CONTROLLING FRAUD, WASTE, AND ABUSE IN THE PUBLIC SECTOR

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Contents

Introduction

The value of public resources lost each year in Australia because of fraud, waste and abuse defies precise quantification, but almost certainly runs to many millions of dollars. In the climate of fiscal restraint which has become normal for all Australian governments, it is more important than ever that public funds are managed responsibly.

There are three basic modes of government activity in which fraud can occur - paying, collecting and contracting. Governments bestow a variety of benefits, subsidies, and payments to individuals and organisations. Not all recipients are entitled to what they receive. Governments collect revenues from individuals and organisations, in the form of taxes and duties, or as payment for services. There are those who do not pay what is due. Governments themselves are consumers of goods and services. There are those providers of goods and services who charge the government for goods not delivered or for services not rendered, or who knowingly provide defective or substandard products. Beyond this, governments control billions of dollars of capital resources, some of which are vulnerable to conversion for private use by unauthorised persons.

Fraud against the government is by no means the exclusive province of unscrupulous citizens. Fraud can be perpetrated by individuals and by companies as taxpayers, contractors, or as beneficiaries of public payments. But government employees themselves can be offenders. And certain types of fraud require the collaboration of public sector employees and citizen offenders.

The problem of fraud against the government cannot be analysed in isolation from the more general issue of unnecessary revenue loss. It is often more useful to focus upon a wider constellation of phenomena which include not only fraud, but waste and abuse in public programs.

The terms fraud, waste and abuse are often used interchangeably, even though they are conceptually and legally distinct. They nevertheless often coexist, frequently arise from the same underlying factors, and, in terms of prevention, they are often amenable to the same countermeasures. Fraud against the government is more easily accomplished in an environment of administrative and fiscal laxity. Indeed, it may well be that a significant proportion of revenue loss flows less from deceit than from careless or inefficient management of public resources. In any event, the appearance of carelessness and inefficiency can be an invitation to perpetrators of fraud.

Defining fraud, waste & abuse

Definition of Terms

To illustrate, fraud is understood to mean a dishonest and deliberate course of action which results in the obtaining of money, property or an advantage to which the recipient would not normally be entitled. This would include, inter alia, theft of government property, or the submission of artificially inflated invoices by a contractor.

Waste entails the expenditure or allocation of resources significantly in excess of need. An example would be the negligent or reckless requisition of three times as much perishable produce as required. Waste need not necessarily involve an element of private use nor of personal gain, but invariably signifies poor management.

Abuse, defined here as a subset of waste, entails the exploitation of "loopholes" to the limits of the law, primarily for personal advantage. One abuses a system of travel allowances by intentionally and unnecessarily scheduling meetings in another city on a Friday afternoon and on the following Monday morning in order to claim per diem over a weekend. Another example would occur where a person, transferred to an overseas diplomatic posting, uses the diplomatic position to export a luxury vehicle for personal use at the posting and subsequently, prior to returning to Australia, sells the vehicle for a substantial personal profit.

From the above discussion, it is not difficult to imagine how mismanagement in the form of waste can constitute an implicit invitation to abuse and to fraud, by companies doing business with the government as well as by public servants.

Principles of Fraud Control

Fraud arises from the conjunction of three factors. A potential perpetrator must have the motivation to defraud, the knowledge, skills, or ability to commit fraud, and the situational opportunity to do so.

It should be noted at the outset that there is no single panacea for the problem of fraud, waste and abuse. Whilst the discussion which follows suggests that improved management at all levels of the public sector is likely to be the one most important safeguard, effective prevention of fraud, waste and abuse will require a variety of overlapping checks - what might be termed an interlocking web of countermeasures.

Three basic considerations bear upon a discussion of fraud control and the public sector. First, it is of utmost importance to avoid measures which would reduce the morale of the workforce. For obvious reasons, poor morale itself increases vulnerability to fraud, by perpetrators both internal and external.

Second and with explicit reference to the procurement of resources, it is important to maintain managerial flexibility and autonomy. Wherever possible, those involved in the procurement process or

in the management of resources should be able to exercise discretion, rather than be bound to a rulebook. In other words, let managers manage. Overly strict regulations can inhibit efficient allocation of resources. Irrelevant or gratuitous specifications can drastically inflate the price of products purchased.

Third, it is essential to maintain accountability for the management of public resources. Enhancing and protecting managerial discretion does not preclude managers being subject to oversight. A necessary corollary is that managers should be accountable for the decisions which they do make and for the resources which they manage.

