



# Public Procurement Workshop

Workshop on Public Procurement & fraud and  
corruption prevention Audit Lisboa-Portugal 14 & 15  
October 2010



# Programme

Procurement fraud-Case study 1

Procurement fraud-Case study 2

Background regarding Economic crime / Auditing-together with the checklist on Procurement already provided to participants ( to equip participants to deal independently with the basic aspects of economic crime)

- Practical preventative measures
- Practical approach to procurement fraud
- Practical approach to investigations
- Practical approach to economic crime and preventative measures



# Procurement fraud-Case study 1

Tenders

Background

A tender for scholastic stationery is placed every year for the supply thereof

“The policy in a nutshell – small companies tender, they take awarded tender to major suppliers (place orders): Major-suppliers responsible for packaging/delivery/transport relevant to the purchasing. The only thing they do not do is tendering that the small companies do”

The above policy is developed to empower previously disadvantaged persons



# Procurement fraud-Case study 1

Background (Scholastic stationery tender)

It was alleged that there was:

- Collusion in the tendering process
- Front companies used to hide identities of actual stakeholders
- Prices of connected parties have been inflated
- Senior officials are associated with connected parties
- Senior officials also actively involved in Tender Committee
- After certain tenders were awarded “price-increases” were granted after the work had been completed (i.e. to connected parties)



# Procurement fraud-Case study 1

The view on above was the following:

“For collusion and price fixing of tenders to be successful for those perpetrating the act, at least two conditions have to be fulfilled”

- Tenders must be awarded to the perpetrators
- The reward for the perpetrators must more than compensate for the risks incurred



# Procurement fraud-Case study 1

Further background information

- Ten(10) companies were awarded the tender (six of the companies were awarded a portion of the tender for the first time)
- Tender documentation require a tax clearance certificate
- A tender levy need to be paid
- Although certain documentation (eg tender levy receipts/tax clearance certificates/tender declarations/supplier invoices) are not available (will be available during workshop) participants should list possibilities or even similarities on such documentation that they think are appropriate to confirm/refute what's being alleged



# Procurement fraud-Case study 1

What's being required from participants:

Prepare a detailed audit/investigation plan indicating-

- the main objective of the assignment
- your approach
- timing and activities (eg legal and contract review)
- deliverables (legal and contract review)
- key engagement staff

Your findings should confirm/refute what's being alleged

Conclude on the appropriateness of the checklist provided for the working group and make recommendations



# Procurement fraud-Case study 2

## Background

Problem areas identified during a scoping exercise, include:

- Tender procedures not adhered to
- Tender accepted with partially completed documents
- Tender documents signed by Tender Committee Chairman and members, but amount field left blank
- High value tenders are allocated without proper background checks
- Instances were found of contractors on site with no sign contracts in place
- Contract was entered into, but the conditions of the contract seem to be unfavourable to the client
- Invoices not verified prior to payment
- Contractor unknown to the authorities involved, which may imply that no detail work was done by contractor
- Preferred suppliers identified
- Asset verification not being done regularly
- Value- added tax searches a concern
- Penalty interest paid
- Reconciliations and monthly reports not being verified timeously





# Procurement fraud-Case study 2

Potential risks relevant to problem areas above:

- Lack of internal controls may result in losses
- Non-adherence to tender requirements may result in preferential contractors being appointed and irregular amounts being quoted
- The employees are aware of these weaknesses and might target the department with such fraudulent documents
- Employees may purposely over-pay suppliers and thereafter receive kickbacks
- Failure to verify the validity of invoices may result in irregular payments being made to suppliers
- Inefficiencies within the appointment of suppliers will result in fruitless expenditure
- The suppliers may be aware of such inefficiencies and defraud the department



## Procurement fraud-Case study 2

What's required from participants:

- Prepare a detailed audit/investigation plan (see case study 1)
- List your findings and indicate the immediate intervention required to address the problem areas and potential risks relevant thereto
- Conclude on the appropriateness of the checklist provided for the working group and make recommendations



- Background regarding economic crime/auditing (consider also checklist provided)
- practical preventative measures to combat fraud/corruption and financial misconduct
  - practical approach to procurement fraud
  - practical approach to investigations
  - practical approach to economic crime and preventative measures



# Practical preventative measures to combat fraud / corruption and financial misconduct



# Learning objectives for fraud, corruption and financial misconduct

To understand:

- the general impact and effect of fraud on an organisation
- the definition of fraud
- the main elements of fraud and other considerations
- attributes of fraud
- the main types of fraud
- Fraud red flags
- definition of corruption
- distinction between fraud and corruption
- definition of financial misconduct



# General impact and effect of fraud

- Fraud has been an area of concern for almost all organisations. Its impact on organisations can be tremendous, involving huge financial implications as well as loss of credibility or public confidence.
- Recent press reports of fraud upheavals involving certain major organisations around the world have exposed the weaknesses inherent in control systems whether internal or external to the incriminated organisations.
- These have revealed that fraud can be perpetrated by almost any party, whether by management itself despite its need to show a duty of care, by those having responsibility for corporate governance, by employees, and even by third parties as well. The need to re-establish values of honesty and of ethical behaviour standards is therefore more and more of prime importance.



# Definition of fraud

- **The unlawful and intentional making of a misrepresentation which causes actual prejudice or which is potentially prejudicial to another.**



# Elements of fraud

- There need to be a misrepresentation;
- The misrepresentation must be unlawful;
- The misrepresentation has to be intentional; and
- The misrepresentation has resulted in actual prejudice or may have the potential to cause prejudice.





