INTEGRITY

INTEGRITY VICE PRESIDENCY
THE WORLD BANK GROUP

FRAUD AND CORRUPTION AWARENESS HANDBOOK

HOW IT WORKS AND WHAT TO LOOK FOR: A HANDBOOK FOR STAFF

FOREWORD

Around the world, member countries are increasingly looking to the World Bank Group to help them respond to crises and deal with risk. Efforts designed to prevent corruption and improve governance are critical parts of economic development. This is as true for public procurement as it is for banking, clean energy, forest management and health care. By improving governance, governments can provide cheaper and better services for more of their citizens.

Therefore, the World Bank must be innovative and move swiftly in assisting our clients in their fight against corruption. This requires that we work smarter by learning more systematically from our own experiences and those of our development partners. The Independent Panel Review of the Department of Institutional Integrity (INT) recommended the creation of the Preventive Services Unit (PSU) for exactly that purpose: to turn the results of our investigations into practical advice on how to identify and mitigate risks of fraud and corruption and to spearhead INT's practical outreach and technical advice.

The World Bank's approach to fighting fraud and corruption has come a long way in a short time. Contributing to this effort, I am pleased that INT has produced this handbook, reflecting the results of its investigations and reviews. We fully realize that eradicating corruption will not be easy, but I am confident that the schemes and red flags described in this handbook will assist our supervision efforts designed to detect not just fraud and corruption, but also other important procurement and implementation weaknesses.

The challenge for us is not to shy away from risk but to think ahead, anticipate risks, ask questions, share information, and keep all senses alert, to find innovative ways to mitigate risk sufficiently, so we can ensure the success of our development agenda.

I must acknowledge the many courageous people around the world, who have come forward to provide information, critical to our investigations—and to subsequent prevention efforts. Many have done this in environments where there are significant risks to stepping forward in opposing corruption. We should encourage this behavior by demonstrating the highest professional standards, confident that this will reinforce the message that corruption cannot be allowed to undermine developmental efforts. Bank staff also play a critical role in referring suspected fraud or corruption to INT—it is not just a duty enshrined in the Staff Rules; it simply makes good development sense.

I hope that this handbook will provide real, practical, and concrete help to Bank staff, in our efforts to ensure that the projects and investments we support, adhere to the highest standards and achieve the greatest development impact.

Robert B. Zoellick
President
World Bank Group

PREFACE

Last year, Multilateral Development Banks committed approximately US$70 billion in loans and grants to developing countries. This sounds like an enormous amount of money, until one considers the oft-quoted World Bank Institute statistic that more than US$1 trillion is paid in bribes each year.

In light of such an estimate, the idea that fraud and corruption can be prevented seems futile. If there were a fail-proof solution, it would undoubtedly include a vast number of people with a keen understanding of the inner workings of fraud and corruption schemes. An organization like the World Bank is geared to get ahead of the next problem, before it occurs. In fact, the Bank learns from its experiences and anticipates where future solutions may lie. As Einstein once said, "Intellectuals solve problems, and geniuses prevent them."

This handbook offers INT's insights about fraud and corruption in Bank-financed projects; how it happens and how we can detect it before it negatively impacts projects. Early detection through paying specific attention to red flags in the procurement process can prevent the perpetrators of fraud and corruption from succeeding, as multiple examples over the past years have shown. World Bank staff are the first-and best-line of defense when it comes to protecting Bank funds from misuse.

This handbook was written with the intent to spur innovation in our operational work, not stifle it. Armed with the knowledge of what can constitute one of the biggest pitfalls to development outcomes, operational staff can confidently engage in informed risk-taking when designing projects. This guide is a compendium of input from a range of people across the Bank, including colleagues in OPCS, the Regions, and INT's own staff.

Thank you for reading this handbook, for keeping it within easy reach on your desk, and for sharing your experiences so that the next version will be more comprehensive and relevant to our work.

LMcCarthy

Leonard McCarthy
Vice President, INT

ABBREVIATIONS AND ACRONYMS

BEC	Bid Evaluation Committee
BER	Bid Evaluation Report
BOQ	Bill of Quantities
CQS	Selection Based on the Consultants' Qualifications
CV	Curriculum Vitae
DIR	Detailed Implementation Review
EOI	Expression of Interest
FM	Financial Management
ICB	International Competitive Bidding
INT	Integrity Vice Presidency
NCB	National Competitive Bidding
NGO	Non-Governmental Organization
OPCS	Operations Policy and Country Services
PAD	Project Appraisal Document
PIU	Project Implementation Unit
PPR	Procurement Post-Review
PSU	Preventive Services Unit
QCBS	Quality and Cost Based Selection
RFP	Request for Proposals
SOE	Statement of Expenditure
SPN	Specific Procurement Notice
TOR	Terms of Reference
TQM	Total Quality Management
TTL	Task Team Leader
UNDB	United Nations Development Business

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INTRODUCTION | 1

What is the purpose of this handbook?

This handbook is intended for task team leaders and task team members, and provides some insights into how fraud and corruption schemes work in Bank-financed projects. The handbook identifies a range of fraud and corruption indicators, or red flags, and relevant schemes that may become apparent during project design or implementation. The primary focus of this handbook is fraud and corruption, with limited coverage of general governance issues.

How does the Bank define fraud and corruption and for what purpose?

The Bank has defined five practices that are considered misconduct, which can be sanctioned through debarment and misprocurement. The Bank has defined corruption, fraud, coercion, collusion and obstruction as sanctionable practices (*see* below).[1] While these definitions are generally recognized and subscribed to by other Multilateral Development Banks (MDBs), they do vary from jurisdiction to jurisdiction as do the standards of proof. The Bank's sanctions are administrative in nature and, as such, the standard of proof is "*more likely than not*", whereas in criminal investigations by a national government it is typically "*beyond a reasonable doubt*". However, in both cases the prosecutorial body must prove the elements of misconduct related to any of the practices, *e.g.*, in the case of corruption, that something of "value" has been "offered" to "influence improperly" the "action of a government official".

- "*A corrupt practice* is the offering, giving, receiving or soliciting, directly or indirectly, of anything of value to influence improperly the actions of another party."
- "*A fraudulent practice* is any act or omission, including a misrepresentation, that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation."
- "*A collusive practice* is an arrangement between two or more parties designed to achieve an improper purpose, including influencing improperly the actions of another party."
- "*A coercive practice* is impairing or harming, or threatening to impair or harm, directly or indirectly, any party or the property of the party to influence improperly the actions of a party."

[1] It should be noted that the definitions come from the latest version of the Procurement and Consultants Guidelines. Depending on the Loan Agreement, different versions of these Guidelines may apply.

- "*An obstructive practice* is: (*i*) deliberately destroying, falsifying, altering or concealing of evidence material to the investigation or making false statements to investigators in order to materially impede a Bank investigation into allegations of a corrupt, fraudulent, coercive or collusive practice; and/or threatening, harassing or intimidating any party to prevent it from disclosing its knowledge of matters relevant to the investigation or from pursuing the investigation; or (*ii*) acts intended to materially impede the exercise of the Bank's inspection and audit rights."

Where are projects most vulnerable to fraud and corruption?

The majority of INT cases show that procurement is particularly vulnerable to fraud and corruption. This vulnerability is primarily due to the large amounts of money involved and the difficulties, at times, to effectively supervise a large number of contracts. In addition to procurement, Detailed Implementation Reviews (DIRs) have found other vulnerabilities in contract and financial management. The schemes INT most often encounters occur in the following areas:

- *Procurement*: corrupt payments to government officials and steering of contracts to favored bidders (*see* Chapter 2); collusion among bidders in obtaining contracts (*see* Chapter 3); and submission of fraudulent bids (*see* Chapter 4) intended to circumvent the competitive bidding process.
- *Contract management*: fraudulent implementation including misrepresentation of goods, works, and services as having been delivered according to specifications (*see* Chapter 5).
- *Financial management*: embezzlement of project funds through fictitious invoices and the diversion of funds or assets (*see* Chapter 6).

Is the prevalence of corruption the same across agencies in the same country?

The prevalence of corruption may vary widely across agencies in the same country. A recent DIR found indicators of systemic corruption in one agency, while activities in another agency were untainted. The manifestation of corruption may also vary from project to project and component to component, depending on the opportunities and the strength of internal controls and external accountability measures. For example, direct payment to headmasters to purchase school books with funds posted prominently at the school, may result in less leakage than the construction of an office building for the Ministry of Education, because of the requirement for transparency of budgets and community oversight.

The basis of INT's experiences

INT has undertaken hundreds of investigations, many DIRs and numerous forensic accounting reviews. For over a decade, INT has investigated allegations of fraud and corruption in Bank-financed projects. An estimated one third of the more than 3,300 INT cases handled have been initiated by Bank staff who, concerned about possible illicit activities affecting a project, reported their concern to INT. In addition, INT has undertaken DIRs of projects in Cambodia, India, Indonesia, Kenya, and Vietnam. On the advisory side, INT has supported more than a hundred task teams across all Regions in assessing and mitigating fraud and corruption risks.

What has been the impact of fraud and corruption identified by INT?

Since bribe-paying firms must find a way to recover these illicit payments and, where possible increase profits, they will often resort to defrauding the project, thereby threatening its development effectiveness. INT investigations have uncovered a number of methods for recovering these costs:

- Charges for goods, works, and services are inflated.
- Goods and services are invoiced but never delivered (or quantities greatly reduced).
- Contract specifications are not met, resulting in substandard work or hazardous conditions.
- Products are substituted for inferior, less expensive and lower quality material than specified in contracts. For consulting contracts, the project is billed for the cost of senior consultants, when lower paid employees are actually performing the work, or billing for "ghost employees" is found.

Competition is often reduced, leaving less capable companies to bid, resulting in higher prices and lower quality (*see* Case 1 on page 4).

Which actors most frequently engage in fraudulent or corrupt practices?

Government officials, companies or their agents, and supervision consultants most frequently engage in the corruption schemes uncovered by INT. These actors play various roles as illustrated below.

- *Government officials* often play a central role in corruption schemes by being in a position to influence the award of contracts, the processing of invoices for payment, and the signing of licenses and approvals.
- *Local and international companies* (contractors and sub-contractors) organize or participate in illicit arrangements in order to win contracts. They divert project funds to project officials, with the bribes usually disguised as 'legitimate' payments for goods, works or services. Frequently, subcontractors—actual or fictitious—are used to channel funds to project officials.
- *Contractors' independent agents* may play a role in brokering the illicit arrangements and shielding the contractors from legal action.
- *Supervision consultants* may be corruptly induced or pressured to sign-off on substandard work.
- *Senior government officials* may provide protection or seek their share of the corrupt payments.

What are red flags and how are they used?

A red flag is an indicator of possible fraud or corruption. There are a variety of red flags that can appear in Bank-financed projects. They can show up as anomalies in bidding documents, such as bids from supposedly different bidders faxed from the same telephone number; in financial records, such as invoices paid in amounts that exceed the contract value; or in the behavior of project officials, who, for example, might pressure the Bid Evaluation Committee (BEC) to select a certain contractor. In some cases, deviations from Bank procurement rules indicate not just non-compliance, but also a heightened probability of fraud or corruption.

Some red flags are more ambiguous than others. Some red flags are quite "bright" and compelling—such as bids from supposedly competing firms sent from the same fax machine, while others are more ambiguous and difficult to interpret, at least in isolation, such as the receipt of fewer than the expected number of bids in response to a tender.

Case 1: Visual indicators of implementation fraud in the health sector

A DIR of a health project identified indicators that fraud and corruption may have affected the quality of both the civil works and medical equipment procured under the project. The DIR team observed significant civil works problems in 93 percent of the hospitals that it visited. The below pictures illustrate some of these problems, including construction problems in new and renovated portions; signs of water damage that caused mold and sometimes structural damage; problems with electrical systems, water supply, sewage and drainage systems, as well as equipment and wiring that was substandard and potentially hazardous.