Large, complex organisations such as one finds in the public sector may be conducive to "passing the buck" by personnel at all levels. The transient involvement of numerous individuals in a given project may make it difficult to fix responsibility on a particular person in the event that something goes wrong. Clearly defined accountability is thus essential.

To summarise, any fraud control measure which would have the effect of lowering morale or constraining managerial discretion must have a very compelling justification. Accountability for the management of resources must be strengthened and given high priority.

Countermeasures

The discussion which follows addresses four basic stages at which measures for the control of fraud, waste and abuse may be implemented. These might briefly be described as prevention, detection, investigation, and sanctioning. The four are necessarily interrelated.

The primary defence against fraud should be **prevention**. Systems and policies should be in place to minimise motivation and opportunities to engage in fraud. One can, for example, identify areas of vulnerability to fraud, and mandate the processes by which resources are acquired and managed. Beyond this, one can provide positive incentives - material or symbolic rewards for efficiency and effectiveness in the procurement and management of resources.

In the real world however, some fraud will occur. Systems for the effective **detection** of fraud are thus essential. Regular internal auditing, reinforced by rigorous external audits. are one such means of detection. Formal procedures for the reporting of fraud are also important.

Procedures for the **investigation** of fraud serve two basic functions. First of these is the preparation of evidence for subsequent use in the sanctioning process. The second goal of investigation is essentially remedial. By determining "what went wrong", by identifying shortcomings in prevention and control systems, it may be possible to strengthen preventive measures and thereby reduce subsequent vulnerability to fraud.

Imposing **sanctions** on individuals or organisations which have perpetrated fraud may entail criminal, civil, or administrative penalties, whether singly or in combination. Sanctions serve four goals. The first of these is deterrence. Perpetrators of fraud should be discouraged from re-offending, and others should be deterred from following in their footsteps. The second is restitution. The government should be reimbursed for any losses sustained as a result of fraud. The third is rehabilitation. Operating procedures and control systems of a company responsible for defrauding the government can be restructured to minimise the likelihood of recidivism. The fourth is denunciation. The act or acts of fraud are subject to formal condemnation, which has as its goal education as well as denunciation.

Prevention

Fraud Awareness

It is obviously essential that public servants and government contractors know which behaviours are tolerable and which are not. There may be practices, currently regarded as acceptable throughout the public sector, which authorities will wish formally to define as wasteful or abusive. To this end, agencies must make a very clear distinction between acceptable fringe benefits and minor theft. This distinction must be communicated clearly and unambiguously to all personnel.

A fraud awareness campaign should not, however, be regarded as a magic bullet, or as **The** solution to fraud, but as one which complements other countermeasures. Moreover, it should be reinforced by word and by deed from the highest levels. A campaign perceived as simple window dressing or a public relations exercise may itself be categorised as waste, if not fraud.

The precise themes upon which a fraud awareness campaign might be based may vary, depending upon the organisational culture of a given public sector agency. Altruistic or patriotic appeals might be more appropriate for some individuals, whereas messages aimed at an individual's self interest may be more effective in other cases. In general, perceptions of formal or informal sanctions, whilst significant, have been found to be less important than internalised norms in explaining the decision to engage in illegal behaviour (Stalans et al. 1989). It would in any event be useful to determine what sanctions are perceived as credibly threatening by potential perpetrators of fraud and waste.

A campaign could be based on one or more of the following change strategies:

1. Rational/empirical appeals based on the principle that fraud control is in the best interest of all personnel.

2. Power/coercive approaches invoking formal authority to force the acceptance of change.

3. Normative/re-educative approaches involving widespread participation in setting goals and in monitoring achievement.

The ultimate success of any awareness campaign is directly related to management techniques of motivation and leadership. In theory, this should pose no problem for public sector managers. Leadership is, after all, an integral element of the managerial role. Leadership style not only determines how well information is disseminated and absorbed by personnel; it also establishes the overall tone of the organisational environment.

Stated simply, thefts are less likely to occur when the rank and file feel that management cares about losses. Ethics and integrity programs should be made a key

component of staff development in public sector agencies. Managers must be leaders, and must set a personal example of high integrity.

Fraud awareness should become an integral part of training for public service officers. Policies for the control of fraud, waste and abuse should be clearly communicated throughout the public sector, and to individuals and organisations in the private sector which are engaged in doing business with the government.

It is essential that any fraud awareness initiatives be reinforced by action. Public sector agencies must demonstrate their commitment to fraud control by deed as well as by word. Policies should be consistently and visibly applied.

Considerations Relating to Procurement

Governments, as purchasers of goods and services, are in a position to influence commercial morality through constructive use of purchasing power.

