses with the need for signatures used in a paper-based system. Electronic systems also obviate the risk that signatures will not be checked properly or will be falsified, as authorisation becomes electronic and checks on financial delegation and position are built in to the system. Electronic systems also mean there is no need for a manual check on signatures.

The formal processes and policies in these two accounts payable units were inadequate for the workload and the expectations of management. Accounts payable staff (many of whom were barely trained temps) were under heavy pressure from management to process tens of thousands of payments within a timeframe that was unrealistic – unless an alternate pathway was adopted. It was almost inevitable that a work-around would develop.

Work-arounds indicate a flawed process. If staff develop a work-around, especially with the support of managers, this is a sign that there is a flaw in the process. The flaws could include an unrealistic workload, staff who do not know the correct process, an overly complicated process or electronic system, or overly complicated instructions about a process or a system. This situation indicates a need to map and re-design some aspects of the process.

Electronic systems can limit work-arounds.

Electronic procurement systems improve a manager's ability to control out-of-process procurement by ensuring that the right person authorises procurement and enforcing limits on financial delegations. Password control becomes even more important, however, when electronic systems are introduced.



The people factor

Aligning the behaviour and effort of individuals to the goals of the organisation is a perennial management issue that goes well beyond procurement. Together with structural arrangements and process quality, the behaviour of (1) staff undertaking procurement, (2) managers, and (3) suppliers to government is central to the control of procurement.

In each of these three groups of individuals, the two underlying determinants of behaviour are considered; first, the expertise, skill, knowledge or competence of the individuals and, secondly, the effort or motivation of the relevant individuals.

Regardless of motivation, the absence of competence or expertise around procurement can lead to inappropriate behaviour. Conversely, if individuals are motivated to behave differently, no level of competence will ensure appropriate behaviour.

Improving employee competence

The Commission's investigation into the university cleaning manager and her ex-husband's company highlights not only the vulnerability of emergency procurement but also the effect of pockets of weakness in procurement expertise across the public sector. Two of the cleaning manager's staff were responsible for actually certifying invoices received by the university from the company and for authorising payment.

Both staff members were inexperienced in procurement and neither had received adequate training on what certification and authorisation of invoices involves; that is, that checks need to be made to ensure that work has been performed to the required standard, and that the amount being invoiced is the correct amount. Both staff members were based at the university's main campus but neither

ever went to the campus where the cleaning services were actually performed to ensure the work was carried out (the campus was approximately 60 kilometres away from the main campus). One staff member gave evidence to the Commission that his role was simply to sign the invoices and not check them – a rubber stamp. The other assumed that whatever the cleaning manager was doing must be correct, stating she "...wouldn't be passing [the invoice] to us for a signature unless she was sure herself, because it was coming out of her budget".

Some public officials with procurement responsibilities are experienced and knowledgeable; others are not. The Commission's experience is that the risk of corruption lies more in this unpredictable inconsistency of procurement expertise across the public sector, than in an absolute absence of skills. In particular, when staff with procurement responsibilities do not understand their job properly, but supervisors believe they do, then corrective management action is unlikely to take place.

In the investigation into cleaning services at the university, lower-level staff at a central location were given procurement responsibilities but had few competencies in procurement policies or procedures. If these staff members had been confident and experienced, they might have objected to certifying delivery of cleaning services to a location they did not visit. It is also less likely that their manager would have risked giving them a role in procuring cleaning services, making her scheme more difficult to carry out.

Subsequent to the Commission's investigation, the university introduced the following measures to improve an employee's basic ability to make decisions about procurement:

- training in relation to the purchasing policy, and procurement generally, for staff involved in the procurement of goods and services

- providing information to all staff with responsibility for certifying invoices regarding their responsibility for verifying that the work charged for has been completed satisfactorily
- introducing a procedure requiring invoices for work performed away from the main campus to be certified by university staff at the campus where the service was provided.

The need for increased professionalism in procurement, generally, has been recognised elsewhere. The Australian Procurement and Construction Council and the Chartered Institute of Purchasing and Supply of Australia both support the establishment of professional qualifications and have commenced developing a uniform accreditation standard for public sector procurement professionals.

Formal procurement training for NSW public officials is already provided by the Department of Finance and Services (DFS) through its Procurement Certification Training Program. Local Government Procurement also provides certificate-level procurement training. A number of agencies advised the Commission that they have developed in-house competency levels and minimum standards for key procurement positions, as well as including procurement training in induction programs for new employees.

Training can improve agency competencies only so far. In most work situations, only a small proportion of knowledge acquired in the workplace is through formal training. Individuals learn on the job from peers, supervisors and through observation of the behaviour of others. Managers are better able to understand the behaviour of staff and guide behaviour when they are closely involved with their staff. Close involvement allows managers to provide developmental feedback following procurement actions, guidance at the time procurement is to take place, controlled mentoring programs, discussions in team meetings, and communication of procurement information

through internal agency channels, such as staff meetings, newsletters and emails.