# Elements of fraud: Misrepresentation

- It is a false statement made by one person to one or more persons. It can be considered as the distortion of the truth. It can take the form of words, conduct, or both, or by omission.
- An example of a misrepresentation by word is that of telling a lie with the sole object of inducing someone to act on it to his/her prejudice.
- An example of misrepresentation by conduct would be the drawing and issue of a cheque for payment with the knowledge that funds would not be available when the cheque is presented at bank for encashment.
- An omission would be where there has been failure to disclose certain information when there is a duty or legal requirement to do so, for example, a second-hand car salesman omitting to mention to a prospective purchaser that the odometer reading on a car is actually considerably more than indicated, because for some reason the odometer does not reflect the true distance already covered by the car.



# Elements of fraud : Unlawful

- The action must not only be wrong in the eyes of the community but it must also be against the law.



# Elements of fraud: intentional

- The person making the misrepresentation must have intended or foreseen that the victim would be deceived by his/her action. There must therefore be an intention to deceive, whether it is acted upon or not. For example misrepresenting a loss-making venture as a profitable one to a prospective purchaser of that venture. A misrepresentation arising as a result of negligence or error on the other hand, may not be considered fraudulent unless willful, that is, there was an intention to defraud whoever was acting on that representation.



# Elements of fraud: Prejudice

- The victim must have suffered prejudice due to reliance on the misrepresentation. It is not only actual prejudice that matters, as potential prejudice is also considered sufficient, that is, when someone relying on that misrepresentation might have suffered harm. In the latter case, it is irrelevant whether someone was in actual fact misled, as the critical issue is the potential of that misrepresentation to cause harm had anybody decided to act on it.



# Elements of fraud : other considerations

- There must be at least two parties to the fraud, namely the perpetrator and the party who was or could have been harmed by the fraud, otherwise known as the victim;
- A material omission or false representation must be made knowingly by the perpetrator;
- There must be intent by the perpetrator that the false representation be acted upon by the victim;
- The victim must have the legal right to rely on the representation;
- There must be either actual injury or a risk of injury to the victim as a result of the reliance;
- There generally is an attempt to camouflage; and
- Fraud involves betrayal of trust.



# Attributes of fraud

- Fraud arise as a result of various factors. These need to be understood by auditors. The presence of these factors however does not necessarily mean the existence of fraud. Awareness of these factors helps the auditor to remain alert to the possibility of fraud to exist or to arise.
- For fraud to occur there must be a motivation to do so. It is also encouraged through the existence of organisational or environmental factors that provide opportunities to cause fraud. Fraud must also be considered as acceptable or feasible or allowable, depending on level of moral or ethical standards prevailing at any given time through a rationalisation process that tends to justify fraudulent acts and the feeling or belief by the perpetrator, justified or not, that he would not be exposed to any legal actions if discovered.
- These factors can therefore be grouped under three main headings, such as:
  - Motivation
  - Organisational/environmental
  - Rationalisation



# Attributes of fraud: motivation

- Fraud may be motivated by financial need, greed, need for prestige and moral superiority. These are stipulated by various Guidelines on Fraud and Corruption as follows:
- Economic motivation :- financial need or gain is the most common motivation for fraud and corruption. Often, persons convicted of fraud and corruption complain that they had unbearable financial problems for which there was no legitimate recourse.
- Greed : – persons with power and authority often commit fraud and corruption because they are motivated by greed.
- Prestige or recognition: – persons may feel they deserve more prestige or more recognition. These persons are often motivated by jealousy, revenge, anger, or pride. They often believe that they are superior to others, that they are shrewd enough to confound and confuse others and can commit fraud and corruption without being discovered or detected.
- Moral Superiority: – persons may also be motivated by a cause or values that they feel are morally superior to those of the victim, or the government in this case.



# Attributes of fraud :

## Organizational/Environmental Factors

- The existence of fraud or the likeness of fraud to occur, is very often due to opportunities that are provided by organizational or other environmental factors to perpetrate fraud.
- Loopholes in internal check or control system may be exploited by management, employees or even third parties to commit fraud. For example absence for a long time of key controlling personnel, empowerment of employees to deal with supplies, exploitation of control weaknesses at goods received end by suppliers to provide lower quality of material than ordered, and lack of organizational policies and procedures.
- The style of management in place may also allow opportunities for fraud. Authoritarian style of management or possibility for management to override internal control system increase the risk of fraud being committed.
- Industrial relationship prevailing between management and employees may cause an uncooperative atmosphere and breakdown in control systems and risk for fraud being perpetrated.
- Poor standards of corporate governance within organizations also increase the risk for fraud.





# Attributes of fraud :

## Organizational/Environmental Factors

- *The organisational atmosphere and its perception play a major causative role in perpetration of fraud and corruption.*
- *Where management is perceived as insensitive, insecure, impulsive or too strict, illtreats employees and judges performance either on short term results or without considering operational constraints, the disgruntlement in the employee is likely to result in instances of fraud and corruption.*
- *Systems and procedures adopted in organisations and organisational policies are particularly important. An organisation in which the corporate policies are unclear, there is inadequate internal control, excessive regulations, red-tapism, inadequate accountability or history of programme abuse is likely to have more instances of fraud and corruption.*
- *An understanding of the organisational atmosphere will enable an auditor to assess whether there is a higher risk of fraud and corruption in the entity and planning of the audit could be suitably modified. Poor management structure and policies are indicated by a high turn over of employees, absenteeism, poor documentation, low awareness of regulatory requirements and lack of transparency in reward systems.*



# Attributes of fraud : Rationalisation

- Through a rationalisation process perpetrators of fraud often have the firm belief that their acts are or can be justified and may therefore not be held accountable for their acts. that they are not or would not be exposed to legal actions in the event fraudulent acts are discovered.
- Such types of belief coupled with existing levels of moral/ethical standards encourage indulgence in fraudulent acts and increase the risks for fraud acts.
- For example an employee accused of fraud and corruption is likely to rationalise his action by saying or believing that his low pay justifies the action or since everybody is doing that he is also well within his right to do it; while a contractor could justify his acts of fraud and corruption as a cost of doing business or problems of securing contract from a government entity.



