

Managing the risk of procurement fraud

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Forewords

The cost of fraud to local government is estimated at some £2.2 billion per year. Of this £876 million has been attributed to procurement fraud.

Procurement officers need to be vigilant against fraudulent activity occurring in supply chains, particularly as contracts enter their 'contract management' phases when it is all too easy to move onto the next task instead of monitoring fraud 'red flags' or enforcing internal controls.

I would encourage all councils to take the opportunity to review their systems in line with the information set out in this guide, identifying risks at all stages and ensuring that adequate and robust measures are taken to prevent fraud.

I would like to personally thank those officers who have contributed to the development of this guide, in particular Lee Digings Associates and look forward to being able to report a reduction in losses to fraud that can be better used for vital front-line services.



Councillor Shirley Pannell
Deputy Chair, Improvement and Innovation Board (2013-15)

Local Government Association

Local authorities remain under incredible pressure to make every penny count, particularly when resources are depleted. This is all the more challenging when procurement fraud can be difficult to detect and prevent. This guide will, I think, make a real difference. Accessible and practical, it will help local authorities as they fight to ensure value for money and integrity in public spending. As Head of the CIPFA Counter Fraud Centre I am pleased to be working with the LGA to improve our efforts to tackle fraud and introduce this Guide as the first of our collaborative efforts.



Rachel Tiffen
Head of Counter Fraud Centre

CIPFA

Why this guide?

Put simply, **fraud** is the use of deception for personal gain (usually financial gain). It is a crime¹.

Bribery and corruption are related concepts. Corrupt individuals seek advantage for themselves or others (eg family or social connections) through actions such as bribery and favouritism in the award of public contracts.

Bribery is defined (in the Bribery Act 2010) as giving or offering someone a financial or other advantage to encourage them to carry out their functions or activities improperly or to reward them for having done so. Requesting, agreeing to receive or accepting the advantage offered is also bribery. These too are criminal offences².

Bid-rigging and other **competition law infringements** are unlawful. At the individual level engagement in **cartel** activity is a criminal offence³.

This guide uses the expression '**procurement fraud**' to refer to all unlawful activity of this kind that happens throughout the procurement cycle including the sourcing, letting of contracts and contract management phases of the cycle.

This activity causes harm to council services and local taxpayers. Fraud can be very costly particularly in the procurement area where losses in individual cases can run into millions of pounds. The consequences of fraud also include reputational risks. Councils are leading the drive against fraud and corruption at the local level with the support of LGA, CIPFA (Counter Fraud Centre) and others through the 'Fighting Fraud Locally' initiative.

It has been estimated that procurement fraud costs local government in the region of **£876 million a year**⁴ making it the **largest single area of financial loss to fraud** in local government⁵. This is fraud – and other related criminal activity – that occurs in connection with the local authority supply chain. It occurs throughout the procurement cycle and is particularly prevalent in the **contract management** phase.

High profile public sector procurement frauds have been in the news in recent years. It has also been widely reported that fraud of all kinds, including procurement fraud, increased during the **recession** and that **cyber-fraud** is on the rise with the new opportunities made possible by the internet. There is growing concern that **organised crime** is engaging in procurement fraud.

The pressure on public finances makes it is more important than ever to **prevent and detect costly fraud and recover losses**. However, according to the Audit Commission, the detection rates for procurement fraud have been falling⁶.

This guide to managing the risk of procurement fraud has been written primarily for **Heads of Procurement** in local authorities who can act as a **focal point for intelligence** on procurement fraud and as a **catalyst for a strategic approach to countering it**.

The intention, however, is that the guide will be useful to a much wider audience, including Finance Managers and those who manage contracts.

It is recommended that councils **periodically review** their approach to procurement fraud beginning with the **identification of risks** and **evaluation of internal controls**. A **checklist** has been included at the end of the guide as a tool for Heads of Procurement.

This is a **leadership guide** with a practical focus. The guide also includes references and pointers to **further resources** for those who wish to delve deeper into the topic.

A strategic approach to procurement fraud

The CIPFA 'Code of Practice on Managing the Risk of Fraud and Corruption' sets out a strategic approach under the following headings:

- acknowledge responsibility
- identify risks
- develop a strategy
- provide resources
- take action.

The core components of an effective, risk-based counter-fraud strategy are:

- deterrence and prevention
- investigation and detection
- sanctions and redress (including recovery of funds or assets).

This strategic approach needs to be applied to **procurement fraud**.

It is important that **competition law infringements** are addressed in an **integral** way.

Make sure your council's strategic approach demonstrates the following clearly:

Developing an anti-fraud culture is an important part of improving resilience. Key elements to this are likely to include:

- clear governance
- audit trail
- effective contract management
- transparency
- scrutiny (including audit committee role)

The fight against fraud begins with getting the '**culture**' of the council right (including 'zero tolerance' of fraud and corruption and support for **whistleblowing**). The council leadership 'sets the tone' and both councillors and top management clearly have an important role to play.

