

In collaboration with Deloitte

Learnings from the Field Cases on Corruption in the Infrastructure and Urban Development Industries

Building Foundations Against Corruption

January 2015



Prepared by the Project Task Force of the Infrastructure & Urban Development Industries in collaboration with the Partnering Against Corruption Initiative (PACI)

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Preface

In many countries, corruption is among the greatest barriers to economic and social development, with negative effects on both sustainability and market growth. The World Economic Forum's *Global Competitiveness Report 2014–2015* rates corruption as the number-one impediment to conducting business in 24 out of 144 economies.

Although bribery and other forms of corruption are risks in almost every industry sector, companies operating in the engineering, construction and real estate industries face unique challenges due to the nature of their business: they operate in countries that lack transparent business practices; they often find themselves bidding for projects with intentionally vague design specifications; enormous amounts of money are at stake in large-scale capital projects; the public sector often interferes with critical business decisions; procurement processes can be opaque; contractual frameworks can be weak; projects are often long term; and supply chains can be difficult to control. The Trace International *Global Enforcement Report 2012* estimates that 10% of all global enforcement activity since the introduction of the US Foreign Corrupt Practices Act in 1977 has related to the engineering, construction and real estate industries.

Given the growing worldwide demand for infrastructure and real estate projects and the economic value generated by such projects, the engagement of the engineering, construction and real estate industries in the fight against corruption is clearly of the highest importance.

This collaborative project between the Infrastructure & Urban Development community and the Partnering Against Corruption Initiative (PACI) of the World Economic Forum seeks to further industry-wide engagement on anti-corruption solutions in a way that will benefit both businesses and public organizations. The overall objective of this project is to have businesses commit at the chief executive officer level to collaborate with interested governments in developing a framework for open and more transparent practices. In pursuit of this goal, the project aims at recommending anti-corruption strategies that will increase customer and shareholder value for companies that commit to those strategies. Commenced in 2014 at the World Economic Forum Annual Meeting, it brings together leading Infrastructure & Urban Development companies and endeavours to foster dialogue with governments, including authorities on a local level, as many infrastructure projects are related to local administrations.

To date, the project has generated three key outcomes:

- An industry survey on corruption risks was completed with the greatly appreciated participation of 50 of the world's leading real estate, construction, engineering, consulting and service providers.
- Stakeholders at risk and the key corruption risks during the life cycle of an industry capital project were identified.
- Industry cases on corruption were collected, to illustrate what actually happens in the field.

The insights generated in the projects were condensed into recommendations to the industry and distributed among the members of the Project Task Force.

All outcomes of the project are available on the Forum's online collaboration tool TopLink (<https://toplink.weforum.org/project/building-foundations-against-corruption-iu-paci-project>), and a summary can be found on the homepage of the Forum's Infrastructure & Urban Development Industries website (<http://www.weforum.org/iu>). The Task Force has decided to continue this collective action project in 2015 and has identified corruption in permitting and licensing as a key risk area. The project will identify concrete corruption issues in permitting and licensing and come up with solid mitigation strategies.

This project would not have been possible without the collaboration of various stakeholders. The contributions and support of the Project Champions and their companies are gratefully acknowledged. Many thanks are expressed to the Advisory Expert Committee and the Project Sponsor, Deloitte. Finally, grateful recognition is extended to the Forum for enabling this project.

Foreword by the Project Champions

Our Commitment to Action on Corruption

In today's global and local economies, the Infrastructure & Urban Development (IU) industries are key drivers for growth but are also challenged by transparency issues. The IU industries have a key opportunity and the responsibility to jointly address these issues across the entire IU value chain, to create a level playing field and improve the state of the world.

As leaders of companies in the engineering, construction and real estate sectors, we recognise that corruption is a strategic business risk and a risk to society and that these risks need to be addressed through a multistakeholder approach and collective action.

Hence, we agree on the need to:

- Build on the achievements of the World Economic Forum's Partnering Against Corruption Initiative (PACI) to raise business standards and to contribute to a more competitive, transparent, accountable and ethical business society.
- Accelerate collective action to eliminate corruption from our value chains, to preserve our sectors' competitiveness, and to strengthen our sectors' role in sustainable economic and social development worldwide.

Therefore, as Partners in the World Economic Forum's Infrastructure & Urban Development community and as representatives of the companies we lead, we are committed to collective action to fight corruption. We aspire to corruption-free engineering, construction and real estate value chains. Building on this report, we will:

- Continue the collective action project and collaborate in building cross-industry and public-private coalitions to address corruption issues in areas such as permitting and licensing in key regions, thereby contributing to the creation of a level playing field and ultimately to the improvement of our sectors' competitiveness.
- Promote increased interaction with government in key countries to address industry concerns in areas such as public procurement and tendering, permitting and licensing, and reporting mechanisms, as well as to leverage opportunities for improvement, such as generating support for technical solutions to transparency problems and promoting the mutual knowledge exchange of public and private institutions.



- Share insights on corruption risks and good practices more broadly, collaborate in building cross-industry and public–private coalitions within the engineering, construction and real estate sectors, and enhance and evolve our internal compliance programmes, practices and benchmarking to prevent and manage corruption risks.

We call on all engineering, construction and real estate stakeholders to join efforts by:

- Supporting collective action and dialogue in key regions and seeking collaboration and partnerships to drive corruption out of the system.
- Supporting the PACI principles and becoming PACI signatories and engaged community members, and participating in global and local initiatives.
- Contributing to the PACI global transparency and anti-corruption agenda to advance a level playing field across industry sectors and across communities.

We have the opportunity to open the Collective Action project in 2015 to a broader industry base, giving more organizations the possibility of joining PACI and supporting the Project Task Force. Thus, we also call on other leading organizations committed to a level playing field and to improving the state of the world.

