

# PROCUREMENT: 10 IRREGULARITIES, HOW TO MITIGATE THEM & HOW TO AUDIT THE PROCUREMENT PROCESS

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## Section 1: WHAT IS PROCUREMENT?

Investopedia defines procurement as “the act of obtaining goods or services, typically for business purposes”.

Chartered Institute of Procurement and Supply (CIPS) defines procurement and supply as “buying the goods and services that enable an organization to operate in a profitable and ethical manner”

In summary, procurement is acquisition of a good or service in the most economic manner to meet an organization’s needs.

## WHY DOES AN ORGANIZATION PROCURE GOODS AND SERVICES?

1. For an organization to achieve their mandate and objectives they may need goods and services from an external party. For example, during a board meeting, refreshments may be needed to ensure that attendants to the important meeting are refreshed while focused on the meeting.
2. During the course of business operations, an organization may realize a need to buy new furniture or office equipment such as a computer for a new employee or realize a need to replace a printer.
3. An organization may also realize that they do not have capacity to undertake a special strategic project that is required for achievement of their mandate and would need to outsource the skills.
4. An organization may also decide to outsource a previously insourced service, for instance, they may decide to engage a cleaning company as opposed to hiring an employee to do the cleaning.
5. A construction company may require to buy a dump truck for their day-to-day work.
6. A mining or manufacturing company requires production inputs to achieve their objectives.

For an organization to acquire the above and meet their need, they need to procure the goods and services, and thus achieve their goals.

## Section 2: HOW PROCUREMENT IS CONDUCTED

As mentioned earlier, procurement is triggered by a need. When a need has been established:

1. a Purchase Requisition is raised by the user department, and the budget holder who is usually the department head authorizes the purchase requisition. The approved Purchase Requisition is then sent to the Procurement department.
2. the Procurement department would then source quotations, usually three in number. This would be from available suppliers in the market or a list of pre-approved suppliers from the organization's supplier database. The quotations would be assessed and one approved for the bidder to supply.
3. A Purchase Order would then be raised by the Procurement department and sent to the approved supplier to fulfill the order required by the company.

This e-book excludes procurement done using the organization's petty cash, which normally applies to purchase of low-cost items.

How procurement is conducted is determined by the value of the good or service being sourced. For instance, it does not make economic sense to have a tendering committee meet to decide the type of tea to buy for office use. In the same vein it would not be best to leave the decision to one officer to buy the required dump truck, or a decision made by one employee to engage a project management consulting firm on behalf of the organization.

## Open Tender purchase

An organization may source goods or services through an open tender process. In this case an organization would have identified a need and a Purchase Requisition raised and approved. On receipt of the approved Purchase Requisition by the Procurement department, they prepare the tender documents which will detail specifications of the required goods or services as articulated by the user department. An advertisement of the Invitation to Tender (ITT) is placed in a newspaper or company website for potential suppliers to purchase the tender documents and bid for supply of goods or services.

- A Tender Committee is a body that is appointed to assess and award contracts to successful bidders. It usually consists of high-level employees such as Head of Finance and other high-ranking management. The Tender Committee is usually led by a chairperson and has a secretary.
- The Tender Committee is tasked with evaluation of submitted applications by potential suppliers in terms of the specifications as set out in the original tender document. The Committee evaluates financial and technical bids of the tender. Usually for technical bids a member of the user department would be at hand to support the evaluation.
- The winning bidder is offered a contract to supply the goods or services required by organization as per the agreed terms and conditions in the contract.

## Types of procurement

1. Purchase Order
2. Request for Quotation (RFQ)
3. Open Tender
4. Restricted/Selective Tendering
5. Single-Source

## **Purchase Order**

This mode of buying is the most basic form of purchasing by an organization. This has been detailed above where following recognition of a need, a Purchase Requisition is raised and approved, sent to the Procurement department where a Purchase Order is raised and sent to the supplier to fulfill the need identified.

## **Request for Quotation (RFQ)**

Another mode of procurement is to raise an RFQ. In some instances, an organization raises this and sends to companies they are already familiar with, or companies in their approved supplier database to request for quotations. This would have been preceded by recognition of a need, approval of a purchase requisition by the user department. The Procurement department raises a Request for Quotation after approval of the Purchase Requisition. The RFQ is sent to the targeted potential suppliers, who then based on the detailed specifications provide a quote to supply the required goods or services. This would be followed by raising, approval of a Purchase Order and sending it to the chosen supplier.

