

Eating the elephant – procurement protection in the food supply chain

Food advisory group
Fraud

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The procurement cycle can be complex with multiple opportunities to conceal significant losses to fraud and corruption. John Baker and Duncan Swift of Moore Stephens break down the exposure in the food supply chain and look at how to mitigate it by judicious tightening of policies and controls.

With the latest fraud loss estimates running into billions of pounds, the risks of irreparable damage to brand and sales, as well as the sums fraudulently taken out of the procurement cycle, present a clear threat to the success – even viability – of any food supplier or retailer. In our experience the recent well-publicised ‘protein-substitution’ cases involving horse meat and white fish simply represent the tip of the iceberg.

Beware of fraudsters

The good news for fraudsters is that in food manufacturing there is always a need to procure ingredients and other foodstuffs – often urgently. The still better news for fraudsters is that with the prevention and detection eyes most focused on the finance department, fraud risks through procurement are often overlooked. Worryingly, after finance, procurement is the highest value target; combining the highest rewards with least likelihood of detection (factoring in what might happen to the perpetrator if s/he is caught) and little wonder then that fraudsters gravitate to this area of business.

Procurement fraud is typically a deliberate deception intended to influence any stage of the procure-to-pay lifecycle for financial gain or to cause a loss and it is complicated in the food supply chain by the significant potential to successfully pass-off low-cost substitutes in ‘satisfying’ a customer’s procurement needs.

Detecting fraudulent activity

Due to the complexities, procurement fraud is difficult to detect and measure and can be carried out by those inside or outside an organisation – often with most success when there is an element of collusion. As an example, we came across a ready-meals supplier agreeing with a supermarket buyer to supply cheaper, though same stated ingredient standard, ready-meal product where the supplier ensured that certain of those ingredients would be temporarily inferior in return for that buyer delisting the principal competitor’s product.

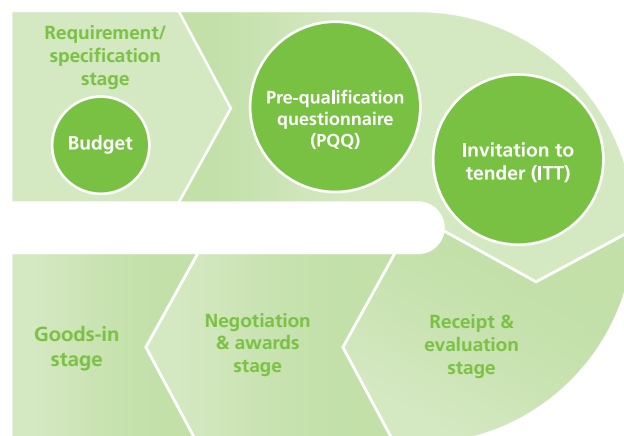
The supply chain involves so many different people and departments that tackling fraud is a major challenge.

The opportunities for fraudsters range from false/duplicate/double/inflated invoicing, false payments, altered payment details and diverted transfers, to price fixing, bid rigging and cover pricing, exacerbated by the opportunity to deliver inferior or sub-standard substitute products being particularly high in the food sector.

Sounds too big to tackle?

All is not lost: the answer to ‘How do you eat the elephant?’, is it’s easier to digest if you slice it into manageable chunks. Rather than viewing the procurement cycle as a single process, the key is to unbundle it and focus on the different stages and operations in finer detail, for it is most often in the details that the devil lies. Each stage should have its own policies and procedures and each has its own risks and controls.

The procurement cycle



The significant majority of fraudulent food stock keeping unit (SKU) or ingredient substitution occurs in the Goods-In stage where all too often, a ‘contract and forget’ mentality is adopted. Food and ingredient substitution frauds invariably creep in post-award. How do you check on quantity and quality of goods you have received? Whilst it’s easy enough to count SKU volume and weight, what about ingredient or whole SKU specification issues – are your checkers qualified and equipped to check?

Do they check on a random and irregular basis without notice to your suppliers and to your buying team? Are the results of these checks, and details of the amount and value of any identified sub-specification SKUs or ingredients, flagged in your traceability records and considered at board level? These checks are your reputational 'firewall'.

Consider whether goods are secure after receipt and how their movements can be monitored and accounted for (and whether there are further opportunities to switch inferior goods). The asset register/audit trail should be secure, permanent and simple. The value of effective reconciliations of Purchase Order to Goods Received Note to Invoice cannot be overstated. Think about how you check to see how damaged goods/returns/refunds are processed. Are customer complaints as to inferior product quality, particularly as compared with specification, separately identified and monitored? Whilst it's reactive, monitoring the level of such complaints and their frequency, attributed to the SKU or ingredient supplier(s) can be a real litmus test of whether a larger food SKU or ingredient fraud exists.

Understanding the risks

It is important to understand the food fraud risks in the procurement cycle and where the attacks are most likely to originate. Regular re-evaluation of controls is critical as they may be out of date and based on structures that have since changed. Try to ensure a balance between prevention and detection and the operational imperative – you need to reduce fraud but you also need to do business. As detection can be difficult, it is important to look for fraud indicators and encourage and facilitate whistleblowing and complaints from customers. Also, do not immediately dismiss complaints, whether direct or indirect, from competing SKU suppliers. It's such a tight-margin market that most suppliers know when a competitor is unfairly 'cutting corners', an aspect noted in the detection and successful prosecution of the Heart of England Eggs fraud. When instances of fraud/bribery are detected, it is essential that investigations are conducted professionally, lawfully and cost-effectively and that successful outcomes should be used as a moral deterrent.

Raise awareness

Those who do business with you must be made aware of your organisation's anti-fraud/bribery stance and ethical standards. Raising understanding of what constitutes food procurement fraud with staff who are involved in purchasing is also pivotal in defending the frontline. 'Prevention is better than cure' rings true in the lifecycle of food procurement as much as it does in medicine. And remember, eating an elephant in one sitting is not good for you!



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Duncan has worked in the UK food supply sector for over 20 years and heads Moore Stephens' Food Advisory Group. Duncan holds an MSc degree in Agricultural Business Management and has particular expertise in assisting owners and other stakeholders involved in financially challenged food production (agriculture, horticulture) and food processing businesses. He particularly enjoys success in helping food producer and food processor businesses to survive and thrive in their dealings with major supermarket buyers. His views and experience on ensuring fair-dealing between food suppliers and supermarket buyers have been well reported in the media over the last ten years and he is a regular conference speaker on corporate governance matters in the food supply chain. Duncan has recently been appointed to the Advisory Board of the Institute of Food Safety, Integrity & Protection.



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John has over 18 years' experience in countering fraud and corruption. He advises clients on the effectiveness of their anti-fraud/corruption arrangements and is a regular public speaker in the UK and overseas. John has extensive experience gained from working on a wide range of projects in the public, private and not-for-profit sectors. John sits on the Advisory Panel of Portsmouth University's Centre for Counter Fraud Studies, on the Editorial Board for the 'Fraud Intelligence' magazine, on the National Fraud Authority's 'Fighting Fraud Locally (FFL)' Steering Committee and is Vice-Chair of the London Audit Fraud Group. Until recently he was a Director of the London Fraud Forum and an Executive Committee member of the Institute of Counter Fraud Specialists.

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