Procurement Fraud
Looking through the Smokescreen!

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www.cipfanetworks.net/procurement
procurement and commissioning network

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Steps to Procuring Catering Contracts/ Food More Smartly
4th March 2014 – London

Procuring ICT Goods and Services
Contracts More Effectively
28th March 2014 – Leeds
1st April 2014 – London

Assessing the Financial Health and Viability of Service Delivery Partners and Contractors
29th April – Manchester
1st May – London

Purchasing Children and Young People Services – What represents a “Fair Price” for Care?
13th May 2014 – London and 15th May 2014 – Leeds
Uncertainties - Known's and unknowns

- There are **known known's**. These are things we know (or should know)
- There are **known unknowns**. These are things that although we know or have awareness of their existence, we have no detail
- There are **unknown unknowns**. These are things we don’t even know that we don’t know about them. (*Thanks to Donald Rumsfeld*)
- There are **unknown known's** – things which we really do know but intentionally refuse to acknowledge that we know
  (*Thanks to Slavoj Zizek*)

*Prof Prowle*
Session Agenda

› What is Procurement Fraud?
  - Different types of procurement fraud
  - Cost of procurement fraud
  - Developing an anti-fraud culture
  - How to plan your procurement function to protect yourself

› Straitened Times = Maximum Procurement Fraud Risks
Key Challenges

The sheer size of the prize!!! – why rob a bank?...

- Procurement is the second highest target for fraudsters. (Finance wins, data comes in at third place)

- Procurement will always be needed, in the public, private and not-for-profit sectors.

- Procurement is becoming increasingly complex with Outsourcing, Partnerships and Provider/Commissioner arrangements.

- It is generally accepted that there will be approximately 2 – 8% losses in this area!
General Fraud Facts

- Cost of fraud to the UK economy - £21bn to £38bn+
- Cost of corporate fraud in US $400bn+ (Source ACFE)
- 1 in 9 UK organisations have experienced problems (CIPS survey)
- London and South East lead in fraud league
- Most procurement fraud involves an “insider” (employee) as well as an “outsider” (contractor)
- In a high % of all major fraud cases, the fraudster also falsifies his/ her expense claims
- Spot fixing – it's not cricket
- Whiplash capital of Europe
- Election Fraud – Afghanistan, Russia...
- ICAC – NSW - 32% said they did not bid on a contract because of corruption concerns
- “S” word also often involved!
## Major Public-Sector Fraud 2013

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<td>Tax Credits fraud</td>
<td>£670 million</td>
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Key highlights from the UK

Bribery: A threat to expansion?
- 12% of UK organisations report less than half the amount of bribery
- UK organisations report less than the global average
- 93% of UK organisations have reported that they’ve been asked to pay a bribe in the last year despite 41% having operations in high risk territories
- 87% of organisations in the UK have made changes to their policies and procedures because of the UK Bribery Act

Cybercrime: A growing risk?
- Nearly two-thirds of respondents felt their awareness of cybercrime was greater than it was two years ago despite the UK reporting a fall in the percentage of organisations reporting cybercrime
- A lot of cybercrime may be going unreported and/or undetected. A recent PwC/CBI survey showed that 60% of large organisations had experienced a cyber breach in the last year

Types of fraud
- 35% of organisations who experienced fraud, experienced accounting fraud in 2011. In 2014, this has fallen to 14%
- 22% said that they suffered a procurement fraud, a new category in 2014

Perpetrator
- 41% in 2014
- 34% in 2011

Detecting fraud: What works best?
- The most effective methods of detecting fraud are suspicious transaction monitoring and fraud risk management
- 83% of organisations in the UK have whistleblowing mechanisms but nearly 40% hadn’t been used in the last two years
Need for Vigilance

1. Public procurement at needs assessment stage
2. Public procurement at bid design stage
3. Public procurement at award stage
4. Public procurement at contract implementation stage
5. Control and accountability over outsourced services
6. The revolving door of personnel between local authorities and private companies bidding to provide services
7. Planning discretion and influence regarding ‘permissions to build’ decisions
8. Planning discretion and influence regarding ‘changes of use’ decisions
9. Failure to enforce section 106 agreements
10. The conflict of interest where councils make planning decisions about property they own
11. Collusion in housing fraud or deliberately ineffective monitoring of housing fraud
12. Manipulation of electoral registration”
Sign of the Crimes

“Our analysis shows that in times of economic slowdown, when belts are tightened and processes are committed to greater scrutiny, more high value frauds have tended to be uncovered “

Alex Plavsic, KMPG Forensic

“Pay particular attention to high risk areas such as procurement...”