Although competitive bidding for government contracts is regarded as the most economical means of procurement and as a safeguard against corruption, the ideal of open competition is not always achieved. The risk of collusive tendering, or other anti-competition practices, requires vigilance on the part of purchasing officers.

Tenders should be compared for "identical computations and totals which are unlikely to be coincidental" (Australia 1983, 10/2). Other circumstances which may warrant suspicion include changes in bidding practices on the part of traditional suppliers, and changes in patterns of bidding by groups of tenderers (Australia 1983, 10/2). Collusive tendering activity is a violation of the *Trade Practices Act.*

Even when honest, competitive bidding is achieved, it may take place in such circumstances as to entail significant unnecessary costs and other undesirable outcomes. For example the regulations which constrain procurement decisions may not permit consideration of contractor past performance or anticipated product reliability.

The acquisition of resources by public sector agencies should be based on demonstrated need. Not only is the acquisition of unnecessary or superfluous materials wasteful per se, it sends the wrong message to public servants and to outside contractors.

Ideally, procurement should take the form of purchase on the open market, based upon competitive purchasing and contracting methods. This does not necessarily imply that the award of a contract should always go to the lowest bidder. There are circumstances, discussed below, where contractors should be rewarded for exceptional compliance on previous contracts. In addition, procurement managers should enjoy sufficient discretion to trade off cost, schedule, performance, and service/warranty considerations.

Where possible, procurement officials should seek products which are commercially available "off the shelf" rather than those which require custom manufacture. Where "off the shelf" products are inadequate or unavailable, specifications for the desired commodity should be drafted with great care. Insufficient specification may lead to the acquisition of an inferior product. By contrast, overspecification can lead to excessive cost. Guidelines on specification writing should be available to procurement officials.

In general, simplicity is a virtue. Wherever possible, procurement officials should opt for the basics, and avoid complicated accessories. Elaborate frills, or design add-ons, referred to by some as "goldplating", can significantly add to the cost of a purchase and may enhance the risk of malfunction at some future stage. Decisions to favour capability at the expense of economy, reliability and ease of operation and maintenance should be made with the greatest caution.

The attractions of "state of the art" technology should be weighed carefully against the downside risks of runaway cost and possible malfunction.

It has been suggested that split sourcing of contracts is a useful means of promoting competition and of ensuring that prices of a product or component do not significantly increase after it goes into production (Nemeth & Glastris 1989, p.30). With split sourcing, the government awards up to 80 per cent of the contract to the tenderer with the lowest bid. The tenderer with the next lowest bid is awarded the remainder of the contract. This can enhance future competition by assisting the commercial viability of two producers.

Defective or unreliable equipment can pose significant risks to human life as well as to other public sector resources. Safeguards against the acquisition of defective products, whether intentionally or negligently supplied, might include the requirement that the product undergo independent testing and certification, and that the product be subject to warranty. Products which fail to function as promised by their supplier should be returnable for a refund. Any waiver from warranty requirements should require ministerial authorisation.

In some cases, it might be appropriate to require that a contractor post a bond, refundable upon satisfactory delivery of goods or completion of a project. Needless to say, the imposition of such requirements upon contractors should not be undertaken gratuitously. The burdens which they impose might discourage some potential contractors from pursuing government business altogether, thereby reducing competition. But it might be argued that commercial interests which stand to profit from government contracts may be expected to tolerate some inconvenience as part of the price of doing business.

Value Engineering

Another method of cost control is that of value engineering, the systematic scrutiny of a project in its design stage for alternative project components, materials or methods which would perform the intended functions at less cost (Tufty 1987). The analysis is performed by an independent team, whose members' qualifications depend upon the nature of the project or product under scrutiny. Ideally suited to large scale construction projects or to the procurement of major capital equipment, value engineering can save 5 to 10 per cent of total project costs. Over the course of a large scale project, such savings can amount to more than a tenfold return on one's original investment in value engineering services. For example, in 1986, value engineering applications to construction projects for the United States Air Force achieved savings of US$37.4 million, a savings to cost ratio of 11:1 based on the value engineering costs of US$3.2 million. Value engineering clauses are routinely incorporated in most contracts and subcontracts for the U.S. Department of Defense (Mittino 1987, pp.77, 70). Through value engineering, the annual operating costs of correctional facilities in New York City was reduced by US$3.2 million (McElligott & Chang 1987, p.120).

Management Information Systems

Efficient management of an agency's resources requires some means of monitoring resource acquisition, inventory and use. Whilst this might appear obvious to the point of banality, it would seem that existing management information systems within many public agencies may not permit the degree of internal oversight necessary for the effective control of fraud, waste and abuse. At each level within the organisation, managers should be able to compare patterns of resource acquisition and use by subordinate units. The very existence of such oversight is likely to induce managers of those subordinate units to manage their resources more carefully. Observed anomalies will provide senior managers with early warning indicators of fraud or waste.

