



# African Development Bank African Development Fund

## Comprehensive Review of the AFDB's Procurement Policies and Procedures

### *Summary of Literature on Fraud & Corruption in Public Procurement*



FRAUD & CORRUPTION

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This summary has been prepared by a Consultant and the views expressed herein are those of the Consultant and not of the Bank.

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## ACRONYMS

AfDB	African Development Bank
BDs	Bidding Documents
ECA	Economic Commission for Africa
HLF	High Level Forum
ICB	International Competitive Bidding
IFIs	International Finance Institutions
IMF	International Monetary Fund
ITB	Invitation for Bids
MDBs	Multilateral Development Banks.
OECD	Organization for Economic Cooperation and Development
ORPF	Procurement & Fiduciary Services Department
UNCAC	United Nations Convention against Corruption
WB	World Bank

# **SUMMARY OF LITERATURE ON FRAUD & CORRUPTION**

## **IN PUBLIC PROCUREMENT**

### **I. OBJECTIVES**

1. The objectives of this Paper are to review, analyse, synthesise, and to summarise background documentation available in the public domain concerning the theme of **fraud and corruption in public procurement**, which could be of relevance to, and also inform the Bank's review of its procurement policies, procedures and processes.

### **II. FINDINGS**

2. This Summary relies on an extensive number of publications and articles, all of which are itemised hereafter, in the List of References and Resources. Among these, due note needs to be taken of the following, besides information existing in Bank (ORPF) documentation: *Debarment as an Anti-Corruption Tool in the Projects Funded by MDBs – Dissertation*; *Combating Corruption in the Multilateral Development Banks*; *Corruption in Public Procurement: Causes, Consequences and Cures*; *Corruption and Government: Causes, Consequences and Reforms*.
3. The etymology of the word “corruption” originates from the Latin verb “*rumpere*”, which means “*to break*”. Consequently, corruption occurs when something is broken. No country is immune to corruption. This is because corrupt behaviour is a pervasive human failing. However, those who suffer the most from this phenomenon are poor people in developing countries.
4. In general, corruption in poor countries is perpetrated by, and maintained through, a culture of silence, while more often than not, being extended by secretive cults, as well as political and/or criminal repression. This cultural opacity [or, lack of transparency], is upheld through ignorance, and by national “secret acts” that protect official corruption. Citizens have not been educated and empowered into questioning sudden and unexplained wealth, or ostentatious living. Since there is no real freedom of information (and, the law may not entirely protect informants), investigative journalism remains undeveloped.
5. Under the circumstances, the law-enforcement machinery itself is weak, and, worse, may be part of the problem. Because there is no strong tradition for the declaration of assets by government officials or politicians, there is little possibility for organising an “*audit trail*” with respect to ill-gotten “*personal wealth*”.
6. It is therefore against this backdrop that, each year, MDBs must spend billions of dollars on loans intended for development and reduction of poverty in poor countries. Whereas, these efforts shall surely be in vain if the funds were allowed to be lost through corrupt practices.

7. Corruption is not a new phenomenon. It has been in place for as long as there has been a willingness to accept different kinds of favours in exchange for conducting private affairs, business or carrying out government policy, in the interests of certain individuals. The first documented cases of bribery date back to the year 3000 B.C. and seven centuries ago, *Dante* placed bribers at the bottom of Hell, demonstrating thereby the negative attitude to corrupt behaviour.
8. Corruption has been described as “**a prism with many surfaces**”. As such, the element [“something”] said to be “broken” (in the etymology) depends on which angle the occurrence is viewed from. For example, it could be a moral, social, political or economic code of conduct, as well as criminal, civil or administrative law. However, to comprehend the whole picture and, in order not to see just one side of the prism [by presenting corruption, for instance, as a criminal behaviour], it is necessary to take a broader view thereof.
9. Although corruption has been defined in many different ways, there is no generally accepted definition that applies to all forms, types and degrees of corruption. In most cases, observers need to agree on whether a certain behaviour constitutes corruption. Unfortunately, the behaviour is often difficult to observe because acts of corruption do not typically take place in broad daylight.
10. Difficulties in arriving at a common definition of corruption are rooted in legal and political considerations, as well as in varying attitudes and customs in different cultures. For example, gift-giving in many village traditions is not considered as corruption, since the transaction is not made “...**under the table**...” It is open and transparent; the scale is not life-changing; the benefits are usually shared within the community; and no public rights are violated. In fact, corruption should not be about “...**putting one's fingers in the till but more about the abuse of power or improbability in the decision-making process**...”
11. This issue of definition is amplified and compounded by the fact that, in many circles, corruption is so ingrained in daily exchanges that it is tolerated, and accepted to be normal behaviour, e.g.: “...**greasing the wheels of business**...” Given the insidious nature of corruption, people have become inured (or blasé) thereto, and this culminates in the existence of “agents” that serve as liaison with decision-makers. Thus, it is the need to modify attitudes that could present the most difficulty in the combat against corruption, especially, in poor countries, which, at any rate, possess a low forensic capacity to detect corruption.
12. Because of the discrepancy in notions of corruption in different societies, this presents some challenges for concerting international efforts to combat the phenomenon. For example, during the negotiations of the *United Nations Convention against Corruption* (UNCAC), it was decided not to define corruption at all, but to establish a wide range of acts constituting corruption. The Convention included not only basic forms of corruption, such as bribery and the embezzlement of public funds, but also trading in influence, concealment, and laundering of the proceeds of corruption, as well as

