

Procurement Fraud Prevention and Detection

5 April 2018
Kuwait

Main Topics

Fraud Terminologies

Cost of Fraud

What is Procurement Fraud ?

Types of Procurement Fraud

Main Topics

Red flags in Procurement Fraud Schemes

Fraud Red flags

Internal Control Weaknesses that Contributed to Fraud

Anti-fraud Strategies

What is Fraud ?

- Fraud essentially involves using deception to dishonestly make a personal gain for oneself and/or create a loss for another.

CIMA

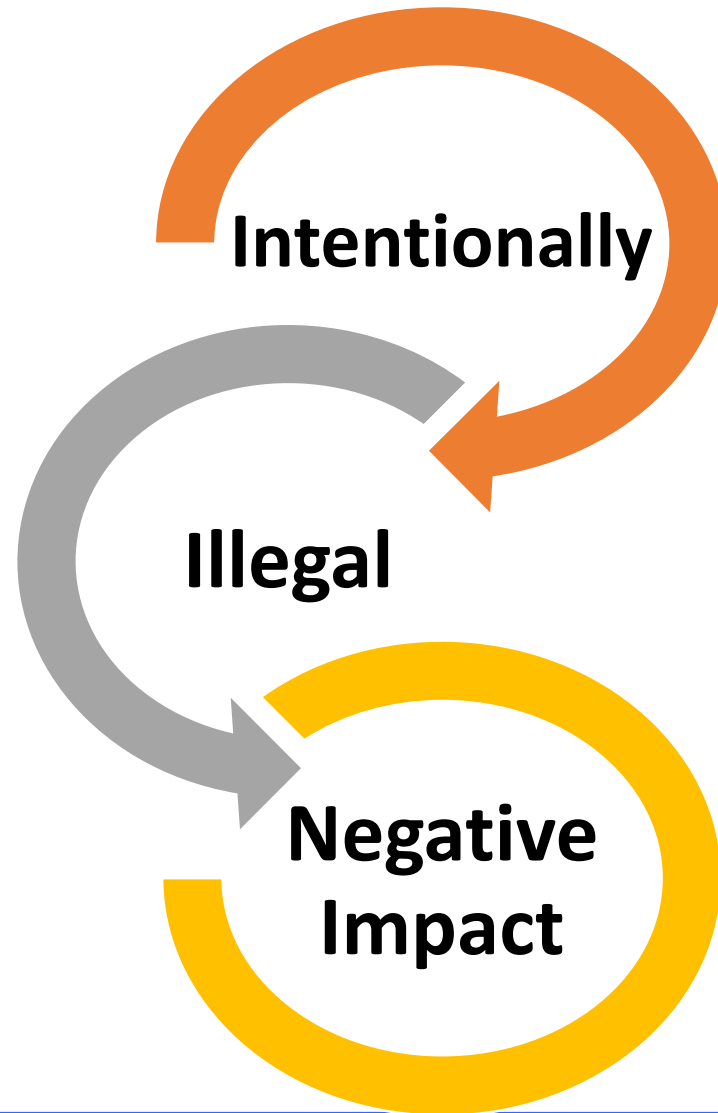
- Fraud: Any illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force.

IIA

- A fraudulent practice is any act or omission, including a misrepresentation, that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation.

World Bank Group

Fraud is an Act made



Cost of Occupational Fraud

**“ Fraud costs organizations 5% of
revenues each year ”**

ACFE

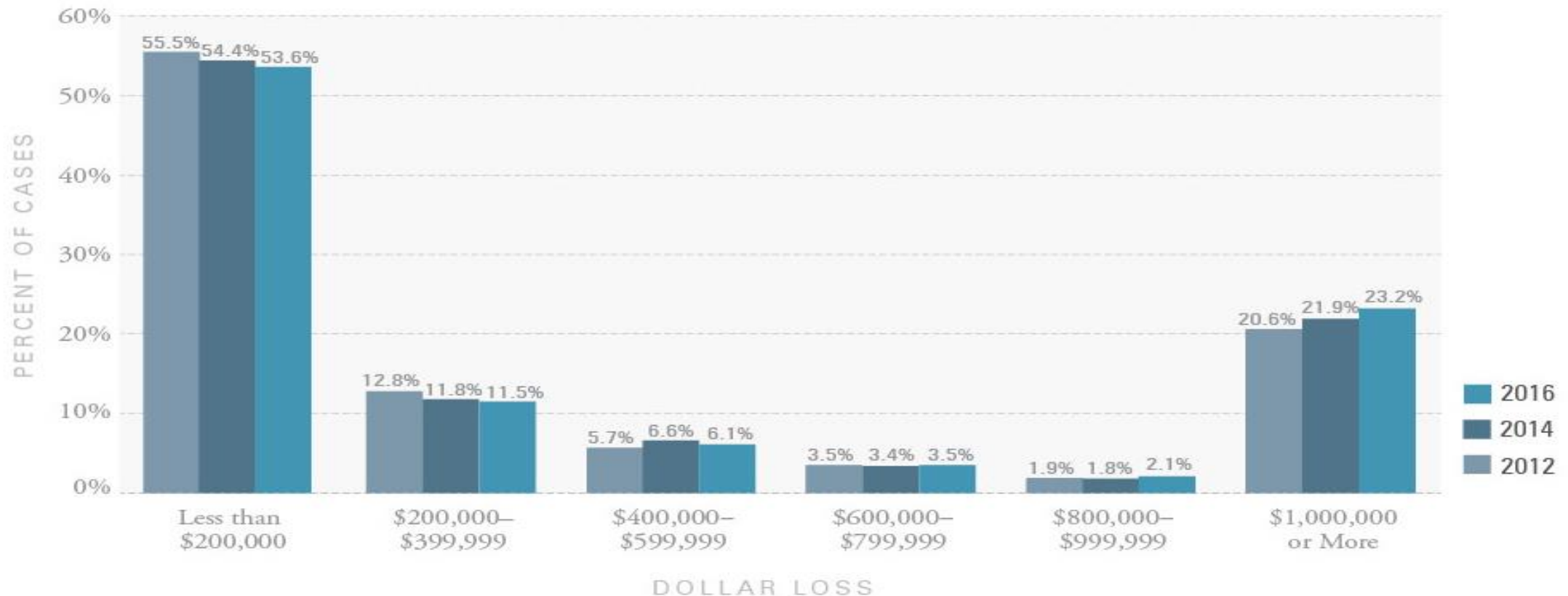
Cost of Occupational Fraud

Figure 1: Geographical Location of Victim Organizations

Region	Number of Cases	Percent of Cases	Median Loss (in U.S. dollars)
United States	1038	48.8%	\$120,000
Sub-Saharan Africa	285	13.4%	\$143,000
Asia-Pacific	221	10.4%	\$245,000
Latin America and the Caribbean	112	5.3%	\$174,000
Western Europe	110	5.2%	\$263,000
Eastern Europe and Western/Central Asia	98	4.6%	\$200,000
Southern Asia	98	4.6%	\$100,000
Canada	86	4.0%	\$154,000
Middle East and North Africa	79	3.7%	\$275,000