Public Vigilance: Visibility of Transactions

The principle that sunlight is the best disinfectant is applicable to much public sector activity. The more visible the transaction, the less vulnerable it is to fraud and corruption (Gardiner & Lyman 1978, p.145; p.211). Whilst it can be argued that matters of individual privacy, trade secrecy, and national security might militate against public access to many transactions involving public sector agencies, democratic principles imply that activity conducted on behalf of the public should be visible to that public. For example, regulations require the gazettal of Commonwealth government purchases. Beyond this, aggressive investigative journalists and citizen "watchdog" groups have an important role to play in enhancing the visibility of public sector activity (Grabosky 1990).

Preventing Fraud by Government Contractors: Conditions of Eligibility to Enter into Contracts with Government Agencies

Whilst it is desirable to maximise competition amongst prospective government contractors, fraud prevention considerations might militate in favour of certain conditions of eligibility to enter into contracts with the government. These could entail the imposition of disclosure requirements upon or the assumption of self-regulatory responsibilities by prospective contractors (Braithwaite 1982; Monahan & Claiborne 1988). The virtue of such measures is that they shift some of the costs of oversight from the government to the contractor, at the same time as communicating the government's concern for fraud prevention.

The development of a corporate culture resistant to fraudulent practices is easier to advocate than to achieve. Many will pay lip-service to corporate ethics, while continuing to place primary value on increased profit at any cost. Thus, self-regulatory initiatives must often be supplemented by other measures.

Companies could be obliged, as a condition of eligibility to do business with the government, to demonstrate that they are in compliance with one or more stringent requirements. These might include:

1. The disclosure of any previous regulatory violations or criminal offences with which the company or any of its directors may have been charged;

2. The implementation of a corporate ethics program, including the promulgation of clear standards of employee conduct, the establishment of staff ethics training programs, company hotlines, and voluntary disclosure policies; and

3. The implementation of appropriate systems of internal control and compliance monitoring.

Prequalification of contractors can be reinforced by additional controls. Contractors can be required to post performance bonds, which might be subject to forfeiture in the event of non-compliance. These are discussed below, under sanctions.

Information clearinghouse on corporate compliance

Intelligence can be of considerable utility in assessing one's vulnerability to fraud. Agencies throughout the public sector might well benefit from access to information which reflects the past performance of potential contractors, not only with their own projects, but also with regard to their performance on contracts with other government agencies.

To this end, some consideration might be given to the establishment of a database or clearinghouse for information on the compliance histories of companies doing business with all agencies of government. It would be useful to have ready access to information regarding the nature, dates, and amounts of previous government contracts performed by a tenderer, and whether the work was satisfactory.

Such a database could include information on other aspects of regulatory compliance as well. The data base could be expanded to include information on the principals and directors of a company, including data on whether they had been the targets of any previous investigations or prosecutions, or whether they had any record of convictions. Adverse information need not imply automatic disqualification from doing business with the government, but rather that the company's activity in the event of a successful tender be subject to stricter scrutiny.

Such information exchange raises obvious questions of privacy, and would almost certainly require the consent of companies concerned. Such consent could easily be made a condition of doing business with the government.

Positive Incentives

Where possible, public sector agencies should rely on positive incentives for fraud control (Gardiner 1986). These might include rewards for exemplary performance by contractors, and symbolic or material recognition for individuals or units with outstanding records in efficient resource management. Whilst this does not preclude the use of severe negative sanctions where situations may warrant, it is submitted that positive incentives have the potential for greater efficiency and effectiveness in the control of fraud and waste. Ultimately, an effective fraud control regime will contain an optimal balance of positive and negative sanctions.

Incentives for Exemplary Compliance: Contractor Incentive Programs

Without drastically altering current acquisition procedures, it should be possible to provide contractors and vendors with incentives for exemplary performance. Commonwealth Government departments are now able to use past performance as a criterion in tender evaluation. A more formal system of weighted tendering is currently employed by the Government of Singapore. The system provides tenderers with a weighting factor based on their performance on previous government contracts. Those tenderers whose previous work was completed on time, within budget, according to appropriate quality standards, and who have met subsequent warranty or service requirements, are entitled to have their tender considered as if it were less than the actual amount bid. Should the discounted tender be successful, the contractor is reimbursed at the level of the actual bid.