A red flag is usually a sign that closer scrutiny is needed. This extra scrutiny might involve asking for more documents or information from the project office or, as is often the case, looking for other related red flags. Receiving fewer than the expected number of bids, for example, could be an indicator of rigged specifications or other measures intended to exclude qualified bidders. If detected, Bank staff should look for other indicators of such schemes, as listed in this guide. Similarly, a poorly prepared bid from a previously unknown company might prompt one to look in the telephone directory or on the Internet to see if the firm is listed, or call or visit the purported business premises to confirm the company's existence. Bank staff should not, however, undertake an investigation of a possible or suspected wrongdoing. If concerns remain after a preliminary review, the matter should be referred to INT for further investigation.

CORRUPT PROCUREMENT PRACTICES | 2

How does a corruption scheme in procurement work?

A corruption scheme often involves more than one type of misconduct. A corrupt scheme in procurement often begins with a demand for, or offer of payment, followed by bid rigging and finally fraud to cover up the scheme:

- *Demand for payment.* A government official demands a bribe or kickback from a firm or individual, or a firm or individual offers a bribe, in exchange for a contract award. In most cases, the corrupt official will permit the bribe payer to inflate the price to cover the bribe and preserve its profits.
- *Bid rigging.* To ensure that the contract will be awarded to the bribe-paying firm (whose prices are now inflated to cover the cost of the bribe), government officials manipulate the bidding process to exclude other (presumably cheaper) competitors.
- *Fraud.* To recover the cost of the bribe, and to exploit the corrupt relationship, the firm—usually with the knowledge and complicity of government officials—inflates prices, bills for work not performed, fails to meet contract specifications or substitutes substandard products during implementation. This often requires further corrupt payments to inspectors or auditors.

What are the goals of any procurement-related corruption strategy?

The aim of corruption is to steer the contract to the favored bidder without detection. This is done in a number of ways, including:

- *Avoiding competition* through, *e.g.*, unjustified sole sourcing or direct contracting awards.
- *Favoring a certain bidder* by tailoring specifications, sharing inside information, *etc*.
- *Excluding qualified bidders* through, *e.g.*, restricted circulation of advertisements, biased evaluation processes, or bid tampering.
- *Avoiding detection* of the schemes by negotiating the removal of audit rights, using shell companies to disguise the official's economic interest, *etc*.

How large are typical bribes and in exchange for what favors?

Not all bribes are monetary, particularly in the early stages of a corrupt relationship. In two cases, local and international contractors provided temporary lodging at company-owned villas, free transportation on corporate aircraft, and paid weekend vacations. Another consulting firm provided several years of free lodging. Some international contractors paid for "plant inspections" or "study tours" for project personnel and their spouses early in a project to attractive destinations that were, in fact, expense-paid vacations and shopping expeditions. In several cases, construction companies paid for female companionship for inspectors and gave them gifts and small amounts of cash to induce them to approve substandard works. Different types of corrupt payments include:

- *Corrupt payments for contract awards.* Corrupt payments in Bank-financed projects in exchange for contract awards may vary from 5–20 percent of the contract amount. On occasion, the bribes were even higher than 20 percent. The payments typically were divided among ministry, other government and project personnel, including Bid Evaluation Committee (BEC) members.
- *Facilitation payments.* These are usually 2–5 percent of the invoice value. Many contractors had to make payments to project staff to approve invoices. In some instances, auditors demanded bribes from contractors to refrain from reporting corrupt payments or other irregularities they discovered. In one Region, contractors on a road project paid one percent of the contract value to a supervisory Non-Governmental Organization (NGO) and an additional one percent to a representative of the local media to suppress reports of corruption.
- *Additional indirect payments.* Government officials may also demand that contractors procure from certain firms or contribute to special funds. In one case, a project director rented "office space" to a contractor, which turned out to be two windowless, empty, dirt floor rooms without electricity in his mother's house. The contractor never occupied the rooms. In other instances, project officials asked contractors, or contractors offered, to pay for the education of project officials' children at foreign universities. It is also not uncommon for government officials to ask bidders to contribute to local "social funds" and "charitable foundations."

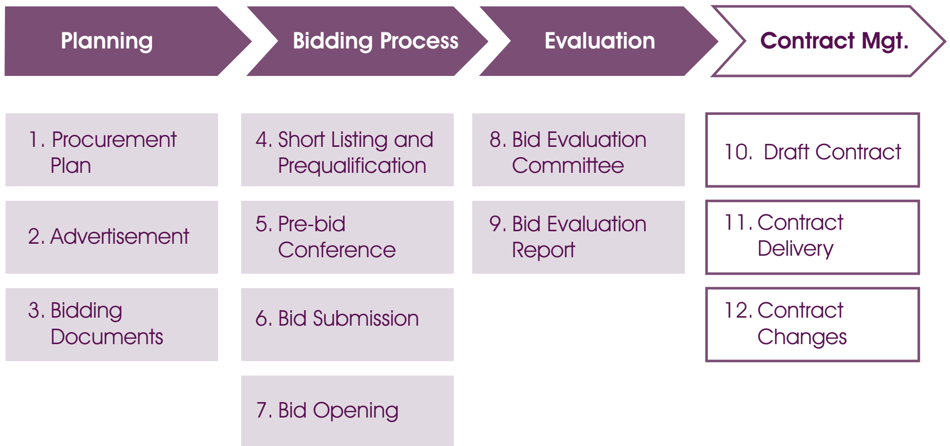
How are bribes paid?

Local contractors usually pay corrupt officials directly, whereas international contractors tend to pay through a middleman. Local contractors usually make their bribe payments in local currency directly to the corrupt officials. International firms tend to pay by wire transfers through a local subcontractor, agent, or middleman, and record the payments on their books as legitimate expenses or commissions. This makes many such payments detectable through the exercise of the Bank's audit rights of contractors' records.

How can corruption be detected?

While it is difficult to prove someone paid a bribe, the paper trail left when a government or project official steers a contract to a favored bidder is easier to detect. The following section deals with indicators, or red flags, that Bank staff can look for when supervising contract awards. A combination of certain red flags should alert staff that a bid rigging scheme may be affecting the project. Corrupt practices and bid rigging can take place at any stage during the procurement process. Sophisticated planning of corrupt activity usually starts at the project design stage when the activities are determined and contracts planned. Officials generally have a level of discretion in drafting specifications or qualification criteria, which provides the opportunity to steer contracts to the favored bidder. Figure 1 below shows the procurement process divided into four phases.

Figure 1: Phases in the procurement cycle where corruption can take place



For each procurement action leading up to the contract award, this section highlights the red flags that can be identified (*see* the brown boxes), as well as related fraud and corruption schemes (*see* the green boxes). The following bid rigging schemes will be presented:

- Unjustified sole source awards (*see* page 10)
- Contract splitting (*see* page 10)
- Inappropriate bundling (*see* page 12)
- Unnecessary or inappropriate line items (*see* pages 10 and 13)
- Rigged specifications (*see* page 13)
- Unbalanced bidding (*see* page14)
- Hidden interest in a company (*see* page15)
- Exclusion of qualified bidders (*see* page16)

For each procurement action, suggestions will be outlined for easier identification of red flags and measures that might strengthen procurement controls. Various contract management issues related to fraudulent implementation are addressed in Chapter 5.

1. Procurement Plan

The Procurement Plan should be scrutinized for the justification of items, procurement methods, Bank review thresholds, and possible contract splitting. The plan includes agreements on the contract packages for procuring the identified goods, works, and services; the methods for procuring them; and the Bank's prior review thresholds. It further lists the respective timetables for the various procurement activities.

Scheme: Unnecessary items. In one case, INT received a complaint that the building of a waste water treatment facility in a local community was not needed, possibly reflecting undue political influence with the intention of benefiting a local contractor. The case illustrates the risk of political pressures adversely impacting sub-components or potentially the entire project.

Red flag indicating unnecessary items	
Unnecessary items	The list of contracts for goods, works, and services is not consistent with the project requirements

Scheme: Unjustified sole sourcing or direct contracting. Direct contracting of goods and works and sole sourcing of consultants are legitimate contracting methods as described in the Procurement and Consultants Guidelines.[2] However, these contracting methods may also be used to steer contracts to favored companies by avoiding competitive bidding. In one consultancy contract reviewed by INT, the scope of work was expanded significantly after the contract had been awarded, taking the contract amount from just below to considerably above the threshold for competitive bidding. In other cases, direct contracting had been carried out when the Procurement Plan stipulated competitive bidding.

Red flags indicating unjustified sole sourcing or direct contracting	
Non-compliance	• Use of sole sourcing or direct contracting when the Procurement Plan calls for use of more competitive methods • Use of sole sourcing or direct contracting for new procurement actions (not listed in the Procurement Plan) without obtaining the Bank's no-objection
Inadequate justification	• Inadequate or misleading justification or documentation as required by the Bank's procurement guidelines (*e.g.*, stating that the equipment is proprietary when, in fact, it is not)
Multiple sole source awards	• Multiple sole source awards or direct contracting to the same company or within the same procuring unit • Certain contract amendments that would benefit from competition or where the items should have been procured separately (*e.g.*, the additional activities are not a natural continuation of the existing contract)

Scheme: Contract splitting. The packaging of contracts is designed to attract as many qualified bidders as possible in order to secure the best price and quality. Legitimate considerations regarding decisions to package certain contracts include: (*i*) capacity of potential bidders to deliver the outputs specified; (*ii*) risks related to the bundling or unbundling of items; (*iii*) centralized versus decentralized procurement; and (*iv*) sequencing of procurement actions in line with needs.

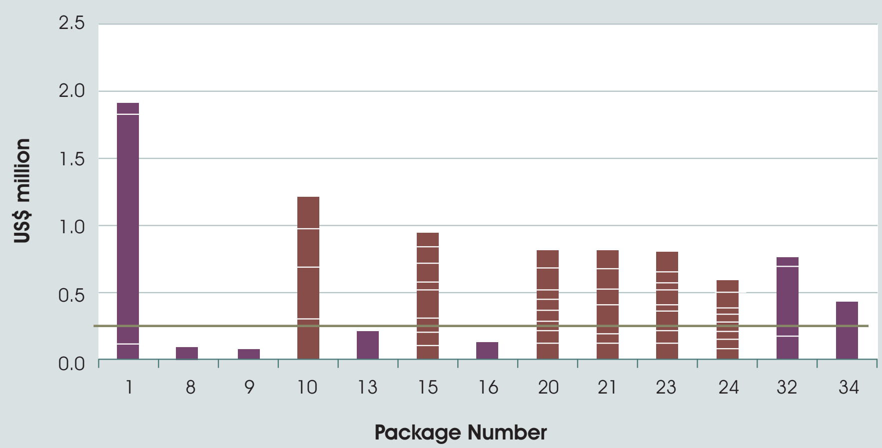
[2] The Bank's Procurement Guidelines allow for sole sourcing and direct contracting provided they are justified and the Borrower publishes "in UNDB *online* and in *dgMarket* the name of the contractor, price, duration, and summary scope of the contract." See Paragraphs 3.9 to 3.13 of the Consultants Guidelines and paragraphs 3.6 and 3.7 of the Procurement Guidelines for more details (versions of 2004 and onwards).

Contract splitting is a deliberate attempt to limit or entirely avoid competition. By splitting contracts into smaller packages, prior review thresholds are circumvented and less competitive procurement methods are made possible. In one case, INT noted that the Procurement Plan submitted to the Bank included three vehicles procured successively over a month by three Ministry of Health agencies. In another case, road contracts were split in unusually short segments allowing for the use of minor works rather than the National Competitive Bidding (NCB) method. Case 2 below illustrates indicators of contract splitting in tenders for medical test kits.