Our efforts and our commitment to a collective action agenda with governments, other industries and representatives of civil society will provide meaningful benefits in tackling corruption in our value chains and ensure that the engineering, construction and real estate sectors remain competitive and inclusive and continue to create growth worldwide.

We strongly encourage others to join us in this endeavour.

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Background

The expansive reach of the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act, in addition to the stringent disclosure requirements of the Dodd-Frank Act and the Basel III Accord, has led to an increased number of enforcement actions by anti-corruption regulators. Countries such as Brazil, China and Germany have recently implemented anti-corruption and transparency measures as well.

The IU PACI project, a collaboration between the Infrastructure & Urban Development community and the Partnering Against Corruption Initiative of the World Economic Forum, seeks to provide meaningful support to companies and to create positive impacts on business. It endeavours to convey practical knowledge and to provide recommendations for action that can be implemented in real life, focusing on best practices that go beyond compliance tools in dealing with corruption risk. In line with these goals, the Project Task Force has collected lessons learned from the field and has conveyed these learnings in this report via short discussions of cases of corruption in the industry, sourced from internal company materials provided by the Task Force as well as from information available in the public domain.

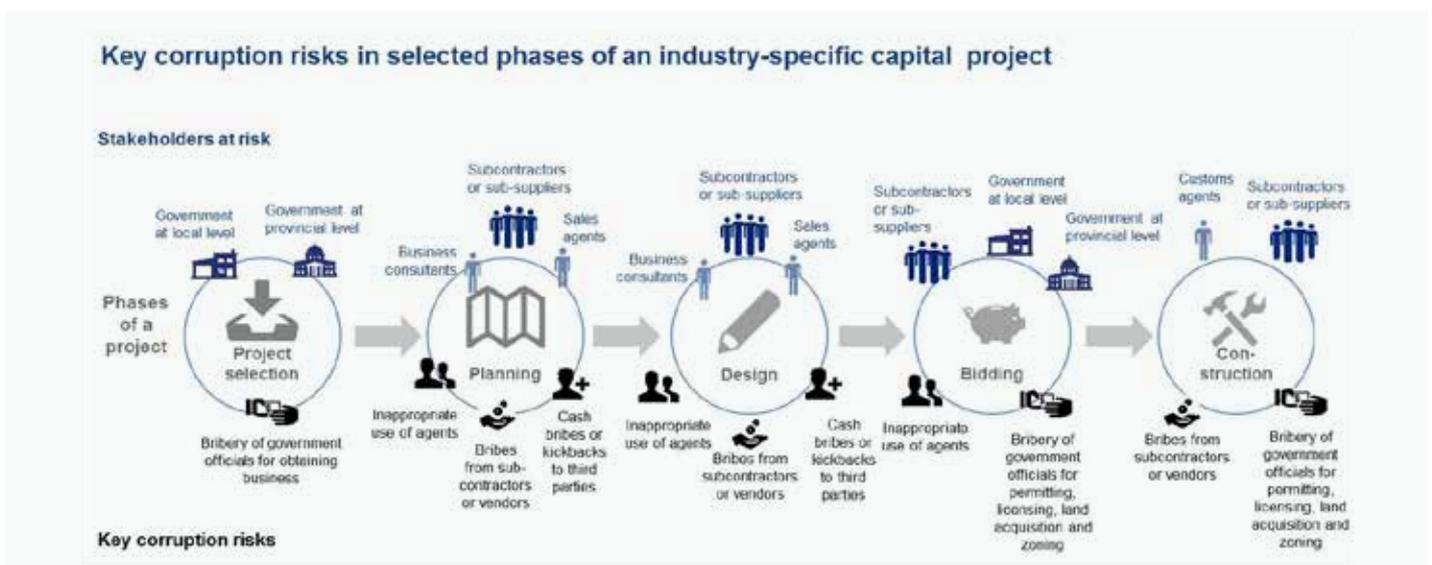
The learnings, which aim at covering a broad range of corruption risks, should provide a sense of the directions from which corruption risks can arise and should reflect real-life business issues in the infrastructure and urban development industries. They are not meant to replace existing training materials but to enrich the discussion around corruption. The project will use the lessons learned as a basis for discussion of the project strategy after the World Economic Forum Annual Meeting 2015 in Davos-Klosters, helping shape the discussion of how interested organizations can advance the anti-corruption agenda.

Infrastructure Corruption Risks Framework

Based on the responses to a global survey targeted at leading companies on corruption risks in the infrastructure and urban development businesses, several aspects of corruption risks were identified and incorporated into a framework that encompasses the following factors:

- **Stakeholders at risk.** The stakeholder groups where the risk of corruption is perceived to be high, such as governments at federal, state and local levels, agents, consultants, vendors, subcontractors and employees.
- **Key corruption risks.** The types of risks that are believed to have the greatest impact on the industry, as well as the likelihood of their occurrence. These risks include bribery and corruption at various levels in governments, bribes paid by vendors and subcontractors, and corruption in approval of invoices and in operations of assets.
- **Phases of a project.** Stages in the life cycle of a project – from project selection and planning to operations and maintenance – and the corruption risks that often arise at each stage.
- **Geographies.** Differences in corruption risks in developing and developed countries and in different regions of the world.

The figure illustrates selected key corruption risks over the course of an industry-specific capital project.





