



A vertical blue bar on the left side of the page contains a stylized illustration of a sheep with a white, fluffy body and a black head and legs. The sheep is positioned in the upper half of the bar, with its body extending downwards. The background of the bar is a solid light blue color.

Procurement fraud

Should the Middle East be concerned?

Major infrastructure activity is occurring over much of the Middle East with significant construction work being undertaken on behalf of government agencies in areas such as airport terminals, hospitals, port facilities and transport networks. In addition, multi-billion dollar projects are being undertaken in the oil and gas industry. But the incentive to win major contracts can lead individuals and even companies to engage in corrupt and fraudulent behavior. Staff within the procurement or project management divisions of contracting organizations may be exposed to inappropriate inducements such as bribes and corrupt offerings. So how does procurement fraud happen and who should be concerned?

The UK National Fraud Authority defines procurement fraud as “a deliberate deception intended to influence any stage of the procure-to-pay lifecycle in order to make a financial gain or cause a loss. It can be perpetrated by contractors or sub-contractors external to the organization, as well as staff within the organization.”

Procurement fraud can be separated into two distinctive sections: The period of time before any contract is awarded, and after a contract has been awarded.

Pre-contract stage fraud includes fraud related to the submission process—such as the premature opening of bids, altering bids, unjustifiable extension of time limits and falsifying bid logs and documents—bid-rigging schemes, as outlined in the box on the right, and leakage of information—where bid information is directed to a particular bidder to provide it with a competitive advantage.

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Bid-rigging schemes

Most bid-rigging fraud schemes involve collusion between competing companies during the bidding process.

Bid suppression scheme

One or more competitors agree with at least one other competitor to refrain from bidding or agree to withdraw a previously submitted bid so that a decided contractor’s bid will be accepted.

Complementary bids/Bid rotation schemes

Complementary bidding occurs when competitors submit token bids that are too high to be accepted. Such bids are not intended to secure the buyer’s acceptance, but are merely designed to give the appearance of genuine bidding.

Phantom bids scheme

Creating dummy companies to submit a variety of bids on a single contract. That way, they give the appearance of vigorous competition while actually bidding against themselves.

Bid tailoring schemes

Staff within the awarding company structure the contract specifications to ensure that they favor a particular bidder.

Post-contract fraud schemes include:

Accounting mischarge schemes: These involve knowingly charging unallowable costs to the buyer, concealing or misrepresenting them as allowable costs, or hiding them in accounts where it is thought that they are unlikely to be detected.

Labor mischarge schemes: Where contracts include payment for labor, contractors falsify the numbers of staff employed and/or hours worked in order to inflate their invoices and payments received.

Product substitution schemes: Once a contract for supplies and products has been awarded, suppliers may attempt to provide inferior quality supplies or products in order to save costs. These schemes can be very sophisticated and intended to deceive the buyer into believing that the inferior product is actually genuine.

Conflict of interest: Including key fraud scenarios, whereby buyers may be silent partners or directors in supplier organizations and purchase on behalf of the awarding company from these organizations; or where relationships between purchaser and vendor may compromise the correct and ethical decisions/actions of the purchaser.

Single source supplier schemes: Where specific goods and services are required, companies may enter into a single source supplier contract. This potentially has fraudulent ramifications in the event of overpricing by the supplier and collusion between buyers and the supplier to source product from a single supplier when it is available through other suppliers at cheaper prices.

False invoicing schemes: Suppliers either on their own or by colluding with the project staff inflate invoices, create false invoices or provide duplicate invoices for goods and/or services.

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So what enables procurement fraud and how can it be prevented?

Most procurement functions, by necessity, require complex information management systems. However, this complexity in itself also leads to procurement fraud risk.

Management systems rarely provide seamless end-to-end transparent data. Different parts of the procurement data such as vendor, customer, payment and receivables data may reside on different systems, which may not be easily reconciled. There needs to be a data mining capability within all the systems to allow for sophisticated analytics to be undertaken.

Data quality issues can also cause problems. Failing to clean vendor data could result in duplicate vendors being listed within the system. This provides an avenue to change addresses, bank accounts and payment details. Lack of controls around vendor creation and management is a major procurement fraud risk.

Educating contractors and suppliers about the organization's code of conduct, ethical stance on fraud and corruption, and ensuring that they sign an acknowledgement of compliance is one of the measures that can be taken to prevent procurement fraud

However, there are several measures that can be taken to prevent procurement fraud, namely:

- Thorough control and adequate performance measures throughout the whole, complex contract and procurement processes.
 - Develop fraud risk, business ethics and compliance training programs. These greatly assist in supporting a good corporate culture to help in reducing procurement fraud risk.
 - Establish a fraud risk management group with direct reporting lines to an audit or risk management committee.
- Implement a whistleblowing policy and process for all staff, contractors, suppliers, and customers.
 - Educate contractors and suppliers about the organization's code of conduct, ethical stance on fraud and corruption, and ensure that they sign an acknowledgement of compliance.
 - Provide incentives for contractors and suppliers to create and adopt their own fraud control and ethical policies and procedures.
 - Embark on a proactive data mining detection program of the entire procurement data.
 - Conduct ongoing fraud risk assessments across the procurement system.
 - Ensure that all staff members provide a conflict of interest declaration.
 - Ensure that a robust code of conduct exists which includes specific gifts and entertainment protocols.
 - Establish a policy of staff rotation within the identified high-risk groups such as buyers.
 - Undertake enhanced background checking of new employees entering the high-risk groups.
 - Develop a fraud control plan.
 - Undertake ongoing internal audit activity into specific areas of the procurement cycle.
 - Perform background checks on vendors and contractors.
 - Implement a debarment policy to exclude suppliers and contractors that are known to have participated in any illegal or unethical activity.

Conclusion

Major capital and infrastructure project activity within the Middle East is set to continue into the foreseeable future. Procurement fraud can be one of the most significant types of fraud faced by organizations within the region, in terms of financial loss, reputational damage, and complexity. A number of high-profile procurement fraud instances that have already occurred in the GCC indicate that fraud prevention programs are either not always in operation or are ineffective. Combatting procurement fraud requires organizations to undertake a systematic and structured approach that must be championed by the executive and senior management.

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