



ICAC

Independent Commission
Against Corruption
SOUTH AUSTRALIA



Received or Deceived?

Managing and monitoring the conduct of government contractors

A report by the Hon. Ann Vanstone QC.
Commissioner



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of government contractors

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Level 1, 55 Currie Street
Adelaide SA 5000
(08) 8463 5191
GPO Box 11066
Adelaide SA 5001
icac.sa.gov.au

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Commissioner's foreword

The Commission has conducted multiple investigations into allegations that suppliers and contractors have defrauded public authorities through the manipulation of contracts¹.

The investigations have identified efforts by suppliers and contractors to conceal their dishonest conduct from public authorities. Public authorities have enabled this conduct through poor contract management practices and a lack of effective systems designed to ensure they receive what they pay for.

Investigations conducted by the Commission have included:

- ▶ An aged care provider alleged to have created fake carers to dishonestly report they were adhering to mandated levels of care.
- ▶ A care provider allegedly invoicing an agency for one-on-one care they were not providing. This widespread false invoicing was discovered when a client went missing from a facility and the provider failed to inform the department in accordance with the terms of its contract.
- ▶ A disability support provider allegedly overbilling an agency by charging the full value of the contract when services of that value were not provided.
- ▶ A transport company alleged to have falsely secured on-time bonus incentives by cancelling and rebooking orders when agreed timeframes were close to expiring. This enabled them to repeatedly 'reset the clock' and claim the relevant bonus.

Previously, these forms of conduct fell under the banner of dishonesty offences and were investigated under the original definition of corruption within the *Independent Commissioner Against Corruption Act 2012* (the ICAC Act). That definition was found in section 5 of the ICAC Act and included section 5(1)(c), which provided that corruption included conduct which amounted to:

Any other offence (including an offence against Part 5 (Offences of dishonesty) of the Criminal Law Consolidation Act 1935) committed by a public officer while acting in his or her capacity as a public officer².

1 Persons performing contract work for a public authority or the Crown are public officers under the *Independent Commission Against Corruption Act 2012* (ICAC Act).

2 Section 5(1)(c) of the *Independent Commissioner Against Corruption Act 2012* (Historical 01 July 2020 – 06 October 2021)

This creates an imperative for public authorities to take steps to ensure they have adequate controls in place to prevent dishonest conduct on the part of contractors.

Late last year that limb of the definition was excised. As I noted in my recent report, “An examination of the changes effected by recent amendments to the *Independent Commission Against Corruption Act 2012*”:

The significance of this change should not be understated. The substantial majority of the investigations I have undertaken relate to offences now removed from the Commission’s jurisdiction. The Commission can no longer investigate dishonesty or theft offences committed by public officers even if the offending is widespread or public resources substantially defrauded...³

Prior to these changes to the ICAC Act, the Commission finalised a corruption investigation into allegations a contractor had dishonestly claimed funds from a government agency. Conduct such as this might not be investigated by the Commission in future because, whereas the contractor could previously have been charged with deception, that is no longer a ‘corruption offence’ as defined. This creates an imperative for public authorities to take steps to ensure they have adequate controls in place to prevent dishonest conduct on the part of contractors. To that end I have determined it is in the public interest that I publish a report on the nature of this recent investigation, to highlight corruption opportunities that were identified and lessons learned.



The Hon. Ann Vanstone QC
Independent Commissioner Against Corruption

³ Independent Commission Against Corruption, ‘An examination of the changes effected by recent amendments to the *Independent Commission Against Corruption Act 2012*’, p. 5.

Power to report

Section 42(1)(c) of the *Independent Commission Against Corruption Act 2012* (the ICAC Act) provides:

- (1) *The Commission may prepare a report setting out (subject to subsection (1a)) –*
- (c) *other matters arising in the course of the performance of the Commission’s functions that the Commission considers to be in the public interest to disclose.*

I consider it in the public interest to disclose the following information in relation to a corruption investigation conducted by the Commission.

A corruption investigation

In April 2021 my investigators completed an investigation into allegations of subsidy manipulation by a Registered Training Organisation (organisation). The organisation was contracted to the Department for Innovation and Skills to provide vocational education and training, for which it received financial subsidies. The investigation established that manipulation of subsidies had occurred for many years, undetected by the Department.

