FRAUD RISKS IN MANUFACTURING SECTOR POST CORONA VIRUS

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In recent pandemic global economy has effected manufacturing sector seriously. Corona Virus was detected in India in early March 2020 lockdown was initiated in the fourth week of March for 3 weeks and most of the non-essential manufacturing units were asked to stop producing and take strict measures before re-opening their units, which affected the sector badly in which employees lost their jobs and man hours, apart from that growing financial burden further pressurised the sector to rationalise and look at other alternatives to stay in business and relook they way they run their businesses.

Unfortunately, post this pandemic the manufacturing sector is facing challenges which have impacted their growth and has bought new and unforeseen challenges. Squeezed margins has been one of major concern for this sector conventionally, and their margins gets further squeezed with incidents of reported and unreported frauds as it eats into its left-over profits from businesses and affects its profitability and growth. Before mentioning or initiating a fraud investigation one should understand the sector, the products manufactured, geography where its operating, manpower and local challenges that the sector faces.

Manufacturing sector has been an integral part of global growth story since industrial age, similarly Government of India over the years had made changes to its policies which has made India as an upcoming and preferred manufacturing hub in Asia. Manufacturing also has multiple sub-sectors such as IT, automotive, engineering, pharmaceutical which are driving employment and are contributing towards countries GDP.

According to ACFE latest report released in 2020 "Report to the Nations" most common occupational fraud schemes in manufacturing sector is “corruption” which accounts for 50% of fraud and accounts for an average of $198,000 median loss to its principal in this sector. Inevitably, fraud risks not only hurt bottom lines but possess other serious implications such as reputational and regulatory risks. The outcome of which terrifies organisations and its management as it drains resources and hurts investors’ trust, shareholders investments, employee’s morale, and consumer confidence. Mitigating and preventing fraud in manufacturing sector is therefore important as it can prevent potential losses, strengthen business, boosts morale and gains and holds its competitive advantage over its competition.
How vulnerable is manufacturing sector?

Global manufacturers are vulnerable to fraud due to multiple reasons which includes high inventory (raw material, unfinished and finished material), making it susceptible for inventory fraud methods and non-cash theft. Apart from that bribery and corruption from associated vendors and conventional fraud methods such as falsification in accounting books or tinkering of financial statements continue to thrive. Although the sector is gearing up to draw the benefits of technology and automation, fraud risks still grow in manufacturing sector. Here are few unique traits of the sector which makes them vulnerable to fraud:

- Unmonitored supply chains, which have a potential loophole for fraud to occur. Large and complex supply chains involve multiple physical activities and several interrelated components, which breed potential risks at various stages - from sourcing of raw material until the final product reaches the consumer.
- Multiple third parties dominate these sub-sectors, such as Aerospace, Pharma, Auto, Textiles, IT and any unethical actions from one third-party directly effects entire chain of organisation and its employees.
- Most of the manufacturers post COVID-19 disruption are struggling to restart their businesses as they are unsure of the raw material and consistency of its supply. Moreover, these vendors are struggling to get trained man-power or other raw material to provide to their principal and underlying assets in form of inventory carries a high risk of fraud and theft.
- Other key risk is government touchpoints for complying in obtaining or revalidating their licences and other permits to restart their businesses and concomitant risk of bribery and corruption looms large.
- Other several regular deals which are often have a low value are susceptible to specific fraud schemes which hurt the sentiments of the sector.

Some of the other possible red flags of fraud in manufacturing sector include:

- Abnormal surge in billing volume, receiving inflated invoices or several payments made to such vendors without any subsequent services provided.
- Evident correlations and connections between company employees and third-party vendors involved in procurement or purchasing of material/goods or involved in distribution of crucial contracts.
- Disproportionate contraction in inventory levels.
- Vendors who are consistently being awarded valuable contracts despite their mediocre performance, absence of any specific advantage over his competition.
- Unexpected and unjustified rise in consumer grievances which can be also attributed to other reasons such as fake/similar look alike products.
- Compensation or gratification payments offered to employees/agents/distributors on account of redirecting orders.

How can we fight fraud in the manufacturing sector?

Initiate fraud risk management programme or fraud risk assessments:

Address crucial exposures in manufacturing sector while composing fraud risk policy. One should understand the product offered and then consider risks associated with them which can be associated to third-parties or counterparties, non-cash fraud and conflict of interest. Another key concern which should be addressed is fraudulent disbursements, which are widespread and can be checked with suitable segregation of duties within departments and key employees.

Strong internal controls:

Every manufacturing sector relies on its internal controls to survive, strong internal controls are essential to prevent fraud and timely detection. Internal controls ensure departments keep appropriate documentation which helps in maintaining crucial paper trail while monitoring various processes. Keeping controls in place also addresses concerns arising from out-dated cash disbursements issues and encourage electronic modes of payments to employees, vendors and other third parties. Consider including strong and vigilant whistle blower policies and internal due diligence for reporting unethical behaviour, code of conduct, etc. For any internal control to be effective, periodic reviews and monitoring are crucial.

Strengthen and use of technology:
Companies who have advance technological advantage have seen that technology has become their first line of defence for their businesses to detect and prevent fraud. Using sophisticated software and IT systems, analysis of voluminous data helps them detect potential anomalies and data monitoring which signifies reduction in losses due to fraud. Moreover, it can provide with data which can help getting rid of redundant processes and improve efficiency.

**Conclusion:**

Manufacturing sector globally would continue to be exposed to frauds which might hamper its growth. However, if sector can introduce robust Fraud Risk policies and initiate regular Fraud Risk Assessments which can identify and mitigate these threats. Apart from that it is also important for manufacturing sector to diligently onboard an employee or a third party as that will help them making a informed decision and will help them build a strong internal control mechanism. Though, frauds will continue to grow, and serial fraudsters will devise new methods to defraud individuals and companies, initiating and implementing tailored made anti-fraud controls and policies can significantly reduce or can even eliminate threats of frauds.
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