

GUIDANCE FOR INTEGRITY IN ENGAGING CONTRACTORS



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Purpose

Engaging a contractor gives Victorian public sector employers flexibility to meet their organisation's workforce needs. They may employ contractors with specialised skills, for a one-off complex project or to cover short-term absences of ongoing staff. Contractors who perform a public sector role must comply with the [Code of Conduct for Victorian Public Sector Employees](#).

It is important that the organisation has an open, transparent process for engaging contractors that balances risk and efficiency. Employees may be tempted to take short cuts if the process is overly complex or time consuming. Contractors may not understand what is required of them when bidding for work. A lack of internal controls could leave the organisation exposed to unacceptable risks including fraud. This guidance note gives employers tips for preventing, detecting and responding to the risks associated with engaging contractors.

Risks

Why is engaging a contractor an important risk to be managed?

In its 2012 survey of fraud, bribery and corruption in Australia and New Zealand, KPMG found that fraudulent tendering was the greatest financial risk in the public sector. When employees colluded with contractors over price, the fraud was harder to detect and accounted for 42 per cent of the total financial loss. Collusion includes releasing confidential pricing information, splitting invoices to circumvent delegation limits, and extending the scope of work from what is really needed. These may all result in inflated prices being paid.

Most employees who committed fraud did not have a history of dishonesty and would therefore not have been detected through a criminal history check. They were often motivated by greed or personal financial pressure and had taken advantage of an opportunity in the process.

An employee who has unchecked control over an entire process or over two closely related points in a process has an opportunity to act corruptly. Examples include an employee who both orders and verifies the delivery of goods. This provides an opportunity to over order and under deliver goods. An employee who raises invoices and pays accounts has the opportunity to create false records.

In a weak market with few alternative suppliers, the contractor has far more information about technical details and costs than the organisation. This provides an opportunity for an employee and contractor to exaggerate the scope and cost of work.

Negotiations following the selection of a contractor may be used to extend the scope or vary the work in other ways. This is both

unfair to the other contractors bidding for the work and perhaps an indication that the organisation has not assessed its need accurately or does not understand the market.

Finally, an employee who fails to tell their employer that they have a private business in a related industry may attempt to subcontract for government work through the contractor. They may also disguise ownership of their company while bidding for government contracts directly.

How can the risks associated with engaging contractors be mitigated?

The culture of an organisation is paramount. Employees learn from formal training but also from observing the behaviour of their manager and peers. The *Victorian Public Administration Act 2004* outlines the values that they need to demonstrate at work. Of particular importance to contract management are:

- Being open, honest and transparent
- Using powers responsibly
- Reporting improper conduct
- Avoiding real or apparent conflicts of interest
- Accepting responsibility for decisions and actions
- Submitting to appropriate scrutiny.

Any employee involved in engaging a contractor should be aware of the organisation's processes and receive sufficient support from their manager. Any departures from standard processes should be rare and the reasons documented. Any suspected corruption should be reported to the organisation's Protected Disclosure Coordinator^[1], Victoria Police or to the Independent Broad-based Anti-corruption Commission (IBAC). Additionally, random monitoring by the manager or internal audit will deter corrupt behaviour and quickly identify any problems. It is reasonable for managers to ask to see the detail of how price estimates were obtained before signing off on budgets.

A good system is both efficient and prevents opportunities for corruption from occurring. The *Standing Directions of the Minister for Finance* under the *Financial Management Act 1994* require organisations to review, approve and oversee their system of internal controls. In keeping with this requirement, organisations may want to map out their processes to make sure there are sufficient internal controls in place. They should also review the internal controls again following an investigation into any incidence of fraud.

The *Standing Directions* prohibit a contractor from being issued a financial delegation or authorisation. There is presently no scope for an exemption to be granted for this requirement.

What are the red flags to look out for?

Red flags are the early warning signs that fraud may be occurring and can include:

- Lack of supporting documentation for the decisions taken
- Bypassing standard processes
- Frequent payments just below delegation limits
- Apparent splitting of orders
- Unusually close relationships with particular contractors
- Allocating work to a small number of contractors
- Acceptance of gifts, benefits or hospitality from particular contractors
- Undeclared private interests that potentially conflict with an employee's role.

Preventing fraud

Are there whole of government policies to consider?

The Victorian Government Purchasing Board (VGPB) issues policies, good practice guides, tools and templates to assist government departments to take a more strategic approach to procurement.

The Minister for Finance has issued two directions that reinforce the VGPB's policies. Government departments must have effective internal controls so that procurement is based on business needs and the following principles:

- Value for money
- Open and fair competition
- Accountability
- Risk management
- Probity and transparency.

Government departments must disclose details of expenditure on consultancies in their annual report. Additionally, the Victorian Government Data Directory (www.data.vic.gov.au) is a website providing public access to government owned data. It includes details of expenditure on consultancies valued between \$10k and \$100k for each government department.

Government departments and public sector organisations also need to retain information about the contractors they have engaged, the services they have provided and the expenditure committed.^[2] This information is generally available on request to Ministers, Members of Parliament and the public, subject to the provisions of the *Freedom of Information Act 1982*. The information may also need to be retained in accordance with the provisions of the *Public Records Act 1973*.

Why is planning the essential first step?

Before deciding to engage a contractor, the organisation must be satisfied that the work is necessary and cannot be completed using internal resources. The organisation must also fully assess potential risks and document the basis of a preferred approach for addressing those risks.

Why use the state purchase contract for staffing services?