Such management activities appear straightforward but can be a challenge to implement. An investigation in which management of procurement staff was a key factor in the corruption that occurred involved the disposal of old equipment and materials at an energy corporation. The Commission's investigation focused on a contracts and tendering manager who was responsible for the letting of tenders for the sale of scrap metal of decommissioned plant and equipment over a period from 1998 to 2002. The Commission examined 19 separate tender processes for which he was responsible, and found that in each case he had appropriated the proceeds of the sale, an amount totalling \$391,856.

During the period of interest, the contracts and tendering manager had two different managers, and both had difficulties managing him. It was hard for them to find out what he was doing, and neither manager understood the process for disposal of scrap metal from decommissioned plant and equipment. The first manager described him as "pretty autonomous in what he did" and said that he was often out of the office. The contracts and tendering manager did not follow established tender guidelines; expressions of interest were supposed to be deposited in a tender box that was not to be opened until the tender had closed, but some of the tenders were faxed or handed personally to him.

The second manager sought to bring a closer level of supervision to his activities. Her office was about six kilometres away from where he was stationed, making it difficult for her to keep track of his movements. To overcome this problem, in 2001, she directed the contracts and tendering manager to move to her location. He resisted this initially, but was forced to comply following an ultimatum. This manager told the Commission she found it

very difficult to get any information out of her subordinate. She described him as “evasive ... he would disappear”. She also said she had no knowledge of 11 tenders that were sent out to suppliers during her time as his manager. The manager gave evidence that she felt she was not supported by the corporation’s senior executives in the changes she was trying to make to the contracts and tendering manager’s behaviour.

Training is effective for complex or technical learning. Training can be used to increase knowledge and is particularly useful when the skills required are complex. This type of learning is best carried out in a structured learning environment.

But training is not a complete solution to learning. Procurement rules shift over time. Acceptable ways of interacting with suppliers will depend on the procurement situation. Novel problems constantly arise. Even if staff were once put through a training program, this does not mean they are equipped to deal with all of these changes and judgment calls. If necessary, mentoring, pre-procurement guidance, debriefs following procurement actions, and frequent management communication can build the tacit knowledge and expertise of staff in a way that training cannot.

Developing and maintaining procurement skills to an appropriate level, across relevant staff, becomes increasingly difficult as procurement responsibilities become more widely distributed across the organisation with staff who only undertake occasional procurement, when staff move in and out of roles with procurement responsibilities, or when there are changes to procurement policies and procedures. The challenge is to identify those individuals with skills deficits and provide the appropriate development in a timely manner, without wasting resources.

Targeting the right people is more efficient. In the Commission’s experience, agencies often adopt a “sheep dip” training program. Large numbers of staff are put through basic training with little regard for existing individual competencies or individual procurement roles. While minimum competence standards may benefit an agency, a one-size-fits-all training approach in order to improve procurement expertise can be inefficient and even counterproductive if staff are forced to do extensive training in processes they will rarely need to know. A skills audit can help determine the procurement capabilities and training needs of staff, and be the basis for a more structured and strategic approach to procurement training and development. The national competencies for

procurement and contracting produced by Government Skills Australia are a useful guide for this purpose.

A competencies plan dealing with staff turnover and change may help identify pockets of low expertise. A high turnover of staff or an influx of new staff creates challenges for agencies trying to maintain procurement competencies. The situation is made worse when structures do not help control procurement and, therefore, responsibility and accountability for maintenance of staff competencies are not assigned to specific management roles. A plan, set of tools or a skills audit may help track weaknesses in competencies as they develop over time. Allocation of responsibility and accountability to specific roles is more likely to result in action being taken.

The Commission has found that in many cases staff are aware of what the code of conduct says and know how to do procurement properly – so there is no question regarding ability. It is not uncommon for witnesses involved in Commission inquiries to admit they knew they had violated procurement rules. In fact, it was often the knowledge of procurement systems and safeguards that allowed them to identify the opportunities for corruption.

In such cases, competencies or expertise is not the issue. The corruption occurred because the motivation of the individual was not aligned with the interests of the agency. Nevertheless, an organisation’s response to corruption that has been exposed is sometimes to simply re-train everyone in the code of conduct or in procurement policies, even though the real problem is motivation. Staff are not necessarily motivated to behave in keeping with policy.

Target motivation, if motivation is the issue. Training will have little impact on staff who understand procurement processes but choose not to follow them. Effort and motivation are more likely influenced by changing workplace norms, encouraging employees to follow their managers’ ethical lead, close supervision, encouraging reporting, rewarding high performance with desirable work, development and work opportunities, public acknowledgement of good work, and by applying sanctions when behaviour is noncompliant.

It is not uncommon for the Commission to uncover self-interested behaviour that is the group norm rather than the individual exception. It can be difficult to change group norms by focusing on one individual at a time. The power of the group to control member behaviour is often greater than the organisation’s power to influence each individual.

Breaking group norms may require breaking up the group.