Anti-fraud culture

Developing an anti-fraud culture is an important part of improving resilience. Key elements to this are likely to include:

- educating staff about the risks of fraud in their areas
- top level commitment
- ensuring that there are robust arrangements in place for raising concerns
- encouraging staff identify weaknesses in controls or other vulnerabilities
- praise and recognition for staff who have helped to prevent, detect or investigate a fraud
- publicising successes widely
- aligning the anti-fraud strategy with the organisational strategy
- benchmarking to identify outliers
- promoting a climate of fairness, transparency, responsibility and accountability.

Source: CIPFA (2012), 'Developing Corporate Anti-Fraud Capability' in the 'Public Services', Briefing from the CIPFA Better Governance Forum.

Councillors can provide **leadership** in a number of different ways. For example, they can help the authority understand the procurement fraud risks it faces, examine the council's performance in this area compared with others, and ensure counter-fraud resources are allocated in a way that is proportionate to the risk and the losses being incurred.

In some councils an **'anti-fraud champion'** or 'anti-fraud tsar' provides leadership (see also the role of the Audit Committee, below) and they will require briefing on the particular issues arising in procurement fraud to perform their role effectively.

Counter-fraud **awareness training** (including coverage of the Bribery Act 2010) needs to be provided to council employees and councillors.

When framing a strategy and deciding how to respond to fraud risk, it should be borne in mind that investigating fraud can be expensive and councils will also incur costs in prosecuting fraudsters and attempting to recover money (not always successfully).

Deterrence and prevention are therefore the more cost-effective measures.

'Councils can deter people from committing fraud if they set out clearly what fraud is and make it clear it is likely fraudsters will be caught and punished.' (Audit Commission (2014), 'Protecting the Public Purse 2014')

Widely publishing the results of counter fraud activity can also deter other potential fraudsters.

Further, if fraud is suspected or detected it is important to **take action quickly to prevent further loss** and to secure records and documents against removal or alteration. The strategy must be clear on how concerns should be escalated quickly to the appropriate managers.

Risk identification and a **review of internal controls** are the critical first steps in building an effective strategy. The risk identification process will show that **procurement risk** (sometimes called 'supply chain risk') is one of the **key strategic risks** for the council. This is true of most organisations. Generally, at least half of council revenue expenditure is with third parties.

This is a category of risk which needs to be managed at **programme, project and operational levels** as well as strategically.

The risk of fraud and corruption is an integral part of procurement risk. The key procurement fraud risks and approaches to their mitigation are considered further below.

The key risks and how to mitigate them

Identifying risks

Following a **standard risk management process**, procurement fraud risks should be **identified** and **assessed** and appropriate **strategies** for their management should be implemented and kept under review (see, for example, 'Management of Risk' in Further Reading below).

This involves estimating the **probability, impact** and **proximity** of each risk. The risks are documented in a **risk register** together with the **risk owners** (and other actionees) and the **risk response strategies** (mitigating actions).

Fraud and corruption can occur during the **procurement** phase (including preliminary market consultations) and the **contract management** phase of the procurement cycle. Some key procurement fraud risks are indicated in the table below.

This is not an exhaustive list. This is a dynamic environment and the sources and nature of the risks changes all the time, particularly with the new opportunities for cyber-fraud presented by the internet.

Procurement fraud risks	
Price fixing	Suppliers collude to fix the prices they will charge.
Market sharing	Suppliers collude to divide up markets between them (eg geographical market share).
Bid rigging	<p>Suppliers collude to ensure a particular bidder wins the contract, for example, by reaching an agreement on the bids that will be submitted. Bid rigging may involve 'cover pricing' where high bids which are not intended to be successful make the favoured bid look more attractive, and may involve 'compensation payments' to those bidders do not win.</p> <p>'Bid suppression' is where one or several bidders withdraw their bid (or fail to bid) or 'Bid rotation' is where bidders take turns at submitting the lowest price.</p> <p>May involve a council employee or councillor.</p>
Manipulation of specifications	Specifications are manipulated to favour a particular bidder. Or specifications not fully developed before contract award. Manipulation of specifications can result from inappropriate involvement in the shaping of the requirement during preliminary market consultations.
Manipulation of procurement procedures	<p>The procurement procedure is manipulated to ensure a particular bidder is successful. For example:</p> <ul style="list-style-type: none"> • rigging of exclusion/selection (PQQ) criteria and contract award criteria • unjustified recourse to single sourcing (direct negotiation) or contract scope change without the need for re-competition • unjustified contract extension • abuse of competitive dialogue procedure, negotiated procedure with competition or innovation partnership procedure (e.g. by disclosing confidential and commercially sensitive information about other bids to a particular bidder during negotiations). <p>The problem can be exacerbated by the (policy and legal) complexity of public procurement procedures.</p>

Procurement fraud risks continued

Bribery for awarding a contract	A bribe ('kickback') is given to a council employee or councillor to secure the award of a contract.
Bribery for disclosing confidential information	A bribe is given to a council employee (or councillor) to secure the disclosure of confidential and commercially sensitive information such as the content of competing bids.
Conflict of interest	A council employee or councillor does not disclose a pecuniary or other personal interest in a contract. This might be perceived to compromise their impartiality and independence in the context of the procurement or contract management process.
Cyber-fraud	Hacking into council systems to obtain confidential and commercially sensitive information.

