

Preventing procurement fraud and corruption

The reality, unfortunately, is that no organisation is immune to fraud and corruption, particularly in its procurement cycles. The reputational and financial consequence is often disastrous. Almost every survey conducted and statistical trend reported indicates that not only is the frequency of procurement fraud and corruption on the increase, but the quantum of losses is becoming significant enough to affect the sustainability of organisations.



Fraud and corruption in the procurement function (such as illicit rebates, kickbacks and dubious vendor relationships) are all too common. While the risk can never be fully eliminated, a company can implement controls to reduce the likelihood of these occurring. Such controls need to be well considered and robust enough to be relevant to the ever-evolving modus operandi of how procurement irregularities are committed.

Although this paper is based on research and guidelines released by our Deloitte Hong Kong practice, the outcomes of the research is common globally, especially to the trends we are noticing and investigating in Africa.

Instances of fraud and corruption in the procurement cycle are not easy to detect, prove or prosecute. They are often dealt with internally, and implicated employees are allowed to “resign”, with their reputations intact.

During a normal business cycle, a high-risk fraud environment is typified by pressure, rationalisation and opportunity. These factors are exacerbated by local and global economic factors, including regulations that affect the ability of citizens to increase their personal debt financing to support lifestyles to which they have become accustomed. Trends show that the current economic factors are increasing the pressure on individuals to meet and maintain double-digit growth experienced in years past. It is this type of mindset in slower economic times that can contribute to increased fraudulent activity.

Employees that are offered a bribe will often ask themselves whether it is more than their job is worth, right or wrong and whether they will be caught.

If they do decide to accept a bribe, there will be a high risk of multiplicity in perpetrating the fraud in order to circumvent internal controls.

Procurement fraud risk

In addition to traditional transversal fraud risks that are prevalent globally, there are unique country-specific fraud risks.

In this paper, we highlight an approach that organisations can take to manage these fraud risks. This is done by having the appropriate corporate governance in place.

Common procurement fraud “red flags”

Throughout the supply chain – from procurement to distribution – employees as well as external parties (such as suppliers, distributors and competitors) have opportunities to commit procurement fraud. These opportunities range from false invoicing, bribery and kickback schemes to inventory theft and substandard goods.

Some of the “red flags” to look out for include:

- Poor or non-existent record-keeping
- Higher-price, lower-quality goods
- Excessive entertaining of procurement staff by suppliers
- Deviations in communications between procurement staff and suppliers, such as calls or text messaging to mobile phones
- Procurement staff demanding extended periods of notice before they allow an audit to take place
- Inexperienced buyers dealing with overbearing suppliers
- Buyers not taking leave for extended periods

We also look closely at data and other records. Our attention is typically focused on:

- “After-hours” transactions
- Matching employee and vendor details
- Short-term changes to employee or supplier accounts
- Inappropriate authority to transact deals
- Conflicts of interest
- EFT transactions conducted without the appropriate approval

The right approach

While the risk of fraud cannot be eliminated entirely, it can be greatly reduced through the right approach.

Deloitte offers 10 tips for companies that are reviewing their procurement fraud approach:

1. Establish the right culture

While paying bribes may be part of the business culture in some parts of the world, an organisation that condones bribes will at some stage find itself in the regulatory or investor spotlight. Setting the right ethical tone within the organisation is therefore vital. So too is communicating this tone to business partners.

Country-specific codes of conduct and ethics policies are a must. They should be practical, easy to understand and easily accessible to every employee. The proactive development and promulgation of these policies by senior management will set the tone for what is deemed fraudulent or unethical behaviour, thereby facilitating the disciplinary process when breaches do occur.

2. Hire the right people

Automated procurement and accounting systems produce information, but these processes are still driven by people. This is particularly the case in emerging economies where most data input is still done manually, providing an ideal environment for fraudulent behaviour. To minimise the amount of control that each individual has over each business process, segregation of duties should be implemented so that no single individual is empowered to oversee the whole transaction. Hiring the right staff and providing suitable training is therefore imperative if processes are to work effectively and as intended.