Following the Wood Royal Commission into corruption in the NSW Police Force, inappropriate norms were ended by breaking up the groups that created the norms and isolating problem opinion-leaders. Where groups of individuals are undertaking procurement in a risky manner as a result of group norms, such a reassignment of individuals to a more positive group may work. Such an approach, however, creates a risk of “infecting” the more positive groups.

bringing a fresh evaluation of the workplace and detecting unmanaged risks and improper behaviour.

In fact, managers need only randomly check a sufficient amount of paperwork to create a threat of detection for staff wanting to do something that is noncompliant. Many cases of corruption investigated by the Commission involve employees who are relatively long term. During their time in a position, they get to know what is checked and what is not, as well as the different pathways and options available to them. If checks are random, if the checking targets change, and if the occurrence of these checks is communicated to staff in a general way, a significant barrier is created in an employee’s mind. In turn, managers develop a better understanding of the processes they are managing.

Managers and procurement

The Commission’s 2008 investigation into a transport agency exposed how managers signed off on requisition orders or receipt of some goods, without checking if the good/service was really needed or whether it had been delivered. One employee controlled the procurement of welding services in one of the agency’s administrative regions, and all requests for welds were made through him and allocated by him to a firm he part-owned. His manager approved hundreds of his weld requests without checking any details. The employee obtained \$1.35 million in corrupt receipts over a three-year period, including \$30,000 from false invoices for work that was never performed.

The failure of managers to adequately supervise their staff is often related to a tick-and-flick attitude, whereby they pay only cursory attention to a document before approving it through a signature; for example, checking something – anything – is written in key parts of a form, then signing off.

Tick-and-flick approvals of procurement decisions by a chain of managers allow them to diffuse accountability to the point where no single manager takes responsibility for any particular decision. Chains of tick-and-flick approvals can create the impression that the procurement is compliant and proper, when in fact the most basic checks were never done in the first place but managers keep signing the paperwork because it was signed by the person below them in the hierarchy.

Tick-and-flick is adopted typically because of the competing pressures on a manager’s time, which results in a manager ceasing to monitor their employee’s work in any meaningful way. One reason for this is because a manager wrongly thinks that “monitoring” involves dutifully checking each and every invoice that comes across their desk.

Checking managers through diagonal acting up opportunities.

When a manager runs a corrupt, risky or simply ineffective unit, it is usually hidden from the rest of the organisation. Diagonal acting up – across sections or divisions – can be particularly useful for

Random reviews to deter corruption are used in parts of the insurance industry vulnerable to fraud. A random sample of closed files is randomly allocated to managers (other than the direct manager) for review. A sample of the reviewed files are randomly allocated to the manager’s manager (other than the direct reporting line) to ensure the reviews have been conducted thoroughly. The fear of the risk of detection is raised and cannot be circumvented, and the fear is heightened by the knowledge that managers are conducting a thorough review. Publically-known and changing random monitoring, such as mystery shoppers, reviews of files, customer surveys, and managers dropping into random stages of the process, make it very difficult to work around the checks.

Random monitoring can be an effective deterrent.

Managers do not need to check every aspect of their staff’s work. If checks are regular but random – and staff are aware the checks are going to happen – this usually creates a significant deterrent against engaging in improper behaviour because employees perceive the probability of being detected as higher.

A second reason a manager might revert to tick-and-flick is because he or she trusts staff to do the right thing. Managers, however, should trust staff only when they can be sure that their staff (1) have the abilities required for the position, and (2) that in any given situation their staff will share the same motivation as management to act with honesty and integrity. If a manager knows that their staff do not have the requisite abilities or cannot be sure that their staff have the same motivation, then less reliance should be placed on trust and more on controls to limit possible noncompliance.

Trust is low risk for some staff but high risk for others. Placing trusting in staff is low risk and more efficient when a manager can be fairly certain that their employee has the abilities required for the position and that their employee shares the same motivation in any given situation. If a manager is not sure about these two things, and the staff member is operating with discretion that could allow corrupt conduct to occur, the risk of improper conduct is heightened and complete trust is inappropriate.

Managers, especially senior executives, can lead in a way that makes corruption easier or more difficult. In 2010, the Commission investigated the conduct of a head carpentry teacher at a Technical and Further Education (TAFE) college. The Commission found that the teacher had used \$21,900 of TAFE funds to pay for private work on a dog kennel complex. The complex was on the property of an acquaintance of the teacher who cared for and trained his racing greyhounds.

The teacher was also responsible for a TAFE pre-apprenticeship program to provide students with hands-on experience in the building and construction industry through construction of public housing accommodation. Part of his role was to identify, hire and supervise subcontractors who could provide additional building services for the program. The teacher wanted to use a favourite supplier for this program. In order to engineer a selection process that would make his biased selection appear fair, he and a colleague created dummy quotes for some of the pre-apprenticeship projects. The dummy quotes were more expensive and enabled him to justify selecting his preferred contractor, whose authentic quote appeared to be the lowest.

