



AN EASYHQ OFFERING

## Identify fraud schemes - the ultimate guide

### Procurement and payment processes



Most of the fraud and corruption detected at businesses occurs within the procurement process which starts from where a need for a service or product is identified till where payment has been made for the product or service. The ACFE's Report of Nations has confirmed that most incidents of dishonesty are detected through tips and whistleblowing (48%) and the second one is internal audit (14%). The bigger the organisation the more difficult it becomes to identify irregularities due to a large amount of data and transactions.

It is therefore important to understand the schemes that are used to defraud businesses and create rules or red flags to identify some of these irregularities. Red Flags are not proof of all irregularities but serve as an indication of possible irregularities which warrant further inspection or investigation. During XTND's investigation of fraud and corruption in the procurement environment, we have uncovered various schemes. Here are the most common schemes with some red flags to identify possible irregularities.

## BID RIGGING

It often happens that an employee(s) at a business and employees of a supplier collude with each other to assist the supplier to get an advantage to win a tender or bid. An employee in the procurement department or the technical department who is responsible for the scope of work and technical requirements will write the scope of work and technical requirements in a way that the identified supplier is the only one who can adhere to these requirements. We have also seen that suppliers often write the scope of work or technical requirements themselves and supply it to the employees to make it part of the RFQ or RFP.

Unnecessary narrow specifications like the use of certain material, make, qualification, etc. favoured a certain supplier or the use of broad undefined specifications will unduly allow a supplier who would normally not adhere to the minimum requirements to qualify to take part in the bid. Undefined and broad specifications are also often used to make amendments to contracts or change orders.

### RED FLAGS FOR BID-RIGGING ARE AS FOLLOW:

- Only one or a few bidders respond to requests for bids.
- Short due dates for complex RFQ's or RFPs.
- Brand names are used in the request for bids.
- Similarities or even exact matches of only one supplier. to the scope of work and technical requirements.
- Changes to specifications and technical requirements. are made after the bid is awarded to the supplier.
- A high number of bids were awarded to the same supplier. where there were no competitive bids submitted.



## COLLUSIVE BIDDING BY CONTRACTORS



It often happens that a group of suppliers forms a syndicate and make a combined effort to inflate the prices in an industry by submitting prediscussed bids. They will also determine beforehand on a rotating basis who will win the bid by submitting the lowest bid. Everyone in the group will get a chance to win a bid or they will share the profits from winning the bids. These kind of practices are common in the construction industry but has been found in even the IT industry. Kickbacks are often paid to employees to ensure the identified supplier is awarded the bid.

### RED FLAGS FOR COLLUSIVE BIDDING ARE AS FOLLOW:

- The similarity in the language used, identical wording, spelling or grammar errors in the proposals of different suppliers.
- Rotation of winning bids by certain criteria.
- The prices of all the bids are much higher than normal industry standards and averages.
- Losing bidders are used as subcontractors on the same project.
- Only one bid adheres to all the requirements and the other is poor.
- Contact details like telephone numbers, addresses, etc are the same on proposals of different bidders.
- Submission of suspicious bids, likely from fake companies.
- More than one bid is sent from the same email address or device.
- Identified bid patterns. For example, the bids are:
  - *Too high*
  - *Too far apart*
  - *Too close*
  - *Round numbers*
  - *Too consistent*
  - *Incomplete Identical or similar to prior or other bids*



## LEAKING OF BID-RELATED INFORMATION

It often happens that an employee in the procurement department who has a corrupt relationship with a supplier leaks information like the pricing of competitive bids or confidential information before the request for the bid is requested. This will benefit the specific supplier and give him/her an unfair advantage.

