


# PROCUREMENT FRAUD

Internal Controls and Monitoring



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According to the Assoc. of Certified Fraud Examiners (ACFE)

- ✘ \$80,000 average loss per incident in local government
- ✘ \$6.3B losses worldwide in 2016

(eSourcingForum.com, acfe.com)

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According to the ACFE

- ✘ Banking, government and manufacturing largest perpetrators
- ✘ Lack of internal controls largest contributor to fraud
- ✘ Purchasing is one of the seven departments with the most fraud

(eSourcingForum.com, acfe.com)

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According to ACFE

- ✘ 18 Months – average length of time before being detected
- ✘ 1% caught by IT controls
- ✘ 14% caught by internal audits

(eSourcingForum.com, acfe.com)

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According to the ACFE

- ✘ 40% were detected through an employee tip
- ✘ The more involved; higher the amount of fraud
- ✘ 80% of fraud cases exhibited a red flag

(eSourcingForum.com, acfe.com)

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- ✘ The 2016 Global Economic Crime Survey conducted by PricewaterhouseCoopers LLP (PwC) (2016), states that 22 - 30% of companies have experienced procurement fraud.

(McNamee, L., 2016, Procurement fraud, LaSalle University Digital Commons)

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- ✘ Procurement fraud is now the second most commonly reported type of economic crime, according to PwC.
- ✘ Large enterprises with a thousand or more employees are most susceptible.

(blurgroup.com)

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### EXAMPLES OF FRAUD INVESTIGATIONS

- ✘ New car
- ✘ Antique clocks
- ✘ New room addition
- ✘ Truck-watering
- ✘ Employee's wife's company winning bids
- ✘ Employee's outside sign business

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### EXERCISE

According to IIA, AICPA and ACFE

What is one of the best methods for mitigation of fraud?

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### MITIGATION METHODS

- ✘ **Repetitive awards to same supplier**
  - Reassign buyers
  - Modify restrictive specifications
  - Recruit new members for evaluation
  - Survey non-responding suppliers
  - Review bid response time



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### MITIGATION METHODS

- + **Low bid/Lots of change orders**
  - Contract clauses
  - Pre-bid information
- + **Invoices for undelivered goods/services**
  - Separation of duties
  - 'Chummy' relationships

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### MITIGATION METHODS

- + **Suppliers who are former employees**
  - Vendor applications
  - Previous Employee Outside Employment forms
  - Look for links such as phone numbers, addresses or bank accounts.

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### MITIGATION METHODS



✦ **Promises of Upcoming Contracts**

- Listen to conversations
- Pay attention to drastic changes in buying patterns

✦ **Duplicate Invoices**

- Technology/database controls

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### MITIGATION METHODS

✦ **False Invoices**

- W-9
- Supplier entry verifications
- Supplier Sunbiz registration
- Employee outside employment database

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### MITIGATION METHODS

✦ **Multiple small purchases**

- Check out unknown suppliers
- Repeated similar amounts
- No backup
- Regular audits -two under the limit, same day

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### MITIGATION METHODS

#### ✘ Circumventing Thresholds

- Regular audits - purchases just below
- Regular audits - two under the limit, same day
- Training

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### MITIGATION METHODS

#### ✘ Fake Companies

- Vendor application
- W-9
- Verify w/Sunbiz

#### ✘ Conflicts of Interest

- Business owners / officers
- Affidavits
- Internal training

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### MITIGATION METHODS

#### ✘ Influencing decision making

- Code of Silence
- Internal Training
- External Training



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### MITIGATION METHODS

✘ **Inflated pricing**

- Research to gain knowledge of marketplace
- Review specs for restrictive requirements

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### MITIGATION METHODS

✘ **Gifts / Discounts**

- Training suppliers
- Training staff
- Disclosure Forms



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### MITIGATION METHODS

➢ **Product substitution / Non performance**

- Receiving inspection
- Regular 'checkups' on quality of work
- Performance measurements w/penalties

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### MITIGATION METHODS

- ✦ **Subcontracting – Bidder becomes subcontractor for awarded firm**
  - Require disclosure of all proposed subs
  - Solicitation provisions prohibiting
  
- ✦ **Leaking details of upcoming bid**
  - Training

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### 10 WAYS TO CONTROL PROCUREMENT FRAUD

- Enforce the procurement process
- Segregation of duties and two person system to add supplier
- Approve all subcontractors
- Set variance limits on contracts and projects
- Audit addresses and bank account numbers
  
- (Guile, P., 2013. 10 ways to control procurement fraud, www.cips.org)

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### 10 WAYS TO CONTROL PROCUREMENT FRAUD

- Acknowledge the risk exists
- Training staff to identify fraud
- Use a 3-way match
- Immediately update permissions when staff change positions
- Enforce purchasing thresholds-no splitting of orders
  
- (Guile, P., 2013. 10 ways to control procurement fraud, www.cips.org)

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### THE MOST COMMON RED FLAGS



- ✘ Living beyond means
- ✘ Financial difficulties
- ✘ Very close association with a vendor or customer
- ✘ Excessive control issues
- ✘ "Wheeler-dealer" attitude

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### THE MOST COMMON RED FLAGS

- ✘ Recent divorce or family problems
- ✘ High volume of consumable purchases
- ✘ Unjustified sole source request



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### EXERCISE

- ✘ New car
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- ✘ A centralized procurement department.
- ✘ Routinely rotate buyers across different vendor relationships.
- ✘ Well-written solicitations / contracts.

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- ✘ Perform surprise audits.
- ✘ Strong code of ethics internally and for suppliers.
- ✘ Investigate all new vendors, including any possible associations.

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- ✘ An efficient process of receiving goods and services.
- ✘ Routine auditing of vendors to ensure contract terms are being met.
- ✘ Regular auditing of purchases.
- ✘ Market research to determine pricing and value.

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- ✦ Impose (and enforce) significant penalties.
- ✦ Solicitation scope/spec review by procurement.
- ✦ eProcurement system with robust reporting.

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### WRAP UP

Those who engage in fraud are counting on the fact that everyone within the organization is way too busy, dealing with massive overload of data, and no one is paying attention.

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### CONTACT

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