The ten point local government counter-fraud blueprint, published by Eric Pickles, Communities and Local Government Secretary, May 2011

Procurement fraud in the public sector is costing the public purse an estimated £2.4 billion,

Eliminating Public Sector Fraud – Cabinet Office and National Fraud Authority

8 June 2011

Huge rise in companies going bust - The recession is forcing more firms out of business. There has been a huge rise in the number of firms going bust in England and Wales because of the recession. The Insolvency Service said that in the last three months of 2008 there were 2,428 corporate insolvencies such as administrations and receiverships. That was a 220% rise on the same period the year before. (Insolvency Service 6th April)
Over 90% of local authorities concerned about contractor financial stability

More than 90% of local authorities say that a contractor’s financial performance has become more important to them during the tender process over the last 12 months, as the recession continues to take its toll on construction.

The survey of 32 different local authorities – which was carried out by pre-qualification register Constructionline – found that 70% had seen a supplier they used regularly become insolvent during the same period.

According to business information firm Experian more than 660 construction firms entered insolvency during the first three months of 2010 alone.

A contractor’s health and safety competency had also become a more important consideration in the selection process for 95% local authorities while the vast majority (88%) said that there were under increased pressure to reduce the cost of their procurement processes.

More than a quarter (27%) plan to abandon framework agreements over the next year to encourage greater competition between contractors in the hope of securing lower bids.

In further good news for the industry’s small and medium sized contractors (SMEs), half of local authorities (46%) said that they planned to do more to help smaller firms from their area compete for tenders.

Constructionline, which is used by over 2,200 different buying organisations across the public and private sectors, commissioned the survey in order to find out more about the way local authorities procure contractors.

Philip Prince, a director from Constructionline, said: “There are a myriad of different issues which local authorities must deal with during the procurement stage, but the recession has made a contractor’s financial well being the biggest concern.

“A contractor or even one of its suppliers going bust mid-project can easily lead to delays and an inevitable rise in costs as the local authority attempts to clear up the mess.

“Increasingly, the public sector is employing more sophisticated techniques at the pre-qualification stage, such as real time financial monitoring, as well as placing tougher demands on their main contractors to thoroughly assess their own supply chains.”
Our Attitudes to Procurement Fraud

- **Self deluding** - “it can never happen to us” – **Wake up**
- **Refusing to accept** - Trying to overlook the problem – **Take action**
- **Actively engaged** – Good control and organised – **Carry on**
The Cost of Procurement Fraud

- Much needed services and Programmes are under-funded
- Doubts on whether services are managed effectively
- Millions of pounds are lost
- Countless management/ staff time in investigating
- External costs (lawyers, accountants etc)
- Reputation, Reputation, Reputation
  - Reduced credibility
  - Potential reduction in quality suppliers doing business with you
  - Employees de-motivated
- Conviction and professional disqualification
Two Sackings, One Resignation and a Retirement

- Unlawful appointment to repair Undercliffe Drive
- Original estimate £5.6M – increased to £18M
- Plans shelved – cost £3M
- Cost of inquiry - £1.3M
- Organisational & Reputational damage – Cost ???

“systematic and on-going failures of the Council’s processes and internal controls…”

“no coherent or consistent explanation as to why the failure to comply with the EU Procurement Regulations and Contract Standing Orders (“CSOs”) occurred in the first place”

Final Undercliff Drive Report – Nov 2007
Procurement – Red Flags

- 20% or more Pre-qualified firms fail to submit tender
- Period from bid opening to contract signing > 7 months
- Contract value >20% above cost estimate
- Number of bidders <3
- Nearest bid above winning bid within 2%
- Bids containing less detail than expected
- Bids received at the same time or containing similar or unusual wording
- Wide margin between the winning bid and second/third

“I have never yet found a contractor who, if not watched, would not leave the government holding the bag.”

Harry S. Truman
Common Problems

- Contract letting procedures inadequate or not followed
- Separation of duties breaks down or is illusory
- Supervision and monitoring are ineffective
- Tight tenders – high extras
- Cartels/Collusive tendering
- Excessive entertaining of procurement staff by suppliers

During a period of one year, a storeman accepted gifts as payment for placing 40 years worth of orders from a supplier.

A manager colluded with suppliers to produce invoices for £25,000 worth of goods which were not delivered.
Due Diligence

- 'No procurement exercise had been undertaken to appoint MetPro, in accordance with the Council’s CPR. No written contract between the Council and MetPro could be found. There is no record of an approval and authorisation for the use of MetPro for providing security services. In the absence of a formal procurement exercise, we could not locate the following documents/confirmation for MetPro, which the CPR require:
  - Financial viability of the company
  - Equal Opportunities Assessment
  - Criminal Records Bureau checks
  - Confirmation of company’s Public Liability Insurance arrangements
  - Confirmation of the company’s Health and Safety registration
  - Confirmation on the SIA licence status of the Company Officers
  - An agreed specification which outlined the service to be provided
  - An agreed schedule of rates for payment of invoices
  - A process for monitoring performance of service delivery to establish if the Council was receiving value for money'
Challenges – Getaway!