### RED FLAGS FOR THE LEAKING OF BID-RELATED INFORMATION ARE AS FOLLOW:

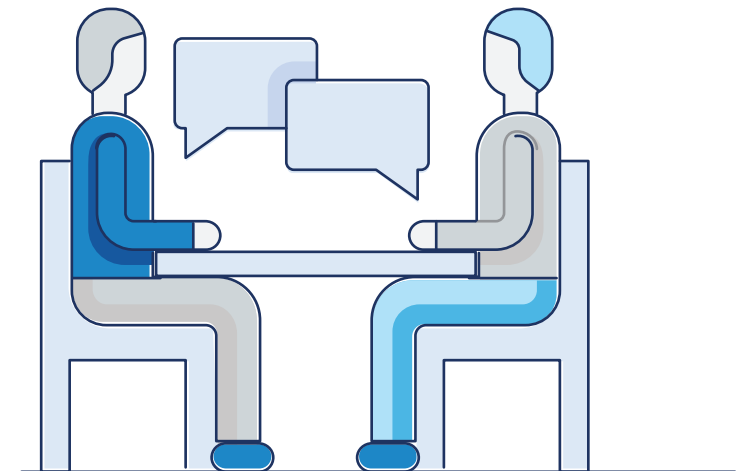
- The winning bid's price of the same supplier is always just below the next lowest price.
- The winning bid is always the last to be received or received even after the closing time.
- Short due dates for bids with complex requirements.
- Not opening bids in the public, or keeping to due dates or times.
- No audit trails for bids received electronically.
- Amendments to pricing after the bid has been awarded.

## CONFLICT OF INTEREST

Conflicts of interest normally occur when employees have undisclosed interests in a supplier or contractor. This usually happens when the employer does not do regular and detailed vetting of its suppliers. Often ex-employees or family members own or works for suppliers. The employees often also receive some kind of gratification like gifts or kickbacks as they will prejudice these suppliers where they have undisclosed interests.

### RED FLAGS FOR CONFLICT OF INTEREST ARE AS FOLLOW:

- No proper vetting process to onboard suppliers.
- Favouritism of a particular contractor or vendor.
- Employee lives beyond their means.
- The employee insists on meeting with the supplier alone.
- Close social relationships like being invited to weddings of suppliers owners or employees or braaing with them over weekends.
- Extraordinary high spend growth of a supplier in comparison to other suppliers in the same industry.



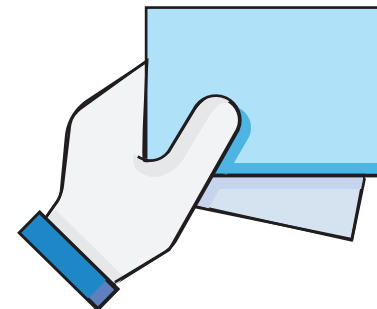
## FALSE, INFLATED OR DUPLICATE INVOICES

It often happens that employees are colluding with suppliers to assist to pay bribes or syphon money from the business. Where corrupt individuals influence government or other businesses to award a bid or work to a specific business the influencing person need to be paid for his/her services. The business that received the work will then register a supplier and make payments to them on invoices supplied without any work being done. This is just a way to pay bribes and take the money out of the business bookkeeping system in a "legal" way.

It also happens that employees who need to sign off work and that is colluding with suppliers will sign off work that has not been done to enable payments to the supplier for work never done. The employee will either share in the profits or get another kind of benefit from being part of this scheme.

### RED FLAGS FOR FALSE, INFLATED OR DUPLICATE INVOICES ARE AS FOLLOW:

- Weak or un-enforced controls in the receipt of goods and payment of invoices.
- Inadequate, unclear, copied or altered supporting documents.
- Invoiced goods or services cannot be located in inventory or accounted for.
- No delivery note for invoiced goods or services.
- Invoice prices, amounts, item descriptions or terms are vague or do not match.
- Discrepancies between invoice and supporting documents.
- Multiple invoices with the same detail like dates, invoice number amounts, description of goods.
- Total payments to vendor exceed total purchase order or contract amounts.



## CHANGE ORDER ABUSE

It often happens that a supplier in collusion with a procurement employee will submit low priced bids to ensure that they win the bid. After the bid, however, is awarded the supplier requests changes to the order and prices and more often the total cost is much more expensive than the other bidders who lost on price.