The investigation was unable to establish conclusively the person at the organisation who authorised or was responsible for the subsidy manipulation. No criminal proceedings against anyone at the organisation were therefore pursued. There was no evidence that any public officer of the Department had any involvement in the subsidy manipulation by the organisation.

Nevertheless, the evidence pointed to potentially serious deficiencies in the manner in which the Department ascertained that subsidies were payable, before paying them.

How the subsidy manipulation occurred

The subsidy manipulation involved falsely reporting that students had achieved full competency for courses before those students had completed their courses. The purpose was to trigger release of subsidy payments to the organisation. Arguably, many of these subsidy payments would have been payable when those students completed their courses. However, for those students who ultimately failed or withdrew from their course (not an insignificant number) the subsidies never became payable. This benefit was estimated to amount to hundreds of thousands of dollars over several years.

This conduct by the organisation was obscured from the Department's view because of a complex system of reporting codes, coupled with unwieldy administrative arrangements poorly designed to verify the truth of facts underpinning subsidy claims. In essence, the organisation fabricated a reporting code that misrepresented the number of students being assessed as competent. This code was not recognised in the national standards upon which the subsidy scheme was based, was not acknowledged in the contract between the Department and the organisation, and its use was not visible in the Department systems used to generate payments. The organisation was twice cautioned by an external auditor that its use of the fabricated code was not consistent with the national coding scheme, and was potentially in breach of the contract with the Department.

Factors at the Department enabling the potential for corruption

Evidence gathered during the investigation suggested various weaknesses at the Department may have facilitated the subsidy manipulation and contributed to it remaining undetected for many years. The significance of this is underlined by reference to the proportion of the Department's budget applied to training by external agencies. In 2020-21 the distribution of grants and subsidies accounted for 85% of the Department's total expenses⁴. An amount of \$296 million was expended to support the delivery of vocational education and training, and a further \$44 million was spent in other subsidy skills and employment grants.

It would seem that allocating subsidy and grant funding is the principal financial activity of the Department. Accordingly, the robustness of the policies, practices and procedures relating to disbursing these funds should have been assured.

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⁴ Independent Commission Against Corruption, 'An examination of the changes effected by recent amendments to the *Independent Commission Against Corruption Act 2012*', p. 5.

Reticence to report

The investigation revealed there had been reticence amongst senior officers at the Department to report the matter to the Office for Public Integrity. Instead, attempts were made to manage the situation internally. An external consultancy firm was engaged to confirm the financial shortfall, and efforts were made to arrive at an accommodating solution for all parties. Some Department staff expressed disquiet about the appropriateness of this strategy, arguing that Departmental delay and failure to promptly report the matter might be construed as concealment, and possibly implicate the Department in the improper behaviour.

The obligation to report matters to the Office for Public Integrity involves the exercise of individual judgement. Differences of opinion about whether a threshold of suspected corruption is met are inevitable. Corruption and fraud can sometimes be difficult to identify, especially in the context of contractual relations. The investigation revealed that staff were contending with challenging matters of integrity and corruption, and questioning how best to address and expose them. This was in spite of the Department's evident commitment to instructing staff on their reporting obligations. Crimes of dishonesty and their concealment are rarely clear cut. This is why the reporting obligations require only a 'reasonable suspicion' of corruption as a trigger for making a report.

In our "reformed" integrity landscape where common dishonesty charges are no longer classed as corruption, it is likely that reporting of this sort of conduct in the future will be further restrained.

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Risk awareness

The Department was aware of the possibility of subsidy manipulation in the training sector. It had investigated a different training organisation in 2016 for manipulating subsidies using a similar method to the one observed by ICAC investigators. That earlier conduct was never reported to the Office for Public Integrity, and was only discovered by the Commission during this recent investigation. Despite knowing of the potential for subsidy manipulation by training organisations, the Department appeared not to have rectified its systems or processes to alleviate this corruption risk in the intervening years. The Department's knowledge of the corruption risk is further evidenced by the fact that when the more recent subsidy manipulation was exposed, documents revealed that some staff believed it highly likely other training organisations were engaging in similar conduct. In any event, the Department should have been aware it subsidises a sector that historically has been troubled by poor standards and instances of corruption. Examples of private training providers exposed as corrupt, and the multiple policies failures which lie behind such incidents have been well documented in media, policy, and academic circles⁵.