Personnel Incentive Programs

Positive incentives may be extended to public service personnel as well. One initiative which could fulfil this role is a program of symbolic and/or material incentives for contributions to the reduction of fraud, waste and abuse. This need not entail informing on or "dobbing-in" offenders; indeed, the program could be structured positively to invite beneficial suggestions. Cash rewards and commendations can be offered to personnel in every division or unit for useful ideas. A "grand prize" could be offered annually to that individual or unit within an agency who has produced the most constructive suggestion. Exemplary performance in the efficient management of resources can be made an explicit criterion for promotion.

Organisational Incentive Programs

The allocation of resources within a public sector agency can be structured to provide for rewards to organisations which succeed in controlling fraud, waste and abuse. A certain percentage of identified cost savings or recoveries can be earmarked for the organisation responsible for achieving them. Specific organisational commendations can also be awarded.

Detection

Audits

Good security practices are integral to good management. The first line of defence against fraud, waste and abuse, whether by public employees or by external contractors, is the audit. An agency's internal auditing capabilities should be strong, and they should be visible. As such, they contribute to fraud prevention as well as detection (Independent Commission Against Corruption 1991, p.17). The advent of "electronic trading" entails particular fraud risks requiring commensurate audit capabilities. Accurate physical inventories of government property should be carried out on a regular basis. In order to evaluate the effectiveness of internal controls, surprise audits and inspections should be carried out as a matter of policy. Through creative management, random, unannounced audits can be made a fact of life, less likely to be regarded as intrusions or as violations of autonomy, and thus not detrimental to morale.

The attention of managers throughout the public sector could be focussed on fraud awareness and prevention by a requirement that chief executive officers submit annual signed statements attesting to the effectiveness of internal controls.

Auditing and inspectorial oversight should be extended to contractors as well. Contractors' internal auditors should themselves be vigilant to ensure that unallowable costs are not charged to the government (Fordham 1989). Internal control systems should be subject to testing by the occasional use of "ghosts" on the payroll, dummy invoices, and other simulated false claims.

Government oversight of contractor compliance is an important backup for contractors' internal audit capability. In addition to the self-regulatory initiatives noted above, contractors' premises and records should be subject to periodic inspection without prior notification. Unlimited access to contractor facilities and records by public officials should simply be made a provision of the contract. Beyond ensuring the accuracy of contractors' control systems, and the efficacy of these systems in the prevention of intentional or inadvertent overcharging, government auditors should be empowered to review the overall efficiency of contractor operations. Among the areas on which contract auditors might usefully focus are labour and overhead billing procedures, and spare parts pricing, traditionally vulnerable to illicit exploitation by contractors (Weisman 1987).

Audits, both internal and external, are necessary but not sufficient for the detection of fraud, waste and abuse. Undesirable conditions or activity which escape the attention of auditors may be subject to discovery by other means. In addition to the beneficial suggestion programs noted above, avenues for the disclosure of fraudulent or wasteful activities should also be established. Initially, the existing chain of command should be given the opportunity to function effectively. It is important to ensure the efficacy of line reporting, by creating the

obligation to report anomalous circumstances to one's superior. Those circumstances which constitute grounds for reporting should be clearly specified. This obligation to report "upwards" will be accompanied by creating the obligation on the part of everyone in the line to report the follow-up action which has been taken in response to the initial report. The creation of such formal channels of communication by the Exxon Corporation has been favourably reviewed by Fisse and Braithwaite (1983, chap. 15).

Compliance monitoring need not be the unique province of government inspectors, or of industry self-regulation. Just as the financial statements of companies are subject to audit by independent professional accountants, so too can contract compliance be subject to audit by an independent agent. Goldstock (1989, p.139) envisages a role for independent accredited companies, or "certified investigative auditing firms" (CIAFs), to verify contract compliance on large projects, particularly large public works projects. CIAFs would themselves be licensed by governmental authority; the cost of their services (somewhere in the vicinity of 2 per cent of the overall contract amount) would be incorporated in the contract. Such "private inspectorates" would relieve some of the pressure on limited government resources. Public sector officers would assume the role of "superinspectors" (Gardiner & Lyman 1978), overseeing the operation of private compliance auditors.

Whistleblowing and Hotlines

The investigative resources of Australian governments are not unlimited. Nor, therefore, is the capacity of Australian authorities to detect or to investigate fraud against the government. Given these finite capabilities, it seems appropriate that the energies of the general public and of public servants generally be usefully enlisted to reduce fraud, waste and abuse.

Whistleblowing

Fraud, waste and abuse are primarily low visibility incidents. Many defy detection through audits; only occasionally do they involve self-reporting. Improved detection of fraud thus requires the assistance of personnel who become aware of an incident and are willing to disclose it.