In July 2007, a new faculty director was appointed to the TAFE faculty in which the teacher worked. The new director challenged his autonomy over the pre-apprenticeship program. He was also concerned about the lack of involvement of the director's position in the preparation of tender documentation, the procurement of subcontractors, and the financial viability of the program. He requested a financial review, which showed that the program was running at a significant loss. By the end of 2007 (within six months of assuming his position), the new director had introduced a series of changes to the way subcontractor services were procured. These changes reduced the teacher's autonomy over the program and introduced better corruption controls.

Controlling procurement corruption should not rely on the luck of having a motivated and skilled manager operating with a supportive senior executive team. Whatever the structural arrangements around procurement, it is reasonable to assign accountabilities to managers and

apply appropriate procurement control key performance indicators (KPIs) to the managers of units undertaking significant amounts of procurement.

Making managers responsible and accountable.

The Commission has found that some managers pay little attention to their procurement responsibilities. Procurement is the means to an end, and delivery of the end goal – whether it be services, reliability or safety – is the focus. Where a unit undertakes procurement that is risky (as in the example of the disposal of equipment and materials at the energy corporation) clear procurement related responsibilities, KPIs and measures, and accountability with consequences can help focus the attention of the manager on both the corruption risks and achievement of value for money.

Informal sources of information are just as important for corruption control as formal sources. The Commission's 2008 investigation into a transport agency found that it was common knowledge among maintenance work gangs that a team leader of a maintenance gang owned a water truck that regularly provided water haulage services to the agency, including the team leader's unit. Yet, over a two-year period not one employee reported his knowledge or suspicion of a conflict of interest to senior management; rather the arrangement was discovered by chance by the agency's safety inspectors.

Corrupt conduct, such as that of the team leader, is not reported for three main reasons: (1) "not dobbing" is a strong group norm, (2) the person with knowledge of corruption, or who suspects corruption, thinks that nothing will be done, and (3) the person fears they will suffer retribution once people find out who made the report. In the context of procurement, these reasons are equally applicable to both public officials and suppliers.

Listen to rumours. In many cases of corruption, staff in a workplace think that corruption is going on but managers fail to act because no one makes an allegation in writing. Managers are entitled to commence an investigation on their own initiative in response to rumours of corruption.

Dealing with suppliers

The current state of relationships between public officials and suppliers appears to be unsatisfactory to many parties. Concerns about probity appear to have constrained engagement between public officials and suppliers.

The Commission's research and the submissions received for this project demonstrate that contact with suppliers creates uncertainty in the minds of public officials, primarily because they worry about conflicts of interests, unsolicited gifts and/or benefits, and whether they are being groomed to participate in future improper activities. These fears have caused some public officials to minimise contact and communication with suppliers. On the other hand, some suppliers – receiving no clear directions about engagement with the public sector and only small windows of opportunity to have contact with public officials – respond by using every precious opportunity to offer gifts or hospitality and to pump officials for information.

The importance of communication

Contact and communication between public officials and suppliers is useful and necessary. It can also occur within clear parameters and in circumstances where risks for corruption are managed. Engagement with suppliers where public officials take the initiative and set the rules improves both corruption control and overall procurement.

Limited engagement between public officials and suppliers has created misunderstandings around procurement. Some suppliers told the Commission that when information about procurement is provided, it is lengthy, complex and difficult to understand. Public officials, on the other hand, complained that suppliers do not read the information provided. Suppliers' lack of understanding of public sector procurement and probity standards can lead them to conclude that a public official is corrupt, because the supplier does not actually understand what is going on.

Minimal contact with suppliers reduces the opportunity for public officials to convey directly or explain the wide

range of information and skills suppliers need when dealing with the NSW public sector. In addition to impairing procurement effectiveness, this results in opportunities to manage supplier behaviour being lost, and in lost opportunities to communicate the following:

- ethical obligations, principles and standards of behaviour relating to procurement
- basic knowledge about corruption and how to prevent it, including the importance of recordkeeping, managing conflicts of interest, gifts and benefits, and reporting
- performance expectations and the criteria that will be used to determine whether a contract should be renewed
- how to obtain information about NSW public sector procurement from websites and documents
- the consequences of engaging in corruption.

Suppliers told the Commission that they need to build a relationship with public officials in order to know whether they are doing a good job and what kind of product or service is required. Specifically, suppliers said that they want clearer specifications on the goods and services the government requires, feedback on unsuccessful tender proposals and information about the progress of contracts (that is, whether the agency is happy with their performance). Constructive engagement between public officials and suppliers gives both parties the certainty they need about key business concerns.

Pro-active communication reduces uncertainty for both the supplier and the public official.

Making easily-understood information about contracts and tendering widely available helps public agencies control public understanding of procurement. This is especially useful for communicating probity messages, when public agencies want to reduce ambiguity about what is required. Developing and distributing a statement of business ethics that is short and in plain English or sending a letter outlining basic probity

Box 2: Supplier comments on government-supplier relations

"Paranoia of perceived corruption means the Government does not get close enough to their suppliers and therefore lacks appropriate knowledge to make good decisions and save the NSW Government money."