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Complex coding and administrative systems

In order to receive subsidies from the Department, registered training organisations electronically report their training activity using various codes which are processed and give rise to payment by the Department. Without detailing the intricacies of the system, the investigation revealed that the software, coding and processing procedures used to administer the subsidies was complex. The systems lacked visibility, integration, ownership and accountability, and were prone to causing confusion. The complex coding and administrative systems undoubtedly enabled the conduct and prevented its early detection.

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5 For example, 'Why exploitation and corruption continue to dog Australia's VET sector', The Conversation, Peter Hurley, 3 July 2017, see, <https://theconversation.com/why-exploitation-and-corruption-continue-to-dog-australias-vet-sector-80321>. And, 'Hundreds of millions lost from vocational scheme', Sydney Morning Herald, Farrah Tomazin, 7 December 2019, see, <https://www.smh.com.au/politics/federal/hundreds-of-millions-lost-from-vocational-scheme-20191206-p53hqk.html>

A trust system

The administrative complexity disguised a system almost exclusively reliant on the honesty of training organisations in reporting their training activity. The only way to ensure the codes used to claim subsidies accurately reflected the training provided was to reconcile them with student records. Though the Department requires organisations to keep student records to allow substantiation of claims if requested, it is reported that these records were rarely checked. A number of Department staff told investigators that the system was, in essence, “a trust system” and that there was a view that comparing subsidy claims against student records was too labour intensive. It was also reported that the Department’s auditing functions were primarily reactive, with minimal random audits of student records scheduled across the training sector. In the end, the evidence suggested a situation where the Department could not be confident it was obtaining the full range of services for which it was paying.

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Diffuse accountabilities

Diffuse accountabilities may also have compromised effective decision-making, supervision, and governance in the Department. The investigation revealed that those within various sections of the Department (finance, audit/compliance, contract management) were unsure who had ultimate responsibility for checking the veracity of subsidy claims made by training organisations. When payments to the organisation subject to the investigation almost tripled around 2018, no red flags were raised in any section of the Department. Employees were unsure who had responsibility for knowing what levels of service were allowed and legitimate, or who should check.

The existence of the Australian Skills Quality Authority (the Authority) also appeared to foster a culture of complacency within the Department in relation to responsibility for supervision and performance monitoring. The Authority is a federal agency which registers training bodies, accredits courses and audits the performance standards of training providers in the vocational education sector. The Authority has no role in monitoring the performance of training organisations in relation to their contracts with state governments. However, it was apparent that many in the Department believed this was part of the Authority’s role, or would nevertheless be monitored in the course of performing its role.

A public authority's ability to undertake proper contract management is dependent on suitable design of funding schemes and contracts.

Subsidy and contract models

It appeared to the investigators that some features of the Department's training subsidy schemes were inefficiently designed in terms of the practicalities of course structure and delivery. A degree of mismatch between subsidy design and course practicality was evident, and historical solutions to the ensuing cash-flow issues for training organisations had evidently failed to keep pace with changes to the training market. This arguably heightened the corruption risk.

A public authority's ability to undertake proper contract management is dependent on suitable design of funding schemes and contracts. Poor initial design can create difficulties for suppliers. Care should be taken that a model does not make compliance so difficult or financially strained that it provokes poor contractor behaviour.

Sector and political pressures

Evidence obtained during the investigation suggested the Department's reticence to report and its desire to manage the situation internally could be explained, at least in part, by the perception they were sponsors or partners of the training sector in South Australia. It seemed likely that the Department was in a sense 'captured' by the vocational education and training sector, and some within the Department saw their role as safeguarding and promoting the sector. Given the Department has key performance indicators, targets and other measures of success tied to the work of training organisations, this is understandable.

The Department is situated at an interface of public and private spheres, where its purpose and reputation are intricately tied to the fate of private firms it subsidises. This heightens the Department's need for robust corruption controls.

It also needs to be acknowledged that the Department operates in a politically sensitive environment, with employment and training being key policy areas for governments. Indications were that awareness of these political sensitivities could have affected the will within management to address the situation with the organisation subject to the investigation.

