

CORRUPTION AND FRAUD IN INTERNATIONAL AID PROJECTS

By probing projects in many different sectors and differing contexts it has been possible to find some striking similarities in terms of how fraud is taking place. That said, one should never underestimate the ingenuity of those who skim or steal project funds to come up with new avenues for enrichment.

This brief describes corruption and fraud schemes that the author has encountered during investigations and consulting engagements, primarily in Africa and Central, South and East Asia, on behalf of major international aid organizations over the last ten years.

The information below supports the premise, now widely acknowledged, that no aid delivery mechanism is free of corruption and patronage. Not every donor will be equally exposed to corrupt practices, as the types of project, choice of partners, implementing mechanisms, and systems for detection vary considerably. It is hoped, however, that this brief will suggest the scope of the problem – too often underestimated – and prompt more urgent action to improve internal procedures in the aid agencies, and to strengthen capacities to detect and prosecute these complex cases on both sides of the development equation.

FINDINGS FROM THE CASES

How often are bribes paid?

One of the most disturbing results of the cases studied is the revelation that local project and government officials demand bribes from contractors and consultants in exchange for virtually every contract awarded by local implementing agencies. Scores of contractors and honest project officials in South Asia and Africa complain (privately, of course) about the pervasive, systemic corruption and the naiveté of aid organizations that seem unable or unwilling to recognize the problem. A US consulting firm operating in Latin America shared the experience of many when they said their only choice was “to pay or protest.”

What is the typical bribe amount?

Bribes paid by contractors to local project and government officials are usually a fixed percentage of the contract or benefit desired: typically 5% to 20% to win a contract award and 2% to 5% to have invoices paid, the two most common reasons bribes are paid. The amount that needs to be paid for a contract award is often subject to negotiation

by the parties, causing significant delays in contracting and project implementation.

In several cases the combined payments totaled 30% to 40% of the contract value, sometimes even more. This made it impossible for the bribe payers to complete the contracts according to their specifications without significant price increases or contract amendments. More commonly, project objectives were abandoned and contractors raised prices and cut back on quality to preserve their profits.

In the worst cases (of which, unfortunately, there are many) corruption and the frauds it engenders consume virtually all of a project's resources. In a case in East Africa corrupt officials and contractors misapplied 90% of a \$100 million refugee resettlement project. In Nigeria, Transport Ministry officials asked a civil engineering company to inflate its bill for preparing a preliminary environmental impact statement from about \$5,000 to \$83,000 (more than sixteen times) and to kickback 80% of the excess. In South Asia, audits revealed that 80% or more of a large social action program, and virtually all of a smaller study project, had been improperly diverted.



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Who pays the bribes, and for what purposes?

In addition to the purposes noted above, contractors often have to pay bribes to be shortlisted (to be eligible to bid), to obtain approvals for contract amendments and extensions, to compromise auditors or inspectors (very common), and to avoid cancellation of a contract for poor performance. In South Asia, NGOs in health sector projects, many of which, according to the local media, are empty shells that provide no useful services, pay bribes to receive grants. In South and East Asia and elsewhere, candidates for “wet” project or government positions, those that offer good opportunities to collect bribes, have to pay for the posts upfront and share the corrupt proceeds with their superiors. Winning bidders in bid-rigging cartels often pay losing bidders to submit deliberately higher or non-responsive bids.

Who receives the bribes?

Bribe takers include project personnel (even clerks and low-level assistants), supervisory government and ministry officials, local and expatriate employees of international aid agencies (more common than imagined), auditors, inspectors of all types, and even the press and NGOs.

The local inspection function is so frequently and thoroughly corrupted in every region as to render it virtually useless in many if not most projects. In Indonesia, government auditors routinely demand a cut not to report fraud and corruption. In East Asia, bribes to government officials on road projects are shared with the press (to avoid negative coverage) and, most disturbingly, with a supervisory NGO engaged to monitor the projects and deter corruption.

It is quite common for bribe payments to be channeled into covering campaign and other expenses for the ruling political party. Bribes collected from aid projects and other sources in Indonesia are used to help cover the shortfall in official budgets.

Corruption can infect all aspects of a project, beginning at the planning stage. It is not uncommon for officials to tilt project design towards areas in which it is easier to inflate prices and collect bribes, such as consulting work and

feasibility studies, and away from those where it will be more difficult, such as, in a case in Central Asia, the purchase of specialized scientific equipment. In that case, the equipment supplier had a monopoly on the needed apparatus and refused to pay a kickback, so the project simply dropped this very valuable component and spent the money instead on useless reports by cronies who shared their fees.

HOW DO THE SCHEMES WORK?

Many of the schemes occur in three stages: first, an agreement to pay a *bribe* to win a contract award, which necessitates some form of *bid rigging* to exclude other, usually more qualified and cheaper bidders (because their prices will not be burdened with the cost of bribes), and finally *fraud* (overcharging, failing to perform, etc.), to recover the cost of the bribe and exploit the corrupt relationship. This last component is usually the most costly, often burdening the projects much more than the initial bribe payments.