"I think it's important to prevent corruption, but sometimes feel that it has become so rigid that any benefit that a supplier/client relationship has, may be lost. There are benefits in supplier relationships, not just problems."

expectations to suppliers, creates an opportunity for an agency to formally describe expected standards of behaviour around transactions. Well-communicated information about procurement is likely to make tenders more compliant and reduce misunderstandings about process.

If suppliers see corruption problems, then management probably has a problem. Suppliers sometimes think corruption has occurred because they did not win a contract or because they did not understand what process was being followed. Obviously, many suppliers will complain loudly that it was wrong that they did not win a contract, that it was not fair or even that it was corrupt. But within this noise is a signal that suppliers may not understand conflicts of interest or gift policies, the process that was followed or that they are not receiving adequate feedback. A perception that the process is corrupt is conducive to actual corruption, as suppliers may believe that the only way to get work is to offer a gift or benefit to a public official.

Suppliers also have a very clear view of where the corruption risks are in the process and Commission research indicates that suppliers see it in different places from those assumed by management. Listening to supplier analysis of corruption risks may help identify agency vulnerabilities.

Communication guidelines on procurement help public officials. When public officials are inexperienced or lack confidence about engaging with suppliers, managers can usefully provide clear guidelines on where and when to meet suppliers (for example, in the office and not during an active tender process), what hospitality is acceptable (for example, modest hospitality for work purposes), and what information is confidential (for example, information from a competitor's tender proposal). Establishing guidelines takes time but once they are in place there are likely to be fewer misunderstandings and complaints about improper conduct.

There are many options for communicating with suppliers in ways that carry a low risk for improper behaviour. Agencies need to decide for themselves which communication channels will work best for them.

Let the market know what you need through...

- public tender briefing sessions and by publishing any additional information in response to any questions that cannot be answered immediately
- industry forums, such as biannual breakfasts, detached from any specific contracts or tenders, which are open to all and run by high level staff, such as the CEO
- regular performance feedback, for example 6-monthly performance reviews, an evaluation at the end of a contract, and whenever a performance problem arises
- centralised internet access to information about all procurement
- seminars/training for suppliers about agency procurement selection processes
- a supplier's guide to procurement (web and hard copy)
- a supplier charter that specifies standards required of suppliers and contracting authorities, or distributing a statement of business ethics
- tender debriefs for all unsuccessful tenderers, as a regular part of contract management.

Develop an understanding of a supplier's business:

- supplier surveys can generate information on a range of issues and from a range of supplier groups, such as whole industry or a group of specialists
- visit vendor sites to see the vendor's safeguards
- consider sending out a request for information before request for quotation or tender.

Work with suppliers to reduce misunderstandings about procurement by...

- establishing communication channels between client and vendor teams
- communicating guidance and rules around interactions with salespeople to existing and potential suppliers, especially if and when those rules are changed
- if a vendor supplies a key part or service to your operation, inviting that vendor to strategic meetings that involve their products
- being available to speak at vendor seminars, conferences, forums and user meetings about public sector procurement.

Managing conflicts of interest

Along with good communication, building sound relationships with suppliers is an essential part of being a good procurement official and of doing business. Because suppliers want to sell goods and services to the public sector, they are also keen to develop relationships with individual public officials. A sound relationship makes trust possible between suppliers and public officials, reducing – although not eliminating – the work required to monitor delivery and quality. Relationships with suppliers, however, also create risks for corruption, namely the risk of undeclared or poorly managed conflicts of interest.

From a corruption control perspective, conflicts of interest involving suppliers fall into two categories. The first category involves a private interest being deliberately kept secret, with a view to committing improper conduct, such as fraud. The second category involves conflicts of interest that emerge because of professional relationships evolving into personal friendships.

Hidden private interests

Conflicts of interest involving hidden private interests are often related to unauthorised secondary employment, such as when a public official establishes a private business or works as an employee for a private firm and keeps this hidden.⁴ Sometimes a corrupt public official might also arrange for his or her (unauthorised) private business or a friend or family member's private business to be subcontracted by a supplier to perform services.

Unauthorised secondary employment can conflict with an employee's public duty, especially if the private employment is in the same sector as the employee's public position (for example, an IT manager with a private IT consultancy). While there are few risks associated with public officials in some areas of an organisation engaging in secondary employment, secondary employment for staff with procurement responsibilities creates considerable risks for corruption. The conflicts of interest in the cases of the public official who had a private stake in a welding firm from which he procured welding services for a transport agency, and the cleaning manager at a university who, together with her ex-husband, owned a cleaning firm from which she authorised the purchase of cleaning services, fall into this category.

From a supplier perspective, it makes sense to actively recruit a public official and offer him or her secondary employment if that employee can increase sales. Public officials with procurement responsibilities who are looking for a second job may also end up with potential suppliers to their agency, simply because they can use the same skill set for their secondary employment. The unfair advantage

that having someone "on the inside" gives a supplier, causes consternation to competing suppliers who may lose out on contracts.