## **Selective/Restricted Tendering**

Selective tendering is sometimes referred to as restricted tendering. In this type of procurement procedure, only suppliers that have been preselected by the organization and invited by the buyer can tender for the contract. Suppliers that are known for being suitable for the contract, for instance, from past experience or known specialist in their industry are chosen.

## **Single-Source Procurement**

This is the type of procurement whereby an organization chooses to source a good or service from one supplier. This is usually done for a specialized area and the organization choosing to source from the specialist in the industry and disregarding other suppliers of the commodity. The reason for this type of procurement may be because of positive previous experience or outstanding quality. Other reasons may include, the selected supplier being the sole supplier of the good or service, or there is a long-standing relationship.

The above are not the only types of procurement. Organizations adopt best practice and what works best in meeting their objectives.

## Section 3: IRREGULARITIES IN PROCUREMENT - WHAT CAN GO WRONG IN PROCUREMENT?

Procurement is typically an area where organizations spend significant amounts of money because in most cases it is unavoidable, particularly for organizations that require production inputs on a regular basis. When left unchecked an organization may bleed to the point of serious financial problems.

### Fraudulent order

An order may be made for something not needed by the business. This may serve different purposes.

1. To boost a friend's or relative's business
2. To steal the procured item
3. To receive a financial reward from a supplier

An example of this irregular procurement was reported at [assets.publishing.service.gov.uk](https://assets.publishing.service.gov.uk). During a routine audit at a Council, it was noted that catering equipment had been paid for but not supplied to schools they were supposedly ordered for. An investigation found that an employee had raised a number of purchase orders and made payments in excess of £50,000 for catering equipment with a supplier, yet there was no evidence that the goods had been supplied.

Enquiries found that many of the items were not required and had never been requested by the schools on whose behalf the orders had been placed. The supplier appeared to have colluded with Council employee to commit the fraud.

### Incorrect order specification

An order may be made for a good required by the business, but incorrect in terms of specification, which means it would fail to serve the purpose it was purchased for. In a best-case scenario, the item may be returned for a refund or replacement, which means the loss incurred would be time, as the organization waits to receive the correct item. Lost production time can unfortunately translate into financial loss.

In the worst-case scenario, the good ordered would have been customized and not returnable without a penalty charged by the supplier. The ordered item may not be returnable and kept with no future plans to use it. The loss would not only be time and failure to meet the need required timely, but there would be a significant financial loss.

### **Incorrect order quantity**

- An order may be made for a good required by the business, but too many items ordered, meaning there will be need to provide storage which may lead to additional costs and possible damage. If kept for an extended period there may be risk of obsolescence of the stored item.
- An order may be made for a good required by the business, but an inadequate number made. This exposes the company to a stock-out or an interruption in operations. This is because the numbers ordered did not meet the numbers actually required to meet the objectives of the organization.

### **Theft**

An order may be made for a good required by the business, but stolen before reaching the intended recipient.



### **Delayed order**

An order may be made for a good required by the business, but made too late and affect the smooth flow of operations. This may be caused by delays in communication with the Procurement department by the user department or a delay by the Procurement department to conduct the procurement process and place the order.

### **Engagement of an incompetent/inadequately skilled service provider**

An organization may engage a consultancy that is not able to fully deliver on the service required. This may happen because there was a government directive to engage local suppliers or because someone in the evaluation team is a relative/friend/shareholder or stands to benefit in some way when they engage the service provider.

A real-life example of this procurement anomaly was reported at [www.procurementexpress.com](http://www.procurementexpress.com). A Council had failed to conduct a due diligence exercise when choosing a key supplier.

The Council had intended to train ten people so that they would have a good chance at securing employment with a local asbestos removal firm that required qualified personnel. The Council made arrangements for a course to take place through an external provider.

It later transpired that the consultant that was due to start the training was not appropriately qualified and was also the partner of the person at council level that had arranged the training. Furthermore, the consultant was listed as a 'Disqualified Director' on Company House documents. The contracted company itself was also not registered to provide asbestos removal training as is required by UK Law and had supplied the Council with a false VAT registration number. It was only through an external audit that this information came to light.

If the planned training had gone ahead, the certification issued at the end of the training was going to be invalid. In the event of an accident the Council would have been held partly responsible. The Council was exposed to significant reputational damage resulting from the failure to confirm competency and appropriateness of the supplier, prior to engagement.