Red flags indicating contract splitting	
Unusual splits	• Issuing two or more contracts for identical items over a short period of time for no apparent reason, resulting in the application of a less competitive procurement method • Procuring items that should have been procured jointly are procured by each sub-unit (*e.g.*, each district office procures its own vehicle rather than the agency procuring all vehicles) • Splitting items that are normally procured together in order to keep individual package values below thresholds (*e.g.*, procurement of computers and related accessories is split into separate contracts)
Many awards just below thresholds	• Awarding an unreasonably large number of contracts just below NCB or QCBS thresholds (*e.g.,* use of CQS method for two or more consultancy contracts versus one contract under QCBS)
Excessive use of shopping	• Using shopping procedures excessively for the purchase of identical or similar items. • Two or more related and simultaneous purchases from the same supplier in amounts just under the NCB threshold

Case 2: Indicators of possible contract splitting

In a number of tenders for medical test kits, INT observed what appeared to be the splitting of a large number of contracts. Investigators consolidated the contracts that had been split and arrived at the list of packages represented by the red bars. As is evident, six additional packages (in brown) were now above the US$300,000 prior review threshold established by the Bank (horizontal line marked in green). The necessity of splitting these packages appeared questionable, because prior and subsequent procurements were not split.



Scheme: Inappropriate bundling. This scheme is the opposite of contract splitting, yet yields the same result of reduced competition. In one case, based on a complaint from a prospective bidder, INT's review of the issued bidding documents showed a wide variety of goods that had no relation with each other, bundled into one lot (*i.e.*, computer equipment, copper wires, hospital beds, *etc.*). A particular provision stipulated that incomplete lots were not allowed and would be considered non-responsive. This made the bidding process biased since not a single manufacturer or authorized dealer could meet the requirements of the entire lot. The process resulted in one bid with prices that were about 30 percent above the estimates.

Red flags indicating inappropriate bundling	
Inappropriate bundling	• There is a complaint from one or more bidders about the bundling of goods, works, and services • Items to be procured within a proposed bundle are not related • There is a significant reduction in the number of potential or actual bidders resulting from the bundling • The agency cannot justify the bundling on the basis of cost savings or reduced integration costs or risks

Suggestions

- Compare the Procurement Plan with the procurement schedule of the Project Appraisal Document (PAD) to identify any inconsistencies, such as the use of less competitive methods than those listed in the PAD
- Compare the procurement action with the Procurement Plan to determine whether the method used was in line with the approved plan

2. Advertisement

Advertisements can be manipulated to exclude bidders. To inform as many qualified bidders as possible, the Bank requires advertising in the online *United Nations Development Business (UNDB)* and in *Development Gateway* (*dgMarket*) for all large consultancy (above US$200,000) and International Competitive Bidding (ICB) contracts. For NCB, the procurement action should be advertised in a widely circulated national or official gazette, or on a free and open access website for a reasonable time. Advertisements can be manipulated by limiting the circulation of the Specific Procurement Notice (SPN) or the request for Expression of Interest (EOI). INT has experienced examples of bidding opportunities that were not advertised. To cover up this fact, agency officials produced false advertisements that were never printed or were printed by the newspaper in just one copy. In one extreme example, all copies of the newspaper with the advertisement were bought by one party.

Red flags in advertisement	
Restricted circulation	• Not advertising the request for SPN or EOI (as required under Bank procurement rules) • Limiting circulation by posting the advertisement in a local rather than national newspaper, when a national newspaper would have resulted in more bids
Short notice	• Period between the advertisement and the bid submission deadline is very short

Continues on next page

Red flags in advertisement *(cont.)*	
Inadequate information	• Providing incomplete contact information so that potential bidders do not know where to submit bids or from whom to request clarification • Drafting overly vague descriptions of the goods, works, or services required so that bidders cannot determine their interest • Drafting overly narrow descriptions of the goods, works, or services required to exclude qualified bidders

Suggestions

- Review past advertisements during Procurement Post Reviews (PPR) to identify and possibly follow up on any red flags
- Encourage that the agency consistently keeps a file of actual newspapers showing the advertisements and date of publication

3. Bidding Documents

In providing inadequate or erroneous information for the preparation of bids, corrupt officials may effectively exclude qualified bidders. Bidding documents[3] must be prepared for each proposed procurement action involving ICB, NCB, and the selection of consulting firms. All large contracts are subject to the Bank's prior review and no-objection by the task team leader (TTL). The thresholds for these contracts are established in the project's approved Procurement Plan. The bidding documents, issued by the Borrower, inform potential bidders how bids should be prepared, the evaluation criteria, and the contract requirements.

Scheme: Unnecessary or inappropriate line items. A review by INT of a bidding document for the construction of three road segments identified a range of red flags indicating potentially unnecessary and inappropriate line items: (*i*) a large number of four-wheel drive vehicles to be used by the supervision consultants, though many would be stationed at the Road Agency's headquarters; (*ii*) the number of vehicles in the bill of quantities (BOQ) did not vary according to the length of the road or size of the contract; (*iii*) training abroad for government officials was included in the scope of the contractor's work; and (*iv*) a provision for the contractor to pay for the supervision consultant's staff.

Red flags indicating unnecessary or inappropriate line items	
Unnecessary items	• Specific line items in the BOQ that are not required to carry out the work and may be used for personal purposes by officials or later serve as bribes (*e.g.*, excessive number of vehicles compared to project needs)
Inappropriate items	• Items creating a conflict of interest (*e.g.*, payment for government officials and supervision consultants in the works contracts)

Scheme: Rigged specifications. In a competitive market for goods and services, any specifications that seem to be drafted in a way that favors a particular company deserve closer scrutiny. For example, specifications that are too narrow can be used to exclude other qualified bidders or justify improper sole source awards. Unduly vague or broad specifications can allow an unqualified bidder to compete or justify fraudulent change orders after the contract is awarded. Sometimes, project officials will go so far as to allow the favored bidder to draft the specifications.

[3] All references to bidding documents and bidders in this handbook include Requests for Proposals (RFPs) and consultants respectively.

Red flags indicating rigged specifications	
Tailored specifications	• Close similarity between the specifications and the winning bidder's product or services • Specifications stipulate the use of a brand name without stating "*or equivalent*", contrary to Bank procurement rules • Complaints from other bidders that the specifications match too closely those of a single competitor, or that a bidder prepared the contract specifications
Poor specifications	• Vague, ambiguous or incomplete specifications • Specifications are significantly narrower or broader than in previous similar procurement actions
Few bids	• Only a few of the companies that purchase the bidding documents submit bids, especially if more than half drop out • Relatively few companies submit bids, compared to prior similar tenders • Fewer than the normal or expected number of potential bidders apply for prequalification

Scheme: Biased evaluation criteria. Instituting biased evaluation and qualification criteria is another method used to steer contracts to a favored bidder. In one ICB contract for the procurement of computers, it was required that the goods must be delivered within three weeks of contract effectiveness. This requirement inappropriately excluded all international bidders since any overseas shipments would take longer than three weeks.

Scheme: Unbalanced bidding. Under this scheme, project officials provide a favored bidder with inside information that is not made available to other bidders, for example, that one of several line items in a request for bids will not be called for after the contract has been awarded or that a certain low-cost solution will be acceptable. This information invariably gives the bidder an unfair advantage and by allowing the company to lower its price or otherwise tailor its bid to defeat its uninformed competitors. Project officials can facilitate the scheme by drafting vague specifications to further disadvantage competitors (*see* Case 3).

Case 3: Secret arrangement allowed bidder to "low ball" item that would later be dropped

A "representative" of a Project Implementation Unit (PIU) promised an international bidder for a US$25 million agricultural testing laboratory that it would win the contract, if it would hire him as a "consultant" to help prepare its bid. The consulting fee would be 20 percent of the contract value, which he would share with project officials. Intrigued, the bidder wondered how he would be able to pay the bribe and still be the lowest qualified bidder. The representative said that the project would remove certain line items that called for expensive humidity and temperature control equipment once the contract had been awarded. The bidder could thus "low ball" this item in its bid, be the lowest bidder, and still have sufficient funds to pay the bribe. Additional contract amendments would be processed as necessary. The bidder agreed to the scheme, but lost the contract after the representative negotiated an even more lucrative deal with another bidder.

Unbalanced bidding is also used to describe the practice of bidders quoting prices significantly below cost for some line items and prices significantly above cost for others, in the expectation that the Borrower will request many more items for which prices have been inflated. As a result, the lowest responsive bidder as determined at the time of contract award may not constitute the lowest-cost solution.

Red flags indicating unbalanced bidding	
Removal of low priced line item	• Particular line items that are unreasonably low compared to market prices are later removed from the list of requirements under the contract
Price disparity	• Wide and inexplicable disparity in bid prices considering the type of works, goods or services being procured
Poor response to request for clarification	• Inadequate responses or clarifications by project officials to complaints from bidders about vague, ambiguous or incomplete specifications

Scheme: Leakage of confidential information. Information about cost estimates and competing bids may be leaked by government officials to favored bidders to give them an unfair advantage, *e.g.*, enabling them to tailor their bid so as to secure contract award.

Red flags indicating leaking of confidential information
• Inadequate bidding procedures, *e.g.*, failure to enforce bidding deadlines, taking breaks during the opening of bids (to provide opportunity to share the content of certain bids and amend others), *etc*.
• A bid closely tracks the project's preferred solutions, budgets, estimates, *etc*.
• The winning bid is just under the next lowest bid
• A questionable "consultant" or "middleman" is involved in the bidding process
• Project officials and the favored bidder communicate (*e.g.*, by email) or socialize during the bidding period

Scheme: Inappropriate contractual terms. In a number of cases which INT investigated, project officials changed the standard contract clauses to reduce accountability. This included omission of the standard audit clause, changes to contractual remedies, and removal of the requirement for an advance guarantee and performance bond. In one case, the project included, in the specifications of three works contracts, that project assets, procured for the execution of the project, should be returned to the contractor.

Suggestions

- Review bidding documents for red flags and ensure that audit rights and contractual remedies are included, as appropriate
- Ensure that the specifications, BOQ, and Terms of References (TORs) for large-value and high-risk contracts are reviewed by an independent expert and that they are not altered at a later time without the Bank's approval

4. Short-Listing and Prequalification

Manipulation of the short-listing and prequalification process can be used to exclude qualified competitive bidders. Where prequalification is required under the Loan Agreement, prior review by Bank staff is mandatory for all documentation and proposals related to the prequalification process. The same holds true for the short-listing of firms for large consultancy contracts as specified in the Loan Agreement. The exclusion of qualified bidders could provide the means to ensure that only the preferred bidder, in whose bidding a government or project official may have a hidden interest, will submit a bid that fulfills the requirements.

Red flags in short-listing and prequalification	
Questionable evaluation	• Unusual or unreasonable evaluation criteria • One or more of the short-listed consultants or prequalified companies does not have the appropriate qualifications for the assignment • Unreasonable prequalification requirements • Short-listed firms do not have similar qualifications or there is a wide gap in qualifications • Highly qualified firms have expressed interest and are not shortlisted

Red flags indicating hidden interest in a company
• Companies with P.O. Box addresses and mobile phone numbers (might be shell companies)
• Complaints that a project or government official owns or is otherwise linked to a supplier or contractor
• A project or government official is linked to a contractor or supplier through company registration information, family relationships, or reports in the market place
• A bidder or supplier is not listed on the Internet or in business or telephone directories
• A contractor's or supplier's address is a residence or a non-business location
• A contractor or supplier provides a wide variety of disparate goods and services at high prices

Suggestions

- Ensure the prequalification or EOI contains sufficient information for the prospective companies to determine their eligibility
- Assess the qualification criteria used for short-listing in order to determine whether they are in line with the contract requirements
- Review the prequalification and short list evaluation report to ensure that the short-listed companies or firms have the required expertise
- Review the reasons for the rejection of the submitted EOI[4]
- Check whether there are any indicators of hidden interests (use of shell companies)

Scheme: Exclusion of qualified bidders. Project officials can facilitate the selection of a favored bidder by improperly excluding other qualified bidders. This can take place at any time from the drafting of the bidding documents to the receipt of bids. The exclusion of qualified bidders often triggers complaints as the potential bidders invest time and money to prepare bids.