# Main types of fraud

- The ways in which fraud may be committed and the circumstances under which they may happen are so varied that a comprehensive list of all types of fraud might not be possible. Moreover the strong correlation between fraud and corruption renders difficult the drawing of a line between the two. However certain general appellations of fraud are often used.
- They are as follows:
  - **Bribery** is the giving, receiving, offering or soliciting of any “thing of value” in order to influence a person in the performance of, or failure to perform, his / her duties.
  - **False Statements and False Claims** occur whenever a person knowingly and willfully falsifies a material fact or makes a false or fictitious representation or files a false or fictitious claim that results in economic or financial loss to the person to whom the false representation has been made.



# Main types of fraud

- • **Embezzlement** is the fraudulent conversion of personal property by a person in possession of that property where the possession was obtained pursuant to a trust relationship. Examples of means to conceal embezzlement are the use of kiting or lapping scheme.
- • **Kiting** occurs when a person withdraws cash from a bank on checks deposited by a person for which the cash has not yet been collected by the bank. To conceal the fraud, the person continuously writes checks against non-existent account balances (“kites” checks from bank to bank).
- • **Lapping** occurs when a person steals cash from payment of accounts receivable, and continuously uses cash from other payments of accounts receivables to conceal the initial theft (“laps” two consecutive accounts).
- • **Conflict of Interest** occurs when a person has an undisclosed economic or personal interest in a transaction that adversely affects that person’s employer.
- • **Phantom Contractor** is a non-existent company whose invoice is submitted for payment by a person involved in the purchase process.



# Main types of fraud

- • **Purchases for Personal Use.** A person may purchase items intended for personal use or may make excess purchases of items needed, some of which are then diverted to personal use.
- • **Split Purchases.** Contracts are split into two or more segments to circumvent the procurement authority limitations, and thus to avoid competitive bidding. This may involve bribery from the contractor to a person of the other party.
- • **Collusive Bidding, Price Fixing or Bid Rigging.** Groups of prospective contractors for a contract form an agreement or arrangement, to eliminate or limit competition. This agreement may also involve bribery.
- • **Progress Payment Fraud.** The contractor requests progress payments based on falsified information submitted to the other party.
- • **Over or under invoicing.** Occurs when there is deliberate misstatement of the invoice value as compared with goods or services received or supplied.



# Main types of fraud

- **Extortion** is the use of authority to secure unlawful pecuniary gain or advantage.
- • **Nepotism and Favouritism** unlawful use of public office to favour relatives and friends.
- • **Loss of Revenue** on account of tax or duty evasion can include different situations where revenue due to the government is not received or paid.
- • **Unfair Recruitment** favouritism exercised in the process of recruitment for unlawful gain.
- • **Computer Fraud** is any fraudulent behavior connected with computerization by which a person intends to gain a dishonest advantage. For instance, salami-slicing is a computer fraud where fractions of interest calculations are transferred to a personal account.



# Example of fraud red flags

- The manager is able to use his position of authority to instruct accounts section to effect payments to particular suppliers in priority without need to seek decision of finance committee members.
- Unclaimed wages were not remitted to cashier. The payclerk decide when to remit amount to site workers. These workers are recruited on a hire and fire basis. This recruitment is not strictly monitored at wages section of head office level. Pending payment , he avails himself of the right to make personal use of this money and in certain cases of long outstanding he has not refunded the money. According to him he was entitled to the money given his belief of being underpaid. He however reports to those enquiring about unclaimed wages that it is kept under his custody



# Example of fraud red flags

- The organisation stated to the client that the building work done for him were according to specifications as per contract terms. In fact the responsible party of the organisation has liaised with a major supplier to deliver materials of a poor standard. The organisation has however paid the price for good standard of materials to the supplier. The client rely on the organisation statement to settle amount as per contract terms
- Vehicles are provided during official working to certain officials for undertaking of the organisations business. Some of them in a senior position avail themselves of use of these vehicles refuelled at the cost of the organisation for the week-ends and when they are on leaves.





# Example of fraud red flags

- Stock take is not done at close of financial year. Purchasing/ receipt and issues functions are managed by a single person at the stores. Store contains many valuable items of small size .proper tagging of these items are not made. Stores are often issued to the manager for his personal use. The manager was never keen to carry periodical or annual stock take. Stock value are stated in the accounts at book value. Stock value represents as high as 25% of net asset value.



# Example of fraud red flags

- Quotations are recorded in the despatch book as being posted to at least 5 suppliers as required by procedures. Delivery of these quotation forms to suppliers are however made personally by the purchasing officer. most of the time only one or two quotes were received and from the same major suppliers . there are however at least ten suppliers able to supply the sort of material used by the organisation. The purchasing officer who owns no property five years earlier, now owns at least two bungalows. According to his rank/status it takes 15 years to acquire a very modest house. The purchasing officer who sit in the purchasing committee as well as the manager have both given favourable replies about the reliability of those major suppliers. The manager contrary to his status runs a recently new limousine and entertains guests in very smart hotels.