Bribes

Most bribe schemes begin with demands by government or project officials rather than offers by contractors, although the latter certainly occurs, as do cases of both sides conspiring to loot a project. In some places corruption is so ingrained that no demands are necessary and the standard payments are automatically built into bid prices.

The schemes often start with relatively small gifts and favors. In Africa, several international contractors paid for “plant inspections” or “study tours” that were really just vacations and shopping expeditions for project personnel and their spouses. A couple of contractors rented living quarters, some of which were never occupied, from local project officials at exorbitant rates. In West Africa, a project official leased “office space” at inflated prices to two road contractors that turned out to be two empty, dirt floor rooms in his mother’s house, without electricity or windows. Not surprisingly, the rooms were never occupied.

Also in West Africa, contractors were asked, or offered, to pay for the

education of project officials’ children, or to employ their relatives. Two consulting firms provided free lodging to international aid agency employees, one for several years. On more than one occasion in Angola and elsewhere government officials asked or required bidders to contribute to local “social funds” and “charitable foundations,” with the funds ending up in the wrong pockets.

As the schemes progressed and contracts were awarded, the parties moved from gifts and entertainment to cash payments. The cash was often generated by the payment of inflated bills from legitimate suppliers or fictitious invoices from shell companies set up for the purpose. In West Africa made-to-order bogus invoices could be purchased in local markets for a small fee.

In a nutrition project in that same region an expatriate employee of an international development organization, acting through a local consultant, began collecting bribes in cash in local currency (which filled many large cardboard boxes) to approve inflated sole source training contracts. The employee then switched to travelers’ checks, in the apparent but mistaken belief that such instruments were not traceable.

Larger bribes, at least those paid by international contractors, are usually paid by wire transfers, most often through local agents, subcontractors or “local partners” – local firms that are attached to the projects ostensibly to facilitate technology transfer. The payments are recorded on the payer’s books as legitimate fees or expenses, supported by false invoices and supporting documents for fictitious services.

Where does the money end up?

Bribe recipients often direct that their payments be made in foreign currency to an account in a developed country where they can travel on business or holiday, speak the language, have property or relatives, or where their children study. In several cases bribe funds have been found to be deposited directly into the children’s or relative’s accounts in those countries.

Traditional bank secrecy jurisdictions, such as Switzerland, are popular, but more often the payments follow the

paths cited above. Bribe recipients in former French and Portuguese colonies in West Africa tend to deposit funds or acquire properties in France and Portugal, those in English-speaking East Africa favor the UK, and so on. Cyprus, Dubai, Hong Kong and Singapore are popular regional sites; the British Virgin Islands attract funds from many parts of the world, and as far away as Africa and Central Asia.

Many payers invest considerable time and effort in preparing false accounting entries and supporting documents to generate and conceal bribes. Some contractors keep the proverbial two sets of books – one to show the auditors and the other for internal use which shows the bribe amounts and the real profits. In Indonesia, a contractor on a huge irrigation project employed four persons full time whose sole function was to prepare fictitious invoices and counterfeit airline tickets, hotel and rental car receipts, etc. to cover bribe expenses.

From kickbacks to front companies

Many dishonest officials discover that they can make more money by secretly owning a contracting or consulting firm than by demanding kickbacks from others. Front companies range from those that actually provide goods or services (usually at greatly inflated prices) and earn millions of dollars, to empty shells that take a cut and sub out all of the work, or bill for work never done.

In West Africa, the local manager of a road project instructed a foreign engineering firm to hire his shell company to conduct surveys and staffed it with project employees. In Central Asia, project officials in charge of building a testing laboratory spent hundreds of thousands of dollars in office supplies, vehicles and computers through a series of front companies they owned and resold the items to the project at several times their actual value. They compounded the fraud and their profits by substituting used, defective or inoperable equipment.

Bid rigging

As discussed above, in every region corruption usually leads to some form of bid rigging, as corrupt contractors and officials need to eliminate the less expensive and often more qualified competitors. Most corrupt demands are

negotiated privately with the favored bidder; in other cases, all competitors are told or understand that they will have to pay if they win, causing all of the bid prices to inflate. Sometimes bribes are not demanded, or the amounts negotiated, until after the low bidder is selected, almost guaranteeing that project implementation and scheduling will be compromised. However, some bidders anticipate the demands and build a cushion into their price or scope of work.

In a few cases, project officials approach all bidders after their bids have been evaluated – but before the winners are announced – and solicit bribe offers from each, accepting the largest offer. The other bidders, including the lowest priced, are excluded as non-responsive for trivial or invented reasons. In such cases, the higher bidders have an advantage, as they can afford larger bribes.

In many instances, legitimate suppliers – often large international companies – tired of the constant bribe demands and bid-rigging schemes, permanently withdraw from bidding for internationally-financed projects. Thus, they abandon the field to the more corrupt and usually less qualified competitors. In parts of Central and East Asia the situation has deteriorated so badly that local criminal elements and organized crime figures have formed cartels and have begun to dominate the bidding, often subcontracting the work.