Red flags indicating exclusion of qualified bidders
• Unreasonable pre- and post-qualification criteria (*e.g.*, abnormally high annual turnover, liquidity reserves, or years of experience in the country)
• The Bid Evaluation Report (BER) provides no objective or poorly justified reasons for the rejection of certain bids (*e.g.*, the disqualification for trivial or arbitrary reasons)

Continues on next page

[4] All qualified bidders must be included in the prequalified list. Under consultancy contracts, only six firms of similar experience are selected for the short list.

Red flags indicating exclusion of qualified bidders *(cont.)*
• Qualified contractors fail to bid indicating that the bidding process may be rigged
• Companies complain that officials refuse to make bidding documents available to potential bidders or to accept the submission of bids (*e.g.*, complaints from potential bidders that they are coerced to refrain from bidding through subtle suggestions, firm statements, intimidation, or physical threats)

Suggestions

- Review the pre- and post-qualification criteria carefully to ensure they are in line with the contract requirements
- Review the BER and ensure detailed justifications are presented for rejection of submitted bids, especially the lowest priced bid
- Ensure that the agency has established controls for submission, opening, and evaluation of bids and that compliance is monitored and results reported
- Follow-up on any complaints received during the bidding process.

5. Pre-Bid Conference

Pre-bid conferences can be used to facilitate unbalanced bidding (*see* page 14). Pre-bid conferences and site visits are often scheduled during the bidding period to clarify any ambiguities or discrepancies in the documents and to give potential bidders information on the bidding process and on the government's expectations. The pre-bid conference is usually followed by a clarification letter or modifications to the issued bidding documents which must then be sent to all the companies that bought the bidding documents. However, government officials may refrain from sharing timely, sufficient or correct information with all the bidders in order to give an unfair advantage to the favored bidder.

Red flags in pre-bid conference	
Timing	• The pre-bid conference is scheduled too close to the bid submission date or yields changes to specifications without changes in deadline
Inadequate information	• Questions raised during the pre-bid conference are not addressed properly
Inadequate transparency	• Clarifications and modifications to the bidding documents resulting from the pre-bid conference are not shared with all the prospective bidders

Suggestions

- Review pre-bid conference documentation for: (*i*) signed attendance list in comparison to the list of sold bidding documents or short-listed companies; and (*ii*) minutes containing a record of questions and responses and verify that answers have been distributed to all companies having purchased the bidding documents
- Verify whether changes to the bidding documents have been made following the conference and that the Bank's no-objection has been requested and obtained

6. Bid Submission

Corrupt project staff may accept late bids, tamper with bids, or exclude valid bids. Bids must be received by the agency prior to the date and time indicated in the bidding documents. Corrupt project staff may: (*i*) accept late bids submitted by favored bidders with inside information about prices from other bidders; (*ii*) tamper with the bids received, *e.g.*, by discarding elements of the bid in order to disqualify the bidder; or (*iii*) exclude bidders by denying access to drop-off points or by failing to open bids.

Red flags in bid submission	
Late submission	• Not all bids are brought to the opening ceremony • One or more of the submitted bids lack a time stamp
Tampering	• A bid is not in a sealed envelope • Bids are not kept in a secure location with limited access
Bid manipulation	• The bid due date has been extended after some of the bids have been submitted • Some or all bids are disqualified for simple errors
Exclusion	• Complaints from bidders that they were not allowed to submit bids • A bid is "forgotten" in the safe

Suggestions

- Ensure that the Borrower's project staff understand the procedures for the bid submission process, and assist in establishing clear and transparent procedures, including:
  - Ensuring that the receipt of the bids is handled by staff not otherwise involved in the procurement process
  - Reducing the number of drop-off points, unless they have been designated to avoid coercion by cartel members
  - Maintaining a secure box where bids can be securely dropped off without opening the box and thus giving access to the other bidders
  - Keeping submitted bids in a safe with limited access and appropriate controls
  - Bringing all bids submitted to the bid opening ceremony at the same time

7. Bid Opening

A key risk in the bid opening phase is the manipulation of bid prices. The Borrower is required to conduct the bid opening in public at the address, date and time specified in the bidding documents. The bids should be opened immediately after the bid submission time. Various tactics may be used at that point to steer contracts to favored bidders, *e.g.*, the price read aloud for the favored bidder does not match the actual bid price or a "new" price is later written into the bid.

Red flags in bid opening	
Submission	• Bids are not opened in public[5]
Tampering	• The original bid form and price schedules or BOQ of all bids are not initialed or signed by the members of the bid opening committee • Pages are missing from one or more bids • Pages with a different typeset are included in the bid
Price manipulation	• Changes to the bid prices and bid security list are handwritten • The applicable currency is not stated
Undue influence	• Members of the BEC are present or participating[6] • The attendance sheet lacks original signatures of the company representatives supposedly present at the ceremony

Suggestions

- Ensure the project procurement officer is aware of the appropriate bid opening procedures including:
  - Ensuring the project procurement officer controls the bid opening and keeps minutes of the opening
  - Checking the attendance sheet for names and signatures of all bidder representatives (including printed names)
  - Verifying that each bid was sealed and accompanied by a bid security, if required, utilizing the assistance of a randomly selected representative

8. Bid Evaluation Committee

A BEC consisting of staff that have inadequate technical competencies could pose a corruption risk. BECs review and evaluate the submitted bids and recommend to which company the contract should be awarded. The BEC has wide discretion in excluding bidders and can abuse this authority as part of a corrupt scheme. On occasion, government officials purchase a position on the BEC to influence the decision making or collect bribes.

Red flags related to Bid Evaluation Committee	
Manipulation of BEC selection process	• The BEC members do not have the necessary technical expertise to evaluate the submitted bids • The project uses a standing BEC regardless of what is being procured • The committee is too large or dominated by a single individual

Suggestions

- Ensure BEC members are selected in accordance with the established project implementation manual
- Ensure the project procurement officer is available to the BEC to answer any procedural questions

5 This practice is contrary to Bank Procurement Guidelines and could result in misprocurement.
6 In some cases, the national laws require the members of the BEC to be present or the implementing agency may be too small to have sufficient manpower to separate these functions. Accordingly, when this red flag is present, other due diligence needs to be carried out to determine the legitimacy of the process.

- Confirm that the BEC does not exceed five members and has the necessary technical expertise to evaluate the bids
- Verify that BEC members sign an affidavit stating that they do not have a conflict of interest in performing their duty, such as current or past affiliation with any of the bidders

9. Bid Evaluation Report

Questionable evaluation and unusual bid patterns may emerge in the BER. After the completion of the evaluation process, the implementing agency presents to the Bank its BER, which describes the results and the process by which the BEC has evaluated the bids received. The BER may include a number of indicators of bid rigging, *e.g.*, questionable disqualifications and unusual bid patterns.

Red flags in Bid Evaluation Report	
Violation of procurement rules	• The evaluation criteria differ from those issued in the bidding documents • Inconsistencies exist between the BER and supporting documentation • Improper or arbitrary evaluation sub-criteria or procedures are developed at the time of evaluation that differ from the issued bidding documents • The BEC ignores the evaluation criteria in the issued bidding documents and develops its own method of evaluation • The winning bidder is not on the short list or is not one of the prequalified companies
Questionable disqualifications	• The lowest priced bidder is declared unresponsive (for no apparent reason) • A high number of bids is unresponsive • Recommendations and disqualifications are poorly justified • Bids are rejected because of allegedly missing components, such as catalogs and brochures for the goods offered • Changes in the scoring of bids or arbitrary scoring of bids • Pressure by project officials on BEC members to select a certain contractor • Complaints from bidders about the evaluation process
Winning bid is poorly justified	• Technical specifications are copied from the bidding documents or are incomplete • The manufacturer's authorization is missing, outdated or inadequate • The bid does not match requirements (*e.g.*, in terms of quantity, quality, qualifications) • Pages of a bid are missing or not signed (when required)
Unusual bid patterns	• Same or similar telephone or facsimile numbers or address shared by bidders • Unreasonably high bid prices by losing bidders for which there is no legitimate explanation and which cannot be attributed to an error • Bid prices differ by a set percentage
Suspicious bidders	• Discrepancy between the company address and its telephone number area code

Suggestions

- Request, review and compare the bids submitted with the BER and each other
- Review the BER for justifications of the rejection of submitted bids and the recommendation for award
- Review the BER with the issued bidding documents for any inconsistencies
- Review the signed copies of all the scoring tables used by the BEC members for any inconsistencies
- Review the timeframe of the evaluation process
- Verify that the number of submitted bids is equal to or less than the number of bidding documents sold
- Compare the BER with the minutes of the bid opening to ensure that the bid values, number of bids, and bid securities are the same
- Ensure that the submitted proposals—in the case of consultancy contracts—are from the same short list as approved by the Bank

COLLUSION | 3

What is collusion?

The Bank defines collusion as "an arrangement between two or more parties designed to achieve an improper purpose, including influencing improperly the actions of another party." This definition includes collusive bidding schemes in which two or more bidders agree to manipulate the bidding process, *e.g.*, to fix prices. These schemes are designed to undermine competitive bidding, a cornerstone of the Bank's Procurement Guidelines. When collusive bidding schemes are able to operate, the result is inevitably higher costs as prices are artificially inflated.

Where are the risks of collusion the highest?

Collusion risks appear to be the highest in the construction sector and sectors where there are few qualified bidders compared to the number of contracts being let. INT has encountered collusion when: (*i*) investigating procurement actions in the construction sector (*e.g.*, roads) dominated by a few large companies; (*ii*) domestic preferences priced-out international competitors enabling a local cartel to operate; (*iii*) business associations were set up to coordinate bids or to represent local companies facing debarment action; (*iv*) international bidders colluded with local firms offering to represent them locally or serve as subcontractors; (*v*) politically connected companies used their influence to steer contracts to the cartel and to coerce other firms to join the cartel or to refrain from bidding; (*vi*) small local shop owners colluded for the bidding of office supplies; and (*vii*) site inspections or pre-bid conferences were used to organize an ad-hoc collusive arrangement. In general, collusion risks appear to be higher when procuring in sectors with few potential bidders (*e.g.*, four or less), compared to the number of contracts being let. This concentration of market share among a few companies in turn may be the result of high barriers to entry and exit or large economies of scale. The risk of collusion has not been found to be limited to any region or country. Rather, it is an often-used strategy for bidders to undermine competition.

What impacts of collusive schemes has INT observed?

Collusive bidding schemes can have a substantial negative impact on development outcomes. The direct impact of collusion is higher prices of goods and services compared to those in a competitive market. Price inflations observed by INT are typically 20–40 percent, but may be much higher. In addition, collusive agreements may: (*i*) negatively impact price levels in the entire sector in the country, resulting in inflated market prices; (*ii*) over time reduce competitiveness of the local industry; and (*iii*) distort investment decisions through undue influence by politicians and government officials.

Examples of cases detected include (*see* also Case 4):

- *Road construction*. In one case, contract prices under a Bank-financed project were 8–9 percent above official cost estimates. However, contracted prices on government-financed road construction were usually about 20 percent below official cost estimates.
- *Insecticides*. Unit prices for wettable powder pyrethroids in a contract awarded under a Bank-financed project were about 400–600 percent above the price level established two years later, after the collusive arrangement was believed to have ceased operation.

Case 4: Pharmaceutical companies rotate bids and charge 65 percent higher prices

INT received a number of complaints alleging that two pharmaceutical companies had engaged in collusive practices in order to secure the award of contracts for the supply of drugs under Bank-financed projects. The investigation discovered that the two companies had colluded and paid kickbacks to project officials in order to win several contracts. The unit prices charged by both companies were significantly higher—in some cases 65 percent higher—than those charged for identical items procured under government-funded contracts.