Whistleblowing should not be portrayed or perceived as the first and only response to an incident of fraud, waste or abuse. Opportunities for the lodging of beneficial suggestions were noted above.

Ideally, there should be internal channels through which concerns might be articulated. Using the chain of command may be inappropriate in the more serious cases of fraud, however.

Disincentives to whistleblowing are formidable (Glazer & Glazer 1989). They can include ostracism by one's neighbours or peers, and harassment or victimisation by one's employer, or one's organisational superiors. The psychological pressures which flow from such conflicts may be intense, and may entail lasting injury. For this reason, mechanisms for protecting legitimate whistleblowers are essential. These would normally entail provisions for employment protection and legal assistance, where required. In circumstances where the legitimate whistleblower sees him or herself as unable to continue within the organisation, assistance with job placement may be appropriate. In extreme cases, support to the extent of that provided by the Federal Government to protected witnesses might be required. On the other hand, safeguards against frivolous or vexatious activity under the guise of whistleblowing should exist. Formal mechanisms for the identification and penalisation of false complaints are integral to any proper whistleblower projection program.

Queensland is the only Australian jurisdiction which has given statutory recognition to the term "whistleblower." *The Whistleblower (Interim Protection) and Miscellaneous*

Amendments Act 1990 contains whistleblower protection provisions, as do that state's *Criminal Justice Commission Act* and *Electoral and Administrative Review Commission Act.* No Australian jurisdiction currently provides protection for private sector employees who "blow the whistle" on wayward employers, although this and other whistleblower protection strategies are under consideration in Queensland (Queensland 1990). For a principled and systematic analysis of whistleblowing and whistleblower protection in the Australian context, *see* Finn (1991). For further comment and a discussion of recent Australian developments, *see* Starke (1991).

Hotlines

Organisations whose managers wish to have fraud reported must make it easier for employees to do so. One obvious vehicle is the hotline. This exists to receive confidential disclosure of irregularities via telephone, and may be available on a 24 hour basis, during normal business hours, or periodically, as is the case with operation NOAH, the drug disclosure program sponsored by Australian police agencies. Hotline complaints are screened, and those with apparent foundation are selected for further investigation.

The manner in which hotlines are established and publicised can effect their utility. The very existence of a hotline can be a reminder to personnel that there is an organisational commitment to fraud control. On the other hand, hotlines are vulnerable to abuse by frivolous or vexatious complainants. In addition, as a means of fraud detection, they may be lacking in both efficiency and effectiveness. Many complaints may be trivial, if not groundless; significant cases of fraud, waste and abuse tend to come to official attention by other means. Hotlines may thus be an inefficient means of detecting fraud. Their very existence, however, may serve an important educative and deterrent function.

False Claims Litigation

In fourteenth century England, there emerged a means of private redress to supplement what were at the time modest efforts at public law enforcement (Fisse & Braithwaite 1983, pp.251-54). The term employed for these causes of action was *qui tam* (Latin for "who as well"; that is, who sues for the state as well as for him or herself).

Qui tam litigation fell into disuse in the English-speaking world, to be revived during the United States Civil War, and more recently, to combat the U.S. defence procurement scandals of the 1980s (Kamuchey 1989).

The legislation is noteworthy in two respects. First, it is a civil and not a criminal statute, intended to be remedial rather than punitive. (It should be noted that the current provision for treble damage awards may have a punitive effect.) The standard of proof required is civil, on the balance of probabilities, rather than the more formidable criminal standard of proof beyond reasonable doubt.

Second, the statute authorises private citizens to sue on behalf of the government, and to share in any recovery of defrauded funds eventually recovered by the government. The government may join the case, in effect taking it over, and the citizen plaintiff may still share in the recovery of funds. The Act contains safeguards against frivolous or vexatious litigation, and provides for criminal prosecution to take precedence over civil action where the government deems it appropriate.

As amended in 1986, the legislation (PL 99-562) incorporated the following:

1. Allowance for a private citizen who discovers fraud against the government to sue for damages.

2. Provision for an award of triple the damages sustained by the government.

3. Provision for a maximum civil fine of $10,000.

4. Guarantees that the private citizen who initiates the suit receives a proportion of the damage award - between 15 per cent and 25 per cent if the government enters the case; if the government does not enter the suit, the successful private plaintiff can receive between 25 per cent and 30 per cent of damages. (Awards are at the discretion of the presiding judge, based on his or her assessment of the citizen's contribution to the litigation).