Contract management risks

Overcharging	Overbilling in relation to the goods and services which have been delivered. This includes unjustified expenses claimed by consultants.
Duplicate payments	The council is charged twice for the same goods or services.
False invoices	<p>A form of identity fraud. Payment to a genuine supplier is diverted to a bank account controlled by the fraudster. This could also be an internal fraud perpetrated by a council employee.</p> <p>External fraudsters can exploit information published by the council under the transparency agenda.</p>
False claims and variations	Unjustified contractual claims and payments for contract variations. This type of fraud is often associated with under-priced bids ('loss leaders').
False performance reporting	Payment is claimed for levels of performance that have not been achieved.
Phantom suppliers	A fictitious company, or a real company that does not have a genuine relationship with the council, is set up as a supplier and receives payment.
Sub-standard materials	Cheaper materials are substituted for those specified in the contract. The use of sub-standard materials may also carry health and safety risks and environmental risks.
Misappropriation of assets	Council assets (including data and intellectual property) are stolen or exploited illegitimately by suppliers in the course of performing a contract.

Note that **competition law infringements**, such as bid rigging, have been included in the tables (see **Appendix - Legal framework** for an overview of competition law).

Bid rigging

In 2009 over 100 construction firms were fined a total of £129.5 million for bid-rigging on 199 tenders in the period 2000-2006 following a Competition Act investigation by the Office of Fair Trading (predecessor of the CMA). Some of the bid-rigging took the form of 'cover pricing'- artificially high bids that are not intended to be successful. The projects affected included schools, hospitals and universities.

In six instances the successful bidder had paid an agreed sum of money to the unsuccessful bidder (known as a 'compensation payment'). This was done by raising false invoices.

Cartel activity can lead to both civil (financial) sanctions on the company as in this case. It can also lead to criminal (financial/penal) sanctions on individuals.

Mitigating risks

As discussed below (Local government environment), councils are required to maintain an effective system of **internal control**. These controls play an important role in countering procurement fraud and corruption. It is important to **review internal controls** periodically to ensure they conform to best practice and to ensure they are operating effectively.

However, sophisticated fraudsters may be well aware of the standard, **preventative controls** and know how to circumvent them. Insiders with the necessary authority can override controls. Sometimes the controls simply fail

to work effectively. So, councils always need to deploy a wider range of countermeasures (**detective controls**) to respond to procurement fraud risk. Additional measures, including use of data analytics and monitoring of 'red flags' are discussed below.

It has already been mentioned that organisation **culture** and **staff training** and, where appropriate, **counselling** play a crucial, preventative role in the fight against procurement fraud. These are sometimes referred to as '**soft**' controls (which is not a reference to their effectiveness) and contrasted with the '**hard**' controls shown in the following table.

Internal controls	Councils should consider
Financial regulations (or 'financial procedure rules') ⁷	<ul style="list-style-type: none"> financial delegations/authorisation limits record keeping/audit trail requirements separation of duties in ordering process including separation of responsibility for raising order, authorising expenditure and receiving the goods and services so that no single individual has control over the whole process supplier set-up process including separation of duties (see below). a policy of no purchase order, no payment purchase card checks prohibition of personal purchases risk management reporting of fraud and corruption reporting of money laundering

<p>Contract standing orders (or 'contract procedure rules')⁹ and procurement procedures</p>	<ul style="list-style-type: none"> • thresholds for competition (quotations and tenders) • compliance with EU procurement law • authorisation of single sourcing and waivers • conflict of interests • confidentiality • due diligence on prospective suppliers (PQQs/supplier suitability assessment) including sub-contractors • contract register • open book accounting • regular contract reviews • separation of duties in sourcing process including authorisation of expenditure, receipt, opening and recording of tenders (especially where non-electronic), tender evaluation/decision-making (by project board) and, where appropriate, independent project assurance ('gateways') • minimum of two to be present during any competitive dialogue or negotiations • mandatory use of standard templates eg for tender evaluation • avoidance of obligatory tenders as a condition of staying on an approved list • objective justification required for any failure to bid.
<p>Scheme of delegation¹⁰</p>	<p>How authority is delegated to councillors and officers</p>
<p>Councillor code of conduct¹¹</p>	<p>Includes requirement to declare interests</p>
<p>Employee code of conduct¹²</p>	<p>Includes requirement to declare interests</p>
<p>Register of interests</p>	<p>Both councillor and employee interests should be recorded in a register</p>