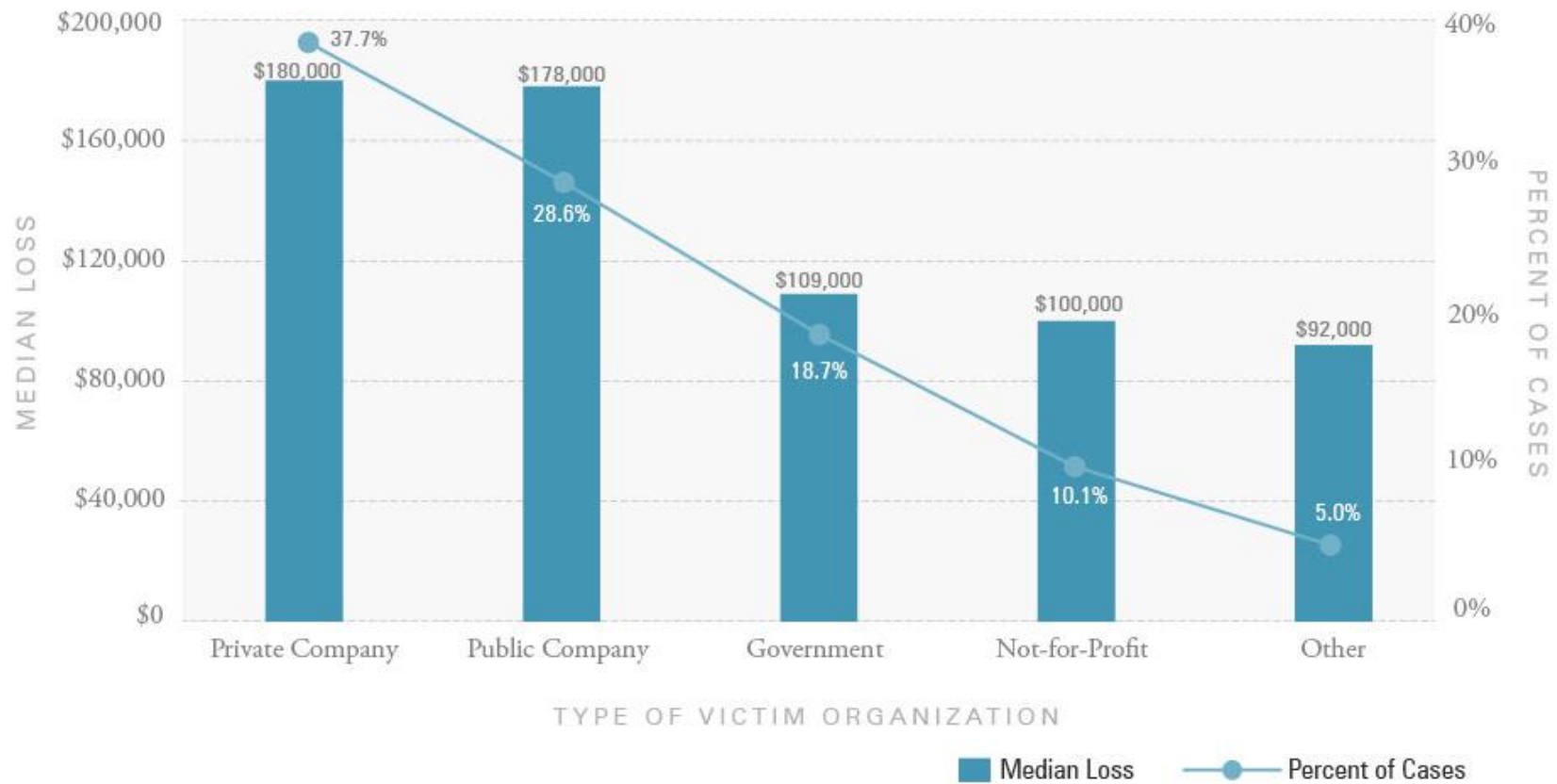
Cost of Occupational Fraud

Figure 2: Distribution of Dollar Losses



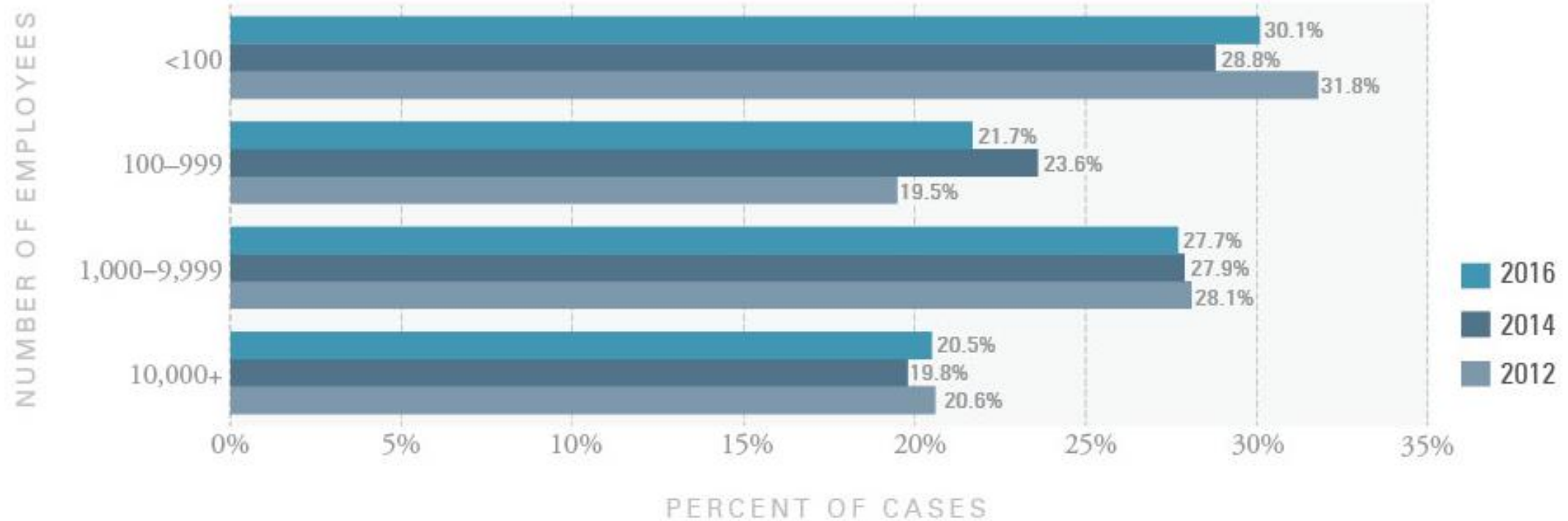
Type of Organization

Figure 38: Type of Victim Organization—Frequency and Median Loss



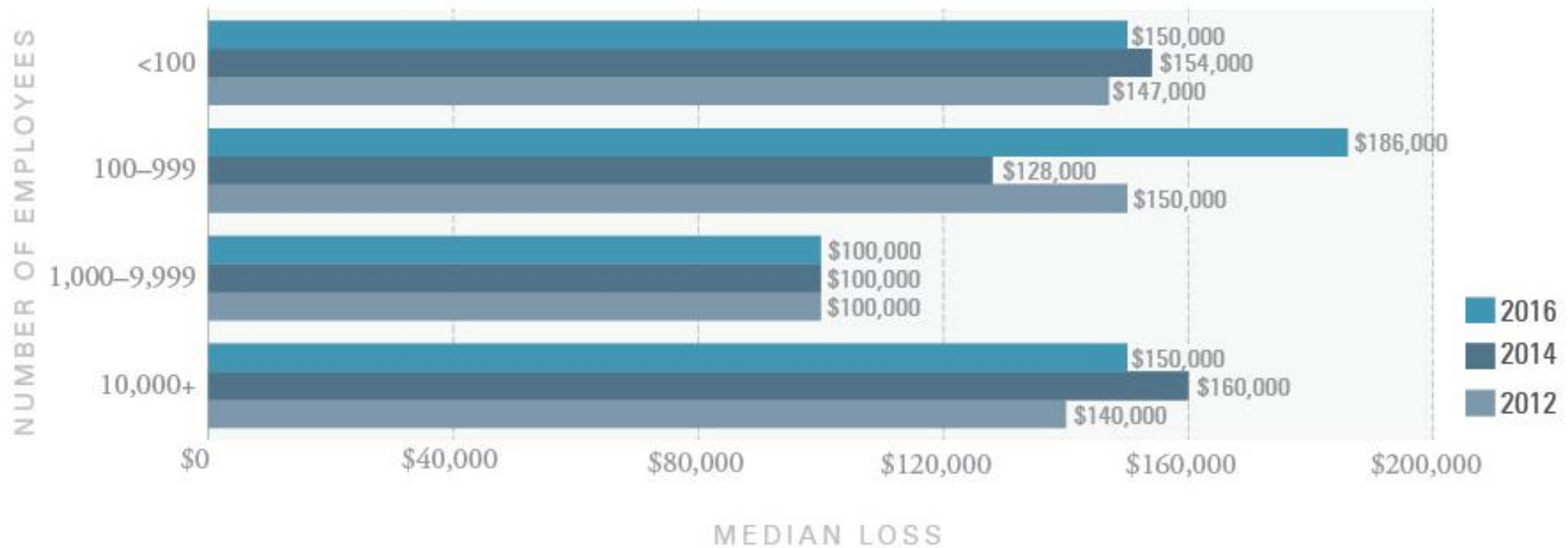
Size of Organization

Figure 40: Size of Victim Organization—Frequency



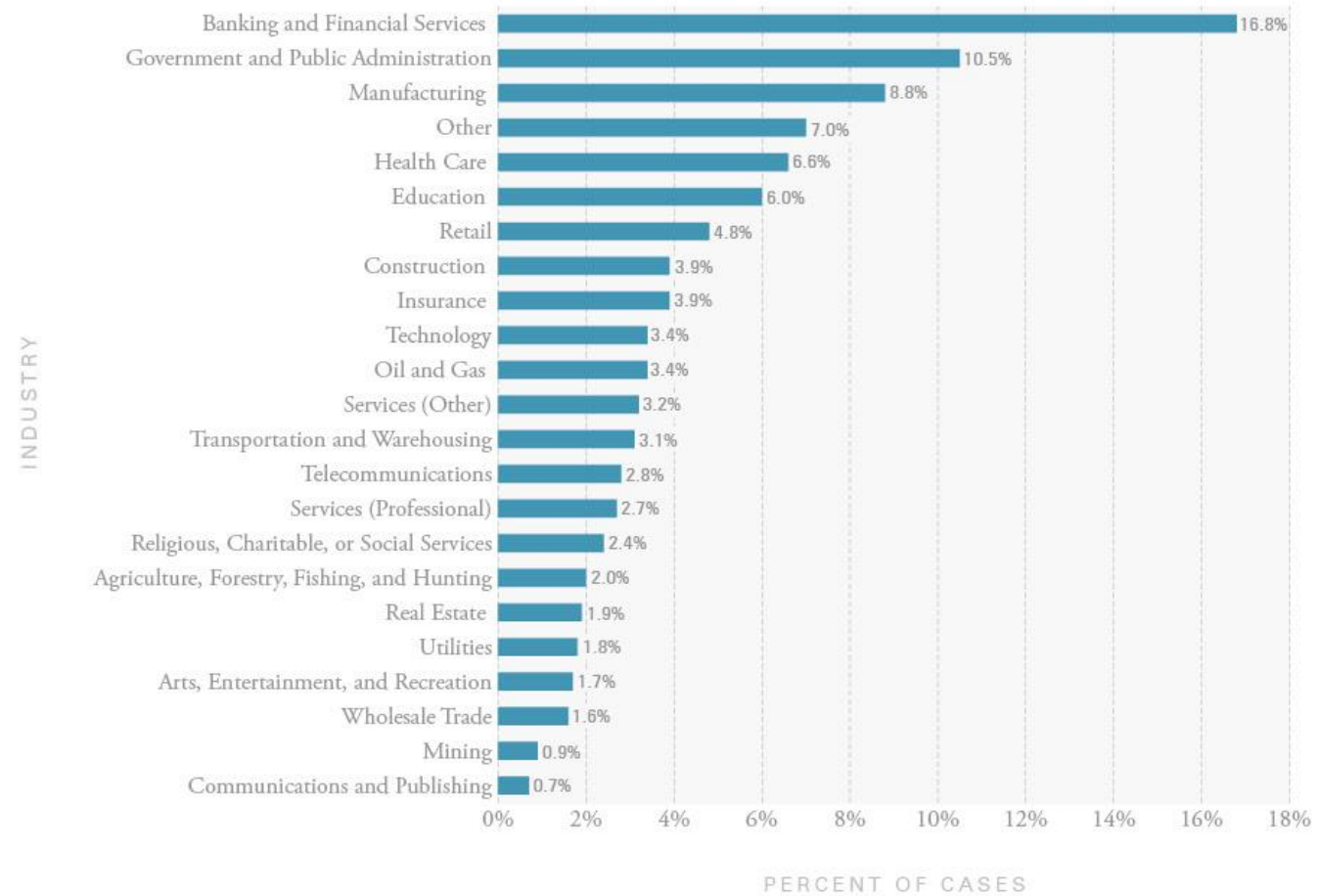
Size of Organization

Figure 41: Size of Victim Organization—Median Loss



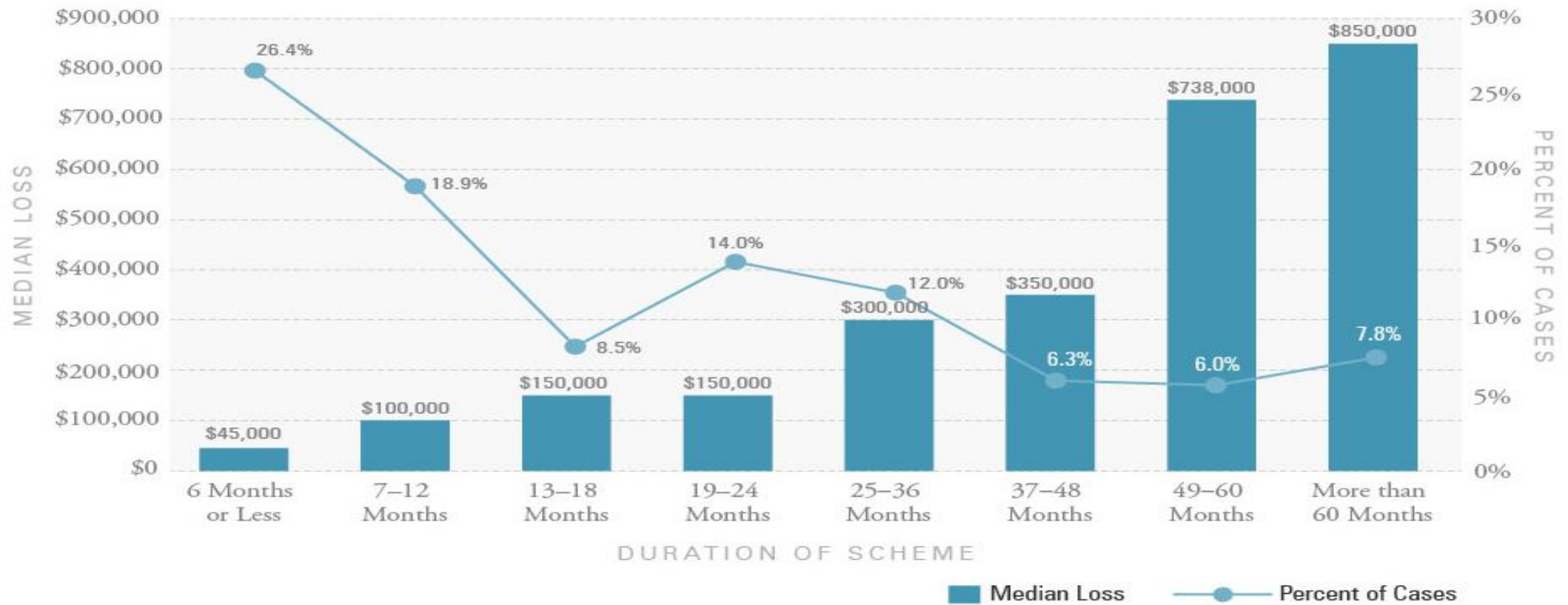
Industry of Organization

Figure 43: Industry of Victim Organizations



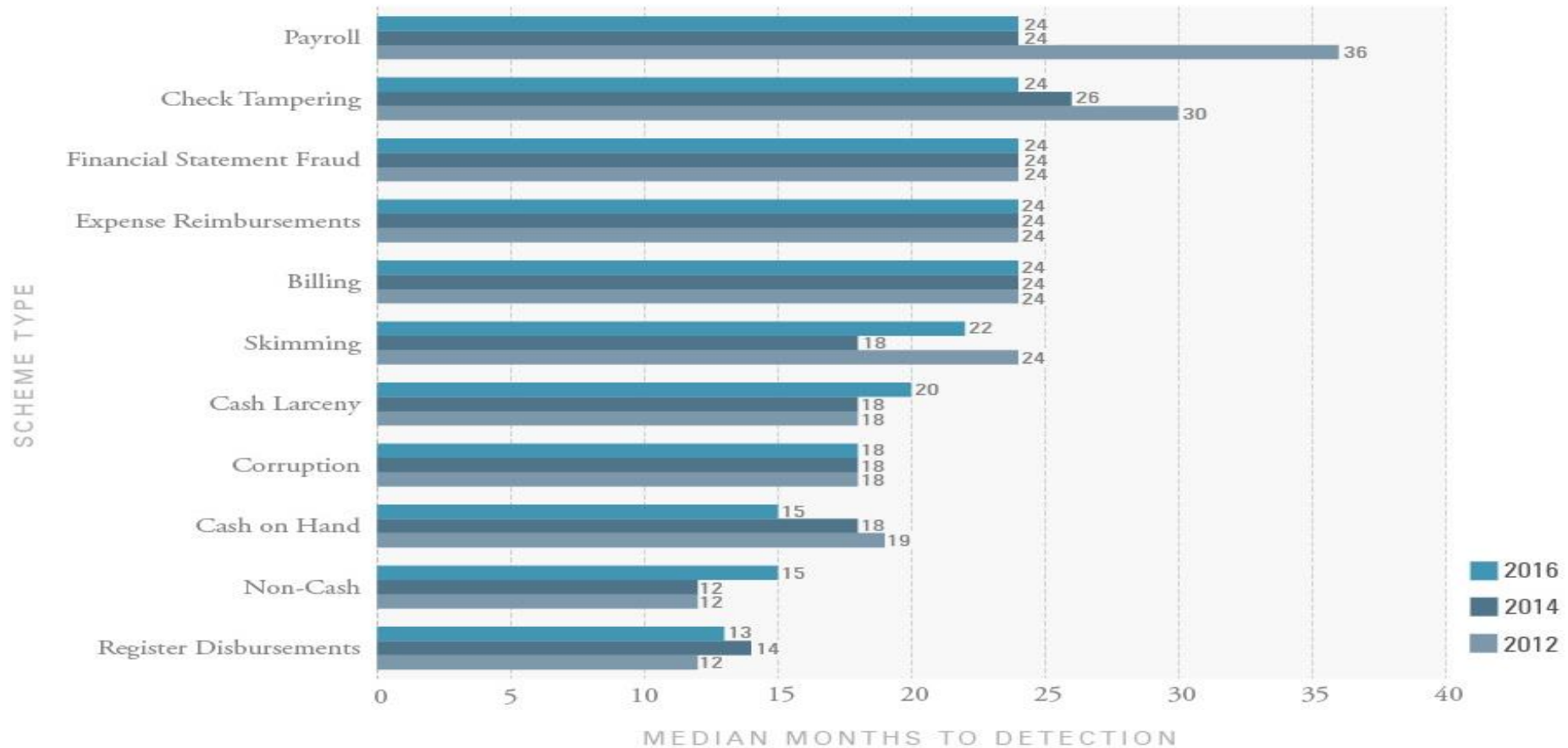
Duration of Fraud Schemes

Figure 18: Frequency and Median Loss Based on Duration of Fraud



Duration of Fraud Schemes

Figure 19: Median Duration of Fraud Based on Scheme Type



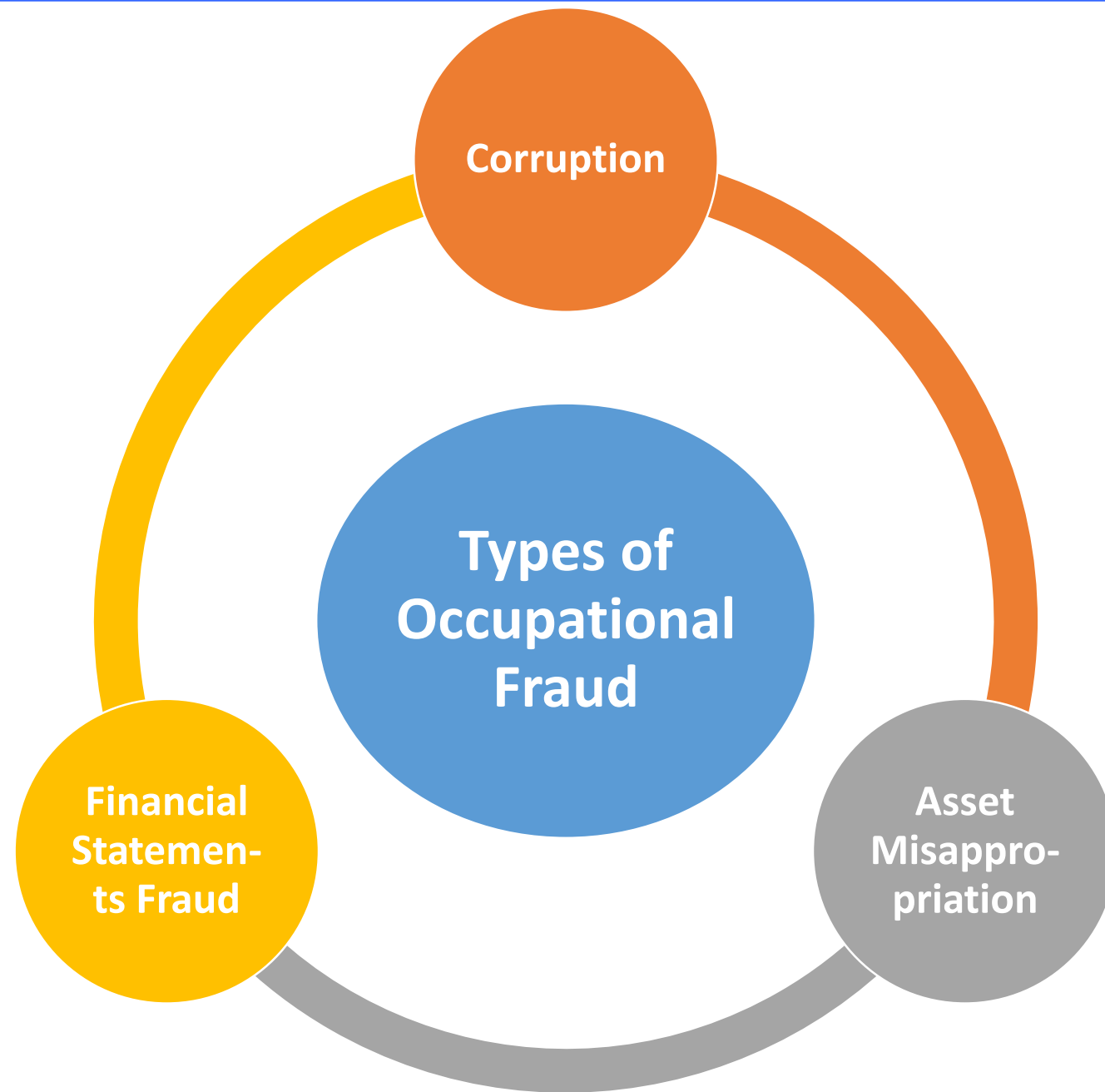
What is Occupational Fraud ?

- Occupational fraud is fraud committed by an employee on an employer in the course of their employment.

Brisbane Chapter ACFE

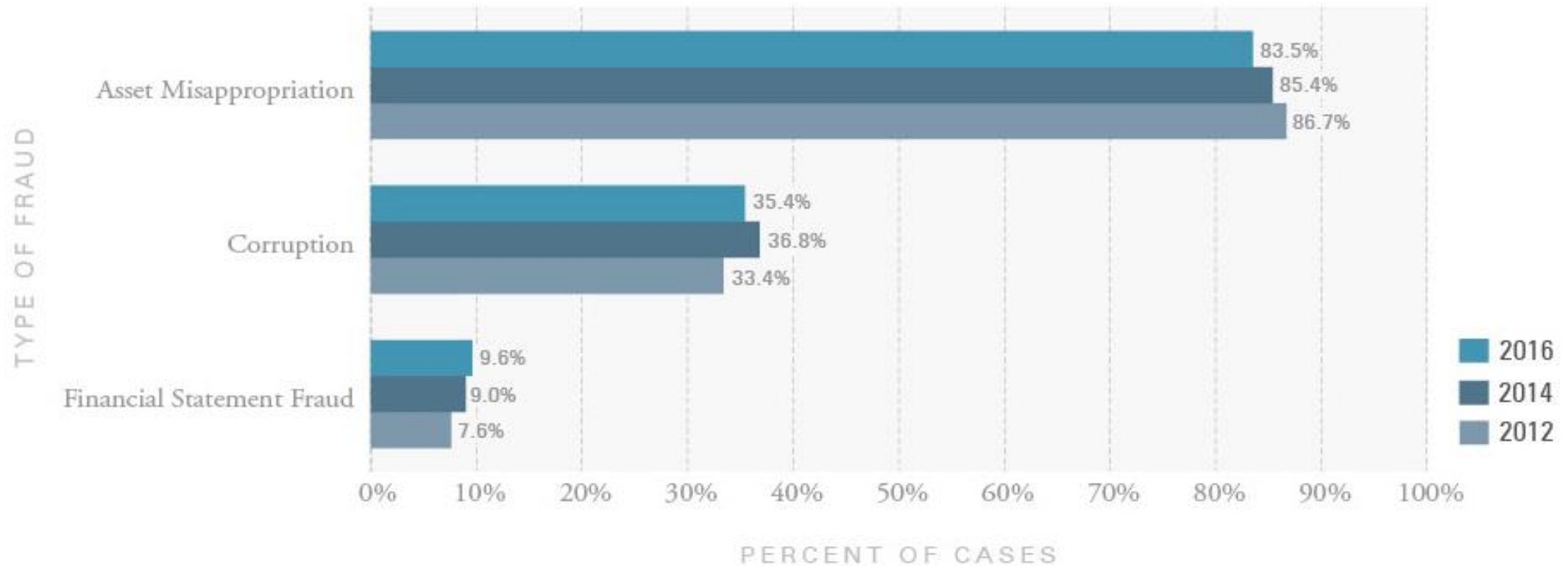
- The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets.

ACFE



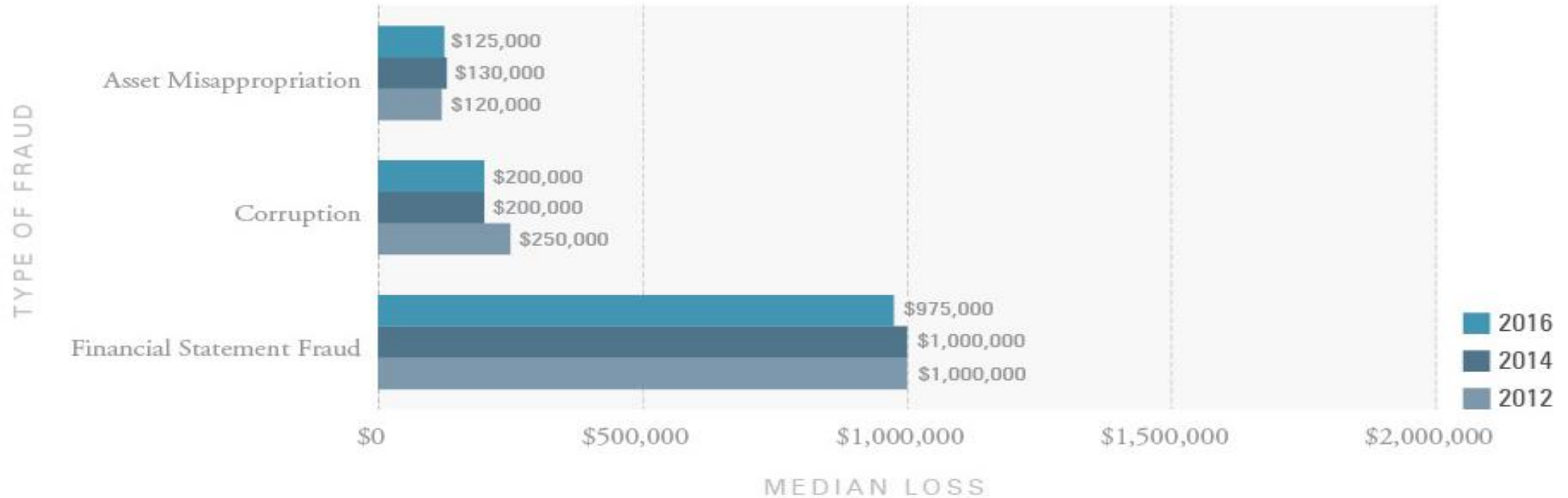
How Occupational Fraud Is Committed

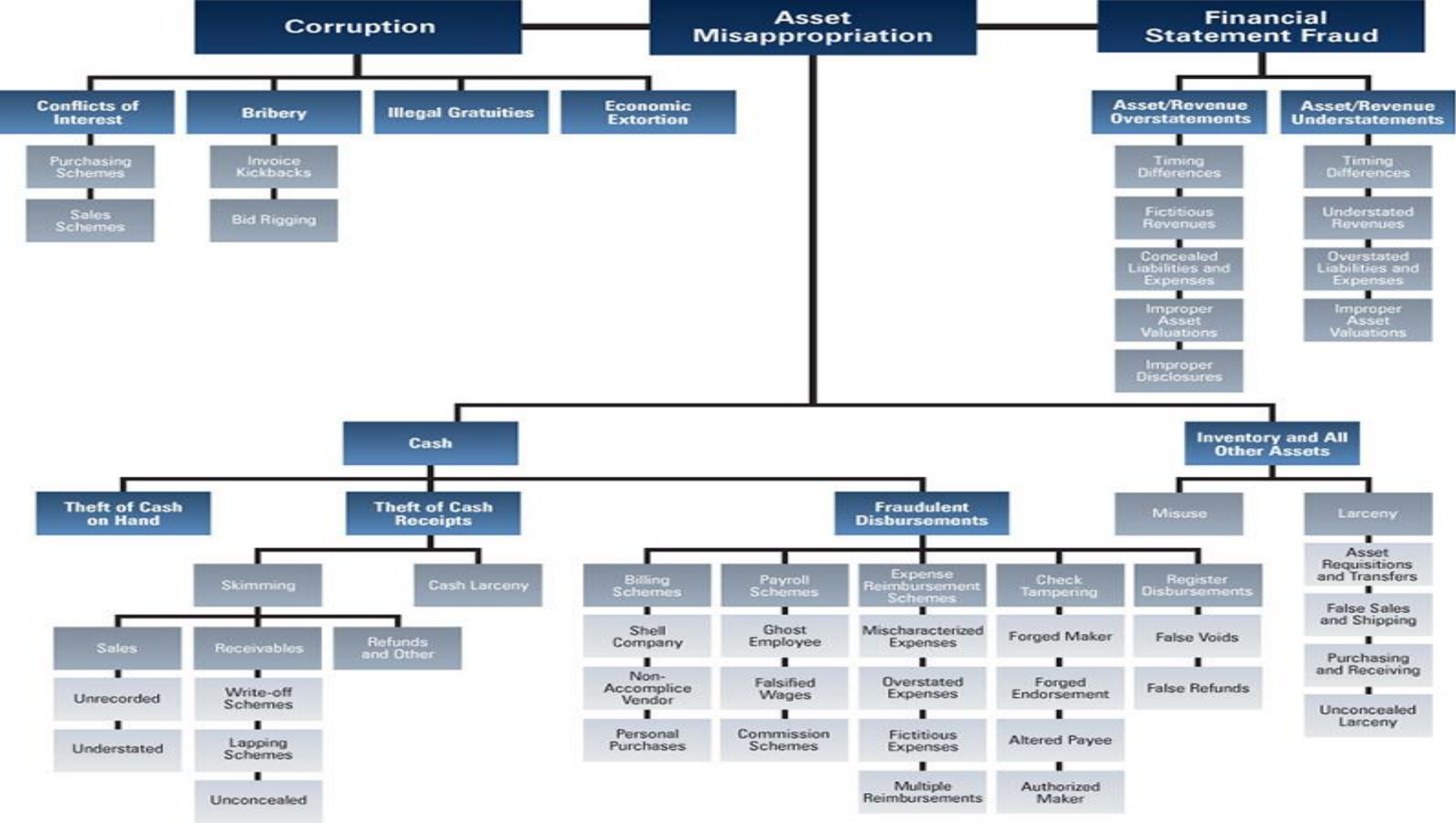
Figure 4: Occupational Frauds by Category—Frequency



How Occupational Fraud Is Committed

Figure 5: Occupational Frauds by Category—Median Loss





Procurement Frauds

Illegal Gratuities are items of value given to reward a decision, often after the recipient has made a decision.