The collusive arrangement operated by: (*i*) rotating contract awards; and (*ii*) excluding other qualified bidders. The collusive parties had approached other companies to submit losing bids in order to create the appearance of competition. In exchange, such companies were allowed to win smaller contracts. Their representatives said that they had no choice but to negotiate with the colluding companies and pay a percentage of the contract value as kickback. The two pharmaceutical companies involved in the collusive scheme were debarred by the Bank.

How are collusive schemes organized?

INT's investigative experience has shown that Bank-financed projects can be vulnerable to various types of collusive schemes. These schemes can range considerably from simple, ad hoc collusive arrangements among local bidders to well-connected cartels involving high-ranking politicians. To remain in operation, a collusive scheme depends on its ability to eliminate competition, generate high profits for participants, and avoid detection and sanctions.

- *Coordinate and organize the collusive scheme*. A cartel must possess information about upcoming bids, have convening power to coordinate the bids, and often also assist with logistical support to carry out the scheme, *e.g.*, by purchasing bid securities on behalf of the designated losers and drafting large parts of their bids. In addition, business associations may be used as a front by assisting in the coordination of bids, lobbying vis-à-vis government officials on matters related to laws and licenses, or by defending companies facing legal action.
- *Generate and allocate supra-normal profits to retain cartel members*. The livelihood of collusive bidding schemes depends on their ability to achieve supra-normal profits. Such profits are often attained by inflating bid prices and then allocating the profits among the cartel members and corrupt officials. The designated winning bidder usually pays off designated losing bidders by employing them as subcontractors, allowing them to win in subsequent bids, or granting them a small share of the bid prices (normally around two percent).
- *Eliminate competition*. The successful execution of a collusive scheme requires the exclusion of competitors that could break the scheme by submitting lower-priced bids. Tactics to eliminate competition can include: (*i*) enticing or coercing competitors to join the collusive arrangement; (*ii*) suppressing bids through threats of physical or economic harm; (*iii*) conspiring with government officials to exclude competitors from short lists, establish biased qualification criteria or specifications,

or to declare their bids non-responsive; and (*iv*) creating anti-competitive conditions, *e.g.*, by restricting the issuance of licenses and permits.

- *Evade detection*. Cartels evade detection by executing their scheme in a manner that gives the appearance of competition, *e.g.*, by cartel members submitting complementary bids, also known as "protective" or "shadow" bids. Since complementary bids will never be successful, designated winners can use shell companies, fictitious firms, or subsidiaries as designated losing bidders. Alternatively, cartels may bribe government officials to ignore red flags.
- *Avoid sanctions*. Cartels may avoid effective legal and administrative sanctions, because of: (*i*) inadequate legislation prohibiting collusive practices; (*ii*) lack of experience or capacity of the national investigative body(ies); (*iii*) ineffective prosecution; (*iv*) insufficient severity of the punishment; (*v*) lack of political will to prosecute, particularly large domestic firms; and (*vi*) undue political influence on the investigative, prosecutorial, and adjudicative processes.

Players in a collusive bidding scheme

There may be several different kinds of actors playing a role in a collusive scheme. The main actors typically include a designated winning bidder, designated losing bidders and government officials.

- The *ring leader* organizes the scheme and often also determines who will win the bid
- The *designated losers* submit higher cost "protective" bids to give the appearance of competition
- The *designated winner*, which may be a shell company, is awarded the contract and may outsource the work to one or more colluding members, in order to share profits and work
- *Government insider(s)* provide(s) privileged information to prospective bidders about cost estimates, competitive bids, and upcoming contracts
- *Divers* are companies outside the control of the cartel seeking to win the contract by placing a lower and often competitive bid

What strategies can cartels pursue?

Cartels can pursue various strategies, requiring different levels of coordination. The most common types of collusive bidding schemes include: (*i*) market division; (*ii*) bid rotation; and (*iii*) price fixing:

- *Market division* occurs when cartel members agree to divide their market (*e.g.*, geographical territories and client segments) thereby restricting competition (*see* Case 5 below).
- *Bid rotation* refers to an agreement among bidders to take turns in winning contracts.
- *Price fixing* refers to an agreement among competitors to fix prices at which goods and services are sold in a specific market.

Case 5: How a "Coordinating Committee" divided the market

INT launched an investigation into allegations of collusive and corrupt practices in an education project designed to supply better quality textbooks to secondary schools. The investigation confirmed the existence of a "Coordinating Committee," which managed the distribution of contract awards among its members. The Committee organized the scheme by:

- Pre-selecting provinces in which individual publishers were to receive contracts.
- Determining bid prices to be submitted by the cartel members, which sometimes were 20–30 percent higher than cost estimates.
- Assigning the printing and distribution component of each contract to certain members instead of allowing the winning companies to implement these components. For their participation in the scheme, winning bidders received a percentage of the contract value, while the assigned subcontractor was made responsible for the implementation.
- Directing kickbacks to various parties, including provincial and central government officials, project officials, and BEC members. Kickbacks to project and government officials sometimes were as high as 20 percent of the contract value.

This collusive arrangement was designed to exploit weaknesses in the procurement process, *i.e.*, the publisher's textbook would have to pass an evaluation prior to the publisher being invited to submit its bid for the publication, printing and distribution of their textbooks. The separation of the submission of the manuscript and the bid price by the publishers allowed the procurement process to be manipulated by the Coordinating Committee's leadership. Other INT findings included:

- Three publishers acted as ring leaders for those companies whose manuscripts were short-listed, and managed the kickback payments to government officials.
- Those companies operated by the ring leaders won a disproportionately high share of contract awards (about 45 percent of the contracts, worth a total of approximately US$20 million).
- Several companies felt that if they had not joined the Committee they would have failed to win any contract in the project.

As a result of the investigation, the Bank debarred ten individuals and 26 firms for 2–15 years. Following the investigation, the Region declared misprocurement.

How are collusive bidding schemes detected?

Collusive bidding schemes can be detected through a review of procurement actions and interviews with industry representatives. Conversations with industry representatives can help identify the operation of collusive arrangements or cartels in key sub-sectors. During an advisory engagement, INT and the TTL met with a Board member of a utility company to discuss collusion risks in the market for transformers. The Board member simply stated that not only is collusion present in the market for transformers, the same is also true for wires, meters and capacitors. To emphasize the point, he said: "*I know what I am talking about. I get phone calls from old class mates of mine who are now running these companies.*"

Besides such conversations, Bank staff or government officials may seek to identify red flags such as those listed and described in more detail in the table on page 27 through the review of procurement documents and the analysis of past contract awards (*see* Case 6).

Red flags indicating collusive bidding	
Bid prices are unusually high	• The winning bid price is much higher than cost estimates or industry averages • Bidders have submitted prices for line items under past procurements that were significantly above or below current price quotes for no apparent reason • Bid prices are much higher than estimates or other comparable bids by the same companies • Bid prices drop when a new or infrequent bidder enters the bidding process • Persistently high or increasingly high bid prices by all bidders
Bidders lose on purpose	• A company withdraws its bid often without explanation, or two or more companies withdraw their bids in one bidding round • A company submits incomplete bids too frequently, or two or more companies submit incomplete bids in one bidding round • A company submits a fraudulent bid security (indicating that it knows it is not going to win) • A company submits unusually high bid prices (especially if prices are rounded or unnatural numbers occur)
Bids show unusual similarities	• Bid prices of all companies are very close (an indicator that the bidders know each others' prices) for items where some variation is expected (*e.g.*, civil works, customized goods, and consulting services) • Submitted bids include unit prices which are almost identical • The bid prices are a fixed percentage apart (*e.g.*, 3 percent, 4 percent, 5 percent and 6 percent above that of the lowest bidder) • Bids contain similar typographical errors, addresses, phone numbers, letterheads, or are printed on similar stationery • Sequential bid securities, indicating that the same person picked up the securities at the same bank, same branch, and on the same day
Bidders take turns winning	• There are only a few companies in the market that always bid together for Bank-financed contracts and they take turns winning contracts
Bidders have close ties to one another	• The successful bidder subcontracts work to losing bidder(s), which may include those that withdraw their bids • Cross-ownership of bidding companies or family ties (similar names of key staff and owners or family members own the bidding companies)
Bidding lacks competition	• Well-known qualified companies do not bid, especially if they purchased the bidding documents • (More than half) the companies that buy the bidding documents refrain from submitting bids • Substantially fewer bids have been received than in previous, similar tenders

Case 6: How a politically connected group of national and international companies colluded

INT investigated allegations of suspected collusion among a group of local and foreign companies, as well as allegations regarding the involvement of politicians and government officials in the tender for two road rehabilitation contracts. More than a dozen witnesses told investigators that under the collusive arrangement, uncooperative potential bidders were disqualified during the prequalification process, and winners were chosen by their willingness to pay large bribes. Losing bidders were allowed to participate in exchange for small payments. Witnesses advised INT that as a result of the collusive activity, contract prices were routinely inflated by 20 to 30 percent. Furthermore, multiple witnesses stated that the existence of the collusive activity was an "open secret," in fact being referred to as the "SOP"—Standard Operating Procedure.

INT found a pattern of inconsistent prequalification results, suggesting that agency officials may have engaged in bid rigging. Project officials disqualified numerous competitive bidders without reasonable explanation and sometimes for vague reasons such as failure to "fit the contract profile".

An analysis of bidding documents provided significant indicators of collusive practices. Some bids showed abnormally high unit costs, which is one way to inflate bid prices to levels beyond that of the designated winner. In addition, bid patterns indicated coordination among the bidders. Examples of unusual bidding patterns included: very close bids (bids US$31 apart on a US$26 million contract) with widely disparate subtotals; bids with lockstep relations to the engineer's estimate; and numerous, large bid calculation errors suggesting last-minute revisions. In addition, multiple companies submitted fraudulent bid securities, indicating that they had no intention of winning the contracts. Some of these red flags are illustrated below.

Red flags		*Above cost estimate*	*Total bid prices*
• Winning bid just below threshold of 30% as per the agency's internal "guidelines" • Bids with lockstep relations to the cost estimate • Rounded and unnatural numbers • Significant number of disqualified bidders	Firm A	28%	1,235,848,743.38
	Firm B	31%	1,266,666,000.00
	Firm C	32%	1,276,000,000.00
	Firm D	33%	1,285,858,585.88
	Firm E	34%	1,296,000,477.64
	Firm F	35%	1,302.573,393.31

As a result of such practices, the Bank decided to not finance the two contracts in question. In addition, eight firms and one individual were debarred from participating in future Bank-financed tenders for a period ranging from four years to permanent debarment.

FRAUDULENT BIDS | 4

What is a fraudulent bid?

The Bank defines fraud as "any act or omission, including a misrepresentation that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation." As used here, a "fraudulent bid" is a bid or proposal that contains knowingly or recklessly misleading information, submitted in order to gain an unfair advantage in the selection process.

What is the purpose of a fraudulent bid?

The evaluation of written submissions to bid solicitations is the foundation of a fair procurement system. A prominent risk to the procurement system is the undermining of the evaluation process by bidders providing false or misleading information in their bids and supporting documentation. When false information is relied upon to make procurement decisions, the impact is often manifested in poor quality of goods, works, and services, and failure to meet developmental objectives.

In INT's experience, there are three "benefits" firms may seek to obtain. First, they may want to meet qualification criteria, *e.g.*, by exaggerating financial statements and past performance. Second, they may simply seek to save costs by falsifying rather than buying a bid security. Third, bids may be submitted from a shell or entirely fictitious firm in order to hide its true ownership, *e.g*, by government officials. Consequently, frauds are made in relationship to the ownership of the bidder, its capacity, and the bid security:

- *Ownership*. Concealed or misrepresented ownership of the bidder: in several cases, bids or proposals were submitted by firms that were secretly owned, in whole or in part, by government or project officials.
- *Financial capacity*. Exaggerated financial resources of the bidder, such as inflated annual turnover or balance sheet amounts. Such bids often were accompanied by false or forged audit reports.
- *Technical capacity*. Falsified or exaggerated information on the firm's professional credentials or prior project or sales experience. Such bids often included forged or fraudulent end user certificates, manufacturer's authorizations and product certifications.
- *Bid security*. Bidders often submitted false or forged bid securities in order to save costs. These included securities that did not have a serial number, were not on the issuing bank's letterhead, or were missing the required signatures.