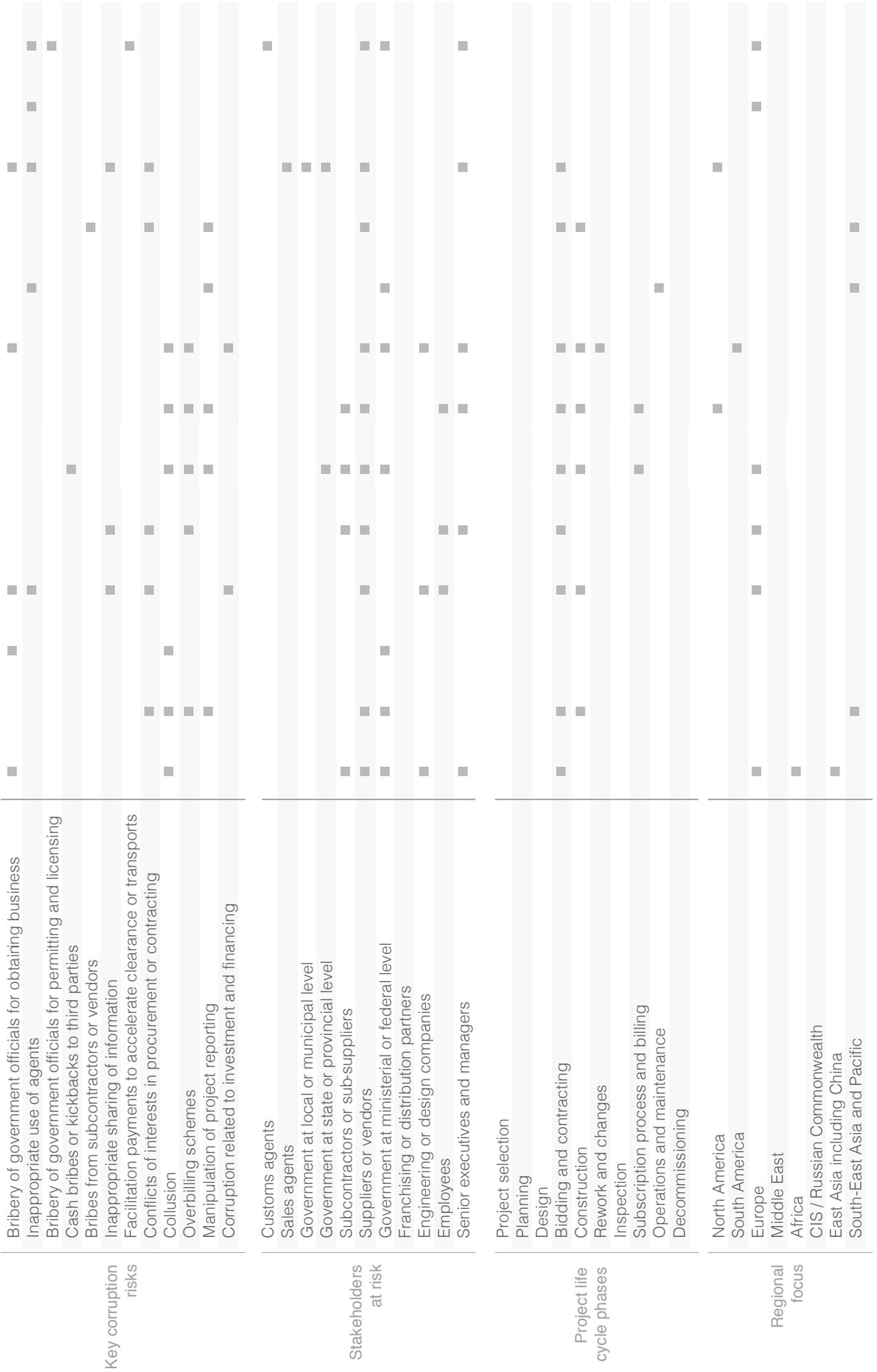
Based on this framework, the list below gives some examples of identified corruption risks. This should provide a better understanding of the risks described in the learnings:

- The involvement of government in approving contracts and orders and in issuing multiple clearances creates a risk of bribery to obtain contracts and orders or to expedite clearances.
- Infrastructure and urban development is a monopolistic sector by nature, giving rise to the risk that bidders will unlawfully collude to rig bidding to favour one bidder or to exchange or fix bid prices in advance of tendering.
- The mammoth size of projects and of the subsequent contracts can create incentives for corruption and provide ample means of hiding corrupt acts. A cascading increase in the number of contractual links provides opportunities to bribe or collude.
- During the construction stage, contractors tend to hire varied groups of workers and acquire equipment so as to effectively meet the job requirements, and due to a lack of transparency in these processes, bills and invoices can be manipulated and exaggerated claims and false documentation can be submitted.

Overview of Learnings

The following table provides an overview of the key corruption risks, stakeholders at risk, project life cycle phases, and regional focus involved in each of the learnings from the field described in the next section of this report.

1 2 3 4 5 6 7 8 9 10 11 12 13



Learning from the Field #1



Bribery of Government Officials for Obtaining Business

What does this case demonstrate?

This case demonstrates that there is ultimately no hiding or profiting from bribery.

Keywords

Agents / Falsification of records / Nigeria / Subcontractors

What was investigated in this case?

The US Securities and Exchange Commission (SEC) charged an Italian company and its former Dutch subsidiary with multiple violations of the Foreign Corrupt Practices Act in a bribery scheme that included deliveries of cash-filled briefcases and vehicles to Nigerian government officials to win construction contracts. The two companies jointly paid \$125 million to settle the SEC's charges, and the subsidiary had to pay an additional \$240 million penalty to settle separate criminal proceedings by the US Department of Justice.

What happened?

According to the SEC's complaint, senior executives within the two companies authorized the hiring of two agents, a UK solicitor and a Japanese trading company, through which more than \$180 million in bribes were funnelled to Nigerian government officials to obtain several contracts to build liquefied natural gas (LNG) facilities on Bonny Island, Nigeria.