Economic Extortion is present when an employee, through the wrongful use of actual or threatened force or fear, demands money or some other consideration to make a particular business decision.

In **Fraudulent Disbursements** schemes, an employee makes a distribution of company funds for dishonest purpose.

What is Procurement Fraud ?

- Procurement fraud is dishonestly obtaining an advantage, avoiding an obligation or stealing or redirecting funds during the acquisition, sale or management of goods or services.

Maxwell Locke & Ritter

- Procurement fraud is any fraud relating to a company purchasing goods, services or commissioning construction projects from third parties.

Action Fraud

What is Procurement Fraud ?

- Unlawful manipulation of the process to acquire goods or services to obtain and unfair advantage.

CPA Handbook on Fraud

- Dishonestly obtaining an advantage, avoiding an obligation, or causing a loss to public property or various means during procurement process by public servants, contractors, or any other person involved in the procurement.

wiki

Types of Procurement Fraud



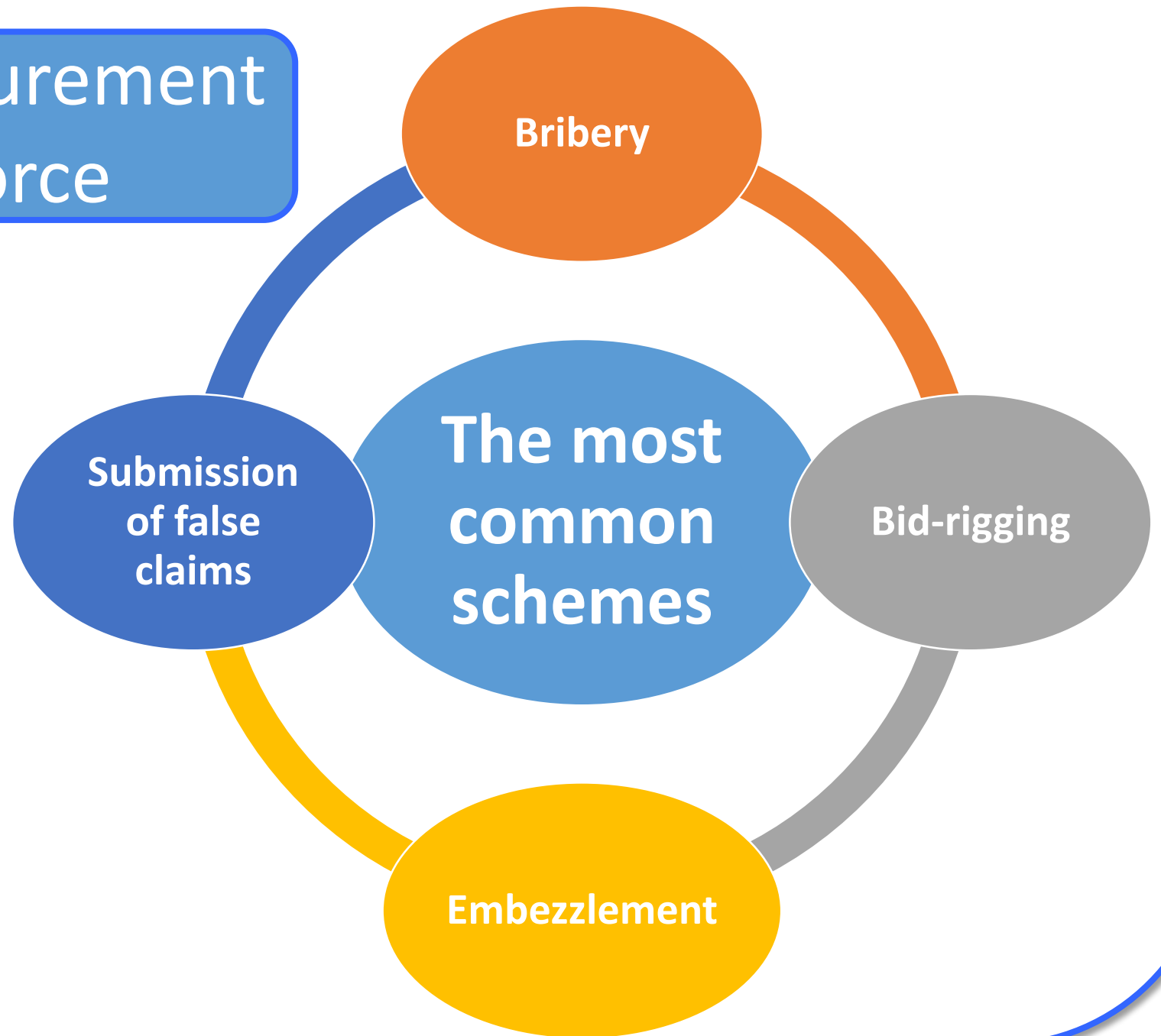
Collusion between employees and vendors

Vendors defrauding the company

Collusion among vendors within an industry

Employees defrauding their employer

US National Procurement Fraud Task Force



Most Common Frauds in Selected Industries

Financial Services

Pharmaceuticals

Consumer & Industrial Markets

Mostly **embezzlement**

Energy & Natural Resources

Public Sector & Information

Communications & Entertainment

Mostly **procurement fraud**

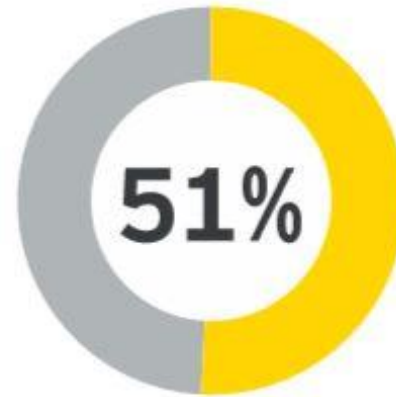
EY 14th Global Fraud Survey 2016

Justifying unethical behaviour and misconduct



42%

could justify unethical behavior to meet financial targets



of respondents in emerging markets

believe that bribery and corruption are still perceived to occur widely in their countries

Reflecting the views of 2,825 executives from 62 countries



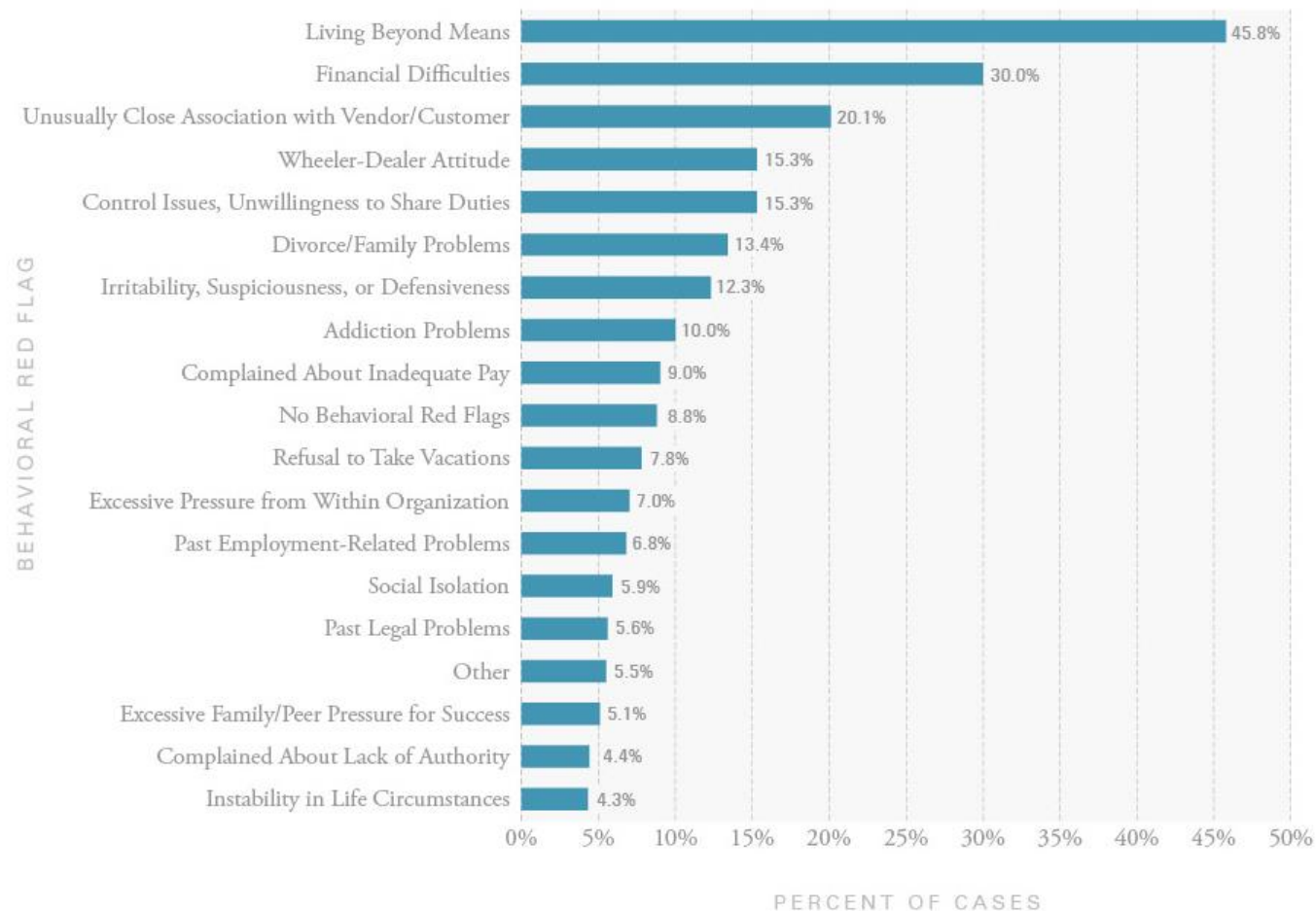
Fraud Red flags



- **Red flags** is items or actions that have been associated with fraudulent conduct.
- Red flags are **subjective in nature**.
- Many common red flags are not always associated with situations of fraud.
- The mere existence of red flags would not immediately warrant a fraud investigation.

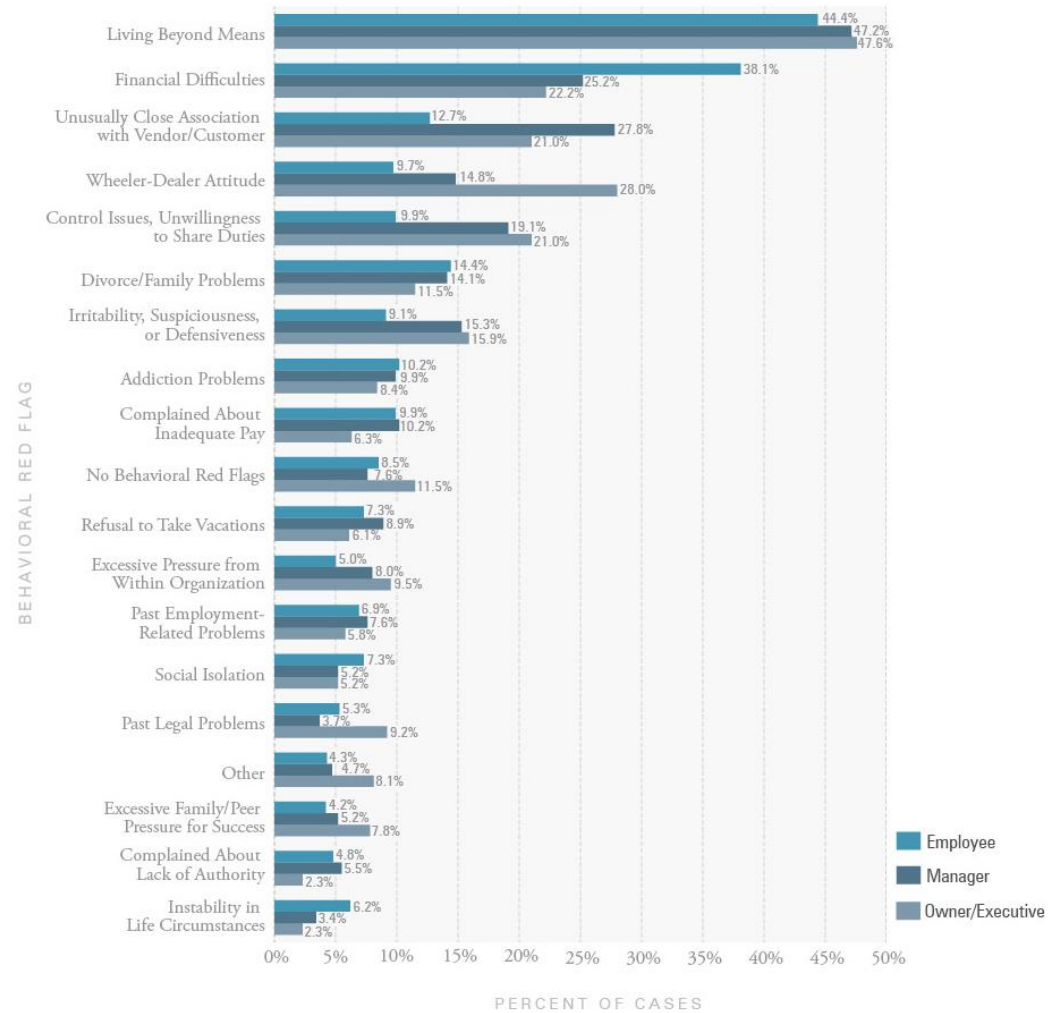
Behavioral Red Flags Displayed by Perpetrators

Figure 94: Behavioral Red Flags Displayed by Perpetrators



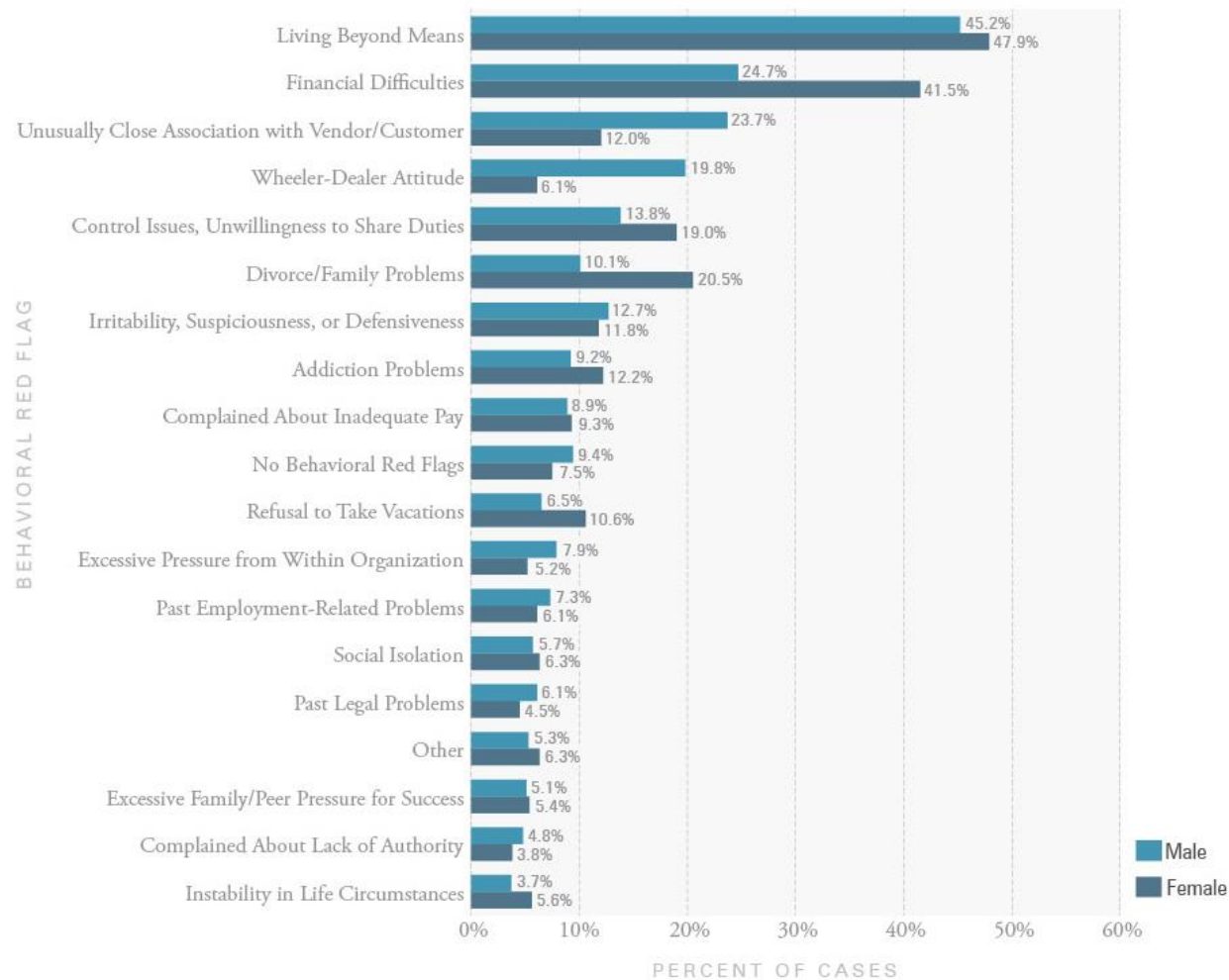
Behavioral Red Flags Based on Perpetrator's Position

Figure 95: Behavioral Red Flags Based on Perpetrator's Position



Behavioral Red Flags Based on Perpetrator's Gender

Figure 97: Behavioral Red Flags Based on Perpetrator's Gender





Employee Red flags



- 1) Employee lifestyle changes: expensive cars, jewellery, homes, clothes**
- 2) Significant personal debt and credit problems
- 3) Behavioural changes: these may be an indication of drugs, alcohol, gambling, or just fear of losing the job
- 4) High employee turnover, especially in those areas which are more vulnerable to fraud
- 5) Refusal to take vacation or sick leave**
- 6) Lack of segregation of duties in the vulnerable area**