# Definition of corruption

- A basic definition is:
  - giving or receiving of a gratification
  - to/by somebody that is not due
  - for doing something that he should not do
  - or for not doing something that he should do



# Distinction between Fraud and Corruption

Fraud	Corruption
Two parties to fraud : <b>perpetrator</b> and the <b>victim</b>	At least two parties to corruption: person who <b>offers</b> reward and the <b>party accepting</b> it
A <b>material omission or false representation</b> made knowingly by perpetrator	There must be <b>misuse of office</b> or position of authority <b>for private gain.</b>



# Distinction between Fraud and Corruption

<p>Fraud</p> <p>There must be <b>intent</b> by the perpetrator that the <b>false representation</b> be acted upon by the victim</p>	<p>Corruption</p> <p>There must be <b>intent to solicit</b> an offer of inducement or <b>reward</b> as benefit for performance of an official act</p>
<p>There generally is an attempt to <b>camouflage</b></p>	<p>There may be an attempt to <b>camouflage.</b></p>



# Distinction between Fraud and Corruption

Fraud	Corruption
Involves <b>betrayal of trust</b> between the <b>perpetrator</b> and the <b>victim</b>	Involves <b>breach of loyalty to a principal</b>
May not have <b>third party involvement</b>	Necessarily includes <b>third party involvement</b>



# Distinction between Fraud and Corruption

Fraud	Corruption
There is always <b>loss to one party</b> and gain to another	The effort to misuse position or illicitly influence another may not necessarily result in <b>loss to a party.</b>



# Financial misconduct

- Generally means wilful or negligent in fulfilling:
  - General responsibilities
  - Budgetary responsibilities
  - Reporting responsibilities
  - Non-compliance: sanction is up to five years imprisonment





# Procurement fraud a practical approach



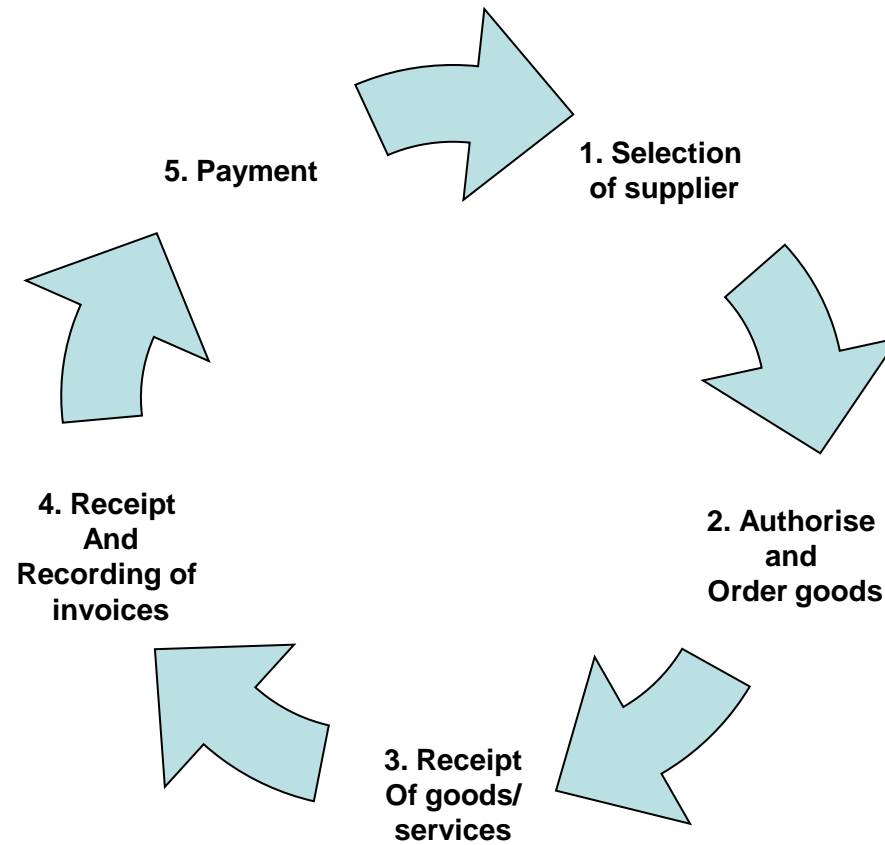
# Learning objectives for procurement fraud

To understand:

- the fraud in the procurement cycle
- typical direct and indirect benefits
- Characteristics of corrupt employees/suppliers
- Red flags and counter measures



# The Procurement Process





## Definition

“The unlawful and intentional making of a misrepresentation which causes actual prejudice, or which is potentially prejudicial to another”



# Elements

- Unlawfulness
- Misrepresentation
- Intention
- Prejudice (actual of potential)



# Procurement fraud

- **Common methods of contract fraud**
- The following are common methods of perpetrating contract fraud,
- **Bribery and kickbacks**—a contractor gives government employee money, gifts, or other favors in order to obtain business or favorable treatment.
- **Change order abuse**—changes are made to the original contract conditions, resulting in a need for more funds than were provided in the original contract. Change orders may be issued throughout the life of the contract to compensate a contractor who initially submitted a low bid.
- **Collusive bidding, price fixing, or bid-rigging**—a group of prospective contractors may make an arrangement to eliminate or limit competition
- **Co-mingling of contracts**—a contractor bills for the same work under more than one contract.



# Procurement fraud

- **Conflict of interest**—contracts are awarded to organizations that employ government employees or their families, or to companies in which government employees or their families have an undisclosed financial interest.
- **Defective pricing**—a contractor submits inflated invoices that do not comply with the costs/prices specified in the contract.
- **Duplicate invoices**—a contractor submits separately two copies of the same invoice and is subsequently paid twice.
- **False invoices**—a contractor submits invoices for goods that have not been delivered, or the invoice does not reflect the contract terms.



# Procurement fraud

- **False quality and performance representations**—a contractor makes false representations about the quality of the products to be supplied or qualifications to perform the requested services.
- **Information disclosure**—a government employee releases unauthorized information to a contractor to assist that contractor to win the contract
- **Local purchase order abuse or split purchases**—the total cost of purchasing goods and services exceeds the local authority limit, or a competitive process is required to provide such goods or services. To bypass these rules, the purchases are split into two or more segments.
- **Phantom contractor**— a contractor submits an invoice from a nonexistent company to support fictitious costs contained in a government cost-plus contract.