Register of gifts and hospitality	Non-trivial gifts and hospitality received by councillors and employees should be recorded in a register.
Risk register	The council should maintain a strategic risk register and risk registers for major programmes and projects.
Confidential reporting policy ('whistleblowing') ¹³	Confidential 'hotline'.
Procurement documents	<ul style="list-style-type: none"> • Mandatory use of standard documents. • Pre-qualification questionnaire (PQQ)/ supplier suitability questions for low value requirements include EU mandatory and discretionary exclusion grounds. • Non-collusive tendering certificates. • Information on sub-contractors to be disclosed before commencement. • Standard terms and conditions of contract include non-collusion clause and provide for termination/ removal of contractor personnel for fraud and bribery.
Contracts register	Part of the audit trail concerning council contracts and suppliers.
Transparency agenda ¹⁵	External transparency surrounding council contracts, suppliers and payments.
IT strategy and policies	<ul style="list-style-type: none"> • IT and information assurance including cybersecurity. • Alignment of council and supply chain with Government Cyber Essentials Scheme.

Councils are also bound by EU public procurement law⁷. Following recent reforms, the rules are now set out in the Public Contracts Regulations 2015 which contain strengthened provisions relating to procurement fraud and corruption (see **Appendix - Legal framework** for an overview of procurement law).

Among other things, councils can take advantage of these strengthened rules in their **'due diligence'** process for council suppliers and their sub-contractors (mandatory and discretionary exclusion of bidders).

For major projects and programmes it is advisable for councils to conduct independent **'assurance reviews'** (on the OGC Gateway™ model) to inform decision-makers (project and programme boards) at key stages in the procurement process. While not specifically designed to detect fraud and

corruption the reviews do throw 'sunlight' on the process and should provide management with assurance that everything is on track for successful delivery.

Sometimes, as the National Fraud Authority has noted, public procurement procedures are so complicated that it is difficult to maintain effective oversight, giving rise to opportunities for fraud. The **simplification of procurement procedures** should therefore be pursued wherever possible.

Countering identity frauds

Councils should ensure that checks are in place to identify potential bank account/invoice related scams and fraud. For example, check that:

- supplier banking/invoice information is verified/authenticated
- email addresses are accurate (eg checking email address ends in .gov rather than .org)
- requests for payments to be made to new bank accounts are followed up with a separate appropriate independent individual
- invoices are matched against works carried out/goods and services provided.

For example, councils might ask for two separate forms of identity when setting up suppliers on the financial management system.

While fraudsters always seek to conceal their activities, in today's world fraud inevitably leaves some kind of **digital trace**. Most councils make use of an electronic purchase-to-pay system. So the council's response to the threat of procurement fraud should also provide for the use of **analytical tools**

(software) that can identify patterns in data (a type of detective control).

Analytics can be used proactively to understand the council's exposure to risk as well as in the case of suspected or known fraud.

Data analytics

Tools can be used for the proactive/continuous monitoring of invoices. Councils can consider looking at:

- regularity of payments of £10,000 or below
- data matching between Companies House and payroll
- geographic (GPS) mapping of suppliers – in order to identify clusters far away from the delivery location or next to the address of an employee
- time/date tenders arrive, similarity of tenders (ie are the same phrases used or identical errors evident?).

Sometimes the way people or organisations behave might suggest they are committing a fraud. The signs are referred to as '**red flags**'. Individually they may be no cause for concern but several together usually

suggest that a closer look is required. Managers and auditors need to take note of these red flags and take appropriate action. Timely intervention can prevent more serious problems developing (see below).

Fraud red flags

Fraud

- significant changes in behaviour that you've noticed
- an individual has large personal debts or financial losses, and a desire for personal gain
- audit findings deemed to be errors or irregularities
- transactions take place at odd times, odd frequencies, or involving unusual amounts or to odd recipients
- internal controls that are not enforced, or often compromised by higher authorities
- discrepancies in accounting records and unexplained items on reconciliations
- missing documents, or only photocopied documents available
- inconsistent, vague or implausible responses arising from inquiries
- unusual discrepancies between the client's records and confirmation replies
- missing inventory or physical assets
- excessive voids or credits
- common names or addresses of payees or customers
- requests for change of bank details supposedly from suppliers then requests for refunds into the
- alterations on documents (such as back dating)
- duplications (such as duplicate payments)
- collusion among employees, where there is little or no supervision
- one employee has control of a process from the start to finish with no segregation of duties.

Fraud red flags

Corruption

- abnormal cash payments
- pressure exerted for payments to be made urgently or ahead of schedule
- payments being made through third party country – for example, goods or services supplied to country 'A' but payment is being made, usually to a shell company in country 'B'
- an abnormally high commission percentage being paid to a particular agency. This may be split into two accounts for the same agent, often in different jurisdictions
- private meetings with public contractors or companies hoping to tender for contracts
- lavish gifts being received
- an individual who never takes time off even if ill, or holidays, or insists on dealing with specific contractors himself or herself
- making unexpected or illogical decisions accepting projects or contracts
- the unusually smooth process of cases where an individual does not have the expected level of knowledge or expertise
- abuse of the decision process or delegated powers in specific cases
- agreeing contracts not favourable to the organisation either because of the terms or the time period
- unexplained preference for certain contractors during the tendering or contracting processes
- bypassing normal tendering or contracting procedures
- invoices being agreed in excess of the contract without reasonable cause
- missing documents or records regarding meetings or decisions
- company procedures or guidelines not being followed
- the payment of, or making funds available for, high value expenses or school fees | (or similar) on behalf of others.

