INCENTIVES AND INDUCEMENTS

In this KLiP, let's discuss how to deal with Incentives and Inducements offered by suppliers.

Facts of the case:

Shan Ltd is a manufacturing company. The company finance team is in the midst of preparing the year end budget. Mr. Shaw, the newly joined Finance Director (FD) is responsible for the control of budgets and selection of suppliers for the raw materials, based on submission and recommendation by the Purchasing Manager. Mr. Shaw makes the final decisions of approving the supplier. In one incident, Mr. Shaw was approached by the Purchasing Manager who successfully persuaded him to enter into a special agreement with a supplier whom he has a good relationship with.

The Purchasing Manager had assessed and decided to choose the supplier based on the gifts and kickbacks offered by the suppliers rather than the level of service & quality of materials supplied. The value of the gifts is contingent on the quantity of materials purchased. The Purchasing Manager had received a limited-edition Swiss watch previously and does not see any reason why he should not receive the gifts now.

Analysis:

- Mr. Shaw approved the supplier upon the influence of the Purchasing Manager.
- The incentives/inducements received by the Purchasing Manager could result in involving himself in unethical conduct.

Comments/Recommendations:

As per the Code, ***inducement can unduly influence actions or decisions. It can encourage illegal or dishonest behaviour and the individual might obtain confidential information and use it to their favour.*** This creates self-interest threat to objectivity and confidentiality. *Intimidation threats to objectivity or confidentiality are also created if such an inducement is accepted and it is followed by threats to make that offer public and damage the reputation of either the professional accountant in business or an immediate or close family me*mber.

In many jurisdictions, incentives/inducements are prohibited as they relate to bribery or corruption. By offering incentives/inducements to the purchasing manager results in improper influence to perform an action.

To determine whether there is actual or perceived intent to improperly influence the behaviour, it is required to exercise professional judgements, such as:

1. **Will this incentive/inducement create threats?**

   - The Purchasing Manager should consider whether the incentives offered will create any threats before accepting it and it appears to be yes in this case.

     As he persuaded the Finance Director and influenced him to select the supplier not based on the quality of services, materials provided or the price, but the incentive for him to receive luxury gifts.

2. **The significance of the threats depends on the nature of, value of, intent behind the offer and the cumulative effect of the inducement**

   - In this case, the FD should inform and declare to the management/Board of Directors or professional bodies or employer of the individual who made the offer about the incentives and other relevant information before accepting and engaging the preferred supplier. Should the third parties, having knowledge of all relevant information, consider or deem that the inducements are insignificant and not intended to encourage unethical behaviour, then it may be concluded that the offer is made in the normal course of business.

3. **The likely safeguards to address these threats**

   - ***If the threats are significant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.*** When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in business should not accept the inducement. As the real or apparent threats to compliance with the fundamental principles do not merely arise from acceptance of an inducement, but, sometimes, merely from the fact of the offer having been made, additional safeguards should be adopted.

     A professional accountant in business should assess the risk associated arising from this inducement and consider whether the following actions should be taken:

     - Immediately informing higher levels of management or those charged with governance of the employing organisation;
     - Inform third parties of the offer – for example, a professional body or the employer of the individual who made the offer; and
     - Seek legal advice, if required.

     Once the FD becomes aware of the offer received by the Purchasing Manager, the FD should highlight and inform the Purchasing Manager of the consequences prior to accepting the supplier. In the event that the significance of the evaluated threats is unclear, the above safeguards should be considered and put in place. Should the purchase manager continue to receive the incentives without the above considerations and safeguards, his professional conduct, ethics and compliance with the fundamental principles are in question and management must be informed immediately, for disciplinary action to be taken. He could also consider informing the relevant authorities to take necessary actions on the grounds of bribery.

4. **Preventive steps to be taken**

   Adequate safeguards should be implemented to ensure that there are sufficient and appropriate controls to deter such kickbacks from occurring.

Entities should have a proper procurement and purchasing policy in place, which will require those who negotiate contracts, obtain quotations and place orders to perform the following:

- Disclose to the senior management wany possible personal interest in the procurement transaction;

- Deal with all suppliers in an honest, impartial manner and not prejudice any fair and open competition; and

- Not to accept kickbacks or gifts of any form.

The company can also maintain a register to record receipts of any form of benefits by any employees of the organisation as an additional safeguard and allow the senior management to periodically peruse through it.

The purpose of reviewing the register is to ensure:

- that the acceptance of the benefits did not materially influence decision-making.

- that it will not be perceived by third parties as being unethical.

- that it is not prejudicial to the entity.

Finally, to ensure that the interests of the entity have not been compromised, the FD should ensure he documents the reasons (qualitative) for entering into contracts apart from the competitive tender process (quantitative).

With this we come to the end of the KLiP.

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