The state purchase contract is mandatory for the engagement of temporary and on-hire staff in the Victorian Public Service and optional for other public sector organisations. The contract covers seven master vendors and can be used to fill information technology (IT), administrative, specialist, professional and senior roles. The purpose of the contract is to minimise the cost of recruitment, provide value for money and supply suitably qualified staff in a timely fashion. It makes the process of hiring staff more independent and less likely to result in a conflict of interest because it involves a third party. Managers are unlikely to hire a personal connection because the master vendors supply the applicants.

Why should exemptions from standard process be monitored?

An exemption from standard process has the potential to limit competition and reduce value for money. The exemption may have been sought to meet tight timeframes or to engage a contractor with unique expertise or prior knowledge. If exemptions are freely granted, a small number of contractors may gain an undue hold on future work in the organisation. By monitoring exemptions, the organisation can identify trends and set processes in place to lessen their need.

How can organisations limit the opportunity for biased decision-making?

Decisions about engaging a contractor should be made by a group of people rather than one person. Each member of the evaluation panel completes a conflict of interest form before commencing the procurement process. The contract is approved by a financial delegate with some independence from the process such as a senior person in the corporate or legal area of the

organisation.

Enforced job rotation is another technique that can bring a fresh perspective to the workplace and limit the opportunity for improper behaviour to go undetected.

What are the benefits of including a procurement specialist in the process?

A procurement specialist can reduce the risk of corruption and increase the effectiveness of procurement. They can advise on what work is needed, how much it should cost and whether a competitive market exists or not. They bring an independent view to the process.

What type of background checks might be appropriate?

Organisations may wish to conduct background checks, including a police check, on staff who are appointed, promoted or transferred to areas of high risk (refer to the VPSC's *Guidance Note on Police Checks in Recruitment* for more details). They may also request the master vendors to supply on-hire staff who have been police checked. Police checks may also be appropriate for contractors who have ready access to the organisation's resources such as those providing catering or cleaning services.

Organisations can check the Australian Business Register (abr.business.gov.au) and the Australian Securities and Investments Commission (connectonline.asic.gov.au) for details about contractors, both sole traders and companies. Possible searches include company name, address and associate details (ABR), banned or disqualified individuals, and notices of insolvency (ASIC). They can also check the Victorian WorkCover Authority database (www.vwa.vic.gov.au) for details of prosecutions and other notices under the occupational health and safety legislation.

In high risk areas, such as the building industry, organisations may wish to cross check the names and addresses of contractors against the names and addresses of staff members to help identify potential conflicts of interest.

How does the contract help to prevent corruption?

The contract needs to be carefully worded and can cover probity checks, fraud, confidentiality, key performance indicators and subcontracting. Organisations may ask for subcontractors to be listed in the contract. Not only does this information give them more detail about who is doing the work but it can also deter or detect conflicts of interest. An employee may have secondary employment as a subcontractor.

The contract manager, contractor and any sub-contractors must comply with the conditions in the contract. The services or goods provided will be assessed against the key performance indicators.

How should organisations respond to suspected fraud?

Organisations should have systems for internal reporting of detected incidences of fraud and establish a fraud and corruption register. The organisation may have an internal investigation unit that can gather evidence, investigate and make recommendations about improvements to internal controls and policies in response to suspected fraud.

Organisations should also ensure that allegations of fraud and corrupt conduct are reported to the appropriate law enforcement agencies or government bodies. For instance, the organisation may refer the matter to the Independent Broad-based Anti-corruption Commission (IBAC) or to Victoria Police for investigation. The organisation must also notify the Minister for Finance and the Auditor-General of any suspected or actual fraud in accordance with the Department of Treasury and Finance's *Thefts and Losses Rules*.

The organisation may want to discipline and possibly dismiss any employee found guilty of serious misconduct or corruption and terminate engagements with contractors who engage in similar conduct. It may also recover money or property fraudulently obtained.

Where can organisations obtain more information about contract management?

Organisations, their employees and contractors can contact:

- Victorian Public Sector Commission for advice on the *Code of Conduct for Victorian Public Sector Employees*, the *Guidance Note for Managers Engaging Contractors and Consultants*, and the public sector values and employment principles
 - Department of Treasury and Finance for information about the *Financial Management Compliance Framework* and the *State Purchase Contract for Staffing Services*.
 - Their organisation's Internal Purchasing Unit (IPU) for advice on the procurement policies and processes they should be following
 - Victorian Government Purchasing Board (VGPB) for advice on the *Procurement Capability Framework*, whole-of-government procurement policies and standard contracts
 - *Procurement People* group on the Victorian Public Service (VPS) Hub to share good procurement practice with peers
 - Australasian Procurement and Construction Council Inc. (APCC) to read its procurement publications
 - Institute of Public Administration Australia (IPAA) Victoria to enrol in its *Procuring with Integrity* and *Contract Administration* courses
 - Chartered Institute of Purchasing & Supply Australasia (CIPSA) to enrol in one or more of its procurement skills training courses
 - Royal Melbourne Institute of Technology (RMIT) University to enrol in its *Master of Strategic Procurement* course
 - Independent Broad-based Anti-corruption Commission (IBAC) for advice on protected disclosures and methods of preventing corruption.
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Footnotes

1. An organisation that is a public service body or a prescribed public body is able to receive protected disclosures under s 13 of the *Protected Disclosure Act 2012*. [↔](#)
2. FRD-22E Standard Disclosures in the Report of Operations. [↔](#)