Management Red flags



- 1) Management decisions are dominated by an individual or small group**
- 2) Managers display significant disrespect for regulatory bodies
- 3) There is a weak internal control environment**
- 4) Decentralization without adequate monitoring
- 5) Service Contracts result in no product**
- 6) Significant downsizing in a healthy market
- 7) Refusal by company or division to use serial numbered documents**
- 8) Compensation program that is out of proportion



Changes in Behavior Red flags



The following behavior changes can be “Red Flags” for Embezzlement:

<ul style="list-style-type: none">• Creditors or collectors appearing at the workplace	<ul style="list-style-type: none">• Borrowing money from co-workers
<ul style="list-style-type: none">• Providing unreasonable responses to questions	<ul style="list-style-type: none">• Refusing vacations or promotions for fear of detection
<ul style="list-style-type: none">• Gambling beyond the ability to stand the loss	<ul style="list-style-type: none">• Bragging about significant new purchases
<ul style="list-style-type: none">• Excessive drinking or other personal habits	<ul style="list-style-type: none">• Carrying unusually large sums of money
<ul style="list-style-type: none">• Easily annoyed at reasonable questioning	<ul style="list-style-type: none">• Rewriting records under the guise of neatness in presentation



Red Flags in Purchasing/Inventory



<ul style="list-style-type: none">• Increase in purchasing inventory but no increase in sales	<ul style="list-style-type: none">• High volume of purchases from new vendors
<ul style="list-style-type: none">• Increasing number of complaints about products or service	<ul style="list-style-type: none">• Vendor addresses matching employee addresses
<ul style="list-style-type: none">• Abnormal inventory shrinkage	<ul style="list-style-type: none">• Purchases that bypass the normal procedures
<ul style="list-style-type: none">• Lack of physical security over assets/inventory	<ul style="list-style-type: none">• Vendors without physical addresses
<ul style="list-style-type: none">• Excess inventory	<ul style="list-style-type: none">• Inventory with unusual slow turnover
<ul style="list-style-type: none">• Charges without shipping documents	<ul style="list-style-type: none">• Purchasing agents that pick up vendor payments rather than have it mailed



Red Flags in Purchasing



- **Payments just under authorization level**

- Payments to vendors who aren't on an approved vendor list

- Large gifts and entertainment expenses

- Sequential invoices paid

- **Slight variation of vendor names**

- Unusual or unauthorized vendors

- **Round-dollar amounts**

- Multiple invoices paid on same date



Red flags in Procurement Fraud Schemes



- Phantom Vendor / Fictitious Vendor
- Conflict of Interest
- Duplicate Payments / False & Inflated Invoices
- Bribes / Kickbacks / Improper Payments
- Vendor Master File Manipulation
- Product Substitution
- Bid Rigging / Collusive Bidding by Contractors
- Foreign Corrupt Payments



Red flags in Procurement Fraud Schemes



- Change Order Abuse
- Co-mingling of Contracts
- Excluding Qualified Bidders
- Failure to Meet Contract Specifications
- False Statements & Claims
- Imprest Fund Abuse
- Leaking of Bid Information
- Split Purchases



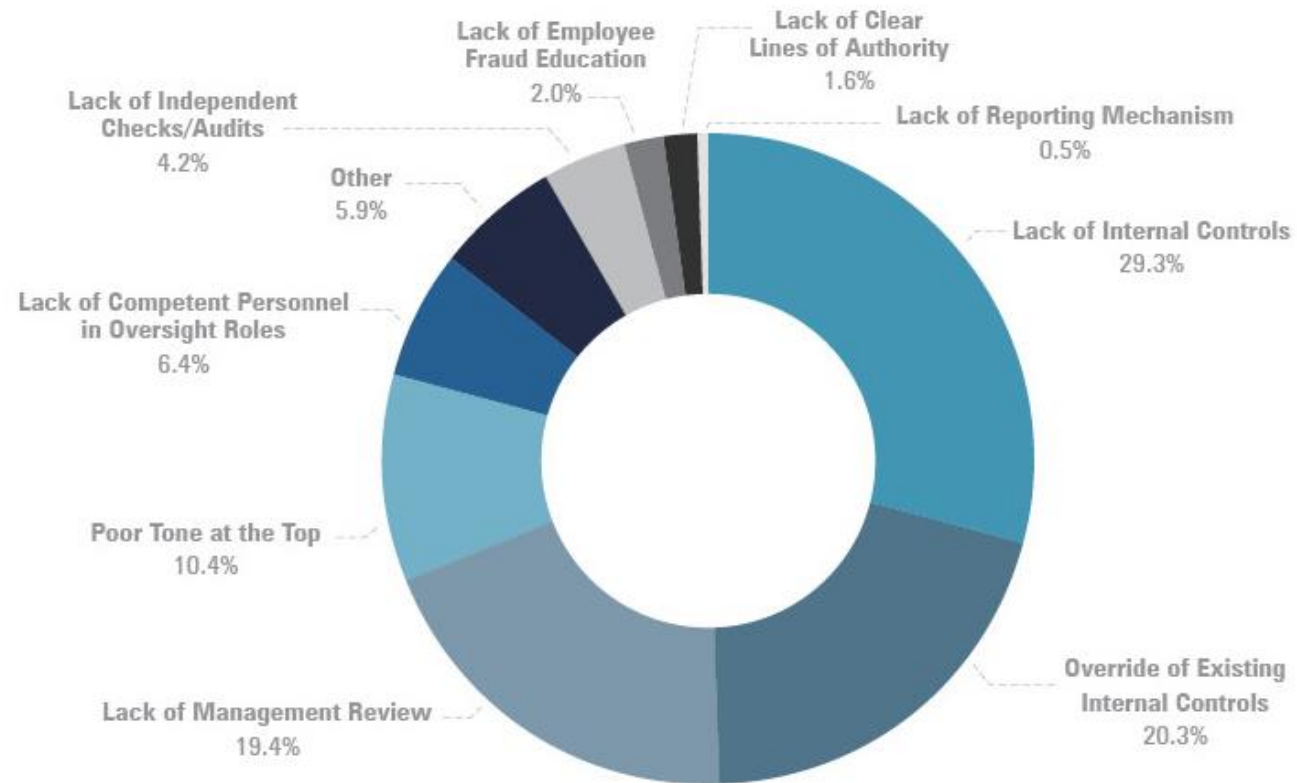
Red flags in Procurement Fraud Schemes



- Unjustified Sole Source Awards
- Unnecessary Purchases

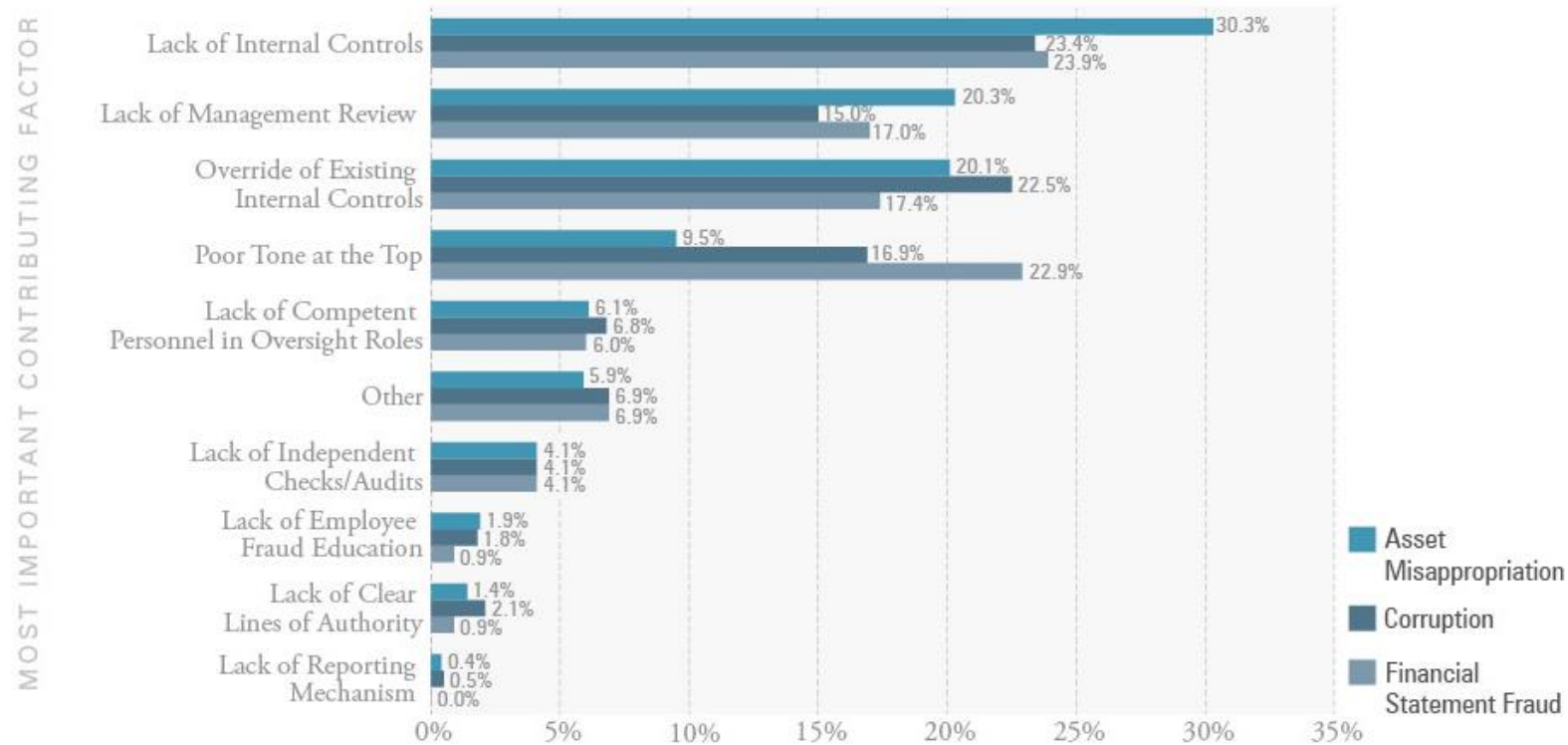
Internal Control Weaknesses That Contributed to Fraud

Figure 63: Primary Internal Control Weakness Observed by CFE



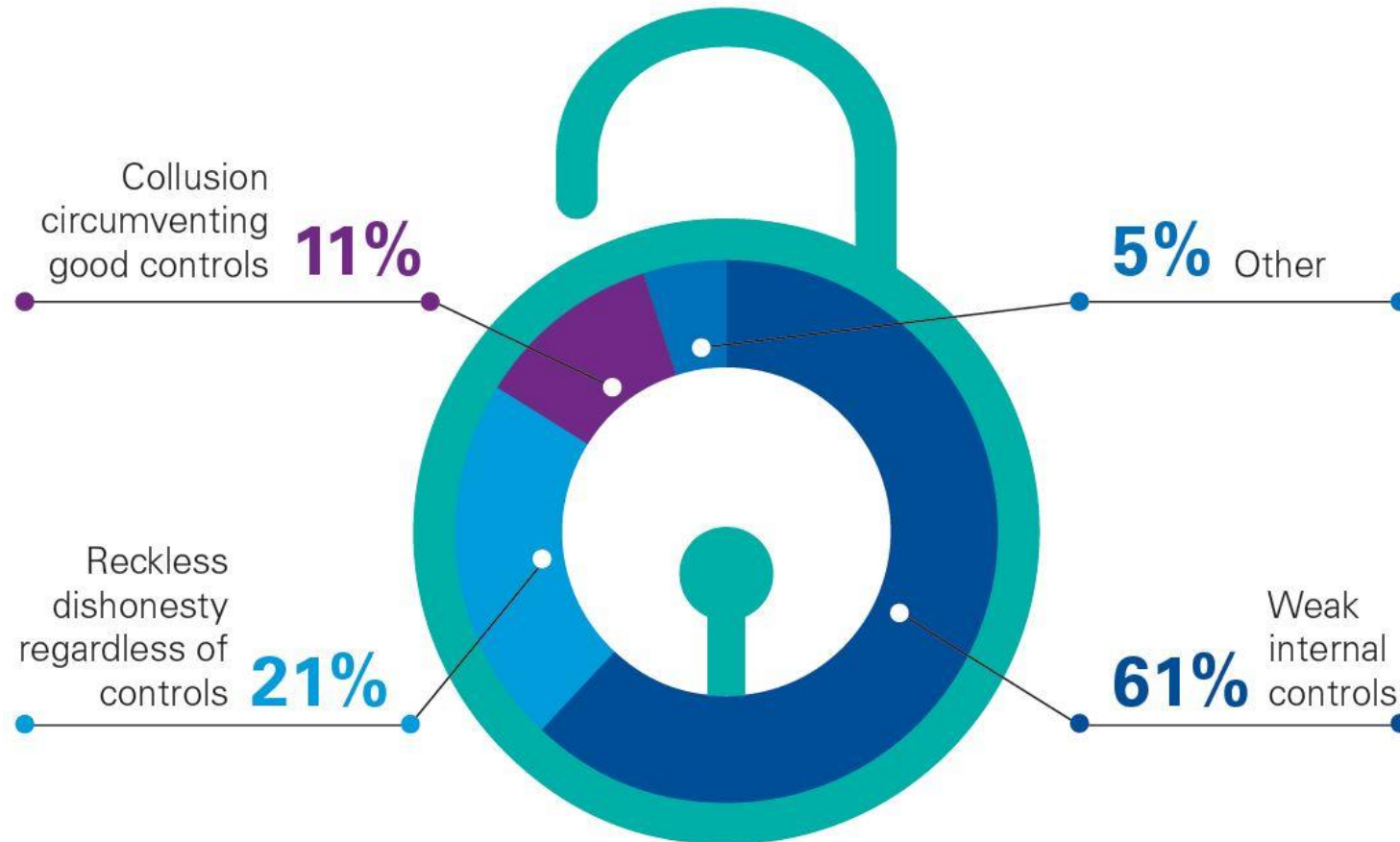
Internal Control Weaknesses That Contributed to Fraud

Figure 64: Primary Internal Control Weakness by Scheme Type



Factors that Contributed to Fraud

Factors contributing to the facilitation of the fraud



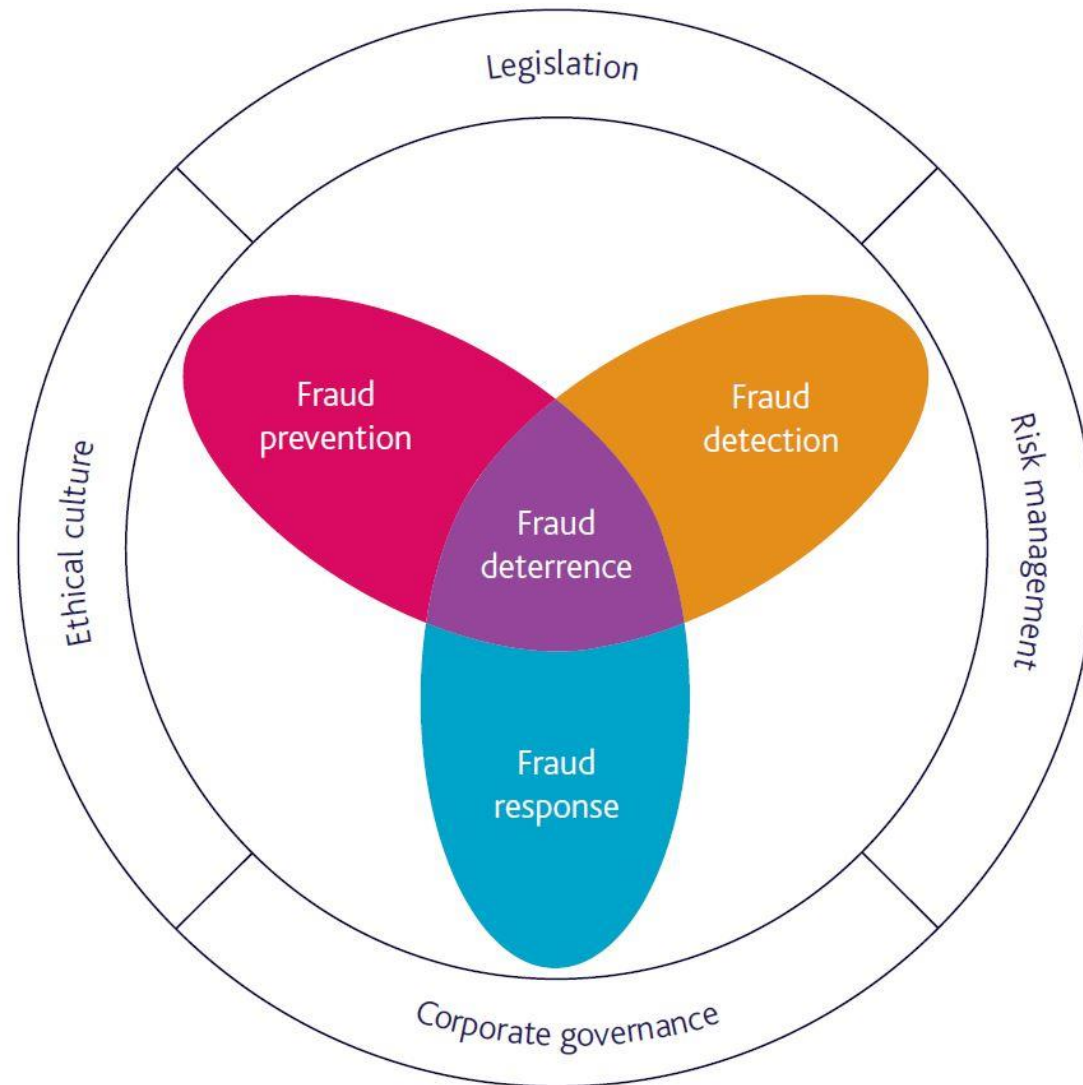
Source: Global Profiles of the Fraudster, KPMG International, 2016

Anti-fraud Strategy

An effective anti-fraud strategy has three main components:

- **Prevention** – by adopting methods that will decrease motive, restrict opportunity and limit the ability for potential fraudsters to rationalise their actions.
- **Detection** – by using of analytical and other procedures to highlight anomalies, and the introduction of reporting mechanisms that provide for communication of suspected fraudulent acts
- **Response** – by sending a message that fraud is taken seriously and that action will be taken against perpetrators.

Anti-fraud Strategy



Safeguards that can Prevent Procurement Fraud

- A **centralized procurement department** that routinely rotates purchasing managers across different vendor relationships.
- A **strong contracting process** that includes well-written contracts and a strong code of ethics that vendors acknowledge and must abide by.
- A **thorough review and disclosure process to investigate all new vendors**, including any possible association with existing vendors or employees of the organization.
- An **efficient process of accepting and acknowledging that goods and services** are adequately delivered in accordance with the terms of their contracts.
- **Routine auditing of vendors** to ensure that pricing is in accordance with agreements and other contractual terms are being met.

Safeguards that can Prevent Procurement Fraud

- **Regular auditing of accounts payable** to look for duplicate disbursements and to verify that credits and discounts are being properly administered.
- **Development of a routine bidding process for contractual items** to determine if pricing is at market rates. Bids should be reviewed by the procurement department, independent of those requesting the goods or services.
- Development of fraud risk, business ethics and compliance **training programs**. These greatly assist in supporting a good corporate culture to help in reducing procurement fraud risk.
- Establishing a **fraud risk management group** with direct reporting lines to an audit or risk management committee.