This elaborate bribery scheme featured sham intermediaries, Swiss bank accounts, and carloads of cash as everyone involved made a concerted effort to cover their tracks. The SEC's complaint alleges that senior sales executives at the joint venture companies formed a "cultural committee" to consider how to implement and hide the bribery scheme through sham consulting and services contracts with subcontractors and vendors. After Nigeria LNG awarded the joint venture companies a \$2.2 billion LNG-related construction contract in December 1995, the companies sent a total of \$60 million to the UK agent's Swiss bank account over the next 52 months. The UK agent transferred the money to accounts owned or controlled by high-ranking Nigerian government officials. The SEC's complaint also alleges that the Italian company

failed to ensure that its former subsidiary complied with the company's internal controls concerning the use of agents, and that the books and records of both companies were falsified as part of the bribery scheme.

What would you do?

How would you make it harder for senior executives to carry out an extensive fraud scheme with foreign government officials?

Why does this case matter?

The key learnings are:

- The use of agents to channel bribes does not absolve a company of wrongdoing. A company cannot claim that it was ignorant about the business practices followed by an agent.
- Companies may design a web of transactions to cover up their involvement in corruption, but the enforcement agencies have extensive access to information and sophisticated investigative tools. Also, in most cases, the people involved in such schemes make mistakes.

Learning from the Field #2



Corruption Allegations, Construction Delays and Cost Overruns

What does this case demonstrate?

This case demonstrates how mismanagement and corruption can have catastrophic effects (such as social and economic impacts, infrastructure failure and security lapses).

Keywords

Cost overruns / government officials / India

What was investigated in this case?

Hosting the 2010 Commonwealth Games was supposed to be a feather in the cap of the Indian government, but it turned out to involve large-scale misappropriation of funds during the preparatory phase and during the Games themselves. The total value of the scam, which involved politicians, bureaucrats and corporate executives, was estimated at least 70 billion Indian rupees (\$1.1 billion). The main accused was the chairman of the Games' organizing committee, who was arrested and charged with conspiracy for allegedly favouring a Swiss company in the purchase of equipment for timing and scoring events. There were several other allegations of corruption, construction delays and massive cost overruns.

What happened?

The Games spawned a maze of corrupt deals, most of them involving inflated contracts. Instead of acquiring equipment and services from the companies offering the best prices, firms that over-quoted were selected. Often, companies offering better deals were disqualified for inexplicable reasons. Additionally, the preparations made for the athletes and foreign crews were in a deplorable state. With the Games skidding into catastrophic conditions, the Commonwealth Games Federation publicly stated their unhappiness with the preparations.

The Games then took place without any additional issues, but a far-reaching investigation of the organizing committee was initiated and several Indian leaders from public and private sectors were brought under the spotlight.

What would you do?

How would you manage construction contracts differently to reduce the risk of corruption and to avoid tarnishing the integrity of an international event such as the Commonwealth Games?

Why does this case matter?

As in the case of the football World Cup in Brazil in 2014, the 2010 Commonwealth Games in India became an exercise in exceptional approvals. Even though the key contracts were signed in 2003, progress in the preparations was abysmally slow, and by 2009 most of those contracts were far from complete. For example, a report by the Comptroller and Auditor General in India estimated that the aquatic complex was only 42% complete by mid-2009. The Games were to be inaugurated on 3 October 2010, which implied that the organizing committee had to complete a large part of the project in a single year, between 2009 and 2010. This created conditions ripe for widespread corruption in the awarding of contracts and a consequent ballooning of costs.

The key learnings are:

- The importance of “tone at the top” should not be underestimated. In this case, despite several allegations surfacing in 2009 and despite the fact that the chairman of the organizing committee had organized another event in 2008 where there were allegations of corruption, the prime minister did not act against the chairman of the organizing committee.
- Organizations need to visibly adopt a zero tolerance approach to bribery and other forms of corruption. To effectively reduce corruption risks in their organizations, leaders have to be seen taking strong action against corrupt employees and vendors.



Litigating in Countries that do Not Have Independent Courts

What does this case demonstrate?

This case demonstrates that litigation in countries where the judiciary is not independent of the government can be highly problematic.

Keywords

Bribery / independent judiciary / undue influence

What was investigated in this case?

RE Company, a public company in a Western country, procured a creditworthy tenant for a to-be-built development in Country X. The developer paid RE Company its \$3 million fee under the contract. However, the developer did not finish the new building on time and the tenant exercised its option under its lease to terminate the lease based on the default by the developer. The developer then sued RE Company for a return of the \$3 million commission, saying that RE Company had been unjustly enriched since the tenant had terminated the lease.

In Country X, judges are appointed by the prime minister and are widely considered not to be independent of the government. The developer was wealthy and influential and was reputed to be a close friend of the prime minister.

RE Company consulted with a prominent local lawyer in Country X and with a global law firm with an office in Country X, and both advised that RE Company had a strong case and should be allowed to keep the commission. Accordingly, RE Company refused to accept a \$250,000 settlement offer from the developer. At the hearing in court, which lasted just 10 minutes, the three-judge panel did not allow RE Company to put on any witnesses. Then, after a 5-minute deliberation and without any commentary, the judges returned a verdict against RE Company and ordered it to repay the full \$3 million to the developer. There was a strong suspicion that the judges had been bribed or had been influenced by the government.

What happened?

This case raises the question of how a company that is, of course, not permitted to behave unethically can get fair treatment in court, especially when it suspects that the judges are being bribed or otherwise unfairly influenced.

What would you do?

How do you think a company can operate successfully in a country where there is no confidence in the rule of law?

Why does this case matter?