# Procurement fraud

- **Product substitution**—a contractor fails to deliver the goods or services as specified in the contract. The contractor may substitute an inferior product without informing the government.
- **Progress payment abuse: front-end loading or advance payment**—under government contracts, payments are made as work progresses. The payments are based on the costs incurred, the percentage of work completed, or the completion of particular stages of work. Progress payment fraud normally includes falsified certification of the work completed in order to receive payments prior to the work being done. The contractor may inflate the costs of the initial work so that, when the percentage of completion billing method is applied; the contractor would receive higher cash flows relative to the actual work completed. The cost of subsequent contract work would be understated with the anticipation that change orders would be approved for additional compensation.



# Procurement fraud

- **Purchases for personal use**— a government official purchases items for personal use, or makes excess purchases of which some items are diverted for personal use.
- **Short bidding time limits**—the lead-time for responding to a proposal is unusually short so that only bidders with inside knowledge will be able to prepare a proposal on time. There is no compelling reason to justify a markedly reduced response time.
- **Tailored specifications**—a government official establishes unnecessary or highly restrictive product specifications that only one contractor can meet.
- **Unnecessary purchases**—goods or services that have been previously purchased are purchased again when there is no additional need.



# Fraud: Ordering of goods

- Fictitious deliveries
- Fictitious supplier
- Ghost employee
- Purchase private use



# Fraud: Selection of Supplier

- Nepotism/conflict
- Bid rigging (group of contractors form agreement to limit competition)
- Cover quoting
- Over billing
- Bid pooling
- Accepting kickbacks



# Fraud: Payment

- Payee names altered on cheques
- Bank account name differ from payee name
- EFT payment vs. manual cheque



## Typical direct benefits

- Incentive tend to start small
  - Gifts, travel, entertainment
  - Cash payments
  - Cheques
  - Hidden interest
  - Loans
  - Payment of personal bills



## Typical indirect benefits

- Selling below market value
- Renting property from contract purposes at inflated prices
- Commissions or consulting fees
- Job change to successful tenderer
- Paying school fees in Europe
- Week long fishing or hunting trips for the enjoyment
- Don't know your taste use our credit card



## Characteristics of corrupt employees

- Close socialization with contractors
- Repeatedly makes excuses for poor performance by a contractor
- Living beyond means
- Assumes responsibilities above/below normal duties
- No leave





## Characteristics of corrupt employees (continue)

- Refuses to accept apparent desirable promotions
- Deliberate, repeated failure to enforce purchasing controls
- Insists that contractors use a certain subcontractor
- Under extreme stress, financial problems



## Characteristics of corrupt supplier

- Routinely offer inappropriate gifts, provide lavish entertainment
- Continues to receive work despite poor past performance
- Persistent allegations of wrongdoing by employees, other vendors
- Repeated discrepancies between proposed/actual labour and materials costs.



## Red flags: selection of suppliers

- Always emergency contracts
- Contract not awarded to lowest bidder
- No segregation of duties
- Supplier from Cape Town to Johannesburg
- Well known contractor repeatedly fail to bid
- Services rendered outside normal range of business



## Red flags: selection of suppliers (Continue)

- Small supplier – large contract
- Tenders accepted after closing date
- Changes to prices after closing date
- Unusual bidding patterns:
  - Winning bid is too high
  - Losing bidders become subcontractor
  - Bid prices close together
  - Same calculations or errors on 2 or more bids



## Red flags: selection of suppliers (Continue)

- Excessive of undocumented change orders
- Appearance of unknown bidders
- Apparent leaking of bids:
  - Extension of bid dates/accepting late bids
  - Last bidder always wins
  - Winning bid very close to 2<sup>nd</sup> contender



## Countermeasures: Selection supplier

- Zero Tolerance
- Gift policy
- Conflict of interest policy
- Formal procurement procedures
- Lifestyle
- Background checks of staff involved in procurement
- Independent market pricing comparison
- Segregation of duties – request vs. authorisation
- Only purchase from approved vendors



## Countermeasures: Selection supplier (continue)

- Compare supplier data to employee data
- Be aware of dormant accounts that have become active again
- Beware of ex-employees becoming suppliers
- Invoice verification – no physical address, fixed line telephone number, proper letterhead, sequentially numbered
- Complaints by staff regarding quality, late delivery



# Red Flags –ordering goods

- stock shortages
- higher usage or wastage rates
- unusual deliveries (time/procedures)
- suppliers with poor reputation
- inconsistent orders
- quality of documentation





# Countermeasures – ordering goods

- stock counts and adequate follow up of shortages
- stricter control over procedures and security relating to goods received
- segregation between ordering/receipt and payment functions



## Red flags: Payment

- Management override of approval procedures
- Account numbers differ
- Employee electronic details correspond to details of supplier
- Old or unidentified credits on the ledger
- Unresolved suspense items
- Duplicate payments
- Company payments diverted to employees or their private companies



## C o u n t e r m e a s u r e s - p a y m e n t

- Segregation of duties
- Password control
- Proper registers to trace the flow of cheques
- Bank reconciliations
- Supporting documentation
- Control over replacement cheques
- Reporting fraud cases to right forum



# Red flags (Further examples)

- **Weak ethical practices.** Senior management sets a poor example for employees to emulate. A code of ethics policy may not exist.
- **The employees take no long vacations and are posted on the same position for more than the normal tenure time.**
- **Inadequate review process.** If there is inadequate review processes the likelihood of an increase in fraud increases.
- **Approval fails to meet standard or normal approval processes.** Exceptions to approval processes should be reviewed to determine why these were processed differently.