Safeguards that can Prevent Procurement Fraud

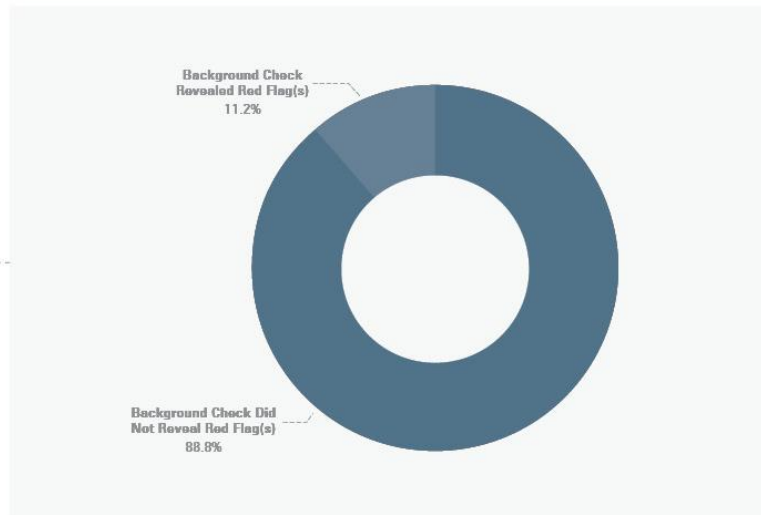
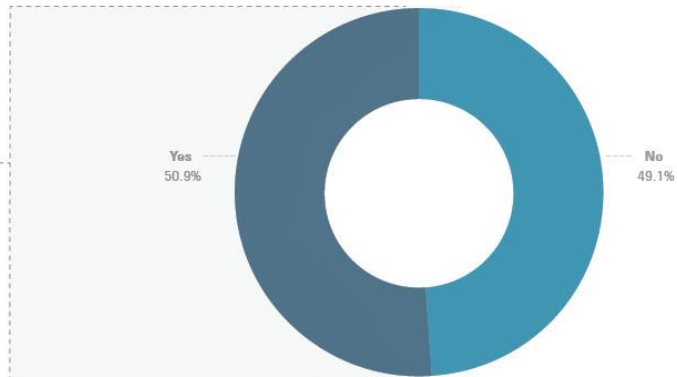
- Educate contractors and suppliers about the organization's code of conduct, ethical stance on fraud and corruption, and ensure that they sign an acknowledgement of compliance.
- Provide incentives for contractors and suppliers to create and adopt their own fraud control and ethical policies and procedures.
- 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.

Safeguards that can Prevent Procurement Fraud

- Establish a **policy of staff rotation** within the identified high-risk groups such as buyers.
- Develop a **fraud control plan**.
- Undertake **ongoing internal audit** activity into specific areas of the procurement cycle.
- Undertake enhanced **background checking of new employees** entering the high-risk groups.
- Perform **background checks on vendors and contractors**.

Background Checks

Figure 61: Background Check Run on Perpetrator Before Being Hired

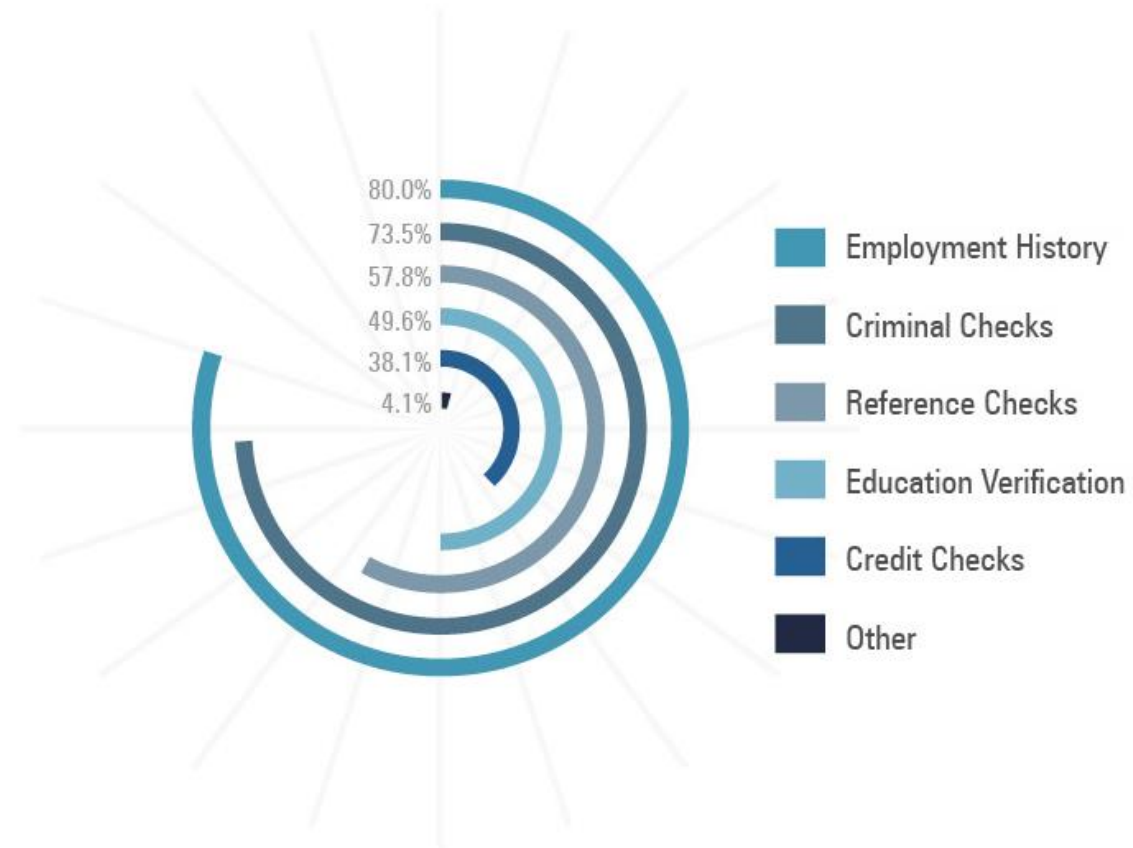


Approximately 51% of organizations conducted background checks and 49% did not.

Roughly 11% of the background checks conducted did uncover at least one red flag (e.g., prior criminal activity, employment issues, or financial problems) regarding the perpetrator.

Background Checks

Figure 62: Type(s) of Background Checks Run on Perpetrator Before Being Hired





Warren Buffett

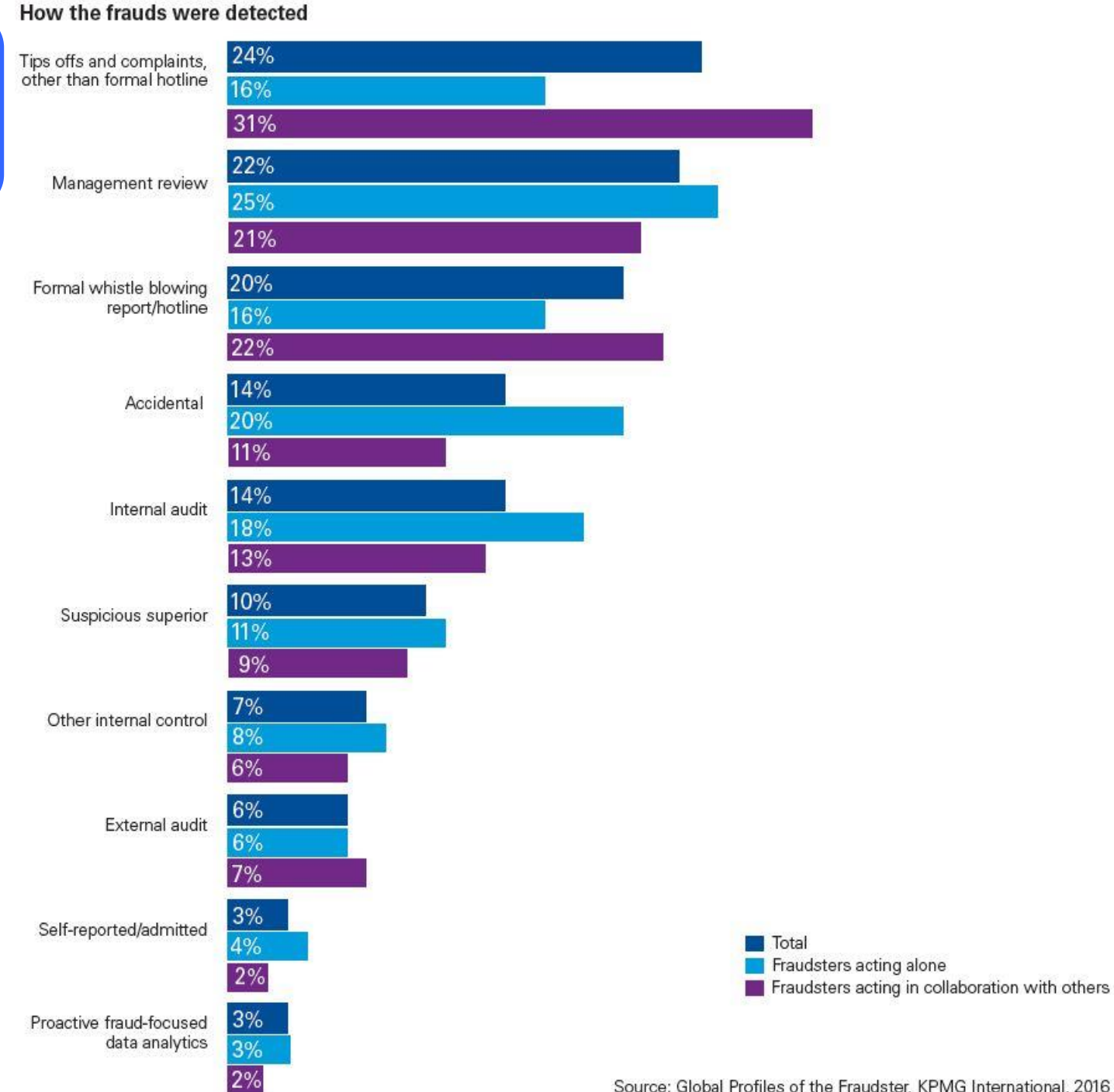
”

Somebody once said that in looking for people to hire, you look for three qualities:

- integrity,***
- intelligence,***
- and energy.***

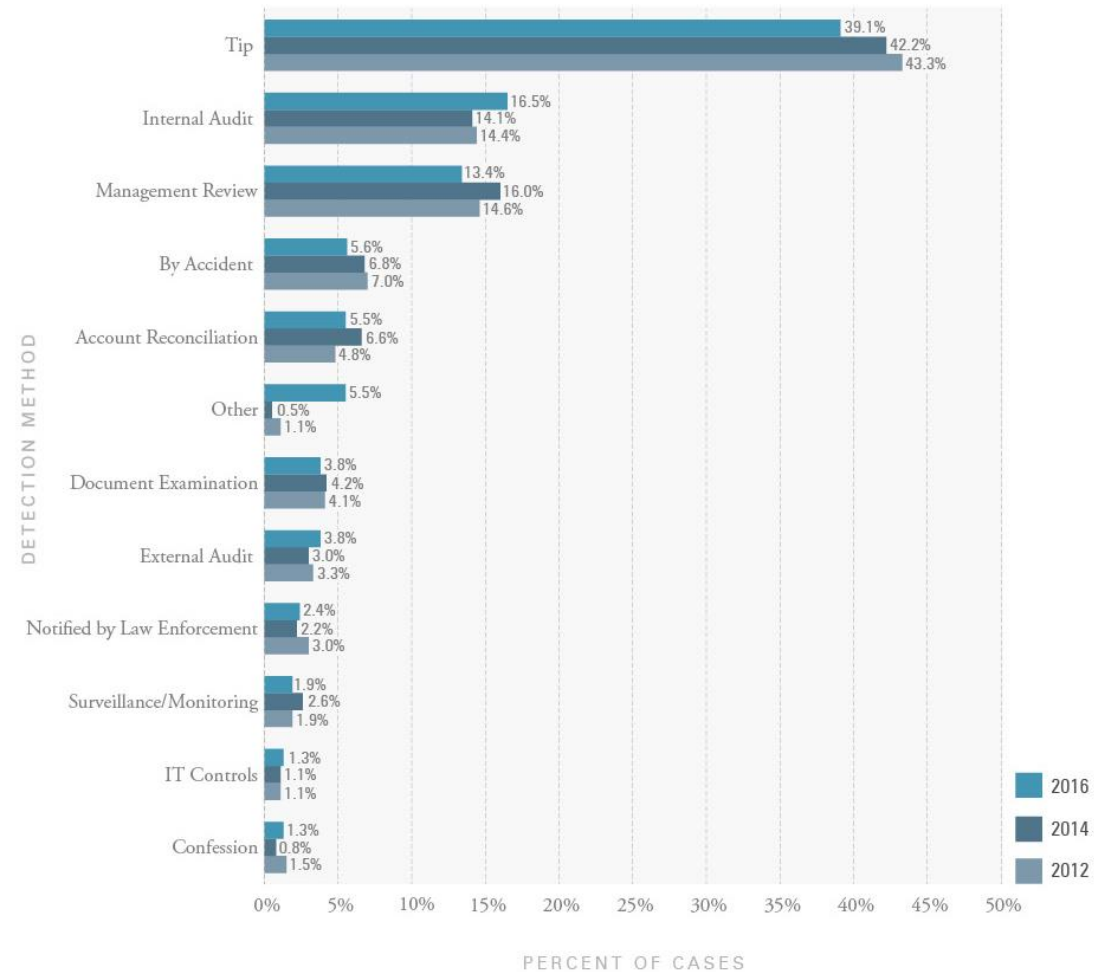
And if you don't have the first, the other two will kill you.

Initial Detection of Frauds



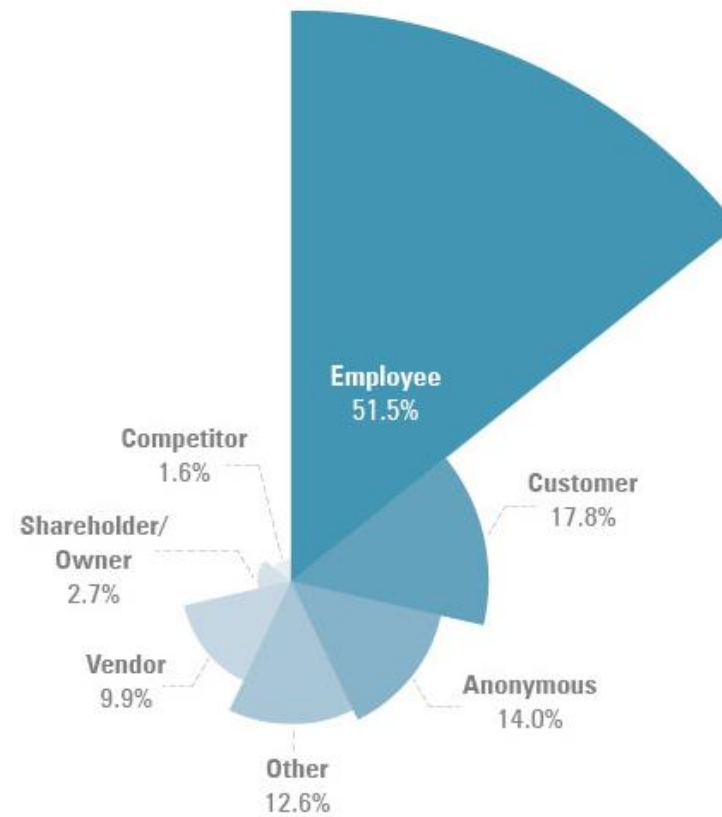
Initial Detection of Occupational Frauds