The key learnings are:

- A company should make every effort to avoid litigation in countries where it is not confident in the independence of the judicial system, and in any event should not be naïve about the possibility of undue influence on the judiciary. In other words, the company should find ways to settle issues out of court if at all possible.
- If a company feels that a court is being unfairly influenced by government officials, it could consider asking other government officials to exert countervailing pressure on the court, particularly where public policy would seem to favour the company on the merits of the case, as in the case above. Of course, the company must be clear that it is just asking for like-for-like lobbying behind the scenes and that it is not acting unethically or illegally, as by offering bribes.
- Typically the most senior courts are relatively less corrupt, so if corruption is suspected in the lower courts, their decisions should probably be appealed.
- Even when the rule of law is not well established, a company may find it useful to hire the most prominent local counsel available, since that may exert some influence and make it harder for the court to issue an obviously incorrect ruling while also maintaining a pretence of the rule of law.



Cartel Agreements Involving Bribery and Antitrust Violations

What does this case demonstrate?

This case demonstrates that antitrust violations can have severe consequences.

Keywords

Antitrust law / collusion / Germany / price fixing / whistle-blowers

What was investigated in this case?

Based on revelations by a whistle-blower, the German Federal Cartel Office and officials from the public prosecutor's office raided the premises of 14 private construction companies and a municipal energy utility. The subsequent investigations revealed that employees of the energy utility had over several years made available confidential tender information to the construction companies. This information enabled the construction companies to manipulate the tenders, allocate the respective contracts, fix the prices and place sham offers in order to "direct" the tender in the right direction. The employees in the procurement department of the energy utility received bribes in consideration for providing the information and awarding the tenders to the company determined by the cartel members.

The cartel agreements caused damages of several million euros to the energy utility. The Federal Cartel Office imposed fines against the cartel members totalling EUR 100 million (about \$120 million). Moreover, the public utility filed damages claims against the cartel members, and the cartel members were barred from any public tenders for five years. Certain employees of the construction companies and of the energy utility were sentenced to jail or were assessed significant fines. Some of the construction companies involved went bankrupt as a consequence of the antitrust fines and tender ban.

What happened?

The case illustrates the grave consequences of antitrust offences. Such offences usually involve a significant number of companies and persons who face severe penalties in case of discovery. Over the past decade or so, almost all significant antitrust jurisdictions worldwide have introduced whistle-blower programmes, granting immunity to the first applicant and significant reductions in fines to the

subsequent ones. This has destabilized cartels and altered the situation in favour of competition authorities.

The economic benefits of cartel agreements are often doubtful. In many cases, there is no clear evidence that price fixing, quotas or customer allocation really lead to higher prices in the long run. On the other hand, in the increasingly likely case of being discovered, there are severe consequences such as large fines, other financial losses and reputational damages. Employees involved in antitrust violations put their professional lives at risk since they face dismissal by their employer, fines and in some countries even jail.

What would you do?

How would you reduce the risk of the dissemination of proprietary information to prevent bid rigging during contract procurement?

Why does this case matter?

Antitrust compliance is of paramount importance for companies and their employees due to the high risks connected with antitrust violations. This is particularly true for companies active in cartel-prone markets, such as markets for homogenous goods or services, public procurement markets and oligopolistic markets.

The key learnings are:

- Cartel agreements are normally concluded in secrecy and hence are difficult to unveil in the course of normal compliance work. It may therefore be worthwhile to introduce an amnesty programme, thus encouraging employees to cooperate.
- Companies are often also cartel victims. The number of antitrust damages claims is on the rise throughout the European Union, and the European Commission aims at facilitating private enforcement of antitrust laws. Hence, the discovery of antitrust violations and enforcement of damages claims should be part of any credible antitrust compliance programme.

Additional Resources

<http://www.marketwatch.com/story/germany-fines-eight-companies-in-rail-cartel-probe-2013-07-23>



Conflicts of Interest in Central and Eastern Europe

What does this case demonstrate?

This case demonstrates that avoiding typical conflict-of-interest scenarios in foreign subsidiaries requires awareness of the business activities of senior managers and attention to the responsibilities of managing directors.

Keywords

Conflicts of interest / Eastern Europe / internal controls / subcontractors

What was investigated in this case?

The newly appointed chief financial officer (CFO) of a group company in Central and Eastern Europe noticed that several senior management employees had stakes in or close relations to the company's subcontractors. The CFO initiated an internal investigation, which revealed that the senior managers had massively privileged "their" subcontractors in awarding contracts. In some cases the subcontractors had been paid on the basis of fake invoices or had overcharged for their work. The managing directors of the company had no positive knowledge of this fraud but should have been aware that several of their senior managers had affiliations with subcontractors.

What happened?

Under company guidelines, each employee has a binding obligation to report conflicts of interest, regardless of whether a conflict actually occurs or just has the potential to occur.

Monitoring compliance with such guidelines is one of management's key operational responsibilities. Failure to meet this responsibility usually has serious consequences. In the present case, some of the managing directors were dismissed and others given new positions.

The senior managers were dismissed too; agreements with subcontractors were reviewed and were terminated if they contained significant imbalances. Moreover, several subcontractors were blacklisted.

What would you do?

As CFO, what actions would you take against the senior executives of a company in a case like this?

Why does this case matter?

Simply having compliance rules is not sufficient. This is particularly true in countries with an underdeveloped compliance culture. In such an environment, the right "tone from the top" is of utmost importance, and special emphasis has to be put on enforcing compliance rules.

Failure to take vigorous action in response to noncompliance with guidelines creates the risk that patterns of such behaviour will become established within the company, making it very hard to weed out the behaviour later.

The key learnings are:

- Periodic changes in key management positions help reveal deficiencies and avoid the establishment of insider relationships.
- Top management has to actively enforce compliance rules and cannot turn a blind eye to the activities of senior managers.

Learning from the Field #6



Siphoning of Funds from a Road Project

What does this case demonstrate?

The case demonstrates that the influence of the Mafia created serious problems for Italy in managing some of its regions during a period of economic crisis, making it necessary for the Italian government to return \$471 million to the European Union (EU) due to corruption in contracting for and implementing the construction of a highway.