# Red flags (Conti)

- **Non-compliance with authorities.** Entity does not comply with government acts and statutory regulations.
- **Conflicting evidence.** When supporting documentation is in conflict with management's or employees' response to inquiries, the transaction should be considered suspicious.
- **Internal controls that are not enforced or are overridden by management.** When management frequently overrides key internal controls or does not enforce the controls, this may suggest a pattern that indicates possible wrongdoing and fraud.
- **Information is provided to the auditor unwillingly or following unreasonable delays.** Failure to respond to information requests in a timely manner raises suspicion about the integrity of the transaction; delays could enable the perpetrators to create fictitious documentation to support the requested transactions.



# Red flags (Conti)

- **Missing documentation.** The absence of invoices, delivery receipts or consultants' products may indicate that a payment was made for goods that had not been received or services that had not been provided. Missing signed approval forms for invoices, contracts, or grants and contribution awards may indicate that appropriate approvals had not been obtained.
- **Only photocopies, faxes or scanned documents are available.** Auditors should review original documentation for proper examination. If only photocopies, faxes or scanned documents are available, this could indicate that originals do not exist or portions of original documents are being hidden from management or auditors or original documents were altered through the photocopying, faxing or scanning process.



# Red flags (Conti)

- **Alterations and discrepancies in documentation.** Documents should be considered suspicious when an addition, deletion or variation has been made to the original content. Alterations may include erasures, opaque or obliterated entries, the addition of new last letters or numbers, the distortion of patches over existing content. In the case of typed or printed text, changes may include adding or deleting sections after the original document has been approved and signed. Payment information that is different from the supporting documentation, for example a new amount or a different name of the payee, should raise questions with the auditor.
- **Bogus documents or fictitious invoices.** When a document's origin cannot be identified or it contains suspicious content, it is most likely fraudulent. Signs of fraud may include using more than one typewriting style, font or typeface, and inconsistent spacing of data. Invoices that do not contain a street address, postal code or telephone number are questionable and need to be investigated. An invoice with only a post office box number for an address or without a goods and services tax registration number and tax amounts may indicate fraud.



# Red flags (Conti)

- **Hand-written documents are provided instead of computerized documents.** In cases where one would normally expect to find a computerized document, a hand-written document may indicate a fictitious document.
- **Incorrect or revised versions of key documents.** Auditors should ensure they have the final version of contracts and agreements to ensure a proper review. They must also watch out for substituted or missing pages in long documents.
- **Fictitious contractor or supplier.** Invoices from a company with a name that is similar to a legitimate vendor name may be fictitious.
- **Transactions that are not processed through the normal accounting process.** Failure to follow normal accounting processes should be looked at to determine why these transactions have been processed differently. Such practices could suggest a pattern of fraud.





# Red flags (Conti)

- **Transactions not recorded in a complete or timely manner.** Transactions that are not completed in a timely manner or are improperly recorded as to classification or accounting period may indicate irregularities.
- **Odd, unusual or different transactions.** Transactions that do not make sense or are out of the ordinary need to be examined thoroughly by the auditor. Transactions that are peculiar in the time of day or week, in frequency (too many or too few), in place (too far or too near) or in amount (too high, too low, too consistent or too different) may be suspect.



# Red flags (Conti)

- The red flags associated with the requirement definition stage are as follows:
- **Limited information** - information in files or needs analysis on potential sources of material is limited to the successful bidder, indicating that the needs analysis was prepared with the intention of directing the contract to that bidder
- **Inadequate review** - to determine if technical or other information to be purchased is already owned
- **Excessive stock is acquired** - information on usage patterns is inadequate or indicates substantial inventory, and large amounts of the same material are routinely acquired from certain contractors



# Red flags (Conti)

- **Shortened replacement period** - this means that goods are being replaced in a much shorter time frame than manufacture
- **Surplus material** – goods in good working condition is being replaced. Goods in working order are being declared surplus but are subsequently replaced
- **Rushed timing of needs analysis** - the time allocated to conducting the requirements definition stage is minimal in relation to the estimated cost and technical complexity of obtaining the goods or services to be contracted. Rushed timing may indicate that someone is trying to circumvent the usual controls in the contracting process



# Red flags (Conti)

- **Inappropriate needs analysis** - the needs analysis is product oriented rather than performance oriented. The contract appears to define a solution rather than a need and the sources of the material have actually been selected.
- **The requirement specifications are narrow** - the requirement specifications are stated precisely rather than generically without reasonable justification, which reduces or eliminates potential competition.
- **Unusual senior official involvement** - a senior official of the entity takes a hands-on approach to preparing the needs definition that would not normally be part of that official's job.



# Red flags (Conti)

- The red flags indicating fraud in the bidding and selection stage are described as below:
- **Unclear Bid specifications**
- The bid specifications are so vague that when selecting a suitable contractor, government officials may exercise considerable discretion.
- **Submission of a low number of bids**
- Defining statement of work and specification to fit the product or capabilities of a few contractors.
- A low number of bidders show an interest in the contract. This may imply that specifications were written so that only certain contractors could compete.



# Red flags (Conti)

- **Unusual official involvement occurs**
- Certain government officials not usually involved in contracting take an unusually active interest in whether or not a certain contractor is awarded a contract.
- **Non-arm's length relationship between government officials and contractor(s)**
- This occurs when there is a close family relationship between the contractor and the government officials responsible for selecting the contractor.



# Red flags (Conti)

- **Confidential information has been released to a prospective bidder**
- Confidential information may be released to selected contractors in advance. This can be done by employees engaged or participating in the design of specifications, or by consultants engaged by the government.
- **Restrict Competition**
- This refers to proposal not being published in the newspaper but made orally to only a few contractors, or was announced in obscure publications, or during a holiday period.