3. Assess internal controls

To mitigate the risk of fraud, existing controls, thresholds and procedures should be regularly reviewed and assessed for relevance, adequacy and effectiveness. This is particularly important with the increasing application of technology and globalisation of businesses. Unfortunately, all too often foreign managers are simply told “this is the way it’s done in this part of the world”. They then leave it at that, until it goes wrong. To identify fraud, one must understand risk, specifically in-country risk, which is identified by detailed and comprehensive due diligence. By identifying the risks within a control system, areas susceptible to fraud can be highlighted and corrected. However, even the most carefully designed and tightly controlled system can be circumvented.

Fraud in the procurement process commonly occurs when controls are deliberately overridden either by the individual who knows he will not be challenged or by a collusive group that is able to use its knowledge to hide fraudulent activity.

4. Actively monitor controls

Having reviewed and enhanced internal controls, there is little point in ignoring them. As business processes develop, so too should the systems that control them. An established control review procedure that tests accuracy and functionality is vital for any company that is seeking to do business in any market.

5. Develop a fraud response plan

The timing of a fraud incident cannot be predicted. It can rear its head at the most inconvenient times. Organisations should “expect the unexpected” and should have a robust, well-communicated fraud response plan in place.

6. Know your supplier

Performing background checks and integrity due diligence can ensure that the manufacturers/suppliers are of reputable standing and can highlight the manufacturers’ or suppliers’ interests, associations, related parties and possible conflicts of interest. Checking on the financial stability and business culture of suppliers is also important prior to engaging in any business activity.

7. Supplier capacity and sub-contracting

Ensuring that the supplier has the required capacity, especially in the South African context, is crucial. In many instances, subcontractors are used, and experience has shown that even subcontractors further sub-contract work to other subcontractors – all without the buyer’s knowledge. In a recent study performed by Deloitte, it was found that only 35% of manufacturers conducted “extensive monitoring” of subcontractors, while 49% performed “some monitoring” and 16% only performed “little monitoring”. Additionally, reviewing both payroll costs and employee numbers may highlight problems of underpayments, overstaffing, illegal overtime or fraudulent billing. Suppliers must be subjected to regular due diligence checks to ensure that they are complying with all their legal and regulatory requirements.



8. Manage your sub-contractors

As supply chains extend and margins are squeezed suppliers are often driven to greater levels of sub-contracting. Recent manufacturing scandals and the resulting mass product recalls demonstrate that, unless an organisation has visibility and control over this process, the risks are enormous. High-profile brands and products cannot afford to be associated with poor-quality production facilities or to use substandard materials in the production process. The risk associated with sub-contracting is particularly relevant to the construction industry in most African countries, including South Africa.

9. Monitor the procurement process

Regular checks on quality are a must. Deloitte's Forensic practice in Hong Kong reports that the saying in China "heaven is high and the Emperor is far away" is an increasing reality and a growing concern. If a supplier is based in China and is responsible for providing finished goods to a corporation based outside of the country, the supplier may be able to operate with little or no supervision, taking advantage of various schemes that may be contrary to the interests of the buyer, such as:

- Production of counterfeit goods
- Selling finished goods at reduced prices
- Outsourcing manufacturing to third parties
- Offering bribes to government officials to avoid being sanctioned for non-compliance with regulatory requirements
- Producing fraudulent financial statements
- Tax evasion

Ensuring that appropriate storage and distribution centres have been set up is also important. Performing regular stock counts reduces opportunities for theft.

If appropriate prevention and detection methods are not implemented, organisations may suffer loss of revenue and profit. Routine checks for non-deliveries, repeat deliveries for the same order and discrepancies between purchase orders and delivery are a few of the procedures needed to reduce fraud risks.

10. Optimise the power of data

Big data is not only useful to provide insights, trends and continuous controls monitoring – but organisations can extract some real value in the form of opportunities it was not previously aware of.



Prevention is always better than cure. The amounts paid to settle any claims resulting from exposed fraud will always be secondary to the loss of reputation and integrity that companies may suffer for being associated with such claims.

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