PROCUREMENT FRAUD IN THE PUBLIC SECTOR:

THE CASE FOR IMPLEMENTATION OF ROBUST CONTROLS

An extract from Perspective: The fraud and identity issue
Essential insights into the issues facing your industry today
Procurement fraud is one of the biggest areas of fraud loss for both central and local government departments. Keeping on top of procurement processes and checks can be both time-consuming and resource-intensive.

In this article, Melanie Hosker, Head of Public Sector at Equifax, takes a look at the different types of procurement fraud, giving a high-level view of the checks public sector organisations can embed in their processes to mitigate the risk of this type of fraud.

**What is procurement fraud?**

Procurement fraud is any fraud relating to an organisation purchasing goods or services from third parties, including the sourcing, letting of contracts and contract management phases of the procurement cycle. It can happen at any point within a contract lifecycle – both pre- and post-contract – and can be committed in many different ways, including:

- Bid rigging and manipulation of the procurement process
- Collusion between suppliers and/or between staff with the procuring organisation and suppliers
- Creation of ‘phantom’ companies to commit fraud
- Supply of false invoices, or invoices with unauthorised additional costs
- Staff diverting legitimate payments intended for suppliers to themselves
- Suppliers not supplying the agreed quality and or quality of goods and services
- Increased workload in detecting procurement fraud
- Increased resources needed for investigations once potential fraud has been detected, and to take any subsequent legal action
- Operational impact from the loss of supply of goods and/or services

**What is the current situation?**

Public sector organisations procure a wide range of goods and services, often duplicating their requirements across departments. Significant work has been undertaken by Crown Commercial Services to try and ensure that procurement regulations are followed. The UK’s impending exit from the EU will have a marked effect on these procurement regulations, as will the set-up of a new Government Commercial Organisation housed in the Cabinet Office. However, despite these two major changes, at a practical level, where the actual procurement is undertaken, the risks still exist and need to be addressed.

**The impact of procurement fraud**

The impact of procurement fraud is wide-ranging. The true financial cost of any type of fraud is hard to quantify, but according to the Annual Fraud Indicator 2016, of the £112 billion spent on procurement by central government, the estimated fraud was £5.4 billion. Similarly, within local government, of the £86 billion spent on procurement, the estimated fraud was £4.1 billion. These figures relate to 4.78% of the total expenditure. If these losses could be reduced then the monies saved could be re-invested in the provision of public services.

However, there are other consequences resulting from procurement fraud than just the financial loss to an organisation, including:

- The risk of reputational damage
- Lower staff morale

If procurement fraud is to be kept to the absolute minimum then public sector organisations need to put in place a vigorous and comprehensive strategy to combat it at each stage.

This strategy should:

- be ‘risk-based’, i.e. it should reflect the size and duration of all contracts – checks made for a low-value, short-term contract might be fewer than those made for a high-value, long-term one, for example
- have the buy-in of all key stakeholders within the organisation, including the support of management at the highest level
- be transparent, verified in its application, and fully audited so that a comprehensive record of all checks that were performed is retained for future reference
- be regularly reviewed to ensure that it remains ‘fit for purpose’

**Where does it occur?**

There is a risk of fraud at each stage of the procurement process: at commencement of the process, i.e. pre-contract award, and then throughout the period of the contract, including during contract management. There is also a risk of procurement fraud even when an organisation has not procured specific goods or services.
**Pre-contract award**
Public sector organisations need to conduct a robust series of checks before contract award. Not only will this help reduce the risk of procurement fraud but it will also save time, effort and potentially embarrassing and expensive mistakes later on in the procurement process. Such checks should include:

- whether the potential suppliers are genuine and legitimate businesses (to highlight phoenix or shell companies)
- the current financial status of the potential supplier. Note that annual accounts filed by a business are not verified and are not up-to-date, so do not provide a true indication of their financial status
- whether there is any link between the potential supplier and any staff members within their organisation that are key decision makers in the procurement process
- checks on the legitimacy and financial status of all major subcontractors that the potential supplier intends to use in order to fulfil the contract
- anti-money laundering checks
- whether there is any previously-recorded negative information about the potential supplier, or its key personnel, from other public/private sector organisations, for example on CIFAS, or on another shared database/fraud hub
- the reputation/public perception of the potential supplier through checks on social media etc
- whether there is any evidence of potential suppliers colluding over the prices that they quote

**Contract management lifecycle**
Once the contract has been signed, the contract management phase of the relationship begins. The checks conducted at the pre-contract phase need to be repeated, or updated, as due diligence to ensure that the supplier remains fit for business and has not waited until they have a signed contract to begin fraudulent activity. Other checks include:

- Criminal record checks on key individuals within the supplier’s organisation (or subcontractor), particularly if they are to work with a public sector organisation and/or on their premises
- What is the latest financial status of the supplier/subcontractors? For example, is there any new evidence that they were not a legitimate business, that they are now financially stressed, or that a recent FCA fine² has been imposed?
- Is there any new derogatory information about any of the supplier’s key personnel, for example being disqualified as a Director, or their name being added to a sanctions list?
- Are the bank account details provided by the supplier for payment genuine, and do they actually belong to the supplier?
- Are invoices sent by the supplier correct, i.e. for the agreed goods or service, for the correct term, and for the agreed amount? Have duplicate invoices been sent?
- Have purchase orders been raised for services or goods that have not actually been procured, or where there is no evidence that a service has been received?
- Are contracts being extended without justification, i.e. has the original contract term ended and the contract automatically renewed without going back to market where a more advantageous contract may be supplied?

Public sector organisations need to take a proactive approach to these checks as suppliers may not own up to detrimental information at contract review meetings.
Procurement fraud in the public sector: The case for implementation of robust controls

‘No contract’ procurement fraud
Public sector organisations can also face the risk of fraud even when they have not engaged in any procurement activity. For example, false invoices can be received for goods or services that were never procured, with the fraudster hoping that they will go undetected and be paid. As above, verification of ALL invoices received should be performed prior to payment, and details of any suppliers of false invoices shared with other organisations.

Internal due diligence
Performing regular due diligence checks on staff will ensure that the risks of internal fraud are greatly reduced. This should cover not only the procurement staff involved in the bid process and award, but also the finance staff and all senior managers who could influence others.

Obviously, any irregularities will need to be channelled to the Internal Audit team, but checking for early indications of fraudulent activity, or of those who may be susceptible to coercion to commit procurement fraud (e.g. through being in financial difficulties) could be flagged by due diligence checks, which also protect staff from false accusations.

Taking positive action
Assessing the financial security and viability of potential suppliers is critical to effective procurement and supplier relationships, particularly in the current climate where business failures are common and corporate fraud is constantly on the increase.

With our extensive consumer and commercial data assets, Equifax can deliver real insights which inform decisions regarding new and current suppliers. This means we are ideally placed to help combat procurement fraud.

We can help clients answer vital questions such as whether the supplier really exists, the identities of the people behind the supplier business, whether the supplier is financially stable and if the company or any of its directors are fraudulent.

As ever, it’s better to be safe than sorry when it comes to tackling fraud, especially when public sector funds are at risk. Fraudsters’ methods are constantly evolving, so no one can afford to be complacent.

To find out more about how we can help protect your organisation against procurement fraud, please contact Melanie by emailing melanie.hosker@equifax.com or calling 020 7298 3000.

Equifax

Idea in brief
THE SITUATION
Procurement fraud is one of the biggest areas of fraud loss for both central and local government departments.

THE CHALLENGE
Keeping on top of procurement processes and checks can be both time-consuming and resource-intensive.

THE TAKE AWAY
It’s better to be safe than sorry when it comes to tackling fraud, especially when public sector funds are at risk. Fraudsters’ methods are constantly evolving, so no one can afford to be complacent.


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