offences committed in support of corruption such as money-laundering and obstruction of justice.

13. Other international or multilateral efforts that define and combat corruption include: the United Nations Convention against Transnational Organized Crime; the Convention on the Fight against Corruption involving Officials of the European Communities or Officials of Member States of the European Union (the EU Convention); the Civil Law Convention on Corruption; the Organization of American States Inter-American Convention against Corruption; the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions; the Council of Europe Criminal Law Convention on Corruption; and the African Union Convention on Preventing and Combating Corruption.
14. The World Bank identifies corruption as the “...**abuse of power for private benefit**...” Similarly, Transparency International defines corruption as the “...**misuse of entrusted power for private gain**...” Obviously, these definitions imply public corruption, which involves a government official benefiting at the expense of the taxpayer, or at the expense of an ordinary person who comes into contact with government. Thus, (and, in reverting to our etymology), the element said to be “broken” becomes **public trust**.
15. In this regard, the range of acts of behaviour that constitute the forms and types of corruption has been agreed upon by MDBs and IFIs, and incorporated in their procurement policies. The version of AfDB is reproduced below, as an example:
  - (i) “**corrupt practice**” is the offering, giving, receiving or soliciting, directly or indirectly, of anything of value to influence improperly the actions of another party;
  - (ii) “**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;
  - (iii) “**collusive practice**” is an arrangement between two or more parties designed to achieve an improper purpose, including to influence improperly the actions of another party;
  - (iv) “**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;
  - (v) “**obstructive practice**” is:
    - (a) 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

- (b) acts intended to materially impede the exercise of the Bank's inspection and audit rights.

16. However, from the wider community of business, commerce and industry, other acts of reprehensible behaviour can usefully be added to the foregoing forms of corruption [taking due cognisance of the potential for overlaps in terms, under the circumstances], viz.:

- i. Bribery is the practice of offering something (usually money) in order to gain illicit advantage;
- ii. Extortion: is the act, or an instance, of coercing someone by force, threats, or abuse of authority, to give something valuable, such as money, information, excessive interest, or the like;
- iii. Nepotism: is the favouritism shown to relatives, or close friends, by those in power, i.e., giving them jobs/privileges/pay raise, etc.;
- iv. Embezzlement: is the fraudulent appropriation of funds or property entrusted to a person's care, but actually owned by someone else;
- v. Unethical Business Practice: actions not conforming to approved standards of social and professional behaviour.

17. In the case of the MDBs and IFIs, sanctions have been provided in the policies for application in cases of corruption, including: (a) the rejection of the recommendation for bid award; (b) the declaration of a misprocurement; (c) sanctioning; (d) bank rights to inspect project contract accounts, and audits. And, finally, inclusion in bidding documents of the fraud and corruption laws of the country.

18. However, it must be understood that this high road taken by MDBs and IFIs, with regard to combating corruption has very recent origins. Because, until the early 1990s, the problem of corruption in international development projects had barely been addressed, either at the national or international level, although everyone knew about its existence. The MDBs had no incentive even to speak or write the word "corruption" regarding their loans. For, no matter how much was stolen, they were confident that they would not have to "...**shoulder any financial burdens**..." Institutions like the World Bank had a global "**don't ask, don't tell**" policy regarding corruption, which was even a taboo subject there for a long time, and used to be referred to discretely as the "**c-word**".