Keywords

Ghost contracts / highway project / Italy / Mafia / Subcontractors

What was investigated in this case?

Construction of the 307-mile (494-km) A3 highway in Italy commenced in 1960 and was not completed until 2012. Over that period, Italy received EU grants exceeding \$60 billion to finance several programmes, including ones related to agriculture and infrastructure. In 2001 the country channelled grant funds into the A3 highway project to upgrade it. However, an investigation found widespread corruption in the awarding of contracts and usage of funds. The EU has now directed Italy to repay \$471 million of EU subsidies on the A3 project, to be used for other road projects subsidized by the EU.

What happened?

In Calabria, where the highway was to be built, the Mafia exerts a strong influence. (Three of 51 members of Calabria's council were arrested for links with the Mafia.) Investigators found that subcontractors on the highway were awarded contracts based on their connection with the Mafia and that the subcontractors had overcharged on contracts by 3%, which found its way to the Mafia. When the Italian government took action against the subcontractors, the project kept experiencing delays.

Apart from overcharging on contracts, the subcontractors were also awarded ghost contracts – for example, a part of the highway was closed for repairs but no work was done on it. Payments were also made to fictitious companies formed by subcontractors.

What would you do?

What process of monitoring and control would you implement to ensure that subcontractors do not overbill or falsify project documentation?

Why does this case matter?

The A3 highway project has generated a lot of controversy in Italy. Since the focus on efficiency gets diluted as a project goes on, delays get measured in years.

The key learnings are:

- Revelations of Mafia-influenced government corruption has put the spotlight on the political system, where government-sponsored projects generate employment and are used to gather votes.
- The Italian government has since investigated the politician–Mafia nexus and is focused on driving efficiency in project execution.

Additional Resources

<http://www.telegraph.co.uk/news/worldnews/europe/italy/9376202/Italy-repays-307-million-to-EU-after-road-project-mafia-corruption-exposed.html>

Learning from the Field #7



Overbilling and Falsified Records

What does this case demonstrate?

This case demonstrates that the manipulation of project documents and reports to create overpayments to a construction firm can result in criminal charges and large fines.

Keywords

Accounting procedures / New York City / overpayments / record-keeping

What was investigated in this case?

A major New York City – based building and interiors construction firm was the primary contractor for construction projects for banks, law firms, financial institutions and advertising agencies. The company was charged when it was discovered that it was requiring subcontractors to increase their bids by adding unnecessary contingencies. The firm also obtained discounts from subcontractors that were not passed along to clients. The firm pled guilty to charges of overbilling and falsifying records and agreed to pay \$55 million.

What happened?

The company did not enforce its own safeguards to ensure the integrity of its record-keeping. In many cases, subcontractors increased their bids by adding unnecessary contingencies under an addendum that was concealed from clients. The firm also created fraudulent purchase orders that omitted subcontractor discounts, with subcontractors holding overpayments for the contractor. The firm would recover those overpayment amounts by having the same subcontractors provide discounts on unrelated projects.

Under the plea agreement, the firm will allow the district attorney's office to review selected projects to ensure that the firm's safeguards are effective. Since the allegations, the firm has instituted new purchasing guidelines and trained its staff in their use. Any additional contingencies in bids are now transparent to all clients, and new accounting procedures have been installed. The firm has also issued directives to purchasing agents to cease obtaining undisclosed discounts from subcontractors.

What would you do?

What additional safeguards should the construction firm put in place to reduce the chance of fraud?

Why does this case matter?

While many large construction firms have internal controls in place to reduce the chance of fraud, waste and abuse, the controls may not be effectively applied.

The key learnings are:

- The firm did not verify that the safeguards in place were effectively preventing fraud.
- Contract clauses and addendums were not transparent to clients.
- Proper accounting procedures were not in place to track the use of contingencies on projects.
- Adequate disclosure protocols were not in place for subcontractor discounts.

Additional Resources

<http://www.nytimes.com/2014/05/01/nyregion/structure-tone-admits-to-stealing-tens-of-millions-from-clients.html>

Learning from the Field #8



Collusion between Government Officials and Contractors

What does this case demonstrate?

This case demonstrates that collusion between government officials and contractors can lead to out-of-control spending and mismanagement.

Keywords

Approvals process / Brazil / collusion / overpricing

What was investigated in this case?

The \$900 million in public funds spent in building Brasilia's World Cup stadium was nearly triple the original estimate, allegedly due largely to fraudulent billing.

The financial links between construction firms and politicians led to increased suspicions of corruption. An analysis of data from Brazil's top electoral court showed skyrocketing campaign contributions by the companies most involved in World Cup projects, a case in point being that the lead builder of the stadium increased its political donations 500-fold in the run-up to the most recent election.

What happened?

In a 140-page report on the stadium, the auditors found \$275 million in alleged price-gouging, based on an examination of just three-fourths of the project. They forecast that fully one-third of the stadium's cost may eventually be attributable to overpricing, which would be the largest single chunk of the \$500 million in suspect spending that auditors have flagged in World Cup construction projects so far. As an example the auditors' report cited the cost of transportation of prefabricated grandstands, which increased from an estimated amount of \$4,700 to a billed amount of \$1.5 million.

Funding for the stadium comes entirely from the federal district's coffers, meaning every cent comes from taxpayers. While it may take a few years for official audits to be finalized and for apparent corruption to result in civil and criminal judgements, there is convincing evidence of collusion between the Brazilian government elite and the business elite.

What would you do?

How would you reduce the potential for collusion between government and business officials in the financing of high-profile construction projects?

Why does this case matter?