- Under the EU Procurement Regulations
- By the EU Commission (Article 226)
- Regulator
- Funders or insurers
- Mysterious complainant

**Impact:**
- Retendering costs – both contracting authority & bidder
- Loss of market interest
- Increase in prices
- Costs of delay
  - security, maintenance and funding costs
  - opportunity cost of lost income
- Embarrassment to the Force/ Authority
Pre-qualification
Mandatory Exclusions

- Economic operator convicted of any of certain offences:
  - its directors
  - any other person with power of representation, decision or control
- Unless overriding requirements in the general interest
  - Conspiracy
  - Corruption
  - Bribery
  - Fraud
    - Tax
    - Fraudulent trading
    - Fraud or theft
- Money Laundering
- Terrorist financing
- Child labour and other forms of trafficking in human beings as defined in Article 2 of Directive 2011/36
Discretionary exclusion at PQQ

Though National Legislation may make mandatory

- Any violation of social and labour law or environmental law
- Bankrupt, subject of insolvency or winding-up, etc.
- Grave professional misconduct rendering integrity questionable
  - Reasonable means of proof
- Entered into agreements aimed at distorting competition
  - Plausible indicators
- Conflict of interest
  - cannot be effectively remedied by other less intrusive measures;
- Distortion of competition from prior involvement in the preparation
  - cannot be remedied by other, less intrusive measures
Discretionary exclusion at PQQ

Though National Legislation may make mandatory

- Significant or persistent deficiencies in the performance of a substantive requirement under
  
  • a prior public contract,
  
  • a prior contract with a contracting entity or
  
  • a prior concession contract

- led to
  
  • early termination of that prior contract,
  
  • damages or
  
  • other comparable sanctions
Discretionary exclusion at PQQ

Though National Legislation may make mandatory

- serious misrepresentation in supplying the information required or has withheld such information or is not able to submit the supporting documents

- undertaken to
  - unduly influence the decision-making of the authority
  - obtain confidential information that confer undue advantages
  - deliberately provide misleading information that may have a material effect
Limit on exclusion

- Maximum period
  - Period imposed by a Court or
  - Regulations to specify or determine the maximum period of exclusion where not remedied
    - 5 years for mandatory exclusion (except tax)
    - 3 years for Discretionary grounds
<table>
<thead>
<tr>
<th>Procurement stage</th>
<th>Fraud Risk</th>
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</table>
| **Identifying need – for the goods/service** | • A need for the organisation to procure is invented.  
• No genuine requirement.  
• Manipulating budgets to include the cost of the false need to help make it appear genuine. |
| **Specification**                 | • Matching the specifications to favour a particular supplier.  
• Splitting a contract into numerous lower value orders to avoid competitive tendering |
| **Selection**                     | • Ensuring a specific supplier obtains the work.  
• Indications include single tenders, provision of information to only one supplier, false information to other suppliers and incorrect disqualification of potential suppliers |
| **Evaluation**                    | • Evaluation is biased, suggested by the acceptance of late and/or incongruously low bids                                               |
| **Contract management**           | • Contracts favour the supplier (use of non-standard contracts, omission of rights to audit relevant suppliers accounts or overly complex/vague schedule of charges to provide the opportunity to overcharge) |
Does the Authority have a corporate procurement strategy that is clearly aligned with the Authority’s strategic objectives?

Is there a strategy to prevent fraud and corruption and maintain ethical standards?

Does the Authority have a corporate contracts register?

Does the Authority publish a forward procurement plan, Selling to the Authority Guide available on a website?

Has clear, user-friendly procurement guidance been disseminated to staff?

Go
Reminder - The fraud triangle

(academic debate – diamond – capability)

Need - Incentive (pressure)

- The fraudster’s advantages
- They have the initiative - are proactive rather than reactive
- They have time to plan when best to strike
- They have the choice of battlegrounds
- They can choose the most suitable method
- They have an awareness of the risks & rewards

Opportunity
(weak controls)

Rationalisation
(behaviour)
Find the fraudsters in your organisation

\[ C = S_0 f(d_1) - e_r T K_f (d_1 - o \sqrt{T}) \]