Figure 21: Initial Detection of Occupational Frauds



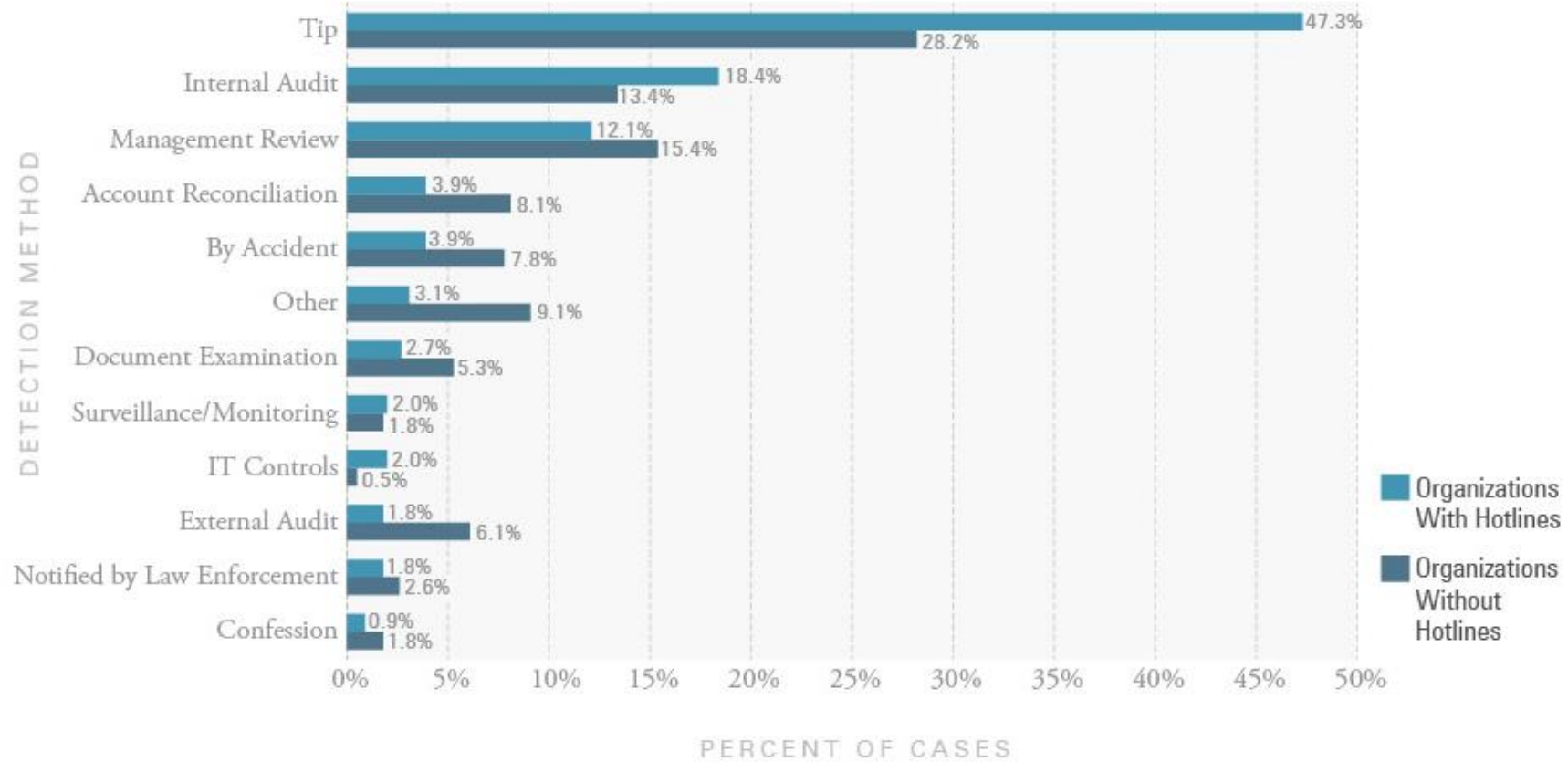
Source of Tips

Figure 33: Source of Tips



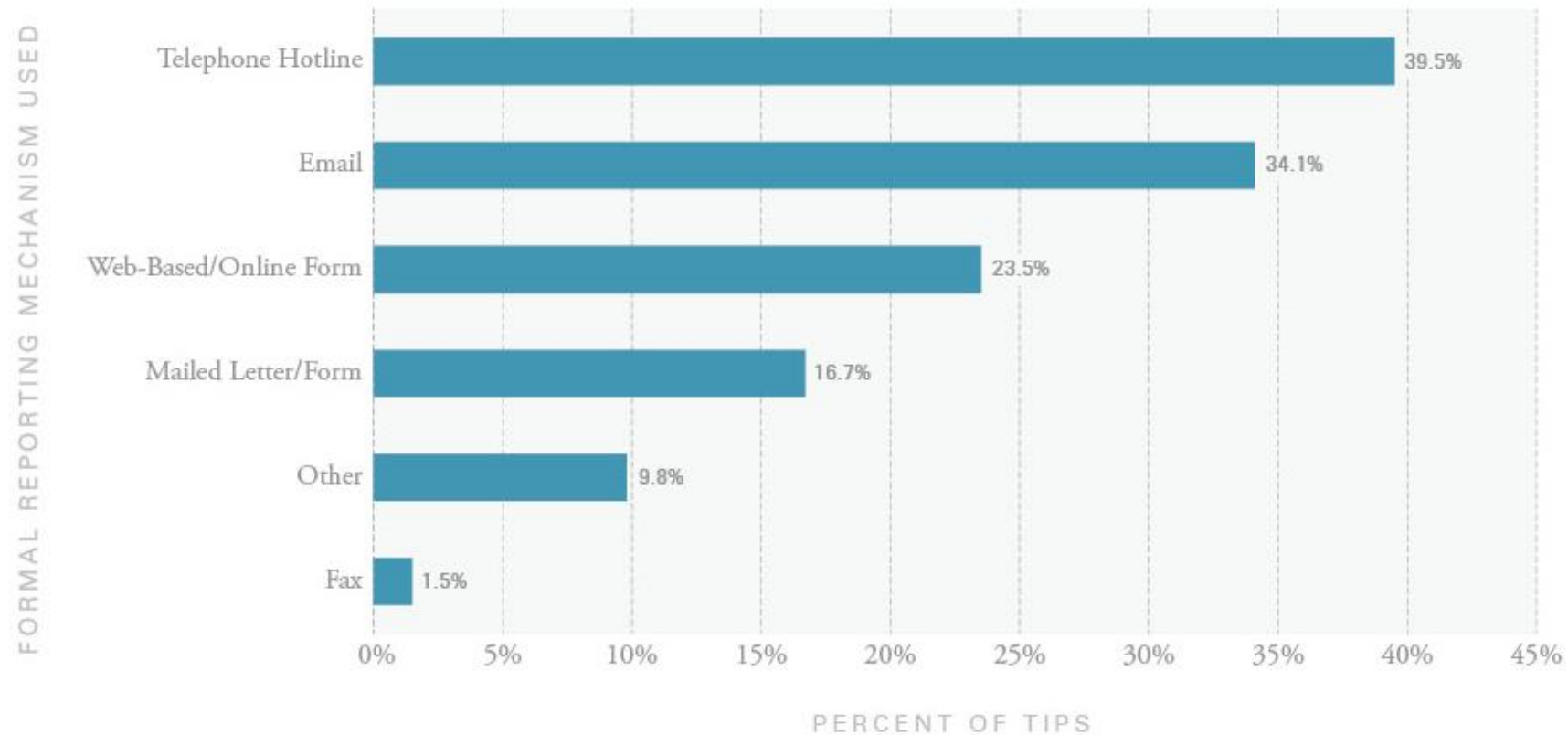
Impact of Hotlines

Figure 34: Impact of Hotlines



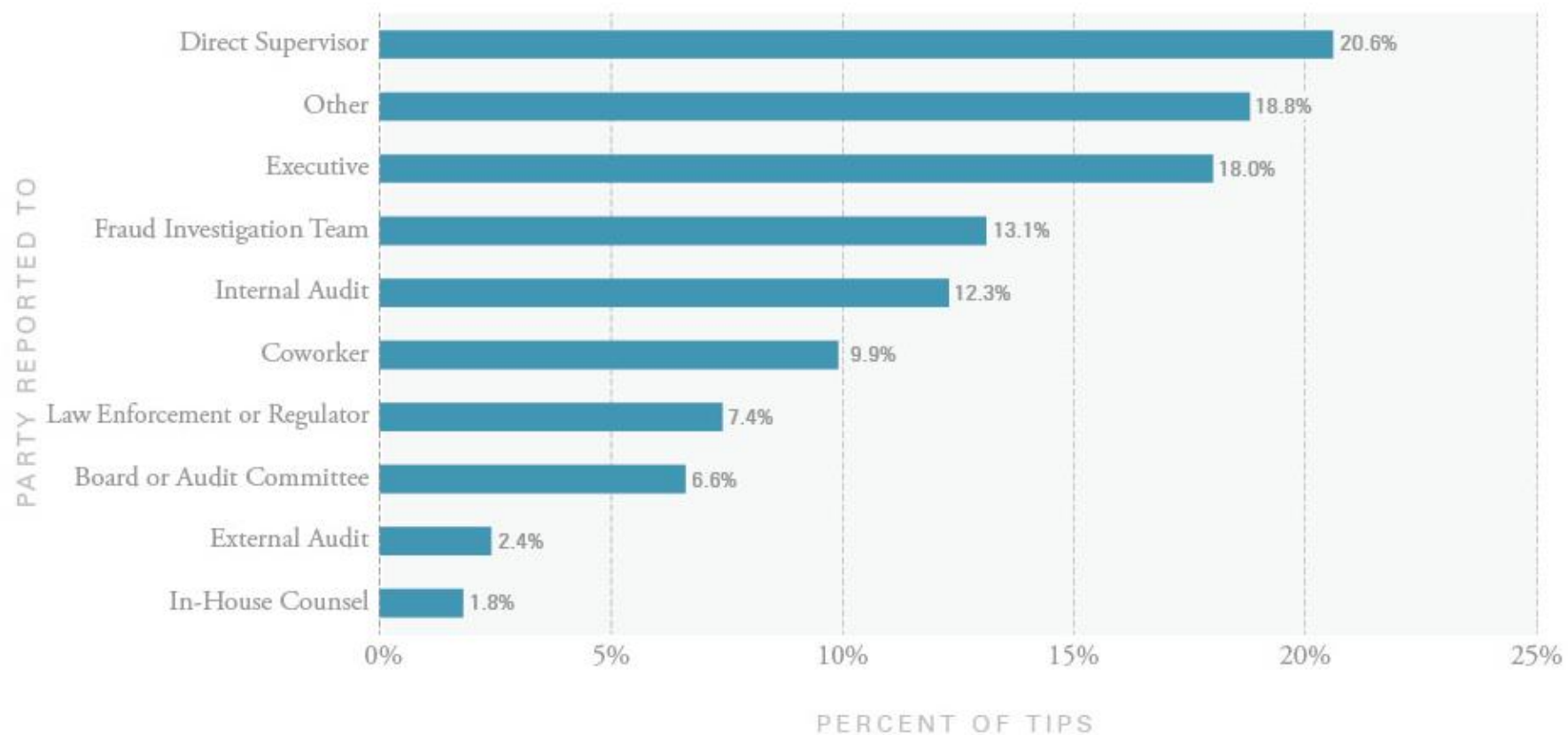
Formal Reporting Mechanism Used by Whistleblower

Figure 35: Formal Reporting Mechanism Used by Whistleblower



Party to Whom Whistleblower Initially Reported

Figure 36: Party to Whom Whistleblower Initially Reported



Party to Whom Whistleblower Initially Reported

Figure 37: Top Three Parties to Whom Tips Were Reported Based on Perpetrator's Department

Operations	Accounting	Sales	Customer Service	Purchasing	Finance	Executive/Upper Management
Direct Supervisor (25.3%)	Executive (38.0%)	Direct Supervisor (26.4%)	Direct Supervisor (28.6%)	Executive (26.7%)	Direct Supervisor (21.1%)	Board or Audit Committee (22.2%)
Internal Audit (18.6%)	Direct Supervisor (27.1%)	Executive (20.8%)	Coworker (23.8%)	External Audit (26.7%)	Coworker (21.1%)	Law Enforcement or Regulator (20.4%)
Fraud Investigation Team or Executive (Both 15.7%)	Fraud Investigation Team (10.1%)	Fraud Investigation Team (17.0%)	Internal Audit (16.7%)	Direct Supervisor or Fraud Investigation Team (Both 16.7%)	Executive (21.1%)	Executive (18.5%)

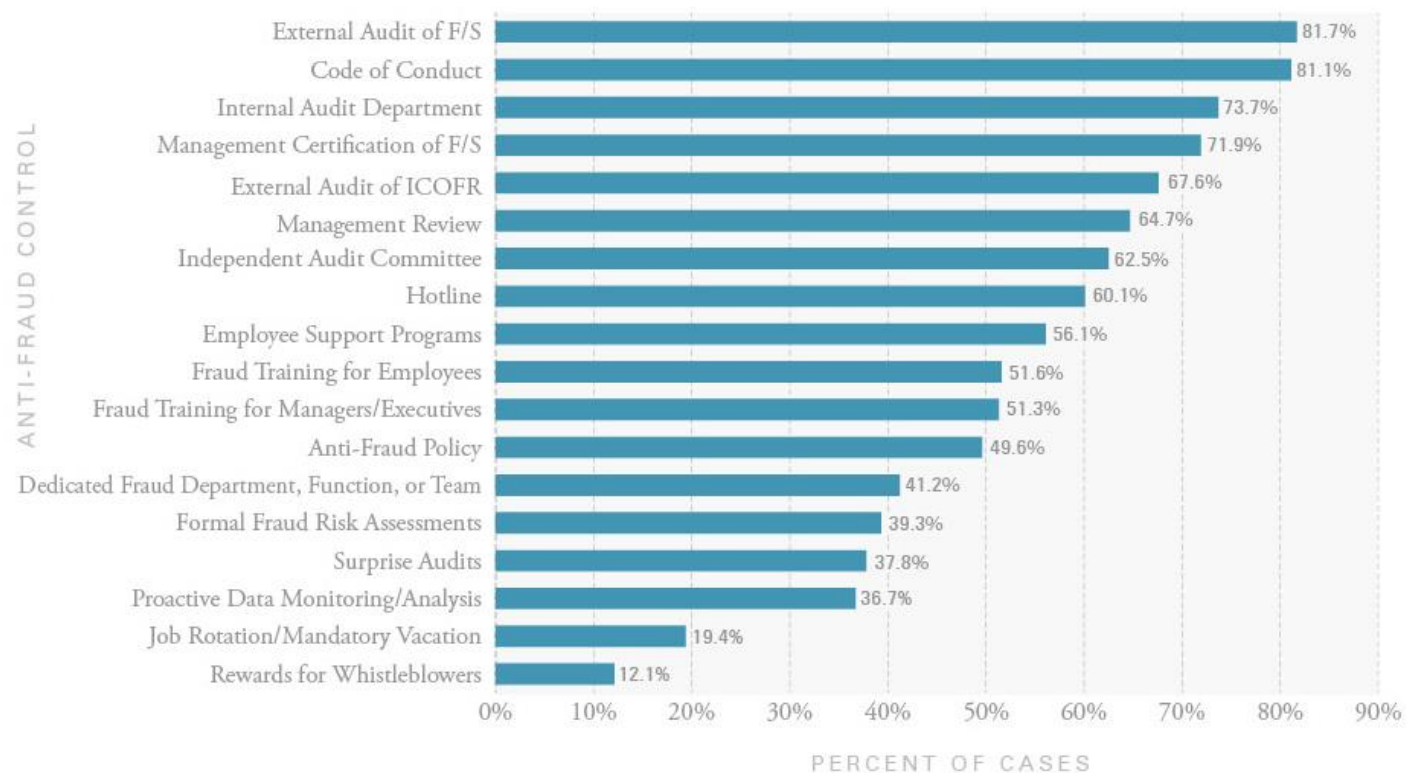
Benefits of a Culture that Encourages Whistleblowing

An organisation where the value of open whistleblowing is recognised will be better able to:

- Deter wrongdoing
- Pick up potential problems early
- Enable critical information to get to the people who need to know and can address the issue
- Demonstrate to stakeholders, regulators, and the courts that they are accountable and well managed
- Reduce the risk of anonymous and malicious leaks
- Minimise costs and compensation from accidents, investigations, litigation and regulatory inspections
- Maintain and enhance its reputation.

Anti-Fraud Controls at Victim Organizations

Figure 47: Frequency of Anti-Fraud Controls



Key:

External Audit of F/S = Independent External Audits of the Organization's Financial Statements

Management Certification of F/S = Management Certification of the Organization's Financial Statements

External Audit of ICOFR = Independent Audits of the Organization's Internal Controls Over Financial Reporting

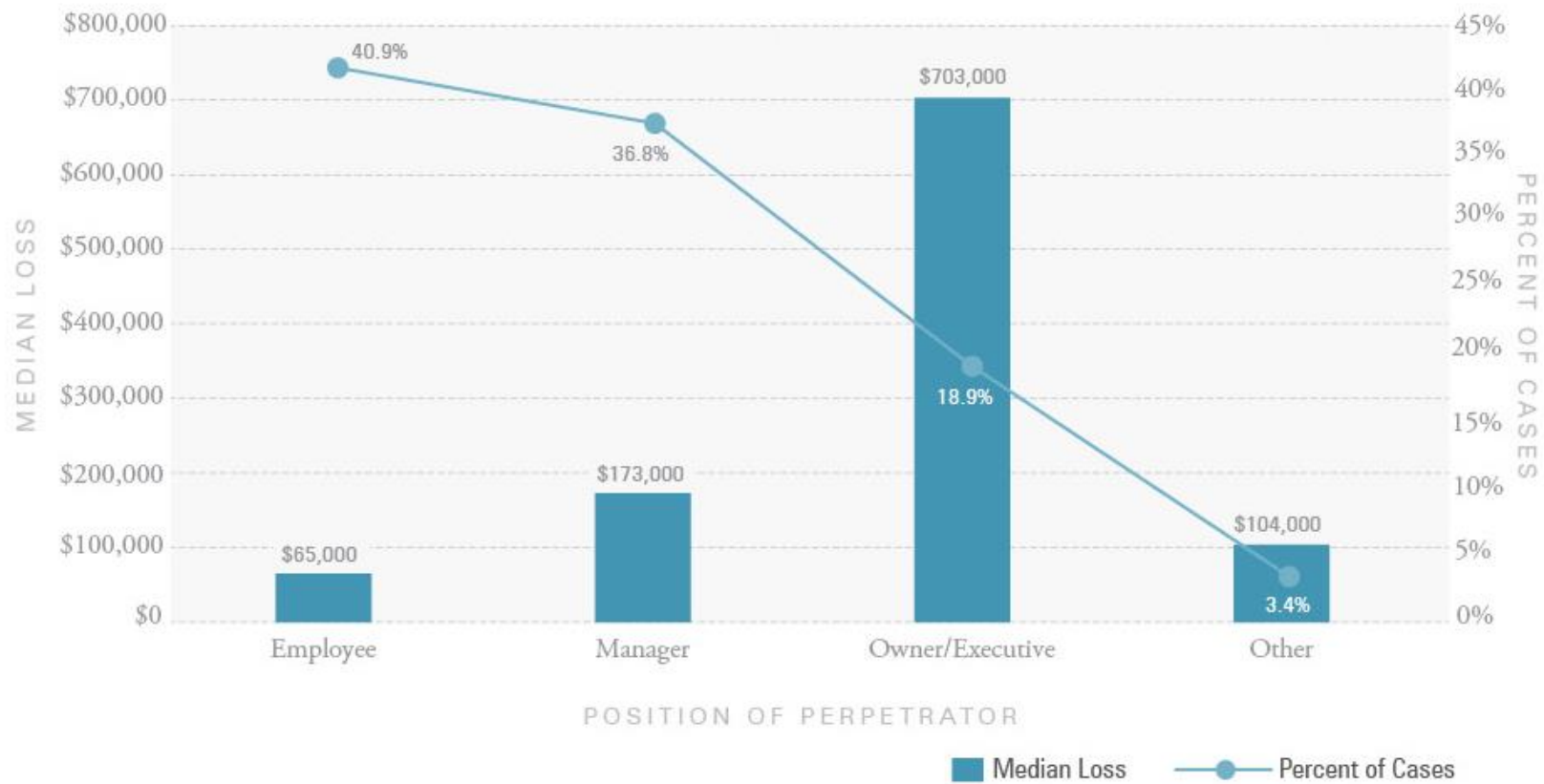
Trends in the Implementation of Anti-Fraud Controls

Figure 49: Change in Implementation Rates of Anti-Fraud Controls

Control	2010 Implementation Rate	2016 Implementation Rate	Change from 2010–2016
Hotline	51.2%	60.1%	8.9%
Fraud Training for Employees	44.0%	51.6%	7.6%
Anti-Fraud Policy	42.8%	49.6%	6.8%
Code of Conduct	74.8%	81.1%	6.3%
Management Review	58.8%	64.7%	5.9%
Surprise Audits	32.3%	37.8%	5.6%
Fraud Training for Managers/Executives	46.2%	51.3%	5.2%
Independent Audit Committee	58.4%	62.5%	4.1%
Management Certification of Financial Statements	67.9%	71.9%	4.0%
Rewards for Whistleblowers	8.6%	12.1%	3.5%
Job Rotation/Mandatory Vacation	16.6%	19.4%	2.8%
External Audit of Internal Controls over Financial Reporting	65.4%	67.6%	2.2%
Employee Support Programs	54.6%	56.1%	1.5%
External Audit of Financial Statements	80.9%	81.7%	0.8%