# Red flags (Conti)

- **Unusual bidding pattern exists**
- Specific contractors either always bid against each other or never bid against each other
- Bid prices drop when a new or infrequent bidder submits a bid
- Certain contractors appear to be substantially bidding higher in some bids than others, with no obvious cost variance to account for the difference
- Certain qualified contractors never, or infrequently, bid in public contracts
- Certain contractors are always successful in a particular territory
- Some contractors are always successful when bidding on a contract in respect of a particular department, but always unsuccessful with other departments.





# Red flags (Conti)

- **Rushed bid deadlines**
- The deadline for bids may be so short that may create instances where only those who have received advance information have enough time to prepare bids or proposals.
- **Exceptions are made to tender deadline**
- This situation arises when tender are opened prior to the deadline or received after the closing dates of the tender without disqualification.
- **Change of bids after submission**
- Bids are changed after submission.



# Red flags (Conti)

- **Changes are made to specifications after awarding of the contract but prior to signing**
- These specifications result in additional charges over and above those originally specified in the tender call documentation.
- **The lowest responsive bidder is not selected**
- There is no adequate explanation for not accepting the lowest bid when it meets all the contract requirements.
- **Payments are allegedly made by the contractor to government officials**
- Where the successful contractor provides more than minor gifts, parties, meals or other benefits to a government official connected with the contract



# Red flags (Conti)

- **Several contracts for the same goods or services are issued sequentially**
- Unnecessarily splitting contracts to avoid competition and allow officials to direct the awarding of the contract to a specific supplier through sole sourcing, or to permit authorization of contract awards by people who would not have the proper authority at the high contract limit.



# Red flags for anti-competitive activity

## Anti-competitive activities by contractors

- Anti-competitive activities by contractors are collusion among contractors, which may involve bid rigging, collusive bidding and price fixing. The common trend throughout such activities is that they involve agreements or informal arrangements among contractors that limit competition. Experience shows that certain market characteristics may make it more likely that companies will engage in collusion as follows;
- **Suppression of Bids**
- Refers to one or more contractors agreeing with at least one other contractor to withdraw from bidding or agreeing to withdraw bids previously submitted in order to enhance another contractor's bid being accepted. The following are the patterns used in achieving this objective;
- **Complementary bidding**
- Contractors submit token bids that are too high to be accepted, or that include special terms that will not be acceptable. Such bids are not intended to be accepted but submitted to give the impression of competitive bidding.



# Red flags for anti-competitive activity

- ***Bid rotation***
- The contractors involved agree to bids submit bids but take turns to submit the lowest bid. This means that if three contractors are submitting bids for a contract, one would submit a very low bid and the others submit an unreasonably very high bid.
- ***Market division***
- Contractors agree to refrain from competing in a designated part of a market. Markets may be divided based on government entities, customers or geographical areas. The results of such divisions are that contractors will not bid or will submit only complementary bids.



# Red flags for anti-competitive activity

- ***Bids that refer to industry wide practices***
- Bidders may collude to fix prices. The indicator that this may be occurring is a reference in a bid to industry price lists or price agreements, or association price schedules, industry price schedules, industry suggested prices or market share.
- ***Correspondence with contractors hinting at possible collusion among companies***
- Letters, notes or memos by government employees, former employees, or competitors make references to contractors that “do not sell in the particular area” or “only a particular firm sells in that area” or “it is not their turn to receive the contract” or it is another bidder's “turn to receive a contract”.



# Red flags

- ***Unusual withdrawals of tenders***
- The lowest bidder withdraws after submission of the low bid, or a bidder withdraws from the contracting process and the justification is inadequate.
- ***A low number of bidders/dummy bids***
- Only one bidder has put forward a complete bid that meets the specifications and requirements. The others have submitted bids that do not correspond to the contract requirements.
- ***Re-bidding results are identical to original bid***
- New bids or supplementary bids are requested as a result of changes in the government specifications after the original bids have been opened. In the re-bidding situation, the contractors rank identically with the original bids.



# Red flags

- ***Peculiar details of bids***
- Bidders who ship their products a short distance bid more than those who must incur more expenses by shipping their products long distances.
- ***The successful contractors use competitors as subcontractors***
- The use of competing bidders as subcontractors in the award contract may indicate collusion.





# Red flags

## Sole-source contracts

- These contracts are awarded without a formal bidding process. Several types of fraud can occur with bribery, sole sourcing and kickbacks, conflict of interest, local purchase order abuse and purchases for personal use.
- Examples of red flags associated with sole-source contracts are as follows:
- A contract initiated as a competitive contract is changed to a sole-source contract
- Documentation used to justify sole-source contracting is inadequate
- Standing offers are unusual and being used frequently
- Unnecessary sole source justification. Falsified statements to justify sole source justification for sole source signed by officials without authority.
- Local purchase orders are above the approved limits
- Contracts are repeatedly awarded to one contractor
- Several small contracts for the same goods
- Services are awarded to the same contractor



# Red flags

- **Contract Administration, performance and evaluation stage**
- This stage refers to how contracts are administered and managed to ensure the fulfillment of the contract. There are different types of fraudulent schemes during this stage with an important one related to the pricing methods of the contract of price mischarging, cost mischarging occurs whenever the contractor charges the government for costs which are not allowable and unreasonable. There are certain pricing methods and problems can occur as follows:
- ***Fixed-cost contracts***