Most of the bid-rigging schemes, however, are relatively straight-forward and include:

- Drafting unreasonably narrow specifications. This is quite common, especially in IT contracts, and includes specifying products by brand name, or requiring that a bidder have been selected an excessive number of times before (twenty-five times in a South Asian case, which, not surprisingly, excluded all competitors but one).
- Promises by project officials to approve later “contract amendments” to increase the price or scope of work after the contract award.
- A variation of the above, in which a favored bidder is given inside information that permits it to

underbid its competitors, such as being told that a cheaper solution will be acceptable, allowing the bidder to low ball the item. This is known as “unbalanced bidding.”

- Sole sourcing contracts, which is by far the most common method, particularly in Africa. This is often accomplished by artificially splitting procurements into several components to avoid reaching competitive bidding levels.

In several similar cases across Asia groups of local construction companies colluded with senior government and project officials to rig the award of road construction contracts. Project officials typically deliberately failed to announce or publicize requests for bids in a timely manner; refused to sell bid documents to outside companies, or found trivial or invented reasons to disqualify outside companies that submitted bids.

Ministry officials designated the winning bidder, or “champion,” before the requests for bids were even announced. The winner was often a shell company in which the official held an interest. It would subcontract all of the work to smaller firms, or losing bidders, at far lower prices. The designated losing bidders submitted complementary bids – higher priced or deliberately non-responsive bids – that allowed the winner to inflate its prices sufficiently to pay off the government and project officials and the losing bidders.

The schemes were detected when it was noted that all of the bid securities submitted by the different bidders were purchased at the same bank on the same day. That was because the designated winner was tasked to purchase all of the securities and to distribute them to the other bidders. Other indicators included losing bids that were an exact percentage apart, because they were all generated by the winning bidder by multiplying its winning bid. There was also a pattern of the winning bids falling just under the threshold of acceptable bids, with the losers being over the thresholds.

Fraud by contractors and consultants

Fraudulent practices by contractors, especially those that pay bribes, are ubiquitous and create very significant losses. Among the most commonly observed schemes are:

- Billing for works never performed, or consultants never employed, or expenses never incurred (this is how it is possible to steal 90% of a project).
- Failing to meet contract specifications, particularly for the construction of roads (failing to lay the proper foundation, or to include drainage, or to use the proper materials).
- Delivering substandard or defective goods, expired or adulterated drugs, used vehicles or computers as new (quite common), and so on.
- Billing for engineering or consulting studies at inflated rates, or delivering useless boilerplate or plagiarized product (in several cases clipped from the internet) at virtually no expense.
- Overcharging for goods and civil works, often by a factor of three or four, or even more.
- Submitting false or exaggerated CVs for personnel, and billing less qualified, lower-paid staff as higher-level personnel.

Submitting forged or false bid securities, performance certificates and financial statements.

Frauds by local project officials include:

- Diverting project assets – from computers to automobiles to heavy road-grading equipment – to the official's private use.
- Unnecessary or padded foreign travel for supposed meetings with suppliers, study tours or training.
- Creating “ghost employees” and fictitious expenses and diverting the payments.
- Leasing warehouses, equipment, or “office space” to the project or contractors.

METHODS FOR DETECTING CORRUPTION AND FRAUD

Encourage and facilitate reports

The great majority of fraud and corruption cases are detected by tips or reports, many anonymous. Whistleblowers are often individuals who base their decisions on religious convictions, and whose choice to disclose information stands firm despite the clear risks of subsequent reprisals. In a case from the Middle East, a devout Muslim agreed to cooperate

in the investigation of a huge fraud and corruption case in which most of the other inside witnesses refused to do so. He lost his good job and a promising career, and he and his wife suffered severely, financially and emotionally, as a result.

It is therefore important to set up systems to encourage and facilitate such reports, such as confidential “hotlines,” as well as to protect whistleblowers against reprisals. In many organizations they are far more likely to be fired than the guilty party, and their allegations must be promptly and diligently pursued. The failure to do so will discourage further reports from them and others.

Voluntary disclosure programs, in which contractors agree to investigate and voluntarily disclose their own wrongdoing in exchange for assurances that they will not be debarred, can also be effective.

Conduct “fraud audits”

Standard audits are not designed to detect fraud and seldom do. In fact, more fraud and corruption cases are detected by accident than by audit. Internal and external auditors must be taught to recognize red flags and to conduct special “fraud audit” steps. These include identifying and tracing suspicious payments, testing prices and performance and inspecting works and deliverables, through interviews as well as reviewing documents. Automated fraud detection programs can detect bid rigging and collusive bidding.

As discussed above, since most of the evidence of bribery and fraud is found in the contractor's records and accounts, auditors need to know how to obtain and examine these documents through contract audits. Audits of project records and accounts might reveal red flags, such as repeat sole sourcing or high prices, but proof of bribes and fraud will come from the contract audit.

Perform better inspections

Bribes are hard to detect, but the results of corruption – poor implementation and low quality deliverables – are often obvious. Better inspections will help detect the fraud and deter the underlying corruption: a contractor that cannot cut back on implementation or get paid for work not performed will find it hard to afford bribes, or a reason to pay them.