Detection is a key corruption prevention issue for conflicts of interest that are kept secret because of a private interest. In the absence of reporting, however, detecting a conflict of interest that someone wants to keep secret can be difficult.

Research can help identify ownership/directorships of suppliers.

Information about present and past directors and owners of registered companies is available on the Australian Securities and Investment Commission's website for a small fee. A search of this database can help detect private interests.

Electronic tools can help detect the exercise of a conflict of interest.

Public officials sometimes approve increases or variations in the volume and/or the scope of work being allocated to a particular contractor or subcontractor to whom they are affiliated as part of a corrupt scheme. Using electronic tools to generate reports on increases, potential order splits, frequent payments just below delegation limits, and variations in work can help identify unusual patterns that suggest a public official may have a conflict of interest with a supplier.

Encourage reporting of undeclared conflicts of interest.

Creating a workplace where staff feel motivated to report is a long-term challenge involving many different actions. These include explicitly encouraging the reporting of corruption (for example, through newsletters, the code of conduct, statement of business ethics and other public forums), acknowledging the importance of reporting when corruption is exposed, establishing and publicising a complaints management process (for example, a dedicated phone hotline and email address may also be a useful reporting mechanism for large agencies), maintaining confidentiality during an investigation (including keeping confidential the identity of the complainant to the extent possible), protecting the complainant against retribution and taking action if retribution occurs, and taking swift and public action against corruption when it is found. Some organisations outsource complaint lines to assure potential complainants that the system is safe and the risk of reprisals taken seriously.

Sometimes unauthorised secondary employment involves a public official contracting work to a supplier, who then subcontracts all or some of that work to a company owned by the public official or his or her family or friends. Being able to obtain information about subcontracting is important for this reason – it can help detect hidden

private interests. The Commission's survey of public agencies' procurement practices found that 42% of surveyed agencies "always" require contractors to both record subcontractor usage and ask permission to use subcontractors but 58% of organisations "never" or only "sometimes" require contractors to record subcontractor usage and request permission to use subcontractors. Reporting and requesting information about subcontractors is straightforward and can be an effective way to deter, and possibly detect, unauthorised secondary employment.

Random checks can deter and detect improper subcontracting. Regular, random checks – outside of audits – help managers determine which companies are actually performing work. These checks can help deter suppliers from not complying with subcontracting arrangements and, in some instances, uncover undeclared conflicts of interest or other improper allocation of work.

Professional relationships that evolve into friendship

The second type of conflict of interest involves a relationship that evolves from a purely professional one into one of friendship (or even antagonism). Unlike a hidden secret interest, such as unauthorised secondary employment, this type of conflict of interest does not involve corrupt conduct at the outset. Rather, the private interest – the personal relationship – is created over time as a public official's professional relationship with a supplier evolves into a personal friendship. The risk is that the public official will become partial when making decisions about this supplier.

In 2010, the Commission investigated allegations that a works manager at a local council received bribes from contractors in return for allocating work. The manager had worked for the council for an extended period of employment, moved up the ranks, and developed long-term relationships with contractors. One of the contractors had fostered this relationship by doing private work on the manager's home and purchasing a boat and a trailer for him. In return, the manager consistently allocated council work to the contractor's company.

Even if a public official, such as the works manager, sees such a relationship as a friendship, a supplier may view it quite differently. The Commission has often found that, while a public official considers a regular supplier to be a mate, the supplier does not view the public official in the same way. Suppliers will seek to create an impression of friendship in the mind of a public official, as part of a deliberate strategy to increase sales by influencing the public official to think favourably of their products and their company.

The risks posed by this second category of conflict of interest require different controls from those created by undisclosed private interests. Common sense and good judgment about relationships and conflicts of interest are key to preventing relationships evolving in a direction that may have a negative impact on an official's public duty. Managing these risks is a particular challenge in rural areas and for local government due to the often tightly-interwoven networks of personal relationships.

Confusion about conflicts of interest is widespread (see Box 3). This is not surprising given the results of a survey of public sector agencies conducted by the Commission. The survey found that about one-third of organisations do not provide any training in conflicts of interest to specialist procurement staff who are permanent public employees, and about half do not provide training in conflicts of interest to contractors/consultants (including project managers) with procurement responsibilities.

Aside from those private interests that are kept deliberately secret for improper reasons, there are many reasons why staff do not declare conflicts of interest. They may not understand what a conflict of interest is, think they will get into trouble if they declare a conflict, do not think the conflict is important, think that they can rise above it and remain neutral, they are embarrassed that they have a conflict, they are embarrassed by the private interest, the declaration process is too cumbersome, and that declaring the conflict will slow down their public duties (for example, their ability to organise a tender).