How are fraudulent bids detected?

The following is an overview of the various indicators that should raise suspicions of possible fraud in the submission of bids with regard to ownership, financial capacity, technical capacity, and bid security. Typically, some additional due diligence through database or Internet searches and document checks could clarify such red flags.

Ownership

Fictitious companies are by definition fraudulent and may also serve as fronts for government officials. INT investigations have uncovered submissions and supporting credentials of purely fictitious companies (*see* Cases 7 and 8). The typical scheme involves corrupt government officials creating a fictitious company that will front as a "vehicle" to secure contract awards. Often, the fictitious—or ghost—company will subcontract work to lower paid and sometimes unqualified firms. The fictitious company may also utilize designated losers as subcontractors to deliver the work, thus indicating collusion.

Shell companies have no significant assets, staff or operational capacity. They pose a serious red flag as a bidder on Bank-financed contracts, because they often hide the interests of project or government officials, concealing a conflict of interest and opportunities for money laundering.

Red flags related to fictitious or shell companies	
Fictitious or shell company	• Complaints from other bidders that a competitor is a shell company or unknown in the industry • The bidder does not appear on the Internet, is not listed in telephone or business directories, or is located in a residence or non-business location

Case 7: Example of a shell company fraud

INT's investigation into the winning bidder of a US$500,000 contract for the construction of a new laboratory complex found that the company did not exist. INT was unable to locate the company's offices, personnel or equipment. Investigators visited the company's addresses as listed in its bid and found an empty lot (top left). However, this town has two identical roads with the same number, so INT visited the second address only to find an auto repair shop (top right). The investigators also visited the two additional addresses under which the company was registered with the Ministry of Commerce, but found instead a rice trader (bottom left), and a shop house (bottom right). None of the occupants of the buildings at the addresses had heard of the company, which turned out to be a front for the consultant that had prepared the design of the laboratory complex. The Bank declared misprocurement on the contract.




Case 8: Example of fraud to conceal conflict of interest

The document on the left had been submitted as part of a proposal by the design consultant while the document on the right was part of the bid of the supposedly independent contractor. However, a number of red flags indicate that the very same firm that carried out the design work was now bidding for the construction contract—which constitutes a conflict of interest. First, the telephone numbers were almost identical. Second, the company description under the first paragraph was virtually identical—the construction company even described itself as a "competent designer". Third, the list of works included an identical format error, *i.e.*, missing a bullet point before "engineering". Fourth, the contact name, "Mr. Narin," appeared on both bids.

PRINCIPAL PLACE OF COMPANY

Company:

Address:

Telephone: ( ) 611321 **Fax:** ( ) 845455

Email:

To:

Dear Sir,

1. We hereby apply to be considered as a competent designer for the works such as:
   - General Construction
   - Architectural Services

   Civil Engineering
   - Landscaping
   - Decoration
2. The names and positions of persons, who may be contacted for further information, if required, are as follows:

Name	Position	Phone
Narin	Director	( ) 611321

3. We declare that the statements made and the information provided in the duly completed application are true to the best of our knowledge and belief, and we understand that, if any false or deliberately misleading information has been given, our application may be disqualified.

Company:

Address:

Telephone: ( ) 611322 **Fax:** ( ) 214 676

Email:

To:

Dear Sir,

1. We hereby apply to be considered as a competent designer for the works such as:
   - General Construction
   - Architectural Design, Research and Consultant

   Civil Engineering
   - Landscaping
   - Decoration
2. The names and position of persons, who may be contacted for further information, if required, are as follows:

Name	Position	Phone
Narin	Financial Manager	( ) 611322

3. We declare that the statements made and the information provided in the duly completed application are true to the best of our knowledge and belief, and we understand that, if any false or deliberately misleading information has been given, our application may be disqualified.

Yours Sincerely,

Financial capacity

The most common form of misrepresentation of bidders' financial data is the submission of falsified audit reports. The purpose is to make the bidder appear to be a larger well-established company supported by strong financial statements (*see* Case 9).

Red flags related to financial capacity	
False or forged audit reports	• Audit reports are not signed or attested • The audit company does not exist • The audit report is not in line with auditing standards
False or exaggerated financial data	• The reported financial information is contradicted by *Dun & Bradstreet* or other reporting agencies • The reported financial information contradicts that provided under prior contracts

Case 9: Fictitious audit firm at center of several fraudulent activities

INT received an allegation that a bidder had submitted forged audit reports of its financial statements in order to qualify under a Bank-financed water project. The investigation found that: (*i*) the audit firm was fictitious; (*ii*) 40 other contracts, submitted by the same bidder, were also tainted; (*iii*) other bidders had also submitted forged or false audit reports; and (*iv*) these audit reports had been issued by fictitious firms. Bidders told INT that the massive use of fraudulent audit reports allowed corrupt officials to steer contracts to favored bidders. The practice had existed in the country for a long time.

Technical capacity

Under the Bank's procurement procedures and as a part of the pre- and post-qualification process, companies are required to submit information on their past experience. Misrepresentations commonly relate to the volume of work within a specified period or years in business as indicated in end-user or performance certificates, manufacturer's authorizations, product certifications and personal credentials.

- *End-user certificates.* As a part of the post-qualification process, the client may request bidders to submit end-user certificates as a means of confirming past experience of the firms, document sales and service claims. INT has found that companies that cannot meet such requirements often resort to falsifying the requested documentation (*see* Case 10).

Case 10: Bidders falsify sales figures and end-user certificates

INT received an anonymous complaint alleging that a company and its owner had falsified the required end-user certificates under three tenders. The investigation found that the company had indeed committed forgery by presenting certificates that either: were not from end-users but other companies; had not been submitted by the end-user in question; or were falsified by the issuer of the certificate at the company's request. The red flags in this case were: (*i*) a detailed complaint that could be validated; (*ii*) similar text used by the end-users in their certificates; and (*iii*) two end-users faxing their certificates to the company within 10 minutes of each other. The Bank issued a letter of reprimand.

- *Manufacturer's authorizations*. Bidders who are not the original manufacturer are required to submit manufacturer's authorizations for the goods they offer. INT has found multiple instances of forged manufacturer's authorizations. When these authorizations are falsified, it may increase the risk of product substitution.

- *Product certifications*. Product certifications are used to ensure that the goods offered meet the performance requirements, as stated in the bidding documents. Some bidders falsify the required certifications, claiming to meet international or country standards, when in fact the product is of a lower quality.
- *Personnel credentials*. Bidders and consultants are required to provide CVs of the personnel they are proposing to work on the contract. The personnel must have the minimum qualifications as stated in the issued bidding documents or RFP respectively. Falsified credentials of key personnel, such as educational degrees, years of experience and language skills, or use of CVs without the individuals' consent, are among the most common approaches used (*see* Case 11).

Red flags related to technical capacity	
False or exaggerated experience	• Discrepancies between self-reported information and other information on the company's website, in *DACON*, in *Dun & Bradstreet* or from other sources
Fraudulent or forged certificates	• Certificates are not signed or dated • Certificates are unprofessional in appearance • Certificates appear to be copies rather than originals • Multiple certificates on different dates, from varying sources, appearing to have identical signatures, formatting, *etc*.

Case 11: Bidders falsify CVs and credentials

INT looked into a complaint about a technical advisor on a capacity building project who allegedly had misrepresented his resume. INT's investigation found that the advisor had misrepresented his participation in a free World Bank seminar as a prior employment on a World Bank education project. He had also misrepresented his education credentials by misstating his year of graduation, claiming his dissertation as a publication, extending the length of his teaching experience, and elevating the title of his professional position. Four witnesses, including the TTL, expressed concerns about the advisor's performance and credentials. The project management unit terminated the contract due to poor performance.

In another case, the implementing agency of a health project became concerned that a consulting firm—hired on a contract valued at approximately US$2.5 million—and its Chief Executive had misrepresented their qualifications. The INT investigation concluded that:

- The consulting firm was not authorized to educate, audit and certify clients in Total Quality Management (TQM)
- The academic credentials of the Chief Executive, his five doctorates and a master's degree from Ivy-League universities, had been falsified
- The Chief Executive had submitted a CV with false representations in connection with an earlier Bank-financed project for a contract valued at over US$1 million

During the mid-term review, the task team established that the poor performance of the consulting firm had contributed to project delays. As a result, project officials decided not to extend the firm's contract at the original date of its closure, although the assignment had not been completed. The consulting firm and its Chief Executive were declared ineligible to receive Bank-financed contracts for a period of four years

Bid security

The Bank's Procurement Guidelines and procedures require the submission of bid securities as part of the bid package to ensure bidders are serious about their bids and will keep them valid for the required period. Bidders may forge bid securities for two purposes: (*i*) to meet qualification requirements of the bid solicitation; and (*ii*) to avoid the cost and inconvenience of purchasing the security (*see* Case 12).

Red flags related to bid security	
Forged or fraudulent bid securities	• Securities do not have a serial number • Securities are copies rather than originals • Securities are not on original letterhead of the issuing bank and lack the required signatures

Case 12: Bidder scans letterhead of commercial bank to forge bid securities

A task team leader approached INT with information that the procurement agent for an urban development project suspected potential bid fraud by a local company. Due to concerns about widespread forgery of bids, the procurement agent contacted all commercial banks that had issued bid securities, performance bonds, and advance payment guarantees to determine whether the documents presented by bidders were legitimate. The agent discovered that a local bidder had not been issued any bid securities from the commercial bank as claimed in its bid.

INT's review of the bids established that the local company submitted three forged bid securities and two forged advance payment guarantees to secure five Bank-financed contracts valued at over US$250,000. The company had scanned the commercial bank's letterhead and produced both sets of false documents to support its bids. The company was debarred for a period of two years.

FRAUDULENT IMPLEMENTATION | 5

What is fraudulent implementation?

INT uses the term "fraudulent implementation" to denote any fraud taking place after contract award in the physical implementation of works and delivery of goods and services. During the implementation phase, firms may deliberately fail to deliver the number and quality of goods, works or services stipulated in the contract in order to save costs and increase profits; abuse contract amendments to increase the scope or volume of work or to avoid competition; and claim or bill for additional goods, works or services not carried out or not needed. Such efforts are often facilitated by bribe payments to agency officials for the approval of work completion certificates and the processing of invoices.

What is the difference between poor and fraudulent implementation?

Fraudulent implementation occurs when firms knowingly or recklessly misrepresent their work as being delivered according to specifications. Investigators have found that poor implementation, as judged by substandard quality works, goods and services is an indicator of fraud. Operational staff have experienced that poor local capacity may result in quality problems as well. Hence, the question arises as to whether the implementation of a given contract is the result of poor capacity or fraud. The implementation is deemed fraudulent when the firm's acts or omissions mislead or attempt to mislead the Borrower to obtain a financial or other benefit, or to avoid an obligation. For example, fraud occurs when a contractor represents that it constructed a building according to specifications, when in fact it used thinner reinforcing bars (to anchor and reinforce concrete and masonry in construction) and less cement than required by the contract specifications. By committing the fraud, the contractor obtains full payment while lowering his costs. Another example includes the delivery of old equipment presented as new or no delivery at all.

What impacts of fraudulent implementation has INT found?