19. In this respect, the watershed moment occurred as the result of a speech given by James Wolfenson, then President of the WB, at the 1996 annual meetings of the WB and the IMF. The speech stressed the need for the international development community to deal with the "...**cancer of corruption**..." Following this clarion call to action, the situation changed

dramatically. For, the taboo was broken; MDBs started addressing the problems of corruption in project financing; and, the fight against corruption became global. Since then, significant changes have occurred in attitudes and understanding among MDBs and IFIs. New anti-corruption policies have been created to reduce the levels of corruption, by addressing with greater care, the issues of selection and supervision of projects.

20. With regard to the imperative for tackling corruption on MDB-financed development projects, it has been observed that it took much time and effort to make society (and the world at large), to understand that fraud and corruption are the greatest obstacles to development. In a survey of more than 150 high-ranking public officials and key members of civil society (from over 60 developing countries), public sector corruption was rated as the most severe obstruction to development and growth. Corruption in developing countries is not simply a domestic problem, but it often involves a variety of actors within and outside.
21. The efforts of international organizations to reduce poverty in poor countries (by providing development funds) shall fail if these funds were stolen, thus making poor people “...**even poorer, by denying them their rightful share of economic resources or life-saving aid...**” Cases like the United Nations Oil-for-Food scandal proved the necessity for more action to be taken by international organizations to protect their financial interests and safeguard taxpayer funds.
22. The ECA opined that “...**good governance is the key...**” to the economic growth of Africa, and, stated in its report of 2005 that, unless there were positive changes in accountability and reducing corruption, other reforms and external support would have only “...**limited impact...**” Similar statements were made by President *Barack Obama* during a trip to Africa, pointing out that “...**development depends upon good governance...**” and “...**that is a responsibility that can only be met by Africans...**” However, it has also been argued that Mr. Obama's message was implicitly addressed also to aid donors, which have had a tendency, especially, up until the recent past, to conceal the situation about poor governance and corruption in African countries.
23. MDB projects are implemented through public procurement. And, a common example of project level corruption is when public officials award the relevant contracts to their friends, or accept bribes during the bidding process, acts that could surely lead to individual gains for such officials, but which, in the long run, could result in either poor quality facilities, or, in extreme cases, no facilities at all. [“...**Funds desperately needed to combat poverty and disease, and to build roads, hospitals and schools are spent instead on everything from palaces on the Riviera, to acres of shoes made of snakeskin, satin and ostrich...**”]
24. According to specialists in the matter, in the process of lending several billions of dollars, the WB thereby exposes itself to significant operational risks of fraud and corruption. Thus, it was estimated, that, by 2002, the World Bank lost about \$100 billion of loan funds to corruption. And, upon tallying similar

- losses from other MDBs, the amount of development assistance lost to corruption would double to \$200 billion.
25. In terms of specific damage, the Africa Union estimated [2002], that corruption cost Africa USD 148 billion a year, compared to Africa's Overseas Development Assistance inflow of USD 22.3 billion a year. According to Transparency International [2004], an increase in corruption by 1 point on a 10-point scale lowers a country's productivity by 4% of GDP. Also, a decrease in corruption by 1 point on a 10-point scale increases foreign direct investment by 19%.
  26. According to expert opinion, corruption proliferates and is perpetuated by certain key factors, notably: lack of resources, education, and jobs; poverty, in general; conditions under which it is difficult to make money legally; greed and low moral standards of an individual; disgruntled employees; incentive incompatibility; vicious circles; lack of accountability; lack of monitoring; or, where managers are a bad example to employees.
  27. In this regard, John Kithongo, the well-known Kenyan anti-corruption activist defined three "Levels" of corruption in the public sector, viz.:
    - i. Petty Corruption: under which small cash or favours are given in exchange for speeding up (private or state) transactions;
    - ii. Grand Corruption: concerning which irregularities occur in public procurement contracts, or in revenue-collection rebates, or write-offs (that could amount to several hundreds of thousands of dollars), with some political cover;
    - iii. Looting: involving acts that may be sanctioned or created for political purposes; e.g., government would place contracts with non-existent organisations, or goods are never delivered. Looting is damaging to the national economy, and, usually, proceeds are externalised quickly [e.g., into Swiss or other tax haven accounts].
  28. Critics refer to such stolen funds as a "**criminal debt**". Usually, countries have some form of a public debt, which must be repaid to creditors by their citizens. On the other hand, "criminal debt" refers to the proportion of total borrowed financing that has been stolen. Although the benefits from these resources would have been enjoyed privately, the fiscal burden of repaying the criminal debt is borne publicly. Critics argue that the debt is criminal for two reasons. Firstly, it was a crime to allow funds meant for development to be stolen; and, secondly, it would be an injustice to make poor people (who would have been denied the full developmental impact that the project could have achieved), to bear the heavy burden of repayment. Indeed, corruption can sometimes place the burden of repayment of loans on some of the poorest people in the world. And, whether they would have received just 70% of the benefits of the MDB loan proceeds, they would nevertheless be obliged to repay 100% of the loans they have never received, plus interest, as applicable.