Limitations on secondary employment reduce conflicts of interest. Use caution when authorising secondary employment for any employee involved in procurement, especially if they are in a position to procure a good or service that they supply in a private capacity and which is also required by their public agency. There are precedents for a prohibition on such secondary employment. In 2008, following a Commission recommendation, RailCorp prohibited all employees involved in procurement from having secondary employment specifically involving the provision of a good or service procured by RailCorp.

Education helps staff understand conflicts of interest. The Commission routinely finds that public officials do not always understand what constitutes a conflict of interest. Actively communicating a clear definition to staff, informing staff of their obligation to report any conflicts of interest, and establishing guidelines for managers on managing conflicts of interest, are key to conflicts of interest being reported and managed properly. In terms of a definition, the following may be useful: a conflict of interest is a

conflict between the public duty and private interests of a public official, where the public official has private interests that *could* improperly influence their official duties and responsibilities.⁵ The NSW Division of Local Government's *Model Code of Conduct for Local Councils in NSW* contains a definition specifically relevant to local councils and councilors.⁶

Well-prepared staff deal better with supplier tactics. Suppliers invest considerable resources into training their sales representatives in how to build relationships and employ sophisticated psychological tactics to influence customers' attitudes. Sales representatives are also often paid on a commission basis, making them highly motivated to achieve sales. In contrast, public officials receive little training or guidance in dealing with well-trained and well-prepared representatives. Public officials will be less vulnerable to influence when they are aware that sales representatives are not their friends but are simply doing a job for which they have been prepared; that is, to sell.

Box 3: Common misunderstandings about conflicts of interest

- **Misunderstanding no. 1:** *A conflict of interest is a difference of opinion between two people (and therefore reporting it would be like dobbing on someone for a disagreement).*

In fact, a conflict of interest is a conflict between the public duty and private interests of a public official, where the public official has private interests which could improperly influence their official duties and responsibilities.

- **Misunderstanding no. 2:** *If a conflict of interest exists this means there must be corruption.*

While not declaring a conflict of interest could amount to corrupt conduct, in general corruption occurs once a decision is influenced by a private interest rather than by public duty.

- **Misunderstanding no. 3:** *A conflict of duty between two professional roles in the same organisation, is the same as a conflict of interest involving a private interest.*

Both types of conflict need to be managed, but conflicts of duty lack scope for personal gain.

- **Misunderstanding no. 4:** *A private interest is simply that – private – and no one at work needs to know about it.*

Private interests need to be declared when they have the potential to conflict with public duty. All NSW public sector employees are required to obtain authorisation for secondary employment.

- **Misunderstanding no. 5:** *The person with a conflict of interest can and should manage it.*

The whole point of managing conflicts of interest is that the person with the private interest explicitly does not decide what course of action to take. Somebody else has to decide how to manage the conflict.

- **Misunderstanding no. 6:** *Conflicts of interest can be banned.*

Conflicts of interest arise because public officials have family and friends, and are part of the community. This means that conflicts are sometimes inevitable and unavoidable, especially in small communities. The focus should be on managing them, rather than banning them, when this may not be possible.

- **Misunderstanding no. 7:** *A public official with a conflict of interest should be totally removed from a situation.*

While conflicts should always be declared, there are a range of measures for managing them. Some matters will simply require limitations on the public official's involvement in a matter; other matters may require total removal.

Gifts and benefits

A specific risk created by poorly managed relationships between public officials and suppliers involves gifts and some types of hospitality. The case involving the 129 toner cartridges ordered by a public official at Arts Victoria, who received gift cards in return worth \$8,300, illustrates the corruption risks of public officials involved in procurement receiving gifts. Amongst other recommendations, the Victorian Ombudsman recommended that Arts Victoria revise its purchasing policy to explicitly prohibit employees from accepting gift vouchers from suppliers, and training in the code of conduct and gifts and benefits policy for all Arts Victoria staff.

An investigation conducted by the Commission in 2011 exposed systemic giving of personal gifts across NSW local councils and some other public sector agencies by suppliers to public officials who place orders on behalf of their agency. The gifts included gift cards, gift vouchers and upscale consumer electronics products, and were offered by suppliers in an attempt to influence the public official to make repeat orders from their company, to order goods that they might not normally buy or to order larger quantities than usual. The gifts were not offered to the actual customer – that is, the public agency that was paying the supplier for the items. In fact, in most cases, the supplier and the public official concealed the gift from the public official's employer by arranging for the gift to be sent to the official's home address.

The secrecy around gift giving can make it difficult to detect, especially if gifts are sent to a public official's home address. If suppliers realise, however, that their future sales are in jeopardy if they give gifts to buyers, this can work as an incentive to discontinue the practice.

Another investigation into a local council found that sales representatives from a company were regularly giving gifts to selected employees who ordered goods for the council. Accepting gifts from suppliers was a breach of the council's code of conduct, and the council was keen to stamp out this practice. In response to the Commission's investigation, the council:

- wrote to the company and asked for a list of the gifts it had given to employees, and asked it to advise its sales representatives to cease providing gifts to council employees
- developed guidance for employees on their interactions with sales representatives, which required that meetings with sales representatives be conducted by appointment through a senior council officer, have at least two council employees present, and not be conducted over a meal or drinks

- developed a simple one-page statement for suppliers explaining its new protocol for meetings and stating that staff are not allowed to accept gifts for more than token value
- temporarily demoted the employee who accepted gifts.

