

COMBATING FRAUD IN PUBLIC PROCUREMENT: A NEVER ENDING STORY

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ABSTRACT

This paper seeks to offer an exploratory review of the array of possible grounds of corruption in public procurement. We will attempt to frame the debate on the fundamental issue of what is practiced in theory and practical. Documents from the Ministry of Finance including, among others, the procurement guideline books, The Financial Procedures Act 1957, the Treasury Circular Letters, the Red Book are examined to determine types and attributes of public procurement. There were few studies on the existence of corruption in public procurement. This study focus on the same scenario, yet supplemented with a study on factors that may initiate corruption in public procurement. Finally, this paper highlights the best possible suggestions that can be considered for future improvement. It is anticipated that this study will contribute to the current literature of fraud and corruption in public sector.

Keywords: *Corruption, fraud, public sector, public procurement*

1. Introduction

Public procurement is a process of acquiring goods and services by public sector to the external parties. Since the government has limited available resources, the buying process should be made at the lowest whole-life costs that meet specifications. Where a contract is not awarded to the lowest responsive bidder, then the value added benefit should be justifiable. In Malaysia, public procurement is highly regulated by the Ministry of Finance. Among others, the government officials are supplied with the public procurement process flows, the procurement guideline books, The Financial Procedures Act 1957, the treasury Instructions, and the Treasury Circular Letters.

Remarkably, Llyod and McCue (2004) claimed that dysfunctions in procurement system naturally occur when so many rules exist. They have supported their arguments by indicating that public procurement was saturated with “a sea of paperwork”, and hence, giving unreasonable workload condition to the personnel. For that reason, some might rationalize themselves to get their own reward, namely, by justifying their action of committing fraud.

2. Study Background

Surely, fraud and corruption do not belong only to the public sphere only. The wave of corporate scandals, beginning in 2001- 2002 with Enron, WorldCom, and others, led to the recognition that deficiencies also existed in the governance and internal control systems of all types of organizations. Reactions to these deficiencies have taken the form of increased regulation such as Sarbanes-Oxley, internal control audits under Section 404 which resulted to an increase in attention of governance, internal control, and fraud detection by auditors, management, and the broad investment community. While there have been many high-profile cases in the corporate world, the governmental and not-for-profit organisations are also not immune from major fraud.

In Malaysian scenario, Wan Abdullah (2008) described that the Malaysian government has made enormous efforts to curb corruption by setting up Anti Corruption Agency of Malaysia (ACA), Public Accounts Committee (PAC), National Integrity Plan (NIP) and the Integrity Institute of Malaysia (IIM), Public Bureau Complaints (PCB), and Disciplinary Board and Code of Ethics. Sidiqqe (2006) has deliberated that Malaysian government has impressive institutional mechanisms and strategies to tackle the issue of professionalism and ethical conduct of public officials. Nonetheless, she pinpointed that gap between policy and practice may exist by looking at issues that encircle the local media on the corruptions and mismanagement of government assets.

Ultimately, the success of each of government department lies in the hands of its employees. There is an increasing awareness of the urgent need to address the issue of “misconduct” among its employees. As shown by the KPMG Forensic’s 2008-2009 Integrity Survey, the prevalence of serious misconduct in public sector stood at 56%. As though to authenticate the survey, 2010 Corruptions

perceptions index proved that Malaysia was ranked 56 from 178 countries with an index of 4.4, an achievement our country should not proud of. The ranking is set in between 10 (very clean) to 0 (highly corrupted).

A survey which was conducted by PwC in 2010 might have shown a serious decline in bribery and corruption due to global change of attitude which consequently, increased regulatory enforcement. According to this survey, this trend was likely to continue as numerous legislations were to be enforced to strengthen anti-corruption campaign. (PriceWaterHouseCoopers, 2010). Nonetheless, one should consider that corruptions may happen not just because of monetary gain. According to Theis and Steven (2007), corruption is commonly referred to the exploitation of power to get personal gain, kickbacks, collusion or misuse of project assets.