29. It is worth mentioning, that the percentage of aid funds lost through corruption does not represent bribe *per se*, but, more appropriately, inflated contract costs, as well as the loss of equipment and other inputs that result from tolerating bribery. The money paid as a bribe must be recouped from some part of the project budget. Thus, this generally results in increased prices [***inflated/additional costs***], while, correspondingly, quality diminishes [i.e., ***optimum goods/service quality not received***]. Consequently, one ends up with a less effective project [i.e., ***best value-for-money not achieved***]. At any rate, once an act of corruption has occurred on such a project, the decision-makers, supervisors, and other responsible officials would have no moral leg to stand on with respect to enforcing the ultimate achievement of its objectives.
30. Just as damaging, when less-qualified bidders are awarded contracts, due to corrupt and fraudulent behaviour, qualified bidders do, understandably, lose trust in government institutions, and confidence in the system. Therefore, ultimately, such bidders stop participation in bid processes, entirely [i.e., they experience "***bidder fatigue***"].
31. While acknowledging the failings of developing countries (i.e., lack of accountability, good governance, integrity, etc.), other critics have turned reproachful sights on donors. These critics have opined that, when financing from international organizations is at stake (either as loans or grants), these institutions (for the sake of efficiency of investment and development assistance), must show a keener interest in the effective use of such resources. Under those circumstances, the donors and development banks themselves should be held responsible, because of the following arguments:
- i. ***Provision of funds with no follow-up on their use:*** MDBs were more concerned about "...*pushing money out the door...*", while looking the other way. In those rare cases when there were some supervision, procedures were result-oriented.
  - ii. ***Selection of large-scale projects in nations prone to corruption:*** Countries with governments known to be opaque used to receive funding in the same manner as transparent ones. Whereas, according to such critics, kleptocratic states should not be helped to become more efficient at controlling and exploiting their own population, and MDBs should not help autocrats collect taxes more efficiently. Other critics argue that the approach of the MDBs changed some time ago, and they would not now fund governments with "...*extreme misgovernance in financial aid...*", as would have happened a couple of decades ago.
  - iii. ***Ignoring the possibility of corruption when drafting contracts:*** For example, leaving out clauses that could possibly prevent bribery or other corrupt acts.
  - iv. ***Closing eyes to notifications of corruption:*** The Lesotho Highlands Water Project was an example of a development project for which very few outside institutions offered help in prosecuting corrupt corporations, whereas poor countries are unable to do it without external aid.

32. Although some of the foregoing criticisms may sound dated, and may not relate to the reality of today, they nevertheless provide an insight into the issues that have led to the most recent reform measures, which have been taken by MDBs to improve the frameworks of, or the atmosphere surrounding development projects.
33. Besides, as argued by other specialists, because MDBs often play a key role in major infrastructure projects, their posture can influence the course of key economic activities of governments and private parties around the world. This results from the fact that MDB officials are technocrats representing no particular political ideology. In addition, MDB policies and practices may also influence the practices of private lenders participating in such projects. Thus, from all indications, good governance remains a key to the effectiveness of development assistance, and the impact of international aid can best be demonstrated in a corruption-free environment.
34. Notwithstanding, it should also be noted that, in the view of other critics, while there may be numerous projects and programmes all over the world aimed at improving governance, they mostly would tend to avoid addressing complicated governance and corruption issues. Whereas, on the contrary, coming to grips with the thorny governance questions should be seen to be of great significance for development.
35. Given the pervasive nature of corruption, its ramifications cut across different methods of procurement, be it International Competitive Bidding (ICB), or any of the other methods itemised in the Bank's **Procurement Rules**. Indeed, irrespective of the procurement method, care must be taken to ensure that the process is based upon good governance and integrity. Under the circumstances, a key reference document is the **OECD Principles**, designed to prevent mismanagement, fraud and corruption in public procurement. The 10 Principles (intended to strengthen integrity and raise confidence in the management of public funds), are divided into four groups, as follows:

A. Transparency

- a. Provide transparency in the entire procurement cycle in order to promote fair and equitable treatment for potential suppliers.
- b. Maximize transparency in competitive tendering and take precautionary measures to enhance integrity.