Source: Serious Fraud Office

A further set of red flags that can aid in the detection of competition law infringements is shown below.

Competition law red flags

Monitoring bids for patterns and practices

Who is bidding?

- suppliers that would normally tender fail to do.

How are they bidding?

- competitors' bids are received together
- identical irregularities in bids or similar wording.

What prices are being offered?

- identical prices
- large difference between price of winning bid and other bids
- significant change from past price levels after bid from new entrant or infrequent supplier
- expected discounts suddenly vanishing or other last minute changes.

Who is winning contracts?

- same supplier is often the successful bidder
- the lowest bidder not taking the contract
- winning bidder seems to rotate amongst several suppliers
- the successful bidder later subcontracting work to a supplier that has submitted a higher bid.

Direct evidence

- explicit discussion between competitors of prices and customers
- other evidence of contacts between competitors
- suspicious turns of phrase in relation to competitors:
 - 'we need to work together'
 - 'as agreed...'
 - 'you know to keep out of our territory'
 - 'it's our/your turn'
 - 'it's all arranged'
 - competitor 'has done us a favour'
 - other references to competitor assistance.

Source: Competition and Markets Authority

Where competition law matters are concerned it is particularly important that councils **benchmark prices** where possible, **collate evidence and identify any concerns** and **share intelligence** with other contracting authorities.

The local government environment

Councils must make arrangements for the **proper administration of their financial affairs** and appoint a Chief Financial Officer ('s. 151 officer')⁸ to have overall responsibility for those arrangements.

There is also a legal obligation on councils to ensure that they have a **sound system of internal control** including effective arrangements for the **management of risk**.

'**Internal controls**' are built into the policies, procedures, regulations, authorities, 'checks and balances', training and the like that the council uses to control and influence behaviour. They can be classified as '**preventative**' or '**detective**'.

Further, councils must undertake an effective **internal audit** to evaluate the **effectiveness of risk management, control and governance processes**. Each year councils must review the system of internal control and approve an **Annual Governance Statement** (formerly 'Statement of Internal Control')⁹.

It is good practice for an **Audit Committee** to consider the review and adopt the Annual Governance Statement (but it may be done by the Full Council or by another committee).

Audit Committees are in a good position to provide leadership to anti-fraud and corruption activity across the council including the countering of procurement fraud and corruption. This might include, for example, adopting CIPFA's 'Fraud Code of Practice' (see above) and the guidance provided here on procurement fraud and overseeing its implementation. It should include oversight of risk management including periodic review of the council's strategic risk register.

Managers in every service area of the council, including Heads of Procurement, bear responsibility for ensuring adequate measures are taken to prevent fraud and corruption. Managers rely on the advice and assistance of auditors (internal and external).

Internal audit provides assurance to managers and to the council that the system of internal controls is operating effectively. This includes procurement and contract audit.

The Head of Internal Audit draws up a risk-based internal audit strategy and audit plan (drawing on the council's strategic risk register) and keeps the adequacy of corporate arrangements, including risk management and the anti-fraud and corruption strategy, under review. They often have management responsibility for the counter-fraud team.

External auditors also have a role¹⁰. They have wide powers which enable them to satisfy themselves on the council's arrangements for preparing the statement of accounts and on the council's use of resources (including powers to obtain documents and information). Among other things, the local auditor can make a **public interest report** to bring an issue to the attention of the council or the public.

What to do if fraud is suspected or detected

Each council will have its own procedures for internal reporting of suspected fraud and corruption and whistleblowing.

These procedures need to be widely communicated as part of **counter-fraud awareness training** (see above).

Sometimes auditors (internal or external) may be approached by individuals who know, or suspect, that management is implicated in fraud or corruption.

Councils generally have specialist counter-fraud teams that can conduct investigations into suspected fraud. However, to date these teams have tended to be more focused on other types of fraud such as housing and council tax benefit fraud and housing tenancy fraud.

Fraud investigations often involve a complicated trail of transactions and may

need to be conducted by specialist fraud investigators (accredited counter fraud specialists). This also provides assurance to all parties that the investigations are being conducted by an independent person without, initially at least, the involvement of the police.

Fraud investigations involve the gathering of evidence and interviews (witnesses and individuals suspected of wrongdoing). Evidence must be gathered with great care otherwise a successful prosecution might be compromised. Even if prosecution is not contemplated, evidence must be gathered systematically and objectively and documented properly. Legal requirements must be observed. In situations where suspicions begin to appear well founded or a fraud has been openly declared, interviews should be conducted by the police, Serious

Fraud Office or others with specialist training.