### RED FLAGS FOR CHANGE ORDER ABUSE ARE AS FOLLOW:

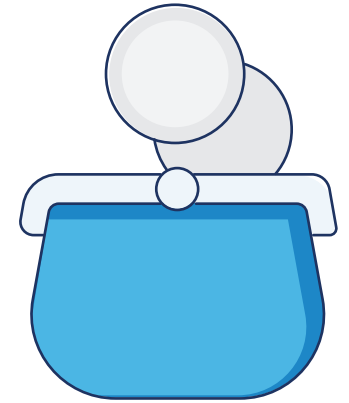
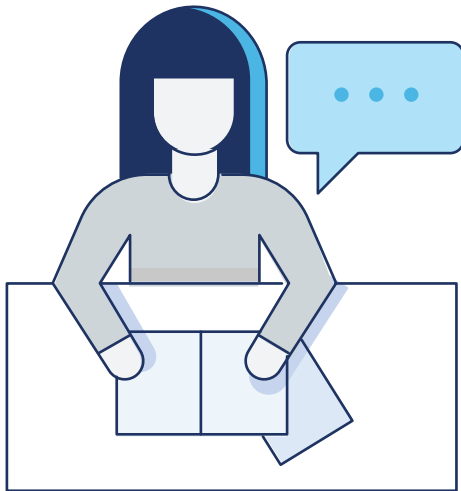
- Weak or no controls and procedures regarding the review of change orders.
- Identified pattern from the same supplier to win bids at the lowest price and then request for change of orders.
- The change orders requested from the same supplier are signed off by the same employee.
- The total cost of a bid is more often higher than the other bids received during the bid process.
- Lack of audit trail and communication regarding the change of orders.
- Scope of work and or technical requirements are changed after the bid has been awarded.

# FALSE STATEMENTS AND CLAIMS

Contractors or suppliers regularly supply false information about their employees' credentials and experience and they often invoice for goods and services that were never delivered. One of the industries where this is often seen is the security industry where a client is charged for a certain grade of guard but the person who is performing the service is of a lower grade or not even registered with PSIRA.

## RED FLAGS FOR FALSE STATEMENTS AND CLAIMS ARE AS FOLLOW:

- Complaints from users.
- Poor quality of service or products.
- Refusal or inability to provide supporting documentation.
- Inadequate or altered supporting documentation.
- High rate of rejections, returns or failures.
- Favouritism from procurement employees in the case of conflict of interest.
- Unclear, partial or forged signature on required documentation.



# PETTY CASH ABUSE

Using petty cash for personal use and falsifying documentation to replenish the fund is a regular occurrence in the procurement departments. Employees often overstate expenses for services like washing vehicles or working in the garden to take the excess money for themselves. We have also found that petty cash is used to buy items for personal use and then paid from the petty cash as if it was a procurement for office use. The problem is that the value of the items is so small that it will not necessarily form part of an asset list as it is regarded as consumable in many instances. There is therefore often very little record of the existence of the item.

## RED FLAGS FOR PETTY CASH ABUSE ARE AS FOLLOW:

- No oversight or weak controls on disbursements and reimbursements.
- Expenses with a lack of supporting documentation.
- The same amount paid regularly to the same people or businesses for similar service.
- Items purchased does not form part of the business requirements.
- Asset list items like televisions for eg. purchased from petty cash.
- Lack of segregation of duties.

## PURCHASES FOR PERSONAL USE OR RESALE

Employees can purchase items through their business that are intended for personal use, such as tools, personal computers, or automobile parts. It also happens that the employee has a side business and uses the business' stock to stock and fund his side business.

### RED FLAGS FOR PURCHASES FOR PERSONAL USE OR RESALE ARE AS FOLLOWS

- High volume or unusual purchases of items without any reason.
- Increased business purchases of stock without sales increasing but stock levels still decline.
- Purchased items "returned" to a vendor without vendor any documentation or refunds.
- Purchased items delivered to another unknown location.
- Undeclared side business by employees.