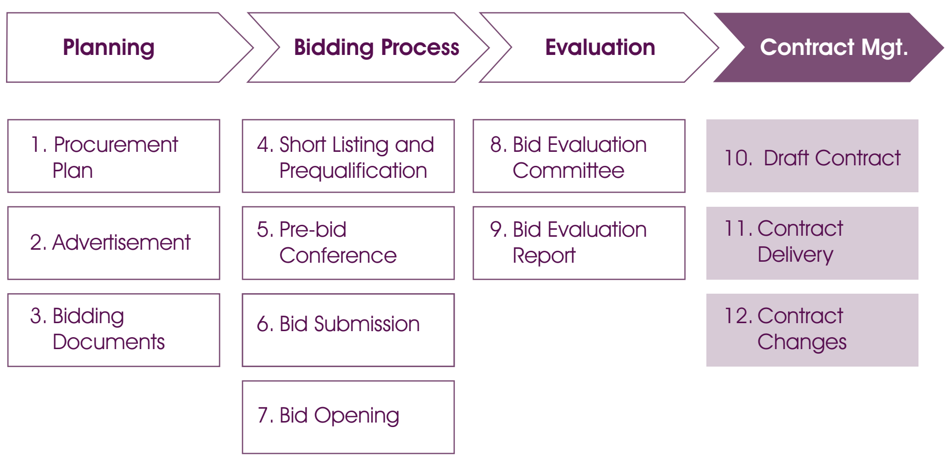
Implementation frauds may impact service delivery, health, and safety. The impact of false claims is mostly financial. However, failure to meet contractual specifications has a range of impacts, and since such schemes are often not discovered until after project implementation, remedies may be limited. For example, as the option to reconstruct a civil works project compromised by implementation fraud may be too expensive and not practical, project beneficiaries are forced to accept a product of substandard quality, unlikely to deliver its projected utility. Some examples of adverse impact on development outcomes that INT found in its investigations include:

- *Health.* Health clinics were unusable due, *inter alia*, to poor sanitary installations and lack of electricity. Faulty equipment posed a health risk. A hole in the roof of a building resulted in the much needed medical equipment being ruined.
- *Transportation.* A road disappeared after one rainy season due to poor drainage. Another road was not wide enough for two vehicles to pass at the same time, thus increasing the risk of traffic accidents. Some shock absorbers were discovered missing from a bridge, which could have consequences for its lifespan and public safety.

How is fraudulent implementation detected?

This section discusses the detection of fraud during contract management and more specifically the draft contract, contract delivery and contract changes stages (*see* Figure 2):

Figure 2: Phases in the procurement cycle where corruption can take place



The following fraud schemes will be highlighted:

- Failure to meet contract terms (*see* page 39)
- False statements (*see* page 42)
- False claims and invoices (*see* page 43)
- Abuse of contract amendments and change orders (*see* page 45)

10. Draft Contract

Questionable deviations from the bidding documents may signal fraud to benefit a contractor or government official. Under the Procurement and Consultants Guidelines, only the consultancy-negotiated draft contracts are subject to the Bank's prior review. However, regardless of which procurement schedule is used, the terms and conditions of the contract cannot, without the Bank's prior approval, materially differ from those on which bids or proposals were asked.

Red flags in draft contract	
Delays	• Long delays in contract award or negotiations
Questionable deviations from the bidding documents and bids/proposals	• Any changes to quality, quantity or specification both to goods and services in the contract deviating from the bidding document (TOR, technical specifications, key personnel, *etc.*) • Price schedules are not the same as the winning bid • Changes to contract type • Changes to standard contract clauses (audit, remedies, damages, *etc.*) • Methodology and Work Plan not attached to the contract • Appendix lacks information about services and facilities provided by the client or are changed substantially from RFP draft contract
Unusual patterns	• Page numbers are missing from the contract or are not sequential • Different typefaces used across clauses

11. Contract Delivery

Scheme: Failure to meet contract terms. Firms may deliberately fail to comply with contract requirements. The contractor will attempt to conceal such actions often by falsifying or forging supporting documentation and bill for the work as if it were done in accordance with specifications. In many cases, the contractors must bribe inspection or project personnel to accept the substandard goods or works, or supervision agents are coerced to approve substandard work. Listed below are common frauds committed by companies failing to meet their contractual obligations.

Red flags indicating failure to meet contract terms	
Failures	• Discrepancies between inspection findings, test results, or contract specifications and the contractor's claims for payment • Failed tests or inspections • Complaints about poor quality from users • Increased or accelerated product failures or repair costs
Inadequate supporting documentation	• Absent, inadequate or altered documentation submitted by the contractor to support billings • Indications from the contractor's expenses, payroll, and other records that it did not incur costs necessary to comply with contract specifications. For example, the contractor did not: – purchase the quantity or quality of materials required under the contract – own or lease all the required equipment to carry out the work – have the necessary labor with required skills on the job site • The contractor resists Bank or government inspection of its books and records in disregard of the Bank's and the government's audit rights
Delays	• Delayed start of works or the delivery of services beyond normal timeframes • Long delays in implementation of the contract
Poor reputation of the firm	• The company is known to be a poor performer • The company has exaggerated or falsified its prior experience

a) Product substitution. Contractors may substitute inferior and often cheaper products than those specified in the contract (*see* Case 13).

Case 13: Contractors substitute old computers for new

A component of an institution building project's Procurement Plan outlined the purchase of new computers with a certain memory capacity and processor speed. Documentation was presented by the PIU supporting the payment for the equipment as specified in the contract, and the invoice was processed. A concerned staff member of the task team had suspicions about the technical specifications of the computers and brought the matter to the attention of INT. During the investigation, officials attempted to prevent the inspection of the purchased equipment, claiming the computers were unavailable and temporarily "loaned out." However, when the physical inspection of the equipment finally took place, it was clear that the computers that had been supplied did not meet specifications. Further inspection revealed that the supplier was not an authorized dealer, but a small company specializing in the sale of refurbished equipment.

b) Deviation from specifications. Companies may seek to deviate from their contractual obligations. In one INT case, the TOR of a consulting firm required that it analyzes various cost estimation packages and recommends three options. The firm failed to do so, recommending only its own solution. In civil works, contractors may seek to reduce the thickness of a road surface, fail to sufficiently compact the soil, avoid vibrating the cement resulting in air pockets, thereby reducing the load bearing capacity and the width of the road (*see* Case 14).

Case 14: Review finds narrow road without road surfacing

INT visited this project site and discovered a road of sub-standard quality. The road was built 30 percent narrower than specifications and lacked road surfacing. Nevertheless, the contract was paid in full.

c) Substandard work. Failure to exercise key controls, lack of independent oversight, and bribery of the supervision agent are the main elements allowing for this type of scheme (*see* Case 15). An example was found during the physical inspection of newly built schools already showing signs of wear and tear, and which had been handed over without doors and windows. In other cases investigated by INT, consultants submitted poor quality studies and reports that could not be used by the project without significant revisions.

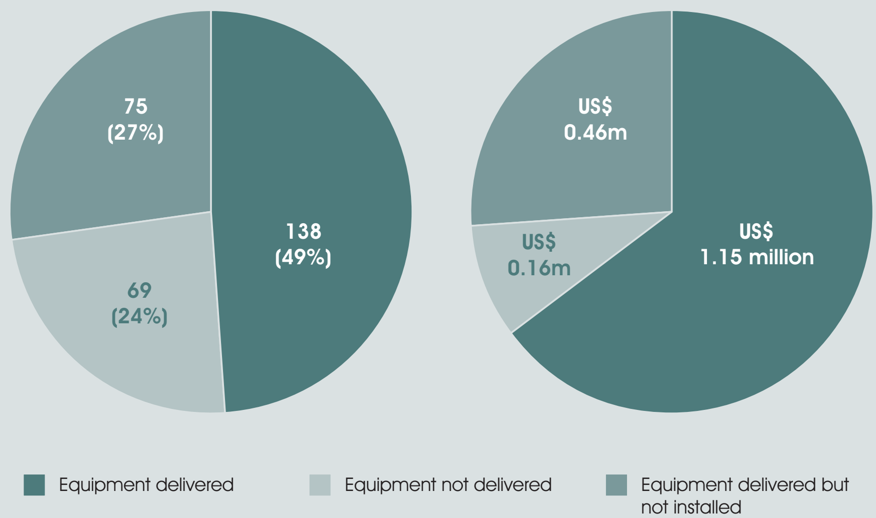
Case 15: Inappropriate earthworks degrades dam

In INT's investigation into an allegation of corruption, it discovered improper earthworks preparation causing significant degradation of a local dam designed to improve irrigation practices.

d) Failure to deliver. INT investigations have uncovered cases where contractors had left project sites with civil works incomplete. In other cases, the training, equipment, and consultant reports had not been delivered at all. Case 16 illustrates how a significant part of equipment under a health project was either not delivered or not installed as per the contract requirements.

Case 16: Equipment delivery and installation problems at laboratories (number and value of equipment)

INT reviewed 15 laboratories and inspected 282 pieces of equipment. Staff found that more than half the equipment or one third of the value of the contracts procured for the laboratories had not been delivered or installed, even though the majority of contracts had been awarded two to three years earlier. Sixteen contractors were responsible for the equipment that had not been delivered and 12 for the equipment that had not been installed.



Scheme: False statements. Contractors and consultants can submit a wide variety of false statements. INT has found false statements such as false time sheets for a company's employees (to support inflated invoices) or false claims that soil conditions were more difficult than those anticipated at the time of bidding (to justify improper contract amendments). Consultant firms also may submit CVs of staff not on their payrolls or substitute junior staff for the senior staff presented in their bid proposals (*see* Case 17).

Red flags indicating false statements	
Discrepancies in supporting documentation	• Discrepancies between statements and supporting documentation or site visits • Inconsistent, missing or apparently altered supporting documentation • Discrepancies between statements and the results of background or due diligence checks

Case 17: Firm substitutes junior for senior consultants

INT investigated a case of poor service delivery and failure to adequately perform in an environment and mining project. Suspicions were aroused when a lump sum consulting contract[7] of nearly US$3 million resulted in reports that were of poor quality.

The contract was awarded to a consortium due to the strength of its proposed technical team, which included the CVs of two experienced specialists, one environmental engineer and one environmental economist. The investigation revealed that these individuals had neither submitted their CVs nor been hired for the contract.Furthermore, no suitably qualified personnel had been hired to carry out the work. In fact, no evidence was found to demonstrate that any personnel had been hired to replace the experts in the consulting team.

Scheme: False claims and invoices. This type of fraud frequently occurs in projects with weak financial control systems whereby the project officials receive kickbacks for approving or processing falsified claims and invoices. Alternatively, the contractor may recognize the weak control environment through its previous interactions with the implementing agency and—acting alone—submit duplicate, inflated invoices or unsubstantiated claims with the intention of defrauding the project (*see* Case 18).

Red flags indicating false claims and invoices	
False invoices	• Not receiving any report for invoiced goods or services • Invoiced goods or services cannot be located in the inventory or otherwise accounted for • No purchase order exists for the invoiced goods or services
Inflated invoices	• Invoice prices, amounts, item descriptions or terms exceed or do not match: – contract or purchase order terms – receiving records – inventory or usage records – invoice and supporting documents
Duplicate invoices	• Multiple payments in the same time period: – for the same or similar amount to the same or related vendors – for the same invoice or purchase order – for the same goods, works, or services • Multiple invoices with the same: – description of goods or services – amount and vendor – invoice number and date – purchase order number • Total amount paid to the contractor exceeds invoiced or purchase order amounts
Other	• Discrepancies between contract or purchase order, receiving documents, and invoices • Contractor submits inadequate, copied or apparently altered supporting documents with the invoices • Discrepancies between the contractor's invoices and supporting documents • Total payments to a contractor exceed the total purchase order or contract amounts

[7] A lump sum consulting contract is a form of contract allowed under the Consultants Guidelines, where payments are made against actual outputs.

Case 18: Consortium submits US$150,000 in false claims

INT was requested by the task team of a forestry project to investigate possible fraudulent invoices for consulting services provided by a consortium of companies. The investigation found that one company submitted US$150,000 in false expense claims on behalf of the consortium for hotel charges, photocopying and report production, equipment purchases, training, and air fares. The company admitted to making the false claims in order to pay kickbacks to project officials, BEC members, and ministry officials. These payments were considered unavoidable and normal business practices by the companies in order to continue winning contracts in the future.

