

# Supply Chain Fraud



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According to the Australian Research Council, fraud costs the Australian economy at least \$3 billion per year; and the number of fraud incidences within the Australian economy is increasing. The ARC reports that Australian entities are ill-prepared to detect and prevent fraud against their businesses with very few developing or implementing any form of fraud control strategy. The growing use of the Internet by organisations for electronic commerce increases their exposure to fraudulent activities. Inevitably much of the cost of fraud is passed on to the customers and the community at large<sup>1</sup>.

Fraud has many guises. These include: counterfeit intellectual property, counterfeit money, data-compromise, embezzlement, insider dealing, market abuse, insurance fraud, fraudulent use of payment cards, procurement fraud, counterfeit products, consumer fraud, investment fraud, false accounting and reporting, bribery and corruption, collusion, false description, industrial espionage, theft, misappropriation of funds or assets, fraudulent administration of contracts, falsification of source records for fraudulent advantage, conflicts of interest, technological abuse.

### Fraud in the news

A hotel storeman from Perth was arrested last year after he allegedly purchased electrical equipment on behalf of his employing company and on-sold the products. After only a month in employment he purchased a large quantity of LCD televisions and other electrical equipment valued in excess of \$166,000 by purchase order on behalf of the hotel. He then sold the equipment to various buyers and kept the proceeds of the sales. These cases rarely get much media coverage, however there have been several high profile procurement fraud cases in recent years involving employees from both private and public sector organisations.

A former buyer for furniture chain Ikea was jailed for two years after accepting more than £1 million in bribes. Sales colleague Paul Hault also received 13 months imprisonment for taking bribes of more than £280,000. The judge in the case said the two men's "moral compass was broken by greed" and a jail sentence was necessary to deter others. The two evaded Ikea's purchasing limits to obtain orders from companies run by Adam Hauxwell-Smith, who was sentenced to three years imprisonment. Ikea's policy prevents it from taking more than 40 per cent of a supplier's turnover, to prevent over-reliance on Ikea's business.

But in this case Ikea took virtually all supplies produced by Hauxwell-Smith's companies, which provided Christmas crackers, pot pourri, candles and kettles, accounting for nearly its entire turnover. The UK's Serious Fraud Office, which investigated the case, said Hauxwell-Smith dictated what Ikea would order, based on the goods he had available. Hauxwell-Smith also paid the two Ikea staff to prevent this being discovered and to ensure his companies' supplies and invoices would be approved.

A potato buyer for UK supermarket Sainsbury's has been arrested over claims he took cash from a supplier. Potato buyer John Maylam was questioned by City of London police recently after accusations he received backhanders from employees of Greenvale, a potato producer. It is understood the alleged payments from within the company, which supplies around half of Sainsbury's potatoes, total some £3m. The "two men were arrested on suspicion of corruption and money laundering, and were subsequently bailed."

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<sup>1</sup> [http://www.arc.gov.au/PDF/LP06\\_Rd2\\_QUT.pdf](http://www.arc.gov.au/PDF/LP06_Rd2_QUT.pdf)

### Impact of fraud

The impact of fraud on an organisation is far reaching. On a corporate level the following issues apply:

- impacts on bottom line, cost, asset valuation and utilisation, corporate asset acquisition and disposal
- impacts on customer/client/ stakeholder records and support
- relates to all aspects of business and commerce
- effects shareholder confidence and share values
- brings loss of operational integrity
- adds to litigation and insurance costs
- impacts on staff morale
- reduces credibility of management
- diverts management resources
- subverts organisation's strategic objectives and policies
- impairs brand value/image and lessens the balance-sheet value of goodwill
- increases reputational risk
- impacts on corporate standards
- must be seen in the wider context of managing all risks
- must identify the processes or activities at risk of fraud
- risk to product and service outputs/deliverables
- risk to operational areas/locations
- risk to revenue generation/profitability
- risk to cash flow
- risk of unbudgeted increases in expenditure.

### What can P&SM professionals do to monitor and combat fraud?

Procurement professionals have a duty to their employers to eradicate fraud and a duty of care to their subordinates, and also to their suppliers. Procurement professionals need adequate training to learn to identify fraud and subsequently to report on the risks flowing from types of fraud. It is important for them to realise that fraud costs organisations significant sums of money and lost profit. It is also vital for supply chain managers to include treatment of fraud as part of risk and business continuity planning.

Organisations should adopt as a minimum benchmark CIPS' Code of Ethics. It is imperative that policies are put in place that lead to the eradication of favouritism towards, and cosy relationships with, suppliers. Checks and balances should be implemented to mitigate against any misuse of payment mechanisms.

CIPS has developed a Knowledge Insight guide to combating fraud. The following is an extract from the document and outlines the measures P&SM professionals should consider when implementing anti-fraud policies.

- Ensure a formal declaration of vested interests programme is established
- Create a policy for the declaration of gifts and hospitality and methods of dealing with these
- Ensure that a strong segregation of duties policy is established and formalised
- Ensure that confidentiality and nondisclosure policies are not too narrow and secretive and, where appropriate, observe the requirements of freedom of information legislation
- Ensure that formal non-collusion statements are signed at the relevant stage in any tendering process

- Link codes of conduct to the disciplinary process and contracts of employment, use CIPS code of ethics as the minimum standard, be prepared to dismiss staff found guilty of fraudulent practices, be prepared to bring in the police
- Create the necessary checks and balances by implementing internal audit or external forensic audit controls and processes
- Ensure 'gateway' reviews are carried out at each stage of a procurement project; the focus of reviews is to 'investigate and challenge'
- Consider installing two separate 'whistleblowers' hot-lines', one for staff, one for suppliers, and investigate all complaints received from any source
- Regularly review standing lists of suppliers
- Ensure that tender evaluation criteria for contract award are objective, fair and nondiscriminatory; consider separating quality and price tenders and not allowing any through to the price stage unless they have passed the quality threshold
- Incorporate strong security measures (lock down computers and increase firewalls) into corporate ICT policy
- Ensure that the policy is well known and understood by employees and other stakeholders
- Carry out regular training and awareness sessions for employees.



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