## SPLITTING OF PURCHASE ORDERS

Employees often split a single procurement transaction into two or even more purchase orders to allow them to circumvent the delegation of authority for signing off expenses up to predetermined levels. Splitting of Orders is one of the most common occurrences to enable irregular expenditure as it allows a lower-level employee to sign off a much higher value purchase. By only one person signing off all the purchase orders, there are fewer questions asked and processes to adhere to. If this happens where the same supplier is involved it is a clear indication of corruption.

### RED FLAGS FOR SPLITTING OF PURCHASE ORDERS

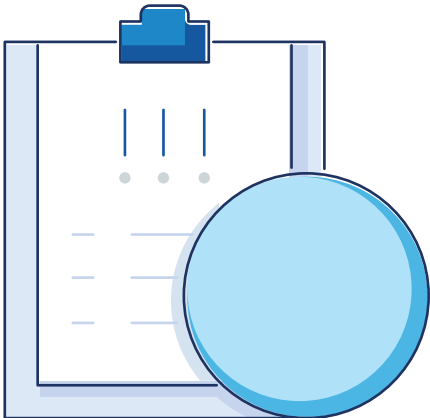
- Poor delegation of authority.
- Two or more similar procurements from the same supplier in amounts just under delegation of authority threshold.
- Unexplained separation of purchases for the same services or goods in the same period at the same supplier.
- Purchase orders and invoices with the same description for services or goods, supplier and the dates are close to each other.
- Sequential or consecutive purchase orders or invoices for orders just below the signing threshold.
- Regular change orders with regards to the same supplier after a contract have been awarded and if the contract price was just below the signing threshold..

## UNNECESSARY PURCHASES

Unnecessary, excessive or inappropriate purchases of goods or services, or unnecessary repairs, might indicate corruption or purchases for personal use or resale.

### RED FLAGS OF UNNECESSARY PURCHASES

- Unusual or unexplained high volume purchases of products or services from a particular supplier.
- Manual override for automated ordering systems.
- Excessive write-off of stock, assets or consumables.
- Replacement or repairs after an unreasonably short period.
- Inadequate or rushed needs analysis and justification.
- Regular manual changes on the stock count of the same item.

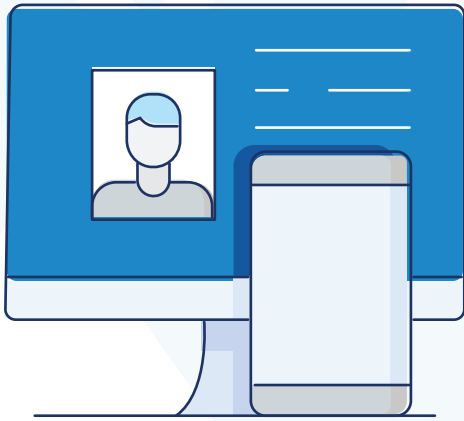


## GHOST EMPLOYEES

The phenomenon of ghost employees is one of the most common but also one of the most difficult schemes to identify and manage, especially at bigger organisations. One example is PRASE which had 3000 ghost employees on their payroll in 2020. Ghost employees form part of payroll fraud and together with time theft, it affects more than 50% of all businesses. It often surprises most businesses and employers to find out who commits these crimes primarily. Research has shown that payroll theft goes up as someone's age goes up. Similarly, 56% of theft via ghost employees is perpetrated by women.

### THERE ARE NOT MANY RED FLAGS TO INDICATE GHOST EMPLOYEES BUT THEY CAN BE IDENTIFIED BY DOING THE FOLLOWING:

- Compare payroll to Human Resources Data.
- Compare Payroll date with Supplier financial data.
- Check for more than one individual connected to the same bank account number
- Check for employees not taking leave – a ghost employee does not need leave.
- Run constant third party checks.
- A proper appointment policy and process must be implemented for appointing anyone (including contract workers). This should include but not be limited to ID verification and background checks.
- Check for the same worker that stays part of payroll but in different roles – especially contract workers.
- Constant verification of all contract workers..