Where council employees are suspected of involvement (internal fraud) they will be suspended while this work is carried out.

In some cases, the appropriate response to red flags (see above) might be no more than counselling or training for an employee to prevent a more serious problem developing in future.

However, where criminal activity is detected:

- The council's **disciplinary procedure** can be applied leading ultimately to an employee's dismissal.
- The matter can be **referred to the police** (or, in **major cases**, the **Serious Fraud Office**) for investigation and, in appropriate cases, criminal prosecution.

Internal fraud investigations

'The investigation of fraud should only be undertaken by properly trained and skilled fraud investigators. This is essential to ensure that the investigation is in accordance with legal requirements and that the evidence is lawfully obtained and managed. A trained and skilled investigator is more likely to undertake an efficient, comprehensive and speedy investigation as well. This can have benefits for the organisation such as reducing the length of time staff are suspended whilst an investigation takes place. The impact of an internal fraud investigation on staff can be difficult so a rapid, professional result is highly desirable. Ideally the fraud investigations resource will have experience of a wide range of fraud types and good knowledge of the service areas affected.'

Source: CIPFA (2012), 'Developing Corporate Anti-Fraud Capability in the Public Services', Briefing from the CIPFA Better Governance Forum

It is important to note that councils can use the civil and criminal law to **recover money from fraudsters** through the courts. This includes the Proceeds of Crime Act 2002 (POCA).

POCA requires the use of financial investigators. Those employed by councils have tended to be focused on benefit fraud and trading standard offences. However, there are examples of where POCA has been used successfully in connection with procurement fraud and corruption (for example, to confiscate illegal payments made to an employee for revealing confidential

information to bidders for council contracts about the tenders of their competitors).

Suspected **competition law infringements** (bid rigging, price fixing, market sharing or limiting markets) should be reported to the **Competition and Markets Authority (CMA)** rather than to the police or Serious Fraud Office. There is a hotline for this purpose. If the CMA accepts the case they will investigate and, if appropriate, prosecute (see **Appendix - Legal framework**).

Procurement fraud review checklist

Heads of Procurement in local government can act as a **focal point for intelligence** on procurement fraud and as **catalysts for a more strategic approach** to tackling it. This includes **periodic reviews** of the council's arrangements for countering procurement fraud and corruption as part of the review process for counter-fraud strategies more generally.

The following checklist, adapted from 'Protecting the Public Purse 2014' (Audit Commission, 2014), is intended to help Heads of Procurement ensure the effectiveness of reviews:

- Do we have a **zero tolerance policy** towards procurement fraud?
- Have we undertaken procurement fraud **risk identification and assessment**?
- Are we **vigilant** for new procurement fraud risks and scams?
- Do we have the **right approach** - and strategies, policies and plans - that are effective in countering procurement fraud?
- Do we have a '**no purchase order, no payment**' policy?
 - Have we aligned our strategy with 'Fighting Fraud Locally'?
- Do we have counter-fraud staff **review the procurement activity** of our organisation?
- Do we **report regularly** on how well we are tackling procurement fraud risks?
- Have we assessed our management of procurement counter-fraud work against **good practice guidance** (including the CIPFA 'Fraud Code of Practice')?
- Do we **raise awareness** of procurement fraud and risks with:
 - new staff (including agency staff)
 - existing staff
 - councillors, and
 - our suppliers?
- Do we work well with **national, regional and local networks** to ensure we know about current procurement fraud risks and issues?
- Do we work well with other organisations to ensure we effectively **share knowledge and data** about fraud and fraudsters?
- Do we identify areas where our **internal controls** are not working as well as intended? How quickly do we then take action?
- Have we reviewed our **procurement procedures** in line with best practice?
- Are our procurement procedures compliant with the **Public Contracts Regulations 2015** regarding mandatory and discretionary exclusion, conflicts of interest and preliminary market consultations?
- Do we have arrangements in place that encourage our staff to raise their concerns about **money laundering**?
- Do we have effective arrangements for:
 - reporting procurement fraud?
 - recording procurement fraud?
- Do we have effective **whistleblowing** arrangements? In particular are staff:
 - aware of our whistleblowing arrangements?
 - confident in the confidentiality of those arrangements?
 - confident that any concerns raised will be addressed?
- Do we have effective **fidelity insurance** arrangements?
- Are we confident that we have **sufficient counter-fraud capacity and capability** to prevent and detect procurement fraud?

Further sources of information

- Audit Commission (2014), 'Protecting the Public Purse 2014. Fighting Fraud against Local Government' (see also the reports for 2009 to 2013; future reports will be published by the CIPFA Counter Fraud Centre)
- Axelos in partnership with HM Government (2014), 'Management of Risk: Guidance for Practitioners', The Stationery Office
- Cabinet Office (2014), 'Procurement Policy Note – use of Cyber Essentials Scheme Certification', Action Note 09/14
- CIMA (n.d.), 'Fraud Risk Management: A Guide to Good Practice'
- CIPFA (2009), 'Contract Audit Toolkit'
- CIPFA (2010), 'A Risk Based Approach to the Audit of Procurement'
- CIPFA (2012), 'A Practical Guide to the Internal Audit of the Operational Phase of PFI Contracts'
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Appendix – Legal framework

Procurement law

Under the Public Contracts Regulations 2015 it is **mandatory** to exclude suppliers from public contracts if they have been convicted of, among other things, the offences of bribery (including bribery within the meaning of the Bribery Act 2010), money laundering and fraud against the European Communities' financial interests.