5. A requirement that the defendant pay the legal expenses of a successful private plaintiff.

6. Protection for private plaintiffs from harassment, dismissal, demotion or suspension by their employer.

Since October, 1986, numerous *qui tam* suits have been filed under the *False Claims Act.* The vast majority were filed against companies or individuals who had allegedly defrauded the U.S. Government.

Voluntary Disclosure by Contractors

In the United States, defence contractors who discover violations through internal audit or other means are encouraged to disclose them to appropriate authorities, and to voluntarily return unlawful proceeds to the government (Brown 1989). Whilst such disclosure need not preclude subsequent prosecution or civil action, it is indicative of good faith and of some ethical sensitivity on the part of the contractor, and may be considered in mitigation of those sanctions which are eventually imposed. It is obviously less applicable to the more unscrupulous cases. It should also be noted that wayward contractors tend not to avail themselves of voluntary disclosure opportunities unless independent detection of their illegality is imminent.

Investigation

In relatively large organisations with significant personnel turnover, it may be difficult to sustain an institutional memory. This becomes even more important with regard to fraud, the investigation of which entails cooperation with or dependence upon external agencies.

Preserving agency autonomy is generally a high priority of public sector managers (Gardiner 1986, p.44). With a view towards maintaining an image that one's organisation is in complete control of its resources and operations, and thus invulnerable to fraud, it may be tempting to ignore indicia of illegality, and to refrain from contacting or cooperating with outside investigators. Such an orientation enhances the risk that an underlying pathology might not be rectified, and that an even larger scandal may eventuate. Clear guidelines relating to the mobilisation of outside investigative assistance should exist to assist managers throughout the agency who will bear continuing responsibilities for fraud prevention and control. Effective relationships between public sector agencies and law enforcement bodies may be assisted by the development of formal agreements which detail the relative roles and responsibilities of law enforcement and client agencies (Australia 1991, p.23).

At a certain point in the course of an investigation, a decision must be made regarding the choice of remedies to be pursued. In some cases, circumstances will be such that criminal prosecution will be the most appropriate course. In others, lack of sufficient evidence to frame criminal charges, or other considerations, may militate in favour of civil or administrative remedies. There may well be some circumstances in which a combination of remedies will be sought. The choice of remedy itself has implications for the allocation of investigative resources; such decisions should not occur on an ad hoc basis, but rather reflect clear policy.

It may be perceived as useful to develop an ongoing program to monitor cases of suspected fraud coming to departmental attention. From this it would be possible to assess such important matters as the effectiveness of control systems and the relative productivity of various detection strategies. If, for example, cases coming to official attention as the result of external audit are more likely to result in successful resolution, this might imply the desirability of greater investment in this particular countermeasure. The implications for achieving greater cost effectiveness in fraud control should be obvious. At the very least, periodic self-assessment and review by an outside agency can be instructive (Great Britain 1991; United States 1988).

Choice of Investigative Methods: Covert Facilitation

In extreme cases it might be appropriate to employ fairly intrusive investigative techniques against suspected perpetrators of fraud. These might include telecommunications interceptions, "body wires" (microphones concealed on the person of an investigator or agent), the use of undercover agents, and techniques of covert facilitation or "sting" operations such as those

used by the U.S. Federal Bureau of Investigation in the ABSCAM operation against corrupt members of Congress (*see* generally, *Journal of Social Issues 1987*).

Although these techniques tend to be very expensive and raise significant ethical questions (Marx 1988), undercover operations have been successfully directed at corruption in procurement and contract letting on the part of county and municipal officials in the United States (Goldstock 1989, p.84; p.94; Hailman 1988).

The use of undercover agents and telecommunications interception in Australian law enforcement is by no means unprecedented. Nevertheless, given their potential for abuse, such methods, if they are to be mobilised against public sector fraud in Australia, should be used only sparingly and very selectively. They should require independent determination of probable cause, and be used as a last resort, only when conventional investigative methods appear unlikely to succeed (McDowell 1988). They should be subject to strict guidelines and ministerial authorisation.

Sanctioning

Given the diverse manifestations of fraud in the public sector, authorities should have available a range of sanctions, so as best to achieve the varied ends of deterrence, rehabilitation, restitution, and denunciation.

Criminal penalties

Should the existing arsenal of criminal sanctions be perceived by Australian officialdom or by the general public as an insufficient deterrent to fraud, further legislation may be appropriate. Such legislation could "raise the stakes" for those who might be inclined to perpetrate major frauds, either by increasing maximum available penalties or by introducing other procedural changes to facilitate prosecution.