Othman, Zakaria, Nordin, Shahidan, and Jusoff (2011) assert the arguments by pointing that even with considerably astounding guidelines and system transparency, the current system is still open for unethical manipulation and corruption practices. The contributing factors for this practice may vary. As challenges grow, the community in the public sector somehow has vague impression on the limit of acceptable and unacceptable behavior (Majid & Mohamed, 2012). Despite the fact that control mechanisms are present, Sidiqqe (2006) has substantiated the claim that gap between policy and practice is real.

3. Public Procurement in Malaysia

Procurement in Malaysian public sector can be observed in the course of purchase classification; supplies, services and work or construction. Procurement methods of supplies and services can be made over direct purchase, quotation and tender.

In Treasury Circular 12/2007, direct purchase can be made by placing straight order to the interested supplier and the annual aggregate expenditure must be under RM50,000 worth of items.

For quotation method, the officials need to identify the value of the supplies and services needed before the buy. Procurement of RM50,001 to RM100,000, Treasury Circular 5/2009 dictates to request quotation from at least 5 registered Bumiputera status companies and must be registered with the Ministry of Finance.

In respect of procurement of supplies and services involving an annual aggregate expenditure above RM200,000, open tender procurement will be exercised (Treasury Circular 5/2007). In this process, priority is given to local products (Treasury Circular 7/2002) and the specification must be in accordance to Malaysian standards issued by the Malaysian Standards Departments.

All of these procedures however, are conducted manually. Since the processes or document movement are time consuming, the progression is subjected to abuse and corruption (Othman, et al., 2011). For that, they have suggested several possible corruptions that might happen along the process such as kickbacks, bid rigging, and misrepresentation of facts.

4. Corruption in Public Procurement

The Malaysian government is unwavering on its commitment for prudent spending and the inspiration is channeled to all departments. Most of the time, public sector operating budget continue to grow tighter. Consequently, dependency of national and local government entities on private sector to secure quality goods and services grows. In many cases, the rationalizations made are to shorten delivery period and to obtain better value for money at the same time. The process to acquire such goods and services are made through public procurement, an area which both public and private sector interact financially. Thus, it is vulnerable for corrupt activity, cronyism, and bribery (Lloyd & McCue, 2004).

5. Detecting Fraud

The question of why people commit fraud has long been an interest to criminologist and psychologist. Cressey (1953) has outlined 3 determinants which lead to fraud; opportunity, rationalisation and pressure. By using the same common factors, PriceWaterHouseCoopers (2010) has pinpointed that 71% of fraud was committed due to incentive or pressure to do so, 15% was due to the opportunity and 12% believed that their rationalisation or attitude to commit fraud was reasonable.

It is important to understand the determinacy of fraud and their causes. According to Kohlberg (1958), human values are developed over time as they grow. He said that the environments and social interactions played significant role in the development of individual personality as well as moral values that upholds the individuals for the rest of their life. This theory explains the development of moral reasoning, which is the basis for ethical behavior in which it is believed that everyone will go on the same stages sequentially (Kohlberg, 1984). His theory in behavioural studies has been used extensively in many subsequent studies especially in criminology. Nevertheless, this theory has discounted on other values such as gender (Gilligan, 1982), norms, values and ideologies of particular cultures (Moshman, 1998), and persons' physical built or mental condition (Adler, Mueller and Laufer, 2007).

6. The Profiling of the Fraudster

Identifying the potential fraudster may help the public sector to control fraud while at the same time developing their anti-fraud policies in the right area (PriceWaterHouseCoopers, 2010). In its survey, it is reported that 57% of the economic crime turned to be the employee of the public sector, rather than 37% from the external parties. The survey also described that 49% of junior management in the public sector were most likely to commit fraud. Economic crime committed by the senior and middle management stayed at 24%.

Often, fraud is discovered by tips or better known as whistle blower. (Greene, 2013). Greene proposed 5 "red flags" of personality profiles that would be corrupt recipient in an organisation.