Further, **discretionary** exclusion is permitted where:

- the authority can demonstrate by appropriate means that the supplier is guilty of **grave professional misconduct** which renders its integrity questionable
- the authority has sufficiently plausible indications to conclude that the supplier has entered into **agreements with other suppliers aimed at distorting competition**
- a **conflict of interest** cannot be effectively remedied by other, less intrusive, measures
- the supplier:
 - has been guilty of **serious misrepresentation** in supplying the information required for the verification of the absence of grounds for exclusion or the fulfilment of the selection criteria, or
 - has **withheld such information** or is not able to submit the required supporting documents
- the supplier has:
 - undertaken to:
- **unduly influence the decision-making process** of the contracting authority, or
- obtain **confidential information that may confer upon it undue advantages** in the

procurement procedure, or

- **negligently provided misleading information** that may have a material influence on decisions concerning exclusion, selection or award.

Exclusion can take place at any time during a procurement procedure. Mandatory exclusion must last for five years; discretionary exclusion can be for up to three years (exclusion in both cases is subject to overriding public interest reasons and satisfactory '**self-cleaning**' by a supplier).

Authorities must take appropriate measures to effectively **prevent, identify and remedy conflicts of interest** arising during procurement procedure so as to **avoid any distortion of competition** and ensure equal treatment of suppliers.

'Conflicts of interest' are defined as any situation where relevant staff members have, directly or indirectly, a financial, economic or other personal interest which might be perceived to compromise their impartiality and independence in the context of the procurement procedure.

Authorities are permitted to conduct **preliminary market consultations** before commencing a procurement procedure including the ability to advertise pre-market engagement through Contracts Finder or a PIN notice. However, advice sought from independent experts or authorities or **market participants** can only be used in the planning and conduct of the procurement procedure if it **does not have the effect of distorting competition** and does not result in a violation of the principles of non-discrimination and transparency.

Where a supplier (or a related undertaking) has advised the authority during preliminary market consultations or otherwise, the authority must **take appropriate measures to ensure that competition is not distorted** by the participation of that supplier. The measures must include communication to the other suppliers that are bidding of relevant information that has been exchanged and the fixing of adequate time limits for tenders.

The supplier can only be excluded from the procedure where there are no other means to ensure compliance with the duty to treat suppliers equally. Prior to any exclusion the supplier must be given the opportunity to **prove that their involvement is not capable of distorting competition.**

The authority must document the measures taken in a **written report.**

The report (which must contain specified information on every above-threshold contract and framework agreement) is part of broader range of measures designed to ensure there is a satisfactory 'audit trail'. This includes obligations to -

- **document the progress of all procurement procedures and keep documentation** justifying decisions for at least 3 years from the award date, and
- **retain copies of all concluded contracts** above certain thresholds for at least the duration of the contract and grant access to them (subject to certain conditions).

Competition law

The Competition Act 1988 (CA98) and the Enterprise Act 2002 (EA02) are the key pieces of legislation governing anti-competitive agreements and conduct in the UK.

The CA98 governs anti-competitive behaviour that affects trade in the UK and is enforced by the **Competition and Markets Authority (CMA)** and a number of sectoral regulators in the UK. In the case of anti-competitive agreements that affect trade between EU states, Article 101 of the Treaty on the

Functioning of the European Union contains similar provisions to the CA98 which are either enforced by the CAM, other sectoral regulators or the European Commission (EC).

UK and EU competition law prohibit two main types of anti-competitive behaviour:

- **anti-competitive agreements**
- **abuse of a dominant market position.**

Anti-competitive agreements are ones that have as their object or effect the prevention, restriction or distortion of competition in a market.

Enforcement action in respect of breaches of these prohibitions by undertakings (businesses) could lead to **fining of up to 10% of worldwide turnover** as well as **director disqualification.**

The EA02 contains a **criminal offence in relation to cartels.** This is aimed at the conduct of individuals. It applies to those who agree to make or cause to be made certain cartel arrangements amongst businesses. These cartel arrangements are specifically **price fixing, bid rigging, or limiting markets.** Those convicted of the cartel offence can face up to **five years' imprisonment, unlimited fines and director disqualification.**

The cartel offence can only be prosecuted by the CMA, the Serious Fraud Office or with the consent of the CMA in England, Wales and Northern Ireland. In Scotland the decision to prosecute is made by the Crown Office and Procurator Fiscal Service.