# Red flags in fixed-cost contracts

- This refers to contracts in which the total price payable is set and the contractor must complete the contract at the agreed price.
- Changes have been made to contracts after they have been awarded, which can result in a substantial increase in charges to the government
- Change orders are issued without an adequate explanation
- Contract deadline is extended beyond the original requirement
- Circumstances develop that result in the contractor charging additional costs that should have been foreseen before awarding the contract, such as during a demolition contract, hazardous materials are uncovered resulting in more costly requirements to demolish a building that should have been foreseen.
- Contract invoices are not reviewed to ensure that fixed-cost contracts are not exceeding the agreed total amount of the contract when required
- The missing of test certificate documentation
- Complaints about inferior quality of the goods and services provided



# Red flags in fixed-cost contracts

## *Cost plus and cost per contracts*

- Contracts involving a cost plus arrangement typically include cost plus fixed fee, cost plus incentive fee, cost plus reimbursable and cost sharing.
- Cost per contracts typically includes contracts that are priced per unit of labour, materials or other measurable unit.
- **The following are some red flags that may indicate fraud in cost-plus and cost per contracts;**
- Photocopies of invoices of subcontractors are submitted to support charges
- Photocopies of only the front part of cheques are submitted as proof of payment
- Details of invoices are questionable or information is crossed out
- Timing of progress payments does not coincide with performance stage
- The rates for the goods and services are higher than those stipulated in the contract
- Third-party invoices have not been paid
- Labour charges appear high
- Charges for overtime seem unreasonable
- There was inadequate inspection of each stage of the contract to verify that the work was completed
- Inadequate or non existence of quality assurance
- Neither the goods nor the materials produced were tested as stipulated in the contract
- The government relied solely on the contractor to ensure that goods and services met government standards or the necessary test requirements

# A practical approach to investigations





# A practical approach to investigations: Learning objectives

To understand:

- The need to define an investigation
- Need for a structured approach to investigations



# Investigations

- Investigation is defined as an independent and objective process whereby procedures are performed in accordance with the guideline to facilitate the investigation of financial misconduct, maladministration and impropriety that may result in legal proceedings for adjudication and to ensure honesty in the accounts, financial statements and financial management of an institution.



# Investigations by the AG (conti.)

AG guideline

5 phases of an investigation

- Pre-planning
- Planning
- Execution
- Reporting
- Follow-up





# Investigations by the AG (conti.)

## Pre-planning

- Request for an investigation
- Compile a risk assessment
- Letter of engagement
- Letter of appointment
- Service level checklist



# Investigations by the AG (conti.)

## Planning

- Knowledge of subject matter/ environment
- Establishes specific procedures
- Update resource allocation
- Allocate budgets and timeframes
- Update work plan



# Investigations by the AG (conti.)

## Execution

- Working papers
- Perform procedures
- Audit evidence
- Formulate findings and recommendations



# Investigations by the AG

(conti.)

Reporting

- Compile a draft report
- Agree on factual correctness with the auditee
- Receive comments from the auditee
- Report to the relevant legislature



# Investigations by the AG (conti.)

## Follow up

- Reporting material losses through criminal conduct.
- Criminal/ disciplinary steps taken



# Investigations and quality control

## Stages

- Planning
- Executing
- Reporting
- IRBA (Independent Regulatory Board for Auditors)



# Risk assessments during investigations: Learning objectives

To understand:

- The need for risk assessments
- The types of risks to be evaluated
- Managing the risks

# AG risk assessment during investigations



## Types of risk

- Mandate of the AG
- Independence of the AG/ team
- Relationship/ image/ reputation of the AG
- Availability of documentation
- Availability of skills/ capacity/ expert
- Payment of investigation fees



# AG risk assessment during investigations (conti.)

- Disciplinary/ criminal/ civil action
- Safety of document
- Safety of team
- Other agencies





# Various practical approaches to economic crimes: learning objective

- To be aware of the various practical approaches



# Various practical approaches to economic crime

- Review audit/management reports
- Interview senior staff
- Specific CAATs exercises to identify specific high risk areas for example:
  - Possibility of cheque fraud
  - Possibility of duplication/ fictitious payments
  - Staff lack of knowledge



# Various practical approaches to economic crime

- Weak computer controls may result in unauthorised access to networks and computers
- Abuse of contracts resulting in over expenditure
- Staff act outside delegation power
- Suspense account long outstanding
- Employees not disciplined
- Conflict of interest ( members of companies doing business with the employer)
- Procurement ( tenders) not managed
- Financial admin is poor



# Preventative measures: Learning objectives

To understand;

- The need to be able to develop and monitor policies for dealing with corruption
- The need to develop economic crime prevention strategies



# Preventative measures

Most effective way of preventing fraud/  
corruption is-

to know the circumstances surrounding it,  
the conditions that will allow it to happen  
more easily



# Preventative measures

Preventative approach should include:

- Strong financial management systems
- Effective internal controls
- Adequate public awareness
- Adequate standards of conduct



# Preventative measures

Developing and monitoring policies for dealing with corruption:

- Monitoring of key operations
- Segregation of duties
- Responsibilities
- Support services
- Confidential procedures
- Internal audit function





# Preventative measures

A formalised economic crime strategy should include:

- A fraud policy & strategy
- Zero tolerance for misconduct
- Responsibility for strategy
- Code of conduct
- Employee awareness
- Client awareness
- Fraud risk assessment
- Fraud reporting system



# Preventative measures

A formalised economic strategy cont.

- Protection of disclosures
- Investigating capacity
- Disciplinary procedures
- Reporting to external agencies
- Minimising loss for institutions
- Improving chances for recovery



# Preventative measures

Various types of legislation:

- to provide sound basis for training with regard to ethical standards and public responsibility



# Preventative measures

Programmes to fight corruption:

- National crime prevention strategy
- Business against crime
- National anti-corruption summit



# Contact details

Nick van der Merwe

- Tel:+2712-5485082
- Cell: +2782 460 6525
- Email:nickvdm49@gmail.com
- Fax: +2712-5485082