- \( C \) = % your organisation is being defrauded
- \( S_0 \) =

Mercedes-Benz

- \( f \) = No of staff totally honest
- \( d_1 \) = No. of middle aged men working for more than 6 years
- \( e_r \) = No. of directors who can explain work of your IT team
- \( K \) = No. of employees/ Directors who can give straight answers
- \( T \) = Score out of 10 – org compliance training
- \( o \) = No of times gut instinct told you something is wrong – 3 months

\( \checkmark \) = No. of senior staff who only take 1 week off
Head of Energy Procurement at Kent CC convicted on 1 count of fraud by abuse of position

Police called in after “significant irregularities” uncovered - £2 Million +

Used “unauthorised management fees” to buy himself a Jaguar car - negotiated an unauthorised management fee with Centrica of 0.04p per kWh of energy supplied and diverted that commission into his own bank account

106 local authority clients

Prison sentence
What the builders did – cover pricing

- **Example 1** - Classroom Extension, Sudbury Primary School, Ashbourne, Derbyshire

  - On 20 March 2001, Derbyshire County Council sought tenders for a classroom extension. Return date for the tender was 11:00 on 19 April 2001
  - Four companies were invited to tender: County Property Division, Admiral, Bodill and E Manton
  - County Property Division “unable to tender” so pulled out of the race
What the OFT found at Bodill

TENDER SHEET.

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SUBMISSION DATE.

Month: THURS 19th APRIL 2001

<table>
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<tr>
<td>1. BODILL</td>
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<td>2. E. MANZON @ FROM US</td>
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<td>3. FORDELL CONSTRUCTION @ FROM US</td>
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<td>4. 01246411754 M. SAVAGE</td>
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Result of example 1

- Bodill: £129,570
- Admiral: £145,499
- E Manton: £133,333

Client’s anticipated value £100,000
Why they said they did it

- Perceived pressure from clients to bid
- Limited resources
- Unilateral high bid might accidentally win or look ridiculous
- “Everyone did it”
- Longstanding and widespread accepted practice
- Taught at colleges and even in a text book
Magic?

Magician Paul Daniels helped his son escape jail 2009 after he admitted stealing £10,000 from the NHS. Gary Daniels, 40, used his position as a hospital IT boss to mastermind the sophisticated computer scam. He authorised IT work which didn't need to be done and then paid himself for the jobs with bogus invoices.

He would commission work through an innocent outside company and then offer to carry it out himself as a sub-contractor when the firm was too busy to do it. They would then invoice the hospital and pay Daniels — not realising that the work was never done. Really thought to be £100,000.
Traditional Fraud Prevention

Internal Audit
- Reacting to incidents/tips
- Ensuring controls are in place

Management
- Reacting to major cost overruns or budget
- Press leak
- ‘Whistleblower’

Human Resources
- Ethics policies
- Conflict of Interest policies
- Employment Checks

Procurement
- Supplier research / selection
- Partnerships?
- Setting specifications

Fraudsters paradise
Strategy for dealing with Fraud

- **Deterrence**: Effective processes ensure fraudster think risk of getting caught is great.
- **Prevention**: Strong Prevention systems make fraudster not risk it.
- **Investigate**: Professional investigation makes fraudster think he will be found out.
- **Sanction**: Strong Sanctions makes fraudster think fraud is not worth it.
- **Recover**: Determined recovery makes fraudster think he can’t benefit from fraud.

Fraud harms the organisation

Create Anti-Fraud Culture
Put Fraud in Focus

- Management Support
- Key Internal Policy
- Publicise ‘Zero Tolerance’
- Train & Educate Staff
Action Points

- Procedures
- Guidance
- Gifts & hospitality
- Communication
- Whistle blowing
- Code of conduct

- Zero tolerance
- Flexibility
- Sanctions & Rewards
- Training
- Competencies
- Rotation
- Verification

- Strategy
- Risk Register
- Compliance
- Audit/ checks
- Electronic reporting
- Monitoring
- Separation of duties
- Controls
- Flexible & pro-active

- Role & focus
- Direction
- Communication
- Information alerts
- Technology
Best Practice Summary

- **Basic Measures:**
  - Segregation of duties
    - Budget Approval
    - Selection process and contract management
    - Approvals and payments
  - Standardised reporting systems
  - Robust and workable policies
  - Contracts Register and payments addresses/ bank accounts
  - Strong risk management
  - Robust forecasting and exception reporting

- **Moving towards (if not already there):**
  - A strong anti fraud culture (internally and with the people you do business with)
  - E-Procurement Vaults
  - Real (or as close as) time reporting
  - Truly joined up systems
A note of caution ....

- Corruption is not the only ill in procurement
- A recent study from Italy indicates that 80% of losses in procurement comes from waste, not corruption
- The costs of fighting corruption need to be considered against the benefits ...
Thank You!

Your Comments:
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Mobile – 07717 345188