The CMA operates a **leniency policy** under which undertakings and individuals engaged in cartel activity can benefit from lenient treatment. Provided they admit their involvement and cooperate fully with the CMA's investigation they can gain immunity from fines and individual employees and directors could obtain immunity from prosecution.

Endnotes

- 1 The Fraud Act 2006 created a criminal offence of fraud and defines three ways of committing it: fraud by false representation; fraud by failing to disclose information; and fraud by abuse of position. The offence carries a maximum sentence of 10 years imprisonment.
 - 2 The Bribery Act 2010 applies to both public and private sectors. The Act repealed the Prevention of Corruption Acts 1889-1916, and the common law offence of bribery, and created a new framework of offences including a corporate offence where a commercial organisation fails to prevent bribery. Bribery carries a maximum sentence of 10 years imprisonment and a fine. Fraud and bribery are both categorised as 'economic crimes'.
 - 3 The Enterprise Act 2002. See Appendix: Legal framework.
 - 4 National Fraud Authority estimate for 2012/13 reported in Audit Commission (2013), *Protecting the Public Purse 2013*.
- It is notoriously difficult to measure fraud accurately and this is no more than an estimate (a percentage applied to local authority expenditure). The LGA consider that the figure is likely to be lower due, apart from anything else, to reductions in public spending since that time.
- Furthermore, it should be noted that the level of fraud and corruption in the UK is not high by international standards. See, for example, PWC (2013), *Public Procurement: Costs we Pay for Corruption: Identifying and Reducing Corruption in Public Procurement in the EU*, PWC (2012), *Fighting Fraud in Government* and Kroll (2013), *Who's Got Something to Hide: 2013/14 Global Fraud Report*.
- 5 By 2016 benefit fraud investigation work will have transferred from councils to the DWP Single Fraud Investigation Service.
 - 6 Audit Commission (2014) *Protecting the Public Purse 2014*. In 2010/11 councils detected 145 cases of procurement fraud worth nearly £14.6 million. In 2013/14, they detected 127 cases worth less than £4.5 million.
 - 7 One of the ways in which the council makes proper arrangements for the administration of its financial affairs.
 - 8 The Proceeds of Crime Act 2002 and the Money Laundering Regulations 2007 (SI 2007/2157). Local government is not a regulated sector but following CIPFA advice most have introduced an anti-money laundering policy including procedures for reporting of suspicious activity to a Money Laundering Reporting Officer (MLRO).
 - 9 Councils are required by Section 135 of the Local Government Act 1972 to adopt standing orders relating to the making of contracts for the supply of goods or materials and the execution of works which make provision for securing competition and regulate the way in which tenders are sought. Contracts below a specified threshold may be exempted from the provisions and the standing orders can permit the authority to exempt any contract where satisfied the exemption is justified.
 - 10 Section 100G of the Local Government Act 1972, Section 15 of the Local Government Act 2000 and regulations.
 - 11 Section 27 of the Localism Act 2011 requires councils to promote and maintain high standards of conduct by members and co-opted members of the authority. A code of conduct must be produced covering the registration of pecuniary interests, the role of an 'independent person' to investigate alleged breaches, and sanctions to be imposed on any councillors who breach the code.
 - 12 There is no statutory requirement for an employee code of conduct in England. Councils are free to introduce one or to include relevant provisions in employment contracts.
 - 13 The Localism Act 2011 strengthens the requirements on councillors to register and disclose interests. Schedule 2 to the Relevant Authorities (Disclosable Pecuniary Interests) Regulations 2012 (SI 2012 No.1464) lists the pecuniary interests that must be disclosed by a member and the member's spouse, civil partner or partner. These interests must be notified to the Monitoring Officer when the councillor takes office and disclosed at a meeting of the council if they are relevant to the matters under discussion. Councils must maintain a register of interests and publish it (subject to certain exceptions). It is a criminal offence if a member fails, without reasonable excuse, to comply with the requirements to register or declare disclosable pecuniary interests. It is also an offence, punishable by a fine and disqualification for up to five years, to take part in council business at meetings, or to act alone on behalf of the council, when prevented from doing so by a conflict caused by disclosable pecuniary interests.
 - 14 Under the common law, in the case of fraudulent misrepresentation a contract may be rescinded and/or damages awarded by a court (see also Misrepresentation Act 1967).
 - 15 DCLG (2015), *Local Government Transparency Code 2015 and LGA (2014) Local Transparency – Publishing Spending and Procurement Information*

- 16 Public Interest Disclosure Act 1998. See also British Standards Institute (2008), PAS 1998/2008, Whistleblowing Arrangements Code of Practice.
- 17 Section 151 of the Local Government Act 1972 (as amended).
- 18 The Accounts and Audit Regulations 2015 (SI 2015 No. 234) which came into force on 1 April 2015.
- 19 The system is currently in transition. The Local Audit and Accountability Act 2014 abolishes the Audit Commission (which closed in March 2015) and makes fresh provision for the appointment of local auditors. The new arrangements will take effect once the current contracts with audit suppliers come to an end.



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