An example of such a strategy may be seen in the U.S. *Major Fraud Act* of 1988 (Malarkey 1989). The Act created a new offence of "procurement fraud" for any government contract fraud in excess of $1 million. Persons convicted of procurement fraud may be imprisoned for up to 10 years or fined up to $1 million, or both. Beyond this, the Court has the discretion to fine a defendant up to twice the government's gross loss or the defendant's gross gain. Other provisions of the Act extent the statute of limitations for bringing a prosecution to seven years.

Responsibility for prosecuting charges of fraud will be borne by the relevant prosecuting authority. In the case of federal matters, this will be the Commonwealth Director of Public Prosecutions (DPP). State, territory, or local government matters will be dealt with by state DPP or crown prosecutors. Presumably, relations between the public agencies and their respective prosecuting authorities are both cordial and productive. Even under the best of circumstances, however, one might envisage situations wherein the priorities of the prosecutor, given prevailing resource and policy constraints, might not coincide with those of the client agency. Close ongoing liaison with the prosecutor would appear appropriate to minimise this risk. Every effort should be made to ensure that the staff of the prosecutor's office includes personnel with expertise in prosecuting public sector fraud.

It might be useful to maintain an ongoing log or diary containing brief post-mortem analyses of each case of public sector program fraud giving rise to criminal charges, and noting both the strengths and the shortcomings of each prosecution. This could help in the preservation of an institutional memory; analyses of remediable weaknesses or defects in the prosecution's case could prove useful in strengthening future cases.

In many of those cases in which charges are laid, and especially those in which prosecutions are successful, deterrence of future misconduct might be well served by

focussing maximum publicity on the offence, its detection, and punishment. This too will require close liaison with prosecuting authorities, to ensure that such publicity does not jeopardise the right of the accused to a fair trial, or is otherwise prejudicial to the interests of justice.

Mandatory Prison Sentences

Some types of public sector fraud are so serious that they might merit imprisonment. Among the more heinous forms of fraud is product substitution, or intentional failure to conduct quality testing, where the act or omission in question creates a substantial risk of death or serious injury. Current Australian jurisprudence tends not to embrace the principle of mandatory sentencing, deferring instead to judicial discretion. Nevertheless, it might be appropriate to express forcefully the seriousness with which such aggravated forms of product substitution is viewed.

Administrative Remedies

Misconduct short of criminal activity or cases where evidence may be insufficient to sustain criminal charges may still permit the mobilisation of negative sanctions. The civil remedies incorporated in false claims litigation were noted above, as was the revocation of performance bonds in the event of contract non-compliance. Another example drawn from the United States experience is the *Truth in Negotiations Act*, aimed specifically at defective pricing fraud. This Act requires that contractors submit cost and pricing data which underlie a bid or tender to the government before a contract is awarded. The contractor is required to certify the currency, accuracy and completeness of the pricing data. Sanctions under the Act include payment of the overcharge, plus interest.

An example of U.S. legislation which provides for civil remedies or criminal penalties is the *Anti-Kickback Act* of 1986. Applicable to all government contracts, it prohibits not only the completed act, but attempts to solicit or offer kickback payments as well. Civil penalties for knowing and wilful violations include damages up to twice the amount of kickback plus $10,000 per occurrence. The Act also imposes a duty on prime contractors and subcontractors to report any possible violations of the Act. Such voluntary disclosure may be regarded in mitigation at subsequent proceedings.

Contractors could be required to notify the government in the event of significant cost overruns, or indeed, if costs will be significantly less than those in the contract. Auditors can then review costs to evaluate their reasonableness. (Neuman 1981)

Contract Cancellation

Other administrative remedies might include, inter alia, the cancellation of a contract, or the debarment of a contractor from doing business with the government for an indefinite or a specified period (Nadler 1989). Specific individuals implicated in improper or illegal activity could be targeted as well, for example, by revoking security clearances.

Contracts might include a termination clause permitting the government to unilaterally terminate the contract in the event of contractor noncompliance.

Debarment

In some instances unacceptable performance by a contractor might merit suspension or debarment; that is the individual or company may be prohibited from doing business with the agency in question, or with any government body, permanently or for a specified time. The

threat of removal from the list of companies eligible to do business with the government has considerable deterrent potential, particularly against those companies which depend on government business for a significant portion of their earnings.

Conclusion

None of the countermeasures noted above can be expected to render Australian governments invulnerable to the risk of fraud, waste and abuse. Given the diversity which characterises the Australian public sector, some approaches will be more appropriate in some settings than others. It is incumbent upon public sector managers to identify and to implement the most effective and efficient mix of countermeasures. In the current economic climate, Australia can ill-afford the theft and waste of valuable public resources.

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