The company reacted with alacrity. It wrote back to the council, stating that in future there would be no provision of gifts to council staff, and emphasised that had it known gifts were outside the council's code of conduct, they would never have been provided in the first place.

Another council discovered similar persistent gift-giving by suppliers to council officers. It continued to allow suppliers to visit, but required that they meet with the purchasing officer and that the meetings occur in the foyer of the civic building. The public context in which meetings now occur – in front of reception, with the public and other employees going back and forth – reduces the likelihood of improper gifts changing hands or improper relationships developing.

Gifts and public officials do not mix. There are very few reasons for public officials, especially those working in procurement, to ever accept personal gifts from a supplier. Gifts create perceptions of a conflict of interest, and managers, colleagues and the public are right to question why they are offered and sometimes accepted. By contrast, minor forms of hospitality provided by suppliers to public officials or vice versa, may be acceptable when they occur in an official context.

Gift guidelines help staff. Agencies can better manage gift-giving when they establish clear guidelines about what constitutes a gift, what constitutes hospitality, what constitutes a "token" gift (specifically, what monetary threshold is token), how to make a declaration, and what the options are for dealing with the gift or benefit.

Unfortunately, some agencies quickly find that a comprehensive policy is no longer simple to understand. Exceptions and other factors make the gift policy difficult to understand and impossible to remember; for example, exceptions for delegations, constituents in holiday periods, definitions of working lunch, definitions of token, that certificates are equivalent to cash and cash is never acceptable, different rules for riskier areas (such as planning, licensing and procurement), and gifts that may create the impression of impropriety.

Simple rules or simple principles work best. Some of the major private corporations, such as those in the IT industry, have very straightforward gift policies that may provide guidance to the public sector.

A simple process expedites declarations.

Organisations are not able to manage gifts unless these are declared in the first instance. Declarations, however, are more likely when the process of declaring a gift is easy, when staff have been instructed in how to make a declaration, and when executives and managers lead by example and make declarations themselves. To this end, organisations need to have a gifts register but the fact that one exists will not guarantee that staff will declare gifts.

Declaring a gift is simply the first step. Once a declaration is made, someone needs to then decide what happens to the gift or benefit. The receiver should never decide what happens to the gift. A designated person, typically a senior executive or the general manager of a council, needs to decide what happens.

Some gifts could benefit agencies. One way for public sector agencies to benefit from suppliers that want to give incentives or rewards to customers, is to allow their procurement staff to request things that benefit the agency. For example, to ask for discounts, additional items or free freight for subsequent orders. In short, a supplier's willingness to give a gift can be used for the agency's benefit.



Conclusion

When it comes to procurement, there is no single method of corruption control. Simple reliance on policies, codes, and training will control only a small proportion of corruption.

There are many factors that create relatively unique sets of risks within each public agency. These factors may include the culture and history of the organisation, the industry and markets it operates in, its structural arrangements, budget and management skills, the procurement expertise available, and so forth. As such, these factors require unique responses, which may include an array of approaches working in concert and tailored to the diagnosed risk.



Endnotes

- 1 As part of its research into procurement corruption risks, the Commission analysed the NSW Government's procurement policy, regulatory and legislative framework, undertook a survey of 153 state and local government organisations (the survey was distributed in 2009 in hardcopy form by mail to NSW public authorities), conducted interviews and focus groups with public sector procurement specialists and suppliers to government, revised the Department of Finance and Services' government procurement training program, analysed the Commission's investigation and complaint data, reviewed research literature, invited submissions to a consultation paper (*Corruption risks in NSW public sector procurement – consultation paper*, July 2010) and undertook the aforementioned survey of NSW government suppliers.
- 2 "Procurement" is defined in this report as all activities involved in planning the acquisition of goods and services or acquiring goods or services, either outright or by lease (including disposal and lease termination). This includes acquiring goods (including consumables, capital equipment, real property and infrastructure) and services (including consultancies, professional services, facilities management and construction), as well as purchasing and the outsourcing of functions and subsequent contracting.
- 3 In July 2010, suppliers to the NSW Government were asked to provide their perceptions of corruption in NSW state and local government by responding to a survey that had been prepared by the Commission. Details and findings of this survey are available in *Corruption risks in NSW government procurement: suppliers' perceptions of corruption* (June 2011), which is available on the Commission's website at www.icac.nsw.gov.au.
- 4 Under NSW Government policy, all secondary employment by public employees must be declared and authorised by a manager before the employee can commence the employment.
- 5 This definition is adapted from the Organisation for Economic Co-operation and Development's *Guidelines for Managing Conflicts of Interest in the Public Sector*, OECD, Paris, 2003.
- 6 NSW Department of Local Government, June 2008, pp. 10–13.



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