All government agency decision-making is necessarily informed by the politics surrounding relevant policy areas. There may be a need to review relevant Departmental practices, policies, and procedures to ensure they are equipped withstand the tensions seen here.

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I was encouraged that the reforms appeared to intervene in the three main areas where the Commission considered improvement was needed.

Measures taken by the Department to address corruption risks

By letter of 1 October 2021, I informed the Chief Executive of the Department, Mr Adam Reid, of my intention to make recommendations about subsidy practices at the Department and make these recommendations public in a report. The letter foreshadowed the recommendations as being related to:

- ▶ improving training organisation compliance with the terms of contracts entered into with the Department, both through appropriate contract design and regular communication of contractual expectations,
- ▶ ensuring the Department has the means to properly verify the accuracy of subsidy claims made by training organisations,
- ▶ ensuring the Department has the resources and procedures in place to adequately monitor and audit training organisation compliance with contracts.

In that letter I also invited Mr Reid to inform me of any reforms the Department had already made to its administration of subsidy and grant programs, and to outline how these would strengthen the capacity to detect and prevent corruption. Mr Reid accepted that invitation.

In a meeting held with Commission officers on 12 October 2021, Mr Reid outlined the reforms the Department had embarked on to mitigate the risk of corruption in the VET subsidy schemes. These were:

- ▶ February 2020 - A Digital Transformation Case to improve claims and subsidy systems, supported by a \$13m investment, and the commencement of a 'compressive business program'.
- ▶ February 2021 – the commencement of a 'Contracting Business Improvement Project', including a review of policies, processes and procedures for grants and subsidies.
- ▶ March 2021 – the development of a 'Monitoring and Compliance Plan' to yield deeper analytical insights into training organisation activity and inform risk-based monitoring and compliance with relevant policies and procedures.

While these initiatives were not elaborated on during that meeting, I was encouraged that the reforms appeared to intervene in the three main areas where the Commission considered improvement was needed.

Accordingly, I chose not to issue the recommendations foreshadowed in my letter to Mr Reid, though I still regard it as important to make these matters public in the interests of transparency and accountability.

Auditor-General informed

On 13 October 2021 I met with the Auditor-General to inform him of financial and governance matters arising from the Commission's investigation relevant to his functions. He indicated an interest in the governance of grants and subsidy schemes generally across public administration, and confirmed his interest in examining grants and subsidy practices at the Department in future audit activities. A written summary of the investigation and an examination of the identified corruption risks was provided to him to facilitate that work.

Conclusion

My predecessor, the Hon. Bruce Lander QC previously had cause to draw attention to the integrity issues surrounding contractors and contracts. In his 2020 *Looking Back* report he remarked on unintended negative incentives which can cause corrupt manipulation by contractors:

I have also seen examples of public authorities devising ill-considered, unachievable or ungovernable incentive structures in their contracts with suppliers. My office has observed and investigated instances where such incentive structures have caused suppliers to engage in deceitful and misleading practices to either fulfil, or appear to fulfil, the terms and conditions of their contracts in the most financially advantageous way⁶.

And in his report on integrity challenges to public administration caused by the pandemic, Mr Lander warned that contract management was an area needing continuing attention:

Agencies should also strive to continue effective contract management, especially if they have dealings with suppliers who have been affected by the pandemic. Nefarious or struggling suppliers may be tempted to reduce services, inflate prices, misrepresent goods and services provided, or needlessly oversell while an agency's guard is down. Ensuring the proper expenditure of public money remains a priority⁷.

I also hold the view that the potential for contractors and suppliers to government to dishonestly gain from manipulation of their contracts is a continuing threat to integrity in public administration. In addition I wonder whether some areas of public administration have the knowledge, means or motivation to address this threat, in circumstances where that conduct is not clearly understood as, and condemned as, corruption.

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6 SA ICAC, *Looking Back 2020*. See, https://www.icac.sa.gov.au/_data/assets/pdf_file/0011/370766/ICAC-Looking-Back-2020.pdf

7 SA ICAC, *Public Administration in a Pandemic: Unique Challenges in the Current Climate*. See, https://www.icac.sa.gov.au/_data/assets/pdf_file/0005/370778/ICAC-Public-Administration-in-Pandemic.pdf



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