As a result of the INT investigation, the company repaid the project approximately US$150,000 and was debarred for a period of five years.

Suggestions

- Require independent annual technical, financial, and procurement audits for high risk projects
- Expand the audit scope to include transaction testing and fraud detection
- Include site visits by technical experts during the supervision missions
- Institute contract management training for project officials
- Check, as part of a procurement and financial management (FM) review, specifically the controls regarding:
  - Contract management—payment listings by contract or contractor
  - Duplicate payment control
  - Certification of goods and services received
- Conduct annual PPRs and ensure follow-up on the findings
- Institute strong complaints handling procedures and publicize the procedures

12. Contract Changes

Scheme: Abuse of contract amendments and change orders. Contract amendments and change orders usually represent legitimate modifications to the signed contracts. However, they can be abused. A common scheme involves collusion between a favored contractor and project officials to award a contract to the contractor at a low price, followed promptly by one or a series of change orders (often just below the change order no-objection threshold of 15 percent of the original contract value).

Red flags indicating contract amendment and change order abuse	
Contractor	• Change in the name and legal status of the firm • Numerous or questionable change orders for a specific contractor that are approved by the same project official
Output	• Pattern of change orders just below the threshold for prior review • Changes in the scope of the contract and required outputs • Changes in technical specifications • Substantial changes in the TOR • Changes to the original design and BOQ • Increase in contract value (*e.g.*, unit costs) • Reductions in the quantity of items to be delivered without a commensurate reduction in disbursements • Substitution of materials and equipment

Suggestions

- Evaluate change order requests, analyze them for legitimacy and request supporting documents, as appropriate, before issuing a no-objection
- Request clients during supervision missions of high-risk projects to inform the Bank of any change orders issued to any of the signed contracts, regardless of value
- Verify physical existence of key goods, works, and services outputs during supervision missions by the task team. Reviews can confirm:
  - consistency between work completion certifications and implementation progress
  - adequacy of supporting documentation
  - legitimacy of officers certifying goods and services received
  - timely asset registration

FRAUDULENT FINANCIAL MANAGEMENT | 6

What are the most common types of fraudulent schemes in financial management?

Fraud in financial management (FM) can take the form of either individuals taking advantage of system vulnerabilities to redirect funds for their own purposes, or working with other parties in a collusive set-up. Contract-related fraud, often but not always a result of corruption, can thrive when there are weak financial controls or deficient accounting systems. INT investigations have identified a range of FM fraudulent and corrupt practices, centered around five types of schemes:

- Diversion of funds
- Billing schemes
- Disbursement schemes
- Asset theft and misuse
- Payroll fraud

Diversion of funds

Theft may range from very small amounts to sophisticated schemes involving large sums of money. More often than not, theft is performed in a manner that is premeditated, systematic or methodical, with the explicit intent to conceal the activities from other individuals. Often, it involves a trusted person embezzling only a small proportion or fraction of the funds received, in an attempt to minimize the risk of detection. The method usually involves direct and gradual transfers of project funds for personal use or diversion of payments for legitimate expenses into a personal account.

Red flags indicating diversion of funds	
Missing funds	• Cash appears to be missing based on a review of transaction documentation and financial documents • Unknown and unexplained expenditures on bank statements
Apparent misuse	• Funds have been spent on personal or non-business related items • Accounting staff have extended personal loans to themselves or to others in violation of agency procedures
Approval override	• Prescribed approval and payment processes have been overridden • Funds have been spent on questionable expenditures
Other	• Lack of bank statements • No reconciliation of bank statements or reconciliation done by an accountant responsible for the accounting ledger with no independent review • Lack of segregation of duties among accounting and administrative staff • Accounting and FM staff never take leave

Billing schemes

This form of fraud involves the forging or production of forged and fictitious documents and is carried out through the manipulation of the procurement and contract management process. Fraudulent billing schemes can be discouraged through sound FM procedures and controls, including the segregation of duties among staff, and appropriate monitoring and oversight. Policy exceptions and the overriding of controls represent red flags, especially if not documented with appropriate justification.

Red flags indicating fraudulent billing schemes	
Suspicious invoice	• Invoices for which there are no purchase orders • Invoices with identical prices and quantities • Two or more invoices received on the same day from the same vendor (when this is outside the norm) • Payments to suppliers without corresponding receipts • High operational costs for vehicle maintenance • Certification of invoices for works contracts that are not in line with reasonable implementation progress
Suspicious company	• Invoices from companies not registered in the approved vendors' list (if one exists)
Approval override	• Prescribed approval and payment processes have been overridden – Change orders are processed without approval authority – Claims (works contracts) are paid without appropriate justifications and approvals
Other	• Lack of original documentation supporting the payment • Payments to an entity other than the contractor (as per contract)

Disbursement schemes

In a weak system of financial controls, it is relatively easy for corrupt project officials to produce fictitious documents and generate payments. Without an appropriate segregation of duties, this can be done by one individual with overall responsibility for both approval and payment. Disbursement schemes also operate through collusion with inside and outside parties when, for example, kickbacks are paid to an accounting officer who then processes forged or fictitious invoices.

Red flags indicating fraud in disbursement	
Discrepancy between contract and payments	• Payments exceeding the total contract value without proper justification and documentation • Discrepancies between the contract and the payment register
Suspicious payments	• Payment of more than one invoice with the same invoice number and amount • Payments are made without corresponding purchase order or receipt documents • Petty cash funds are not reconciled and accounted for on a regular basis
Delays	• Extensive or repeated payment delays (indicating possible demands for bribes)

Asset theft and misuse

Through weak asset and inventory management systems, corrupt project officials can divert project assets and goods meant for the project beneficiaries for their own use or resale in the open market. Small items with outside commercial value are particularly vulnerable to theft. A review of a multi-donor trust fund, for example, showed that a large number of mobile Global Positioning Systems were bought for each state, but the location of these units could not be verified. Some of the control risks associated with asset stripping include: (*i*) lack of segregation of duties in purchase approval, receiving, warehousing, and distribution; and (*ii*) lack of asset management systems and procedures encompassing asset registers, such as physical tags for fixed assets, secure inventory locations, periodic physical inventory, and asset transfer and disposal procedures.

Red flags indicating asset theft and misuse	
Missing assets	• Inventory reveals missing assets • Discrepancies between the accounting transfer records and the end user receiving documents
Control failures	• Physical inventory count is consistently not conducted as prescribed • High-value assets are not physically secured as prescribed • Accounting system integrity is compromised, *i.e.*, access controls to systems or assets have been overridden
Misuse of assets	• Incorrect or improper usage of project assets

Case 19: Misappropriation of a school building

The Bank financed a school building (top left), which was inappropriately used to store onions (top right), while pupils studied in a hut (bottom left).

Payroll fraud

Payroll fraud is typically committed by individuals in charge of payroll, possibly in collusion with inside or outside parties. The risk is more prevalent in sectors where a large number of staff or individual consultants are hired for the projects' various components.

Ghost employees. This term refers to someone on the payroll who does not actually work for the project. Under Bank-financed projects this can also take the form of hiring individual ghost consultants. The ghost employee frequently is a recently departed employee, a fictitious person or a friend or relative of the perpetrator, who can then cash the paycheck by forging the endorsement or by having an accomplice deposit the proceeds into his or her bank account. Under an education project, a pilot integrated payroll system was introduced for the public schools. A review of the implemented system showed that 2,500 ghost employees were added to the payroll system, in effect inflating the actual number of employees by almost 50 percent.

Falsified hours and salary. Dishonest employees or consultants commonly exaggerate the time they work in order to increase their compensation. Moreover, some dishonest payroll clerks look for internal control deficiencies that will permit them to adjust their own salaries. For a share of the extra money, supervisors sometimes approve an employee's falsified hours. Similar schemes have been detected for individual consultants working on project operations.

Red flags indicating payroll fraud	
Suspicious staff	• Two or more salaries being deposited into the same bank account • Staff name appearing on the payroll record after the date of their termination • A temporary requirement that staff pick-up in person and sign for their payroll check leads to a number of unclaimed checks
Unexplainable payroll cost	• Actual payroll costs exceeding the estimated costs by a wide margin • Independent reviews showing discrepancies between the payroll system and the list of personnel

Further Reading

- *Financial Management Sector: Approach to Governance and Anticorruption*. The OPCS-Financial Management Sector Board has produced this paper outlining the sector's overall approach to implementation of the Bank's GAC strategy in FM operational work.
- *Dealing with Governance and Corruption Risks in Project Lending*. This is the latest paper produced by OPCS in its efforts to address GAC in projects.
- *Financial Management Practices Manual*. This manual is currently being updated by the FM anchor and will be posted on the OPCFM website.
- *Audit Toolkit*. http://go.worldbank.org/PRATPGOS70
- *Financial Management on GAC*: http://go.worldbank.org/AKWOX1SWS0

PERSPECTIVES | 7

A brief glance at this handbook may leave the reader disconcerted with the many different fraudulent and corrupt schemes that may have an adverse impact on Bank-financed projects. But there is much reason for optimism. Bank staff, government officials and other concerned stakeholders have been successfully improving their ability to detect and prevent fraud and corruption in our projects. Indeed, it is the Bank's desire to support such efforts that prompted the creation of INT's prevention program. Reflecting on INT's work, several broad lessons stand out:

- Much of what we know about fraud and corruption in Bank-financed projects is the direct result of the many **valid complaints** filed by Bank staff, government officials, bidders, civil society representatives and other stakeholders. Due to the inherently secretive nature of fraud and corruption, an effective system to solicit, channel and respond to complaints is critical. However, we recognize that we must do more to improve both the channels and incentives for reporting concerns to INT or other appropriate authorities and entities.

- The **procurement process** has proven particularly vulnerable to fraud and corruption, because that is the point in the project cycle where money changes hands. The Bank's procurement guidelines and oversight have over time been improved to better enable Bank staff to identify red flags and for investigative or other appropriate action to be taken. Investigations arising out of procurement activities have identified several areas of vulnerability.

  - First, a number of bidders have been found to have fraudulently misrepresented their technical and financial capacities resulting in the award of contracts to unqualified firms and consultants. Independent verification by the Bank, the Borrower, or a third party of the representations made by companies (*e.g.*, prior experience, annual turnover, and validity of the bid security) can often prevent inadvertent reliance on fraudulent representations. Though these types of fraud may on the surface appear to be less serious, they are often followed by bid rigging or other types of misconduct.

  - Second, evidence has been found of a variety of collusive arrangements among bidders, designed to circumvent competition and inflate bid prices—frequently with the knowledge or active participation of government officials . These types of schemes will require stronger independent oversight and supervision.

  - Third, there has been a multiplicity of cases involving bid rigging, intended to steer contracts to favored bidders and exclude more capable competitors. These vulnerabilities have been identified in all Regions and sectors. As a result, careful attention must be given to bid requirements.

- In contrast, far fewer allegations received by INT have involved issues related to **implementation and financial management**, indicating a need to look more carefully at these areas. For its own part, INT is in the process of establishing a core forensic capacity and re-engaging with Operations on how best to identify and analyze risks in this area.
- Like operational staff, INT investigators also rely on **local stakeholders with an "ear to the ground"**, to provide information about what is going on in the project. Over the years, INT has found that many stakeholder groups are well positioned to provide insights into how fraud and corruption schemes work. They include business associations, company representatives, civil society, local auditors, and many others with knowledge of Bank-financed activities. INT will continue to work closely with operational staff to reach out to these groups, to encourage them to bring matters of concern to the Bank's attention.

Bringing integrity to our projects requires a shared commitment. To this end, we will continue to work to ensure that the lessons learned today, help us prevent the risks of fraud and corruption tomorrow.