The issues in this case are similar to those in the Commonwealth Games in India (see Learning from the Field #2, above). One common factor in the two cases was delay in the implementation of projects. Project delays lead to approvals being sought in ad-hoc or exceptional ways, with procurement based on single bids from known suppliers, because most companies do not have a well-defined approval process under those circumstances.

The key learnings are:

- When executing projects, companies need to define processes for exceptional approvals and should also keep tabs on the number of such approvals.
- Any spike in exceptional procurements close to deadlines may be a red flag for suspect transactions.

Additional Resources

<http://globalnews.ca/news/1324991/alleged-fraud-bribes-swirl-over-world-cup-host-brazils-new-stadium/>



Revenue Leakage While Operating an Infrastructure Asset

What does this case demonstrate?

This case demonstrates that a company's acts of omission and commission in pursuit of wrongful gains can result in a colossal loss of government revenue.

Keywords

Audits / India / toll collections / under-reporting

What was investigated in this case?

An autonomous Indian government agency responsible for the management of national highways filed a complaint against a construction company with the government's Economic Offences Wing alleging that the company was siphoning off money from road tolls. The agency also accused the company of forgery, criminal breach of trust and fraud.

The company, its directors, its officers and other persons were accused of having engaged in a criminal conspiracy with intent to defraud, which not only involved forgery of valuable securities by falsifying documents, electronic records, books of accounts, etc., but also involved under-reporting user fees and toll collections, all in full knowledge that the forgeries would result in wrongful losses to the complainants and the government of India and in wrongful gains to the company.

What happened?

Due to these allegations, a traffic survey with video recording was undertaken, along with a forensic examination of the computer systems and back-up data, to reveal any misuse or tampering. A forensic audit by an independent auditor alleged that the company had drastically under-reported the number of vehicles passing through the toll lanes, causing a daily revenue leakage of 1.5 million rupees (\$25,000) during a period of approximately a year.

What would you do?

How would you make it harder to under-report vehicular traffic and to siphon off revenues?

Why does this case matter?

There was an all-round failure in the project from planning to implementation to managing operations. The project was bid out in 2001, but the construction of the toll road was completed only in 2008. The traffic estimates that were used to design the project grossly underestimated the actual traffic flow. This led to long queues at the toll plaza during peak hours despite the fact that the toll plaza had 32 lanes and was the second-largest toll plaza in Asia. The operator allegedly used these queues to clear vehicles without issuing toll receipts and could then under-report traffic numbers as the data was not captured in the toll collection system.

The key learnings are:

- The traffic studies undertaken for toll-road projects should be scientific and rigorous.
- Toll-collection systems should move towards using electronic tags to eliminate congestion and human intervention.
- The data captured by toll-collection systems should enable a comprehensive analysis to generate red flags and reduce leakage.



Manipulation of Accounting Records at a Construction Company

What does this case demonstrate?

This case demonstrates that all-round poor controls at a construction company can lead to significant losses on projects and to the manipulation of accounting records.

Keywords

Accounting procedures / India / project managers

What was investigated in this case?

A subsidiary of a large construction conglomerate in India was in the business of designing and constructing facades for commercial, residential and sports projects. The company's project managers oversaw multiple projects simultaneously. The company did not maintain a management information system for use in bidding for projects and in controlling costs. Towards the close of the company's 2011-2012 fiscal year, the managing director indicated that the company was likely to report a very small profit. However, as the days progressed the marginal profit turned into a loss of \$10 million on a turnover of \$40 million, as the parent company discovered several dubious accounting entries. An internal investigation subsequently revealed that vendors appeared to have bribed project managers and that certain employees were shareholders or partners in vendor or competitor firms.

What happened?

The company did not force project managers to be accountable as long as projects met deadlines. The company had contracts with vendors for procurement of certain materials, but the project managers were free to use their preferred vendors for hiring scaffolding, equipment or labour at the project site. An internal investigation revealed that labour attendance records were manipulated and that there were no contracts for the period when scaffolding or equipment would be hired. One of the project managers was depositing cash at regular intervals in his bank account, at a branch that was close to the project site, in a different city from his residence. A few project managers and employees had joined together to incorporate private companies that were acting either as vendors for the construction company or as competitors.

Even though the projects were running into losses due to poor cost management and other leakages, the company continued to report profits to the parent company. This was managed by reversing expenses and by faulty revenue-

recognition policies, whereby revenue on projects was being brought forward. These irregularities continued for a few years before it became difficult to continue reporting profits as the company was running out of cash.

What would you do?

How would you monitor costs to ensure the integrity of project profitability reports?

Why does this case matter?

The key learnings are:

- The company did not have meaningful internal controls to monitor project expenditures and profitability. Even the bids submitted by the company for large projects were not backed by up-to-date estimates of materials and equipment costs.
- The accounting system used did not allow for project-based accounting of expenditures. The company required infusions of capital despite reporting profits. This was blamed on rapid expansion and multiple ongoing projects that caused temporary disruptions in cash generation.
- The project managers were given freedom to execute projects. This may be desirable normally, but in the absence of project-level controls, it became a problem. The project managers misused their freedom, resulting in high execution costs.



Compliance Programme to Achieve Cultural Change

What does this case demonstrate?

This case demonstrates that cultural change in an organization can be achieved when all the elements of a compliance programme are effective and that an effective compliance programme can add value to a company.

Keywords

Acquisitions / bidding / penalties / United States

What was investigated in this case?

In 1998 a US company was preparing a bid to supply equipment for the network operations centre of a high-risk jurisdiction country, prior to which it had appointed an in-country agent to help it market its products. Through this agent, the company developed a bribery scheme whereby large sums of money and lavish entertainments, including shopping excursions, were provided to government officials. These bribes were intended to induce the officials to give the company information on competing bids and to secure favourable consideration of its own bids. Later, as the company was being acquired, due diligence uncovered the bribes, which were reported to the US authorities. Under a plea agreement, the company was fined and was required to implement an effective compliance programme in order to detect and prevent any further illegal conduct. After implementation, the compliance programme identified continuing wrongdoing, which the company self-disclosed a year after the plea agreement. The company paid a further fine and strengthened all elements of its compliance programme, leading to a cultural change.