### **Economic extortion**

Buying officers from the Procurement Department could be soliciting money from potential suppliers to get them to pay the buyers to secure a contract of supply.

### **Set up of a dummy vendor**

The Accounts Receivable person may set up a dummy vendor in the system, raise an invoice against the company and then pay the bill, pocketing the “payment” made for the fake goods and fake service provider.

A similar real life example whereby there was a fake service provider was reported at [assets.publishing.service.gov.uk](https://assets.publishing.service.gov.uk). In the Council’s road-resurfacing program, the contractor’s Contract Manager and the council’s Principal Engineer colluded over a two-and-a-half-year period to defraud the Council. Approximately 110 resurfacing jobs were significantly overcharged, with surface areas being overstated by as much as 40%.

The contractor received a whistleblowing complaint about the activities of their Contract Manager and engaged an external firm of investigators to undertake a full review.

The investigators found that the majority of the money was taken from the system either by the contractor’s Contract Manager creating “ghost” sub-contractors who supposedly worked on the jobs, or genuine sub-contractors claiming for work not undertaken (in collusion with the Contract Manager). It was noted that money was cashed and distributed to the relevant parties.

## Maintenance and repairs scams

1. An item/equipment may be sent out for repairs which are not actually required. This would be for financial gain of the sender and the “repairer”. In this case there will be no repairs done but the organization will be charged for repairs and payment made by the organization would be shared by the sender and the company meant to repair the equipment.
2. An item/equipment may be needing repairs and sent out for repairs. The equipment may come back with missing parts or with some parts exchanged with cheaper versions. Or it may be a completely different piece of equipment, the original equipment exchanged with an older one.
3. An item sent out for repairs may never come back and follow ups made to the repairer, but the equipment not returned to the organization that owns it.

## Amendment of suppliers' bank details

Fraudulent employees may amend suppliers' bank details to put theirs, so that they receive payment not due to them, and then reset the details after the fraudulent transaction.

An example of this scam was reported at [assets.publishing.service.gov.uk](https://assets.publishing.service.gov.uk). A School Finance Officer amended supplier bank account details to divert genuine payments into their own account. Immediately after processing of the payments the supplier bank details were corrected. The total estimated fraud loss was £80,000.

The irregularity was revealed when genuine suppliers began to chase payment of outstanding invoices.

## Section 4: MITIGATING MEASURES IN PROCUREMENT - SAFEGUARDS

### The anomaly

#### Fraudulent order

An order may be made for something not needed by the business.

#### Mitigation

The Purchase Requisition raised must be authorized by an appropriate level such as the head of the department requiring the good or service. The Purchase Order should be approved by an appropriate level in the Finance department. These levels of authorization and approval would require justification of the procurement prior to approval of the order which minimizes occurrence of fraudulent orders.

### The anomaly

Incorrect order in terms of specification and quantity.

#### Mitigation

The Purchase Requisition should be raised by the user department/section, or raised with input from the user department/section. The actual users should explicitly state the required technical specifications and quantities on the requisition.

### The anomaly

#### Theft

An order may be made for a good required by the business, but stolen before reaching the intended recipient.

## Mitigation

- An organization should have a designated “Receiving Area” for receiving ordered goods where the deliverer brings with the goods a Delivery Note stating the goods and quantities being delivered from the supplier. A Goods Received Note would be raised and signed by the receiver to confirm that the goods were received as expected in terms of quality, quantity and specifications. When there is a follow up on the good ordered, a record would be present that shows who delivered it, who received and when it was delivered since the Delivery Note and Goods Received Note show the dates they were raised.



- A designated “Dispatch Area” would also be important to have to ensure that goods leaving the organization are leaving from designated areas and transported out by specified employees.
- The “Receiving Area” and the “Dispatch Area” areas should be secure with controlled movement. Assigning a security officer in each of these areas who would ensure security of the organization’s assets would be ideal. Security personnel may also be assigned at exit gates and perform random searches in organizations with significant movement of goods.

## Are you losing too much money when procuring goods and services for your organization?

This e-book is here to help you strengthen controls in your procurement process. It will help you to become aware of potential weaknesses and some scams that can occur in your procurement process. Herein Erica gives mitigating measures to those potential holes. It provides a clear guide on how to close those gaps and potentially save your organization money.

This book is a good partner in auditing the procurement process in your organization or when auditing the procurement process of your clients.



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