## SINGLE TENDER AWARD RED FLAGS

It often happens that someone in the procurement department has an invested interest in a specific supplier. This employee uses his influence to motivate why only a single supplier should be used or invited to bid or quote. The regular awarding of bids where only one supplier was invited or where only one supplier responded where a minimum of three are required can be an indication of procurement irregularities.

### RED FLAGS OF PROCUREMENT IRREGULARITIES IN SINGLE BID AWARDS ARE AS FOLLOW:

- Regular deviation process followed where the same suppliers are involved.
- No clear audit trail as to why only one supplier was invited or appointed.
- Single tender awards occur regularly.
- Favouritism to certain suppliers.
- Request for Work or item has to go out on tender again after initial supplier received payments due to bad workmanship or lack of skills.
- Unknown supplier is appointed for specialises services or products.



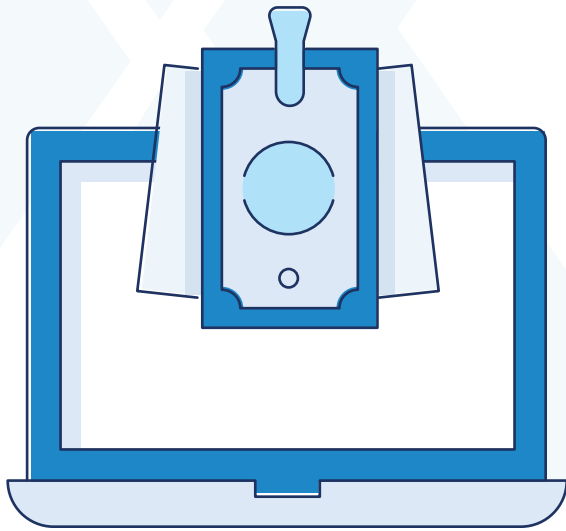
## PAYMENTS RED FLAGS

Accounts payable fraud involves fraudulent disbursements and millions of rands are lost annually due to payment fraud. A continuous suspicious transaction monitoring strategy and the system should be implemented to ensure that all possible irregularities are identified and investigated. The normal sampling approach by auditors is not sufficient to address this phenomenon.

### THE FOLLOWING ARE RED FLAGS FOR PAYMENT SCHEMES:

- Lack of segregation of duties.
- Payments are made after hours, on weekends or public holidays.
- Payments with rounded amounts.
- Employees receiving expensive gifts or payments.
- Additional payments to suppliers in comparison to quote.
- Payment of excessive expenses to suppliers or employees.
- Source documentation is lacking or not available.
- Copies of original documents are used where originals are required.
- VAT paid on invoices with no VAT number.
- Reconciliation is lacking or not up to date.
- Inflated or duplicate invoices.
- Different companies paid with the same PO number.
- Senior employees regularly intervene to authorise a deviation on internal controls.
- Discrepancies in accounting records.
- Discrepancies between information on invoices and the data in the vendor system.
- Missing or shortages in stock or inventory that cannot be explained.
- Alterations or changes on documentation or systems.
- Employees not willing to share duties or accept help.
- Employees never take leave or if they are on leave insists on still do payments at month-end even though they are on leave.
- Payment for poor work or quality goods.
- Regular small payments to the same supplier.
- The invoice date is before the PO date.





## EARLY SETTLEMENT DISCOUNT

Early settlement discount is where suppliers give a business between 7,5% to 2,5% discount if they are paid before the agreed term of payment like 30 or 60 days. The discount will be determined by how quickly the supplier is paid for example 7,5% discount if the business pays the supplier within 5 days of the invoice. There are quite a few schemes where suppliers and employees are involved in defrauding the company where no early settlement discount is claimed by the company and the supplier is paid in full although they should have given a % of early settlement discount.