What happened?

This case shows that there was a gap between the company's culture and its code of conduct. There was a disregard for doing things in the right way across the organization. The discussions around the payments of bribes were conducted via emails, on which numerous people were copied, and payments were approved by people in management, yet few if any red flags were raised. Following the investigation, the company recognized a need for cultural change through an effective compliance programme and shifted the culture of the organization. The company now has an effective programme in place, has changed its culture and is a benchmark for other organizations wishing to implement effective compliance programmes.

Prior to the culture change, the company had a compliance programme with a code of conduct that set standards for the organization, but the other elements of an effective programme were missing. Under the agreement with the US Department of Justice, a rigorous compliance programme was put in place. As the programme strengthened, the organizational culture changed and the company's value increased. The company was then acquired by one of the largest companies in the world and continues to implement a strong compliance programme.

What would you do?

How would you execute a shift in a company's culture to adhere to an effective compliance programme?

Why does this case matter?

For a cultural change to occur, all aspects of a compliance programme must be effective. In this instance, monitoring and control, training and communication, leadership involvement, risk assessments and established standards were missing, which led to the failings in the system.

The key learnings are:

- The company had a code of conduct in place, which is a good start, but it is not enough. All other elements of a compliance programme, such as monitoring and control, training and communication, leadership involvement, risk assessments and standards, must be in place, communicated and effective.
- Cultural change takes time, persistence and determination. Although the company entered a plea agreement with the Department of Justice in 2004, the wrongdoing continued into 2005, when it was self-disclosed by the company.
- Without the right "tone from the top", a compliance programme alone cannot change the culture of an organization. In this case, new leadership was clear about the ethical direction it wanted the company to take.
- Revelations of wrongdoing can have severe consequences for an organization.
- An organization can increase its value by implementing an effective compliance programme. At the time of the plea agreement in 2004, half of the company was sold for \$900 million; three years after the implementation of the programme, the other half was sold for \$2.8 billion



Corruption with External Distribution Agents

What does this case demonstrate?

This case demonstrates that there are inherent corruption risks involved in employing external distribution agents.

Keywords

Agents / bribery / overpayments / Romania

What was investigated in this case?

The Romanian subsidiary of a multinational corporation employed a distribution agent for about ten years on the basis of a tacit agreement. A written contract with this agent had previously been rejected by a company compliance officer because of the obvious corruption risks.

In recent years, the payments made by the company to the agent had amounted to several hundred thousand euros. The money had either been paid in cash or been transferred to bank accounts in other countries, such as Malta, the Cayman Islands and Austria. The agent had not issued any proper reports detailing his activities, and his invoices did not reveal the services for which he had been paid.

Following an internal audit, the responsible managing director was dismissed, on the grounds that he had violated the internal compliance guidelines and disregarded the compliance officer's instructions. The dealings with the agent were also terminated immediately.

What happened?

- The employment of the distribution agent violated several provisions in the company's compliance guidelines. Hence, the compliance officer rightly withheld his approval in the first place. The main violations were:
- There was no written contract with a clear description of the agent's duties.
- There were no periodic activity reports.
- No integrity check was carried out. Payments were made into offshore bank accounts or in cash rather than into a single bank account held in the name of the agent in his country of residence.

There was no proper invoicing by the agent, making it impossible to check whether the payments were appropriate. Overpayments carry an inherent risk that the excess money is being used for paying bribes.

What would you do?

Based on the violations found by the compliance officer, what actions would you have taken against the managing director?

Why does this case matter?

The key learnings are:

- When employing a distribution agent, in particular in a corruption-prone country, a company must carry out detailed background checks.
- Contracts with agents must be in writing and must clearly stipulate the obligations of the agent and his remuneration.
- Payments may be made only against proper invoices detailing the activities performed and only into a bank account held in the agent's name with a bank in his country of residence. Otherwise, there is an inherent risk that the money will be used for corrupt purposes.



Facilitation Payments to Customs Officials

What does this case demonstrate?

This case demonstrates that companies shipping products to countries where corruption is part of daily life sometimes face demands by customs officials' for facilitation payments and that such demands can be dealt with ethically and effectively.

Keywords

Bribery / customs officials / Denmark / facilitation payments / licensing

What was investigated in this case?

A Danish company won a contract worth \$800,000 to supply products in a country where corruption is common. The local sales office filed an application for the import licence needed to ship the products to the customer. The application was rejected by the import licence agency, which said that a document was missing. The sales office reapplied three times, but the application was rejected each time due to "missing documentation". The licence agency suggested that the licence would be granted within five days if the company used an agent who would charge \$1,000 to handle the process. Failure to obtain the licence would leave the company's customer unable to fulfil its obligations. The company would lose business and would suffer damage to its reputation as a reliable supplier.

What happened?

- The official at the import licence agency was asking for a facilitation payment, which is a form of bribery and against the law in most countries. Two factors in this scenario indicate that unethical behaviour was occurring:
- The licence application was repeatedly rejected.

The official suggested that payment be made through an agent.

What would you do?

How do you think the company should have obtained the licence and avoided losing business?

Why does this case matter?

With the support of the foreign ministry in Denmark and the local Danish embassy, the company gained the import licence without paying a facilitation payment.

The key learnings are:

- When faced with requests for facilitation payments from an official, it can be useful to escalate the issue to a superior.
- However, in some cases, senior officials are aware of and benefit from corruption, so they are unlikely to take action.

Contact Information

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