



Tightening the chain on fraud

Procurement fraud has a far lower profile than more headline-worthy varieties – but it provides rich pickings for its perpetrators. How can businesses prevent it? **Paul Guile** has some advice

Procurement fraud is nothing new. Samuel Pepys mentions kick-backs in his diary from the 17th century. In the 21st century, it has the dubious distinction of being one of the highest-risk forms of commercial fraud. Unfortunately, it's also low visibility. It may not grab the headlines like embezzlement or securities fraud. But with both a huge number and value of transactions, procurement is a natural target for fraudsters. The National Fraud Authority's most recent survey, published in March, reports that procurement fraud cost the UK public sector about £2.3bn in 2011 – that's nearly 1% of the entire government procurement budget. And in a CIPS (Chartered Institute of Purchasing & Supply) online survey, 9.3% of businesses confirmed that they had suffered at least one procurement fraud during the past year.

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And while preventative measures are taken against other types of fraud risk – usually ones that have more obvious reputational consequences – procurement fraud appears to be considered a problem only after it has occurred. Fortunately, there are some relatively straightforward steps that can be taken to combat it.

COMMON MISTAKES

The first step towards tackling fraud is to stop making the kind of common mistakes that we've documented over the years, including the following:

- Procurement does not have the importance it should. Operations or sales departments gain kudos for generating company revenues, but most of that money is spent in procurement. Yet many organisations do not have procurement visibility at board level. Some don't even employ procurement specialists.
- There is no procurement fraud strategy. If fraud risks are considered at all, they are not linked to procurement. Yet both of these issues are based on the value for money approach and are therefore natural partners.
- There's been no procurement fraud training – in some cases, it's never even been considered. How can people spot procurement fraud if they are unaware of how it can be committed?

THE RISKS

As is the case with any mitigation exercise, a decision has to be made on whether to treat, transfer, tolerate or terminate the risks, which can be immense both pre- and post-contract award.

To combat the risks pre-award, ensure the tender evaluation board and procurement teams are trained to identify

CASE STUDY Weak links in the supply chain

Some details in this case study have been changed to protect the organisation but the story is true.

Large European project company VictimCo, which had an annual turnover of hundreds of millions of pounds, had various fraud policies in place. But owing to its size and complexity these policies were not implemented and enforced across the whole organisation.

A senior project manager, Peter, was reported to have close relations with one of its suppliers, RipCo. But as no other information was forthcoming this information was initially dismissed as irrelevant.

When the spend for that supplier was checked, it was found to represent a very substantial proportion of the total contract for which Peter was responsible. The value of works awarded should have been tendered but each of the works packages had been separated so that each one dropped below the tender threshold. But although anomalies had already been noted by the company, delivery appeared to be going smoothly so the fraud risks had been ignored.

It transpired that Peter had been raising, signing off and processing purchase orders with a substantial budget. If this was queried by procurement staff – Peter's own temporary appointees to the project – they were removed and someone more cooperative was appointed in their place. So any suspicions remained unreported to both the compliance department and the FD for the area.

Eventually VictimCo discovered that the initial tender process for the supplier, made some years earlier, had been manipulated. The fraud had been planned and orchestrated for some time but the parties involved had been patient and let the fraud gradually develop.

The final loss was estimated to be millions of pounds. But the company declined to prosecute owing to the potentially huge reputational damage. The money was never recovered.

Procurement does not have the importance it should have within organisations

both the procurement fraud risks and, in particular, bid-rigging. If there's any doubt, they should check. It doesn't matter if they are wrong. And they might save millions if they're right.

But as a rule of thumb, risks tend to be greater post-award. Why? This is when the money that's been allocated is actually spent; the end user may not be fraud aware; there is a focus on service delivery not fraud prevention; and there is more time for fraudsters to work where your company process weaknesses are.

Additionally, the contract is open to abuse through variations, maintenance, ad hoc works, inflated invoice prices or bogus consultancy works. (The full list of potential abuses is vast.) Often it's a third party managing and implementing the contract, so there's a new entity to consider. And if fraud controls exist at all, they tend to be weaker post-award.

This is especially true in projects that are often fluid in their delivery and subject to variations and design changes. Contracts that are being fulfilled in remote areas are particularly vulnerable to fraud because staff monitoring is harder and controls less thoroughly applied away from the main organisational hub.

Another area of risk relates to subcontractors. As the commissioning organisation, you may not know them at all even if there is a requirement for them to be disclosed during a tender.

Ensure the board understands the importance of procurement and the risk of fraud across its life cycle

Robust auditing of subcontractors will help mitigate this risk. Where project manager and contractor have to work together for successful delivery, there is also a risk of corruption through collaboration.

MITIGATION

So how do you mitigate these risks? While some of the controls are the same as for bribery and corruption there are additional points to consider.

- Ensure that the board understands the importance of procurement and, crucially, the risk of fraud across the procurement life cycle.
- Advertise your organisation's fraud strategy and supporting policies, including whistle-blowing, to staff and contractors. It might put off fraudsters.
- Use a conflicts of interest policy and ensure that declarations are checked – ask staff to sign up during their appraisals, for example.
- Draw up a policy for gifts and hospitality, including defined financial thresholds. All offers of hospitality should be recorded, whether they are accepted or declined. This information ensures your compliance, audit or fraud department will be aware if a contractor is trying to target your organisation through multiple offers of hospitality.
- Due diligence on suppliers is key. Contractors are usually given advance warning of an audit so consider giving no notice to see what is really going on.
- Consider setting a procurement breach process – exception reporting of anyone who fails to follow procedure. As well as drawing attention to potential fraud, it might also identify other commercial weaknesses – for example, whether staff

understand your policy or not or the policy itself is inadequate.

- Check for potential conflicts of interest by comparing data on your staff with those of your suppliers.
- Initiate a two-person change process so that one person cannot add or delete suppliers on your system nor change bank account details.
- Clear the company's system of any old or dormant suppliers. After a year of inactivity consider removing that supplier – if you start to trade with the business again, re-qualify it.
- Variations are often used as a method of hiding fraudulent losses. Set a maximum limit that the contract can be varied. If it exceeds that amount, then ensure this is reviewed by a variations board.
- Watch staff movements during or after a tender award. If a member of your staff moves to work for a supplier immediately

after a tender, treat that supplier as high risk: information may have been passed in return for a job offer. The US government has addressed this risk in the Procurement Integrity Act.

FDs and financial controllers can start by ensuring procurement risk is raised at the highest level of the organisation (ideally the board) and that suitable training, prevention and detection measures are in place. In lean times, when organisations are looking for every penny to go to the bottom line, this is a risk area you can't afford to ignore. ■



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