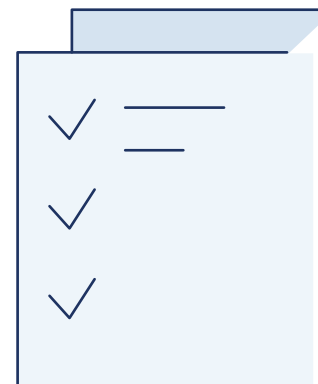
### RED FLAGS WHERE EARLY SETTLEMENT DISCOUNT IS GIVEN UNDULY ARE AS FOLLOW:

- Invoice dates precede the Goods Receive note/delivery note.
- Suppliers continuously phone or inquire about the outstanding payment.
- Outstanding payments with timeframes longer than the agreed terms eg. 30 or 60 days without any reason.

## CONTROLS

There is not one fit-it- all solution with regards to the implementation of controls in the procurement and payment environments. Here are just a few basic controls that can be implemented to limit risk and ensure compliance in the procurement environment.

- Proper Procurement and payment policies and procedures that need to be adhered to.
- Regular training on awareness w.r.t. procurement processes and procurement fraud.
- Strong Whistleblowing policy, solution and culture
- Segregation of duties.
- Collaboration and working across the organisation.
- Do comprehensive due diligence on all suppliers and new employees
- Centralised contract register which is regularly reviewed and analysed
- Strong controls relating to sub-contracting.
- Work on a culture of compliance (King IV™ Reports).
- Training on the Bribery Act.
- Investigation of complaints and whistleblowing reports.
- Rotation of employees.
- Internal audit activity.
- Analyse available data w.r.t. spend growth comparisons between suppliers, breaches of approvals, etc.
- Proper tender evaluation framework agreed at the procurement planning stage
- Proper payment controls.
- Regular review of internal controls and policies. This includes the application of these controls and policies and procedures.
- A 'zero tolerance of fraud' message from the top of the organisation.

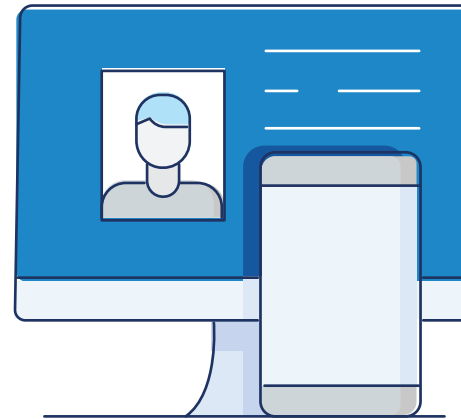


# PROACTIVE FRAUD DETECTION TESTS

Unfortunately, there is not a single or simple solution or recipe to identify, investigate and mitigate procurement fraud. Creating a well functioning whistleblowing solution is probably the most important action any business can take as statistics have proven that 48% of incidents are identified through whistleblowing. As mentioned it is important to create a continuous monitoring system to identify any possible irregularities.

## THIS CAN BE DONE BY DOING THE FOLLOWING:

- Querying Internal and external databases for red flags or anomalies. You need to identify any hotspots and weak spots where misconduct can occur and identify where issues were identified in the past.
- Conducting proper due diligence of suppliers.
- Rotate staff or vendors allocated to staff.
- Audit the vendor list and expenditure growth regularly.
- Use red flags of potential schemes to identify them electronically.
- Use identified red flags to verify indicators of any ongoing scheme.
- Identify the employees who are regularly involved in deviations, corrections and other procurement issues.
- Conduct traditional investigations to verify identified red flags.



Although most businesses have the capable resources to identify and investigate irregularities it is well advised to obtain the services of a specialist third party to assist to identify and investigate anomalies and create measures to limit risk and losses. This will assist with the phenomenon known as mirror-image. This happens when you are too long at a specific business and you are too close to the issues. **XTND** has the specialised skills and extensive experience to assist any business does no matter how big or small with procurement-related issues. At **XTND** we see ourselves as an extension of the client's capabilities. At **XTND** we specialise in Forensic investigations and audits, digital forensics, integrity verification, data analysis, fraud propensity models, etc. For any assistance or advice in risk mitigation please contact us at [info@xtnd.co.za](mailto:info@xtnd.co.za).