Perpetrator's Position

Figure 65: Position of Perpetrator—Frequency and Median Loss



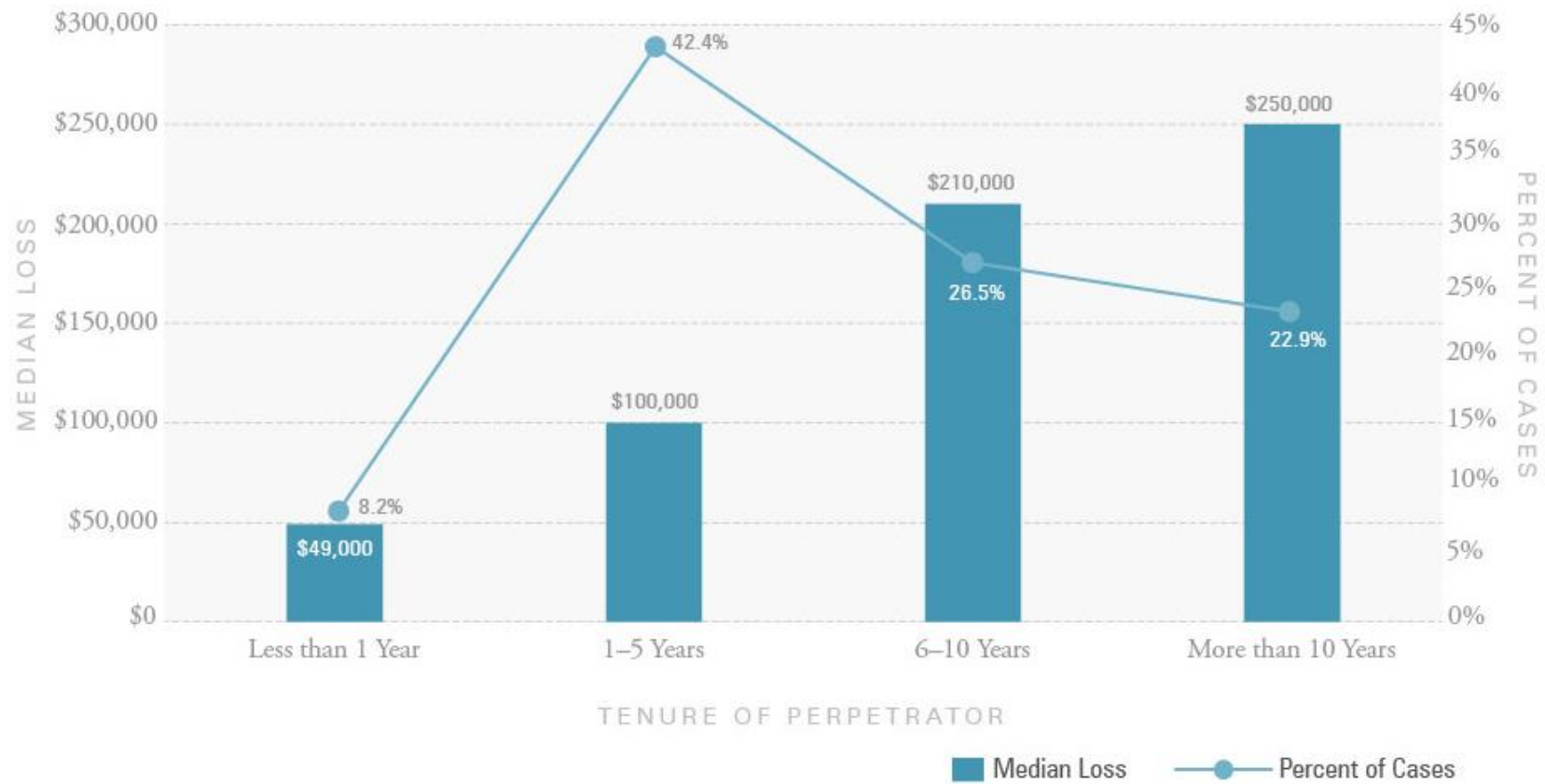
Perpetrator's Position

Figure 66: Median Duration of Fraud Based on Position

Position	Median Months to Detect
Employee	12
Manager	18
Owner/Executive	24
Other	18

Perpetrator's Tenure

Figure 76: Tenure of Perpetrator—Frequency and Median Loss



Perpetrator's Tenure

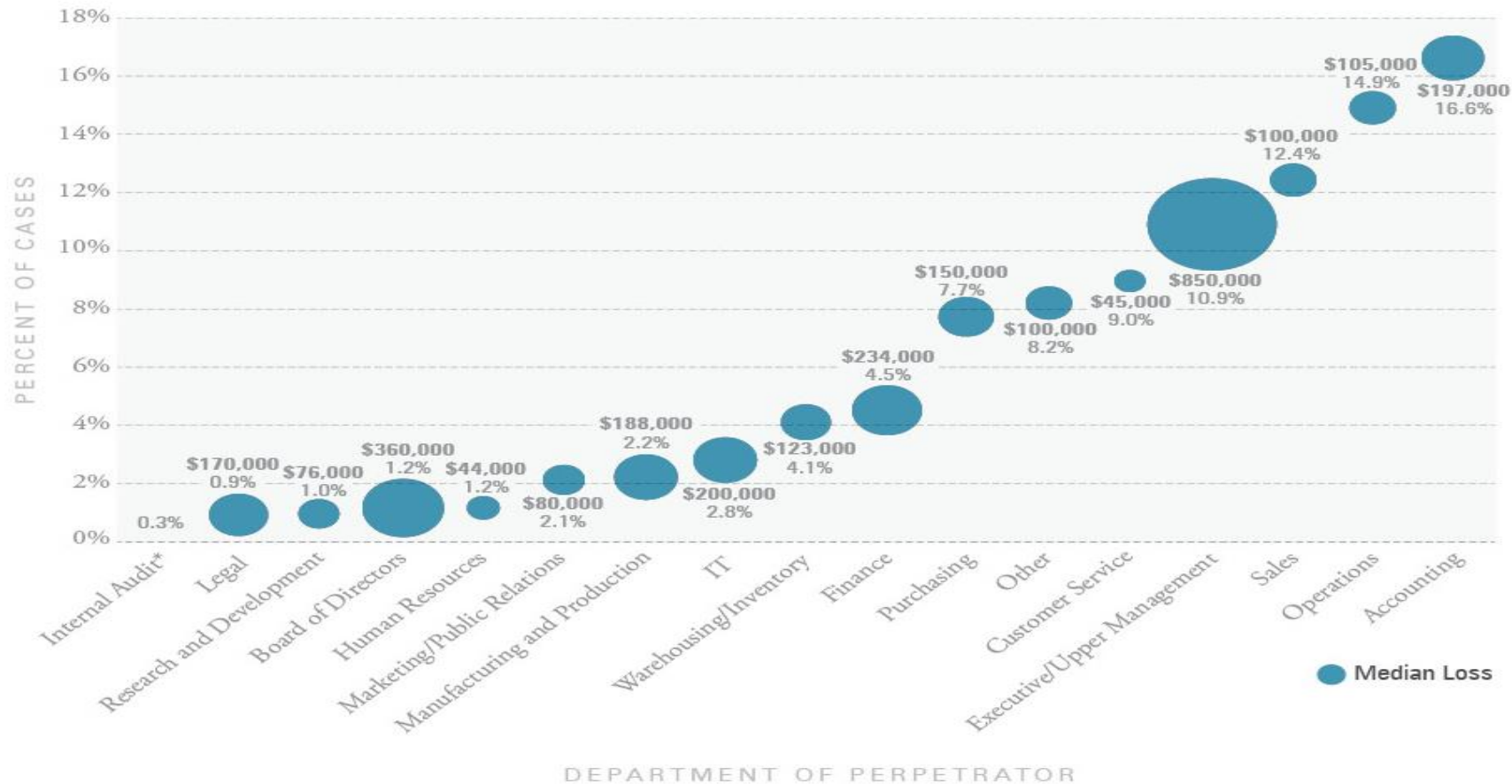
Years of service



Source: Global Profiles of the Fraudster, KPMG International, 2016

Perpetrator's Department

Figure 77: Department of Perpetrator—Frequency and Median Loss



*Internal Audit category had insufficient responses for median loss calculation.

Schemes Based on Perpetrator's Department

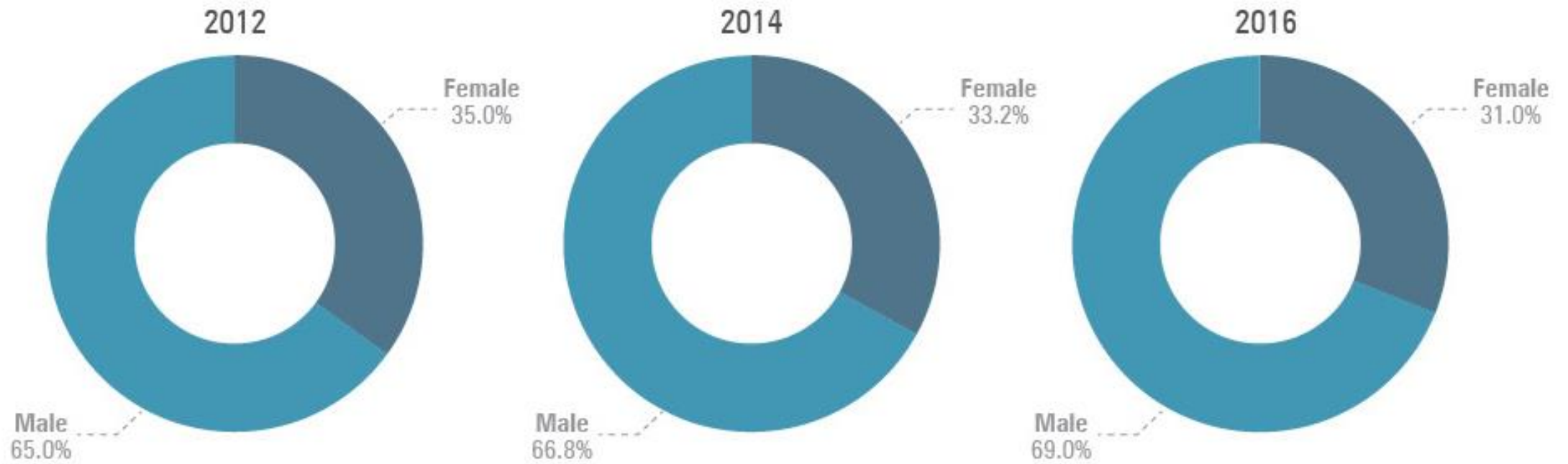
Figure 78: Frequency of Schemes Based on Perpetrator's Department

Department/ Scheme	Accounting	Operations	Sales	Executive/Upper Management	Customer Service	Purchasing	Finance	Warehousing/ Inventory
Cases	348	312	260	228	189	161	94	86
Billing	27.0%	21.5%	14.2%	36.8%	9.5%	25.5%	24.5%	9.3%
Cash Larceny	14.9%	7.7%	8.1%	10.1%	14.3%	3.7%	18.1%	0.0%
Cash on Hand	15.5%	13.8%	6.5%	12.3%	18.5%	13.0%	22.3%	5.8%
Check Tampering	30.5%	9.3%	2.7%	13.6%	7.4%	6.2%	24.5%	1.2%
Corruption	21.6%	34.9%	34.6%	50.9%	25.4%	68.9%	37.2%	32.6%
Expense Reimbursements	15.8%	12.2%	14.2%	23.7%	5.8%	14.9%	14.9%	3.5%
Financial Statement Fraud	12.9%	5.4%	7.3%	30.3%	3.7%	3.1%	23.4%	9.3%
Non-Cash	7.2%	19.6%	20.4%	24.6%	16.4%	18.6%	13.8%	57.0%
Payroll	21.6%	6.4%	1.5%	10.1%	3.7%	5.0%	7.4%	2.3%
Register Disbursements	3.2%	4.2%	5.0%	1.8%	3.2%	4.3%	3.2%	0.0%
Skimming	17.5%	12.8%	11.9%	11.8%	16.9%	7.5%	12.8%	5.8%