- a) The big spender – officials who spend more than their salaries.
- b) The gift taker – officials who regularly accept inappropriate gifts.
- c) The odd couple – officials who regularly appear to have friendly social relationship with the suppliers or frequently meet outside of the office.
- d) The rule breaker – officials who regularly take action on his won. The rule breaker may be the top officials who will direct the subordinates to bend or ignore standard procedures to the benefit of the suppliers.
- e) Genuine need – Crime is committed due to personal problems such as illness of a family member.

7. Tolerance in Corruption

A consensus made by Colombatto (2003) showed that corruption was actually a result caused by bad policy making. He argued that fighting corruption would become more meaningful only if there were no loopholes in policies and in the organization itself. More importantly, he supplemented his arguments by indicating that as long as the top-bottom population was practicing what was called "illegal" practice like corruptions, no matter how small it was, efforts to curb the problem will not likely to go far.

Colombatto (2003) claims can be illustrated by the survey conducted by PriceWaterHouseCoopers in 2010. From the survey result, it seems that public sector is less willing to lay off fraudster in the organization as punishment as compared to actions taken by the private sector. Only 51% cases of fraud faced dismissal action in the public sector compared to 60% by its counterpart (PriceWaterHouseCoopers, 2010). This would indirectly send a wrong message to the fraudsters that they could commit their crimes again and again.

8. Strengthening the Internal Control

The intensify occurrence of these activities has indirectly generate a concern on the effectiveness and the quality of internal control. When it comes to fraud, there will be no different between whether the employees are working in the private sector or in the government service (Macaulay and Lawton, 2006). Considering the importance of the issues, it is believed that fraud might have happened due to the opportunity to do so (Gauthier,1995). Gauthier (1995) added that some of the factors were as a result of insufficient internal control and should there was any, the employees would have the opportunity to override the system. As a result, corruption is hard to curb and

detected. Weisborn and Norris (1997) also found that dishonest management could also be considered as contributing factor to the occurrence of fraud.

In attempt to combat fraud, in 2010 the cabinet of UK Government has suggested several preventive actions that needed to be taken. The task force which was headed by Francis Maude, the minister for the Cabinet Office and Paymaster General, produced an interim report which proposed several steps needed to be taken to tackle fraud in public sector. Among others, the task force has recommended sharing intelligence information in between department, to assess risk of fraud before executing projects and to allocate more resources and investment in necessary countermeasures. In the end, there would not be any acceptable level of fraud and corrupt activities will eventually end.

Hooks et al. (1994) studied communications within the organization and developed a model of whistle-blowing linked to internal control. Of course, the more people – especially people at the top of the organization – that were involved in the fraud, the fewer the potential whistle-blowers exist. Ultimately, however, one or more tips from undisclosed sources did lead to investigation and discovery. Others may suggest appointing independent directors to reduce the likelihood of fraud (Beasley, 1996).

One should not generalised that there is no proper guidelines in fraud prevention in public sector in Malaysia. Public sector in England and Wales, for instance, are governed by National Fraud Authority and are also not immune from the diverge range of frauds (Lane, 2010). In a study conducted by Majid and Mohamed (2012), almost half of their respondents in a public sector organisation have responded either they were not aware of the fraud may happen or fraud was only a norm in their working daily live. Even with internal controls are present, fraud and corruption in public sector still subsist (Jomitin, 2012; Majid & Mohamed, 2012).

9. The recommendations

Public procurement involved large amount of money, therefore it creates a vulnerable subject for corruption. Although no public procurement system will likely ever be fully free of all corruption, we need a system that promotes transparency, efficiency, fairness and accountability so that corruption activities will become difficult to conceal. PriceWaterHouseCoopers (2010) also suggested comprehensive channel of effective whistle policy response.

According to Greene (2013), preventive strategy may begin with a thorough procurement and corporate policy that create awareness among the employees. He also suggested layered procedures and countermeasures for contract that involve a large sum of money.

Issues such as bribery and corruption that exist in the public procurement in Malaysia may become the main concern that disturb the effectiveness and efficiency of the whole procurement policy for the mismanagement will result in huge wastage of public fund. In effect, the authority needs to make sure that independent and trusted whistle blowing channel is in order.

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