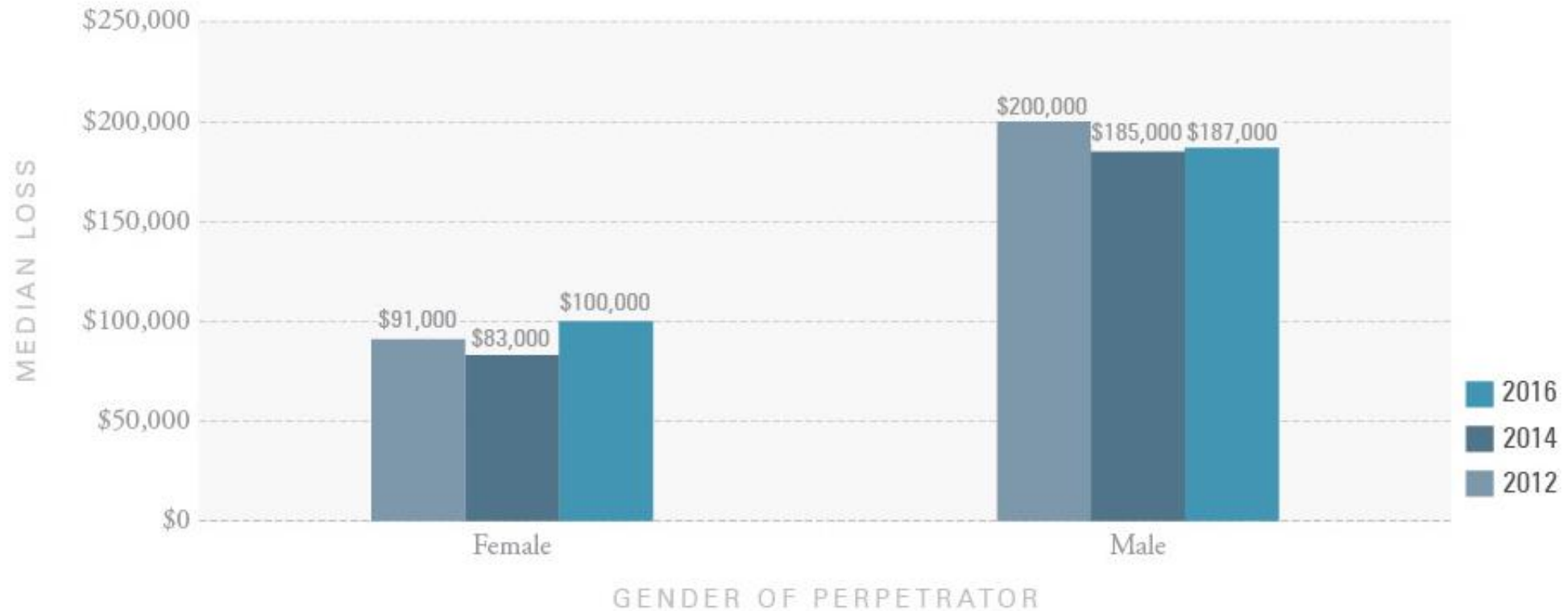
Perpetrator's Gender

Figure 79: Gender of Perpetrator—Frequency



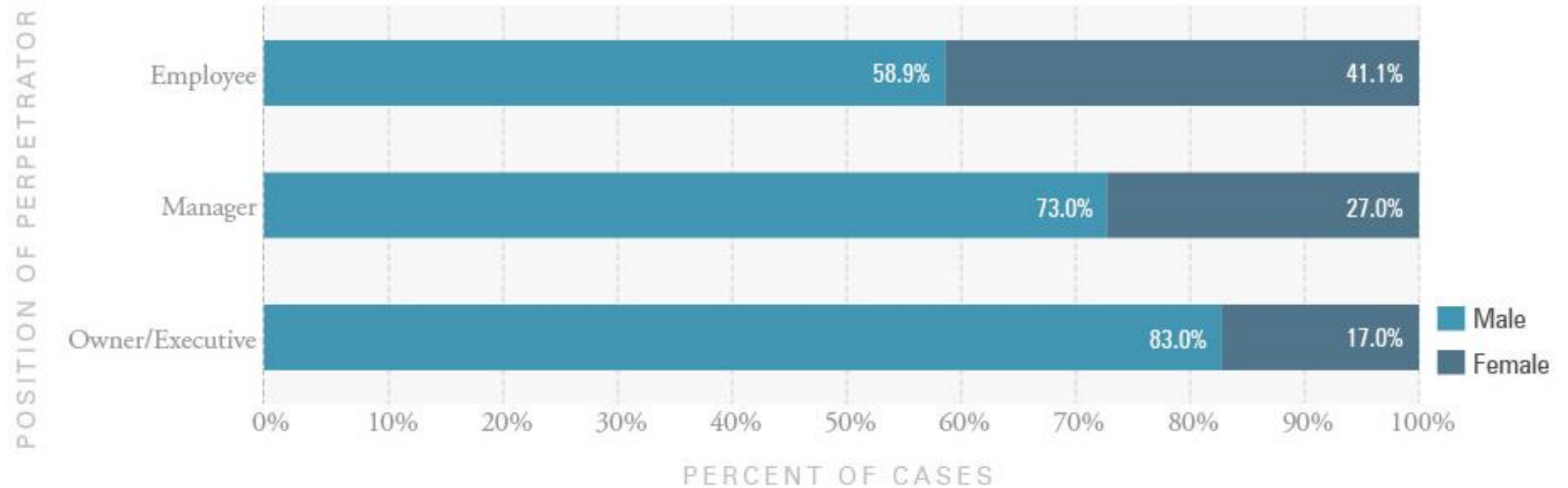
Median Loss Based on Gender

Figure 81: Gender of Perpetrator—Median Loss



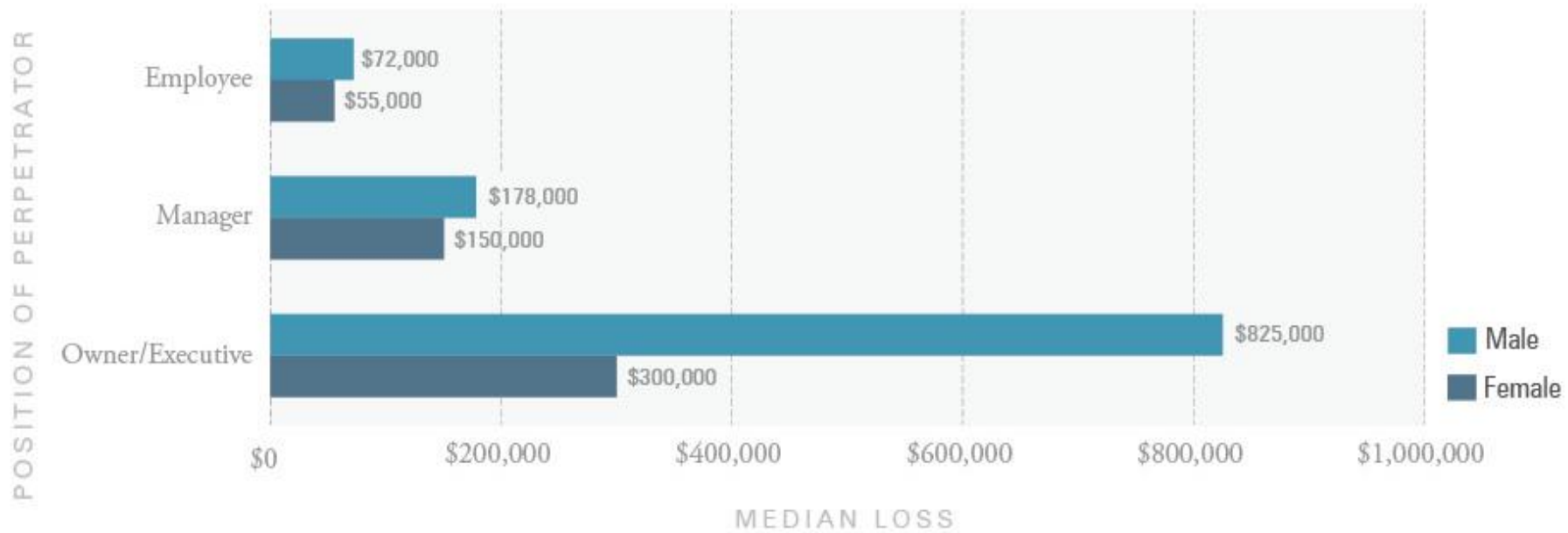
Position of Perpetrator Based on Gender

Figure 82: Position of Perpetrator Based on Gender



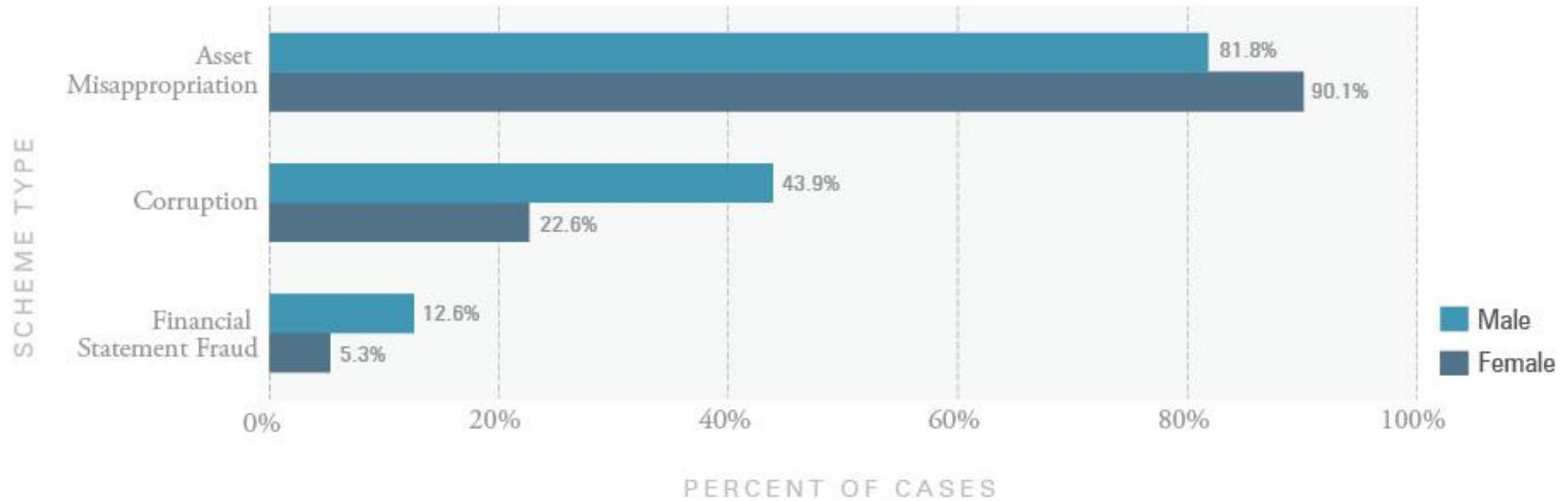
Position of Perpetrator Based on Gender

Figure 83: Position of Perpetrator—Median Loss Based on Gender



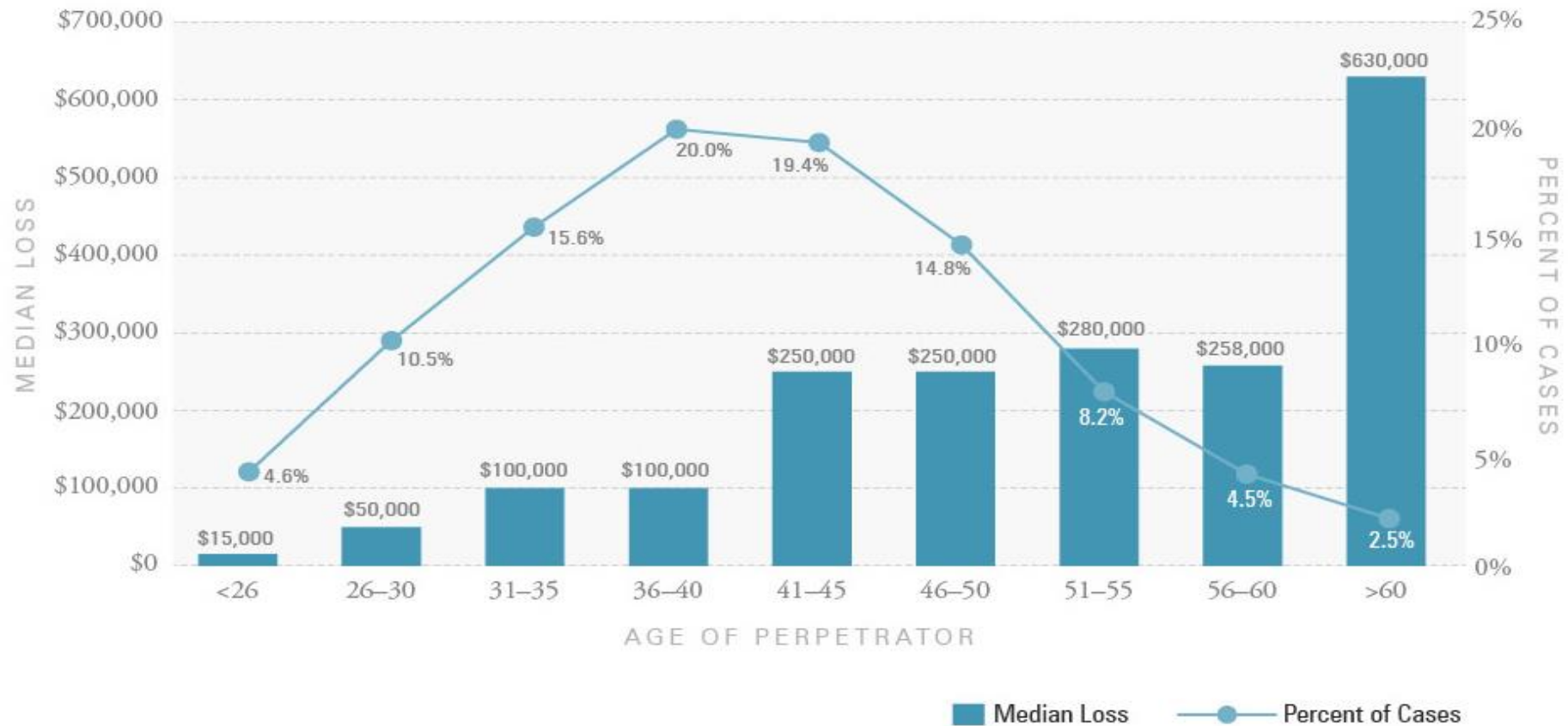
Frequency of Schemes Based on Gender

Figure 84: Frequency of Fraud Schemes Based on Gender



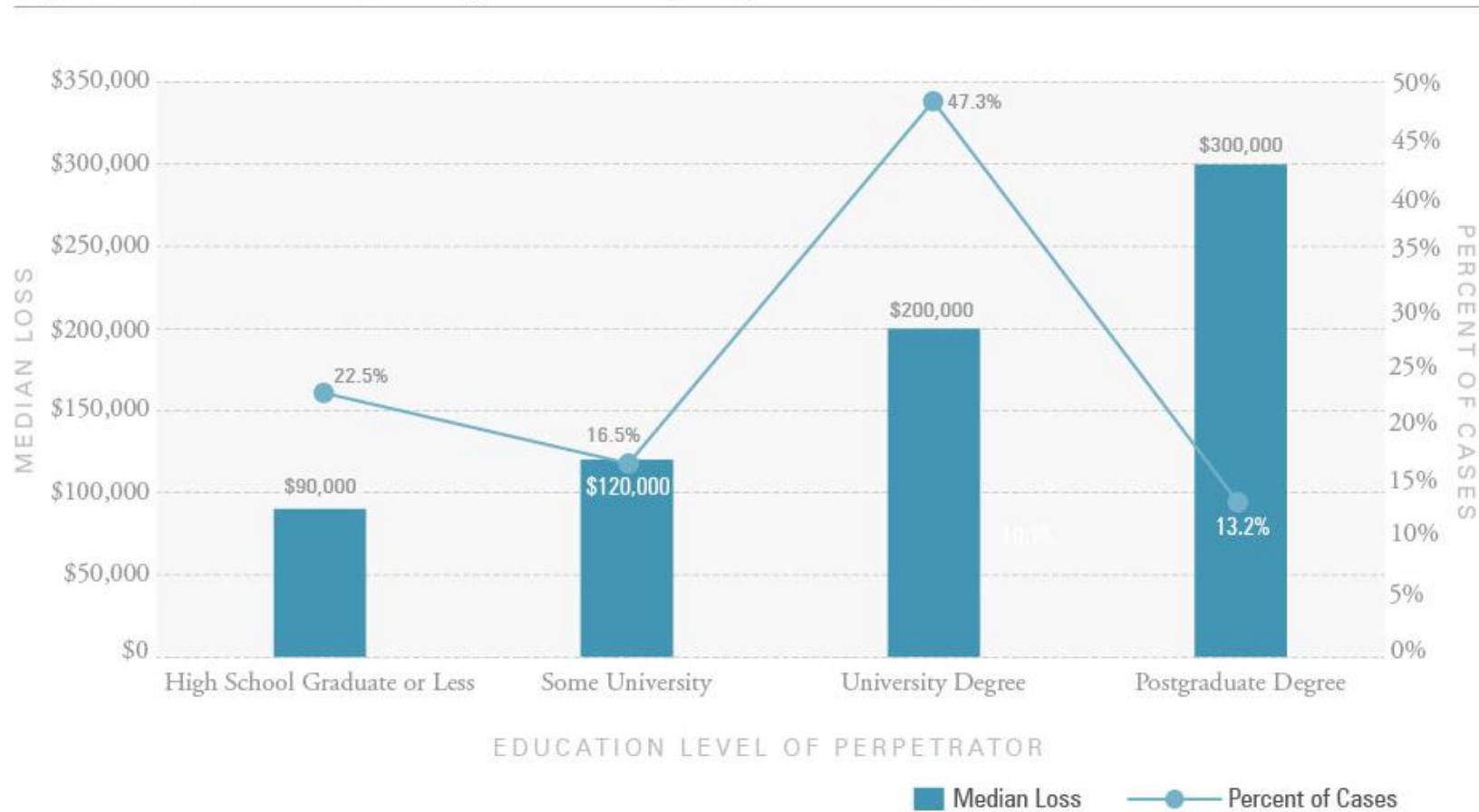
Perpetrator's Age

Figure 85: Age of Perpetrator—Frequency and Median Loss



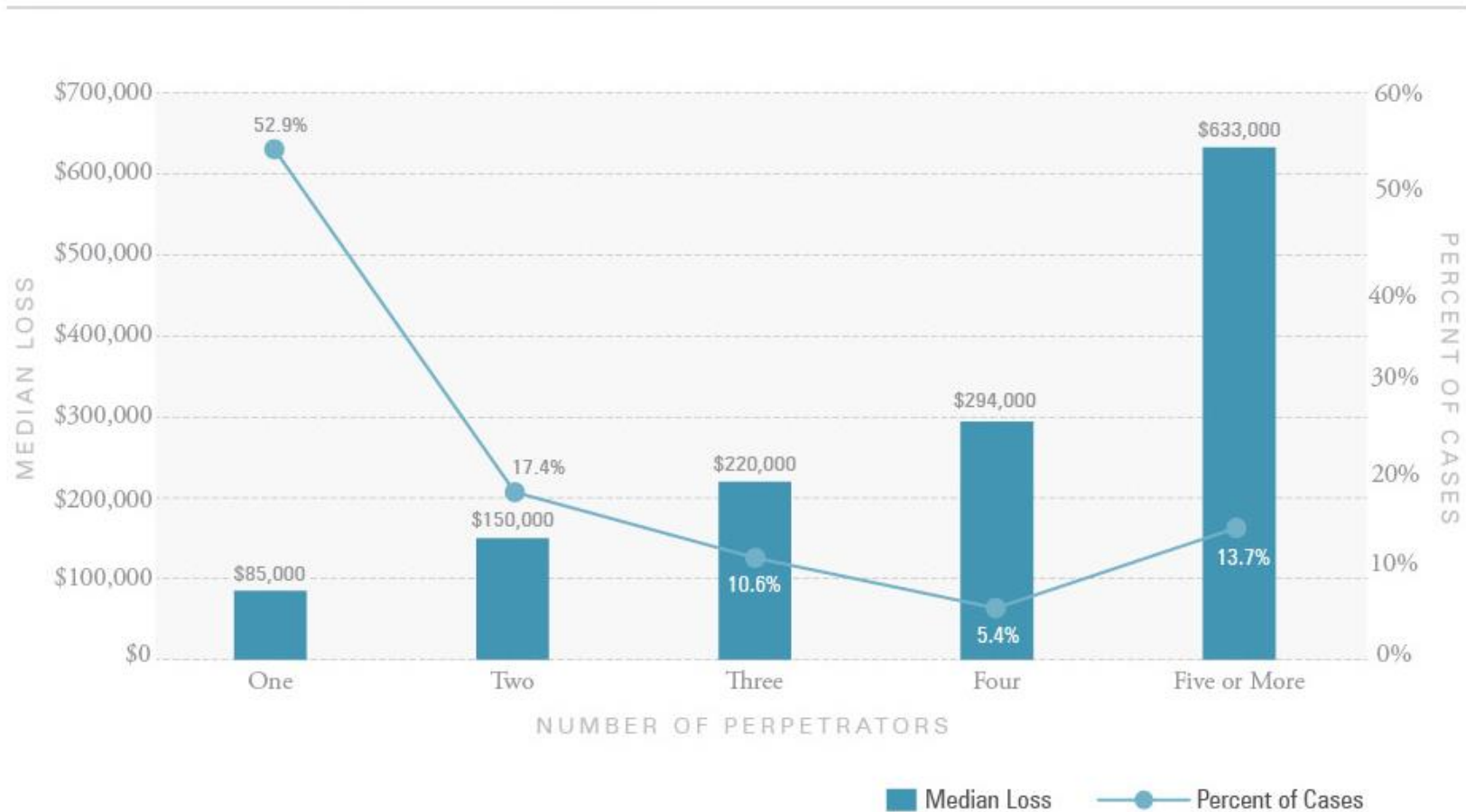
Perpetrator's Education Level

Figure 86: Education Level of Perpetrator—Frequency and Median Loss



The Impact of Collusion

Figure 87: Number of Perpetrators—Frequency and Median Loss



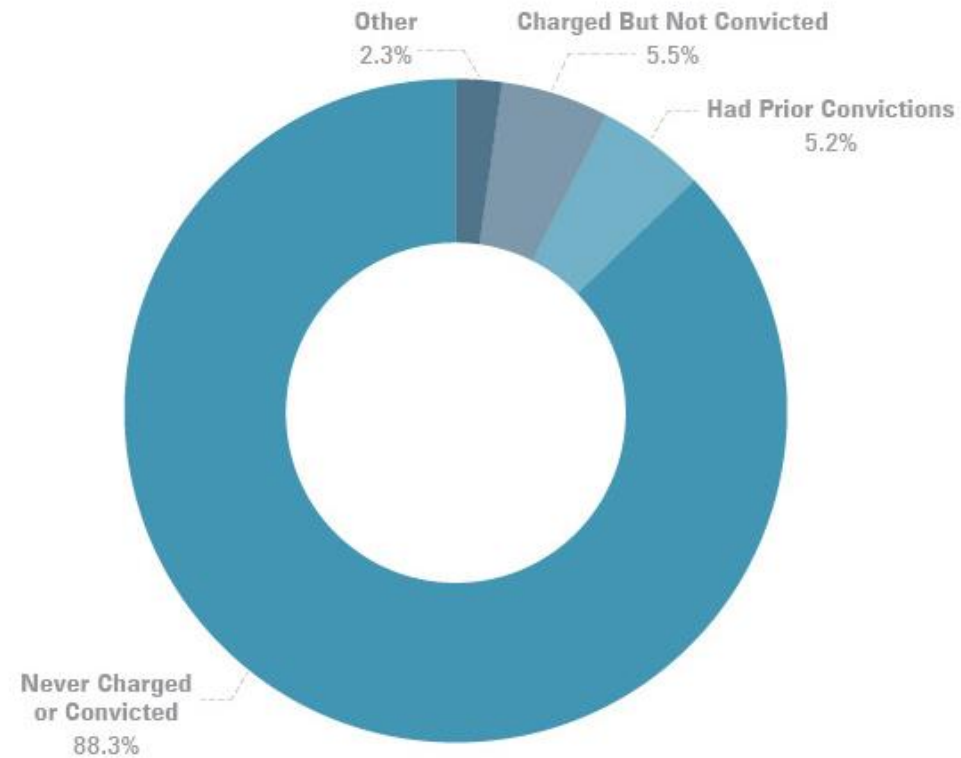
The Impact of Collusion

Figure 88: Median Duration of Fraud Based on Number of Perpetrators

Number	Median Months to Detect
One	16
Two or More	18

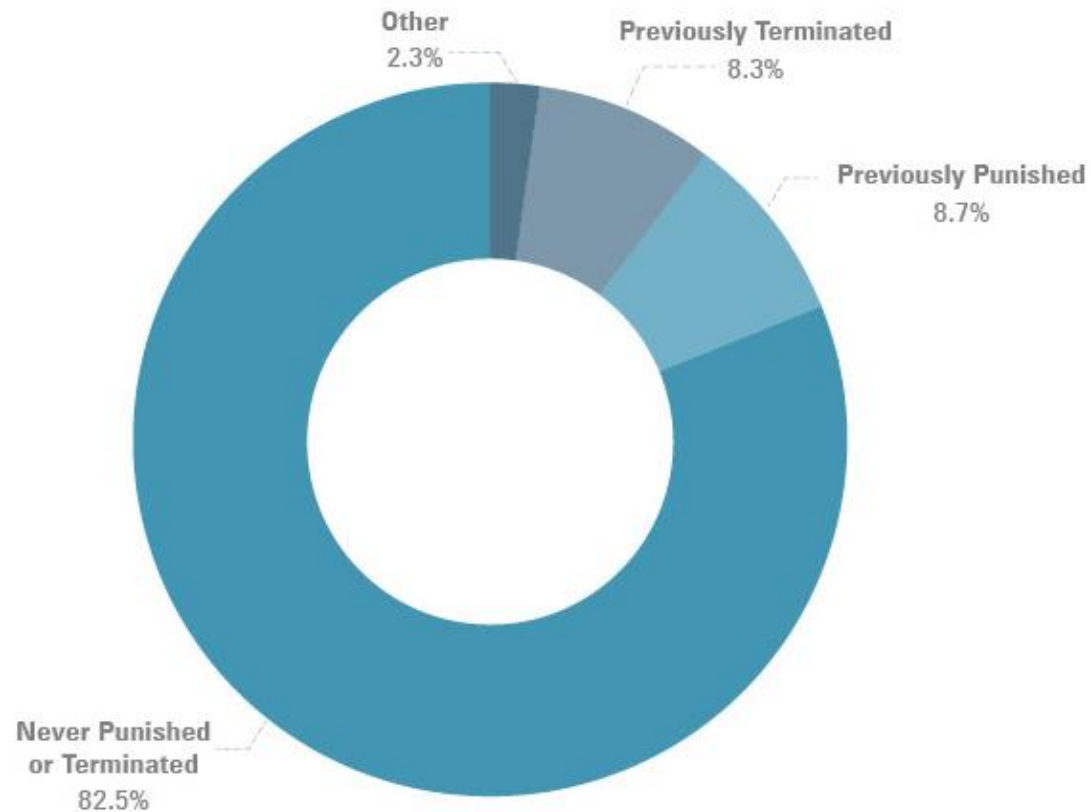
Perpetrator's Criminal Background

Figure 92: Criminal Background of Perpetrator



Perpetrator's Employment History

Figure 93: Employment Background of Perpetrator



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