B. Good management

- c. Ensure that public funds are used in procurement according to the purpose intended.
- d. Ensure that procurement officials meet high professional standards in knowledge, skills and integrity.

C. Prevention of misconduct, compliance and monitoring

- e. Put mechanisms in place to prevent risks to integrity.

- f. Encourage close cooperation between government and the private sector to maintain high standards of integrity.
- g. Provide specific mechanisms to monitor public procurement as well as detect misconduct and apply sanctions accordingly.

D. Accountability and control

- h. Establish responsibility along with control mechanisms.
  - i. Handle complaints from potential suppliers in a fair and timely manner.
  - j. Empower civil society organizations, media and the wider public to scrutinize public procurement.
36. The elaborate and wide-ranging nature of the **OECD Principles** should not be lost on the observer. For, the approach demonstrates the ambitions of the international development community to combat the grave social ills engendered by corrupt and fraudulent behaviour.
37. In this quest, and despite all the “**cloak and dagger**” surrounding fraud and corruption in public procurement, one should posit that there surely must be ways and means through which ordinary citizens may be informed and empowered to recognise the manifestations (or symptoms) thereof. In this regard, experts declare that, for an instance of fraud and corruption to occur, the following conditions must be met:
- a. the act must be intentional, breaking a rule, which is precise and transparent;
  - b. the breach of the rule must be beneficial to the offender and/or people related to him; and
  - c. there must be a direct link between the specific act and the benefit derived therefrom.
38. It must be recalled that public procurement lies at the crossroads of the public and private sectors. A significant part of government budget is spent on procurement of goods and services. Total government procurement worldwide was estimated to be roughly equivalent to 82.3% [1998] of world merchandise and commercial services exports. Given this situation, the temptation to transform public funds into private gain is quite high: This makes public procurement more vulnerable to corruption than any other sector. Transparency International estimated that the amount lost through bribery in government procurement alone was at least \$400 billion per year worldwide [2004] while other estimates put it closer to \$1 trillion.
39. At the same time, the lack of efficiency and waste of donor resources (through corruption) can cause serious damage to public interest. Instead of focusing on the highest quality for the lowest price, borrower officials rather purchase goods or services from the best briber. According to ECA estimations, the false costs resulting in worse quality and unnecessary purchases can add at

least 25% to the costs of government procurement. Consequently, too much can be paid for too little, or even nothing at all. Thus, preventing and sanctioning corruption in public procurement must remain an essential topic.

40. To this end, experts distinguish between **political** (or **high level**) and **administrative** (or **bureaucratic**) corruption. Accordingly, political corruption takes place during the budget preparation phase (i.e., when political decisions are made). Bureaucratic corruption occurs during the budget execution phase. In addition, the ECA report [2005] considered not only politicians and public officials as being responsible for existence of “**signature bonuses**” [the euphemism for bribes], but also placed into the same bracket, the bankers, lawyers, accountants, and engineers working on public contracts.
41. In all honesty, it should be recognised that there is a potential for (and risk of) corruption in public procurement in all countries, and in all sectors. Nonetheless, some sectors of public procurement are more exposed to corruption due to the complex nature of the works, and also, the large related contract amounts. Among the more “*popular*” industries for corruption are: public works and construction of highways, bridges, dams; arms and defence; oil and gas; real estate; telecommunications; power generation; and, to a degree, financial services.
42. It is generally agreed that one of the fundamental obstacles in combating fraud and corruption in public procurement is the difficulty in detecting wrongdoings. This difficulty arises from the fact that there is often no clear offender or victim, but rather, a group of individuals in collusion, with a common interest in keeping their corrupt acts secret. Besides, corruption in the procurement process is far from being limited to direct bribery. For, there are many complicated ways of diverting funds and concealing them. Therefore, efforts aimed at enhancing governance and integrity are indispensable for preventing corruption and, consequently, the waste of public resources.
43. Notwithstanding the obstacles, it is possible, in theory at least, to pinpoint situations and the potential “**actors**” that could be involved in corrupt “**transactions**”, as hereunder:
  - i. a member of staff with spending influence or responsibilities defrauding his employer;
  - ii. suppliers defrauding their customers;
  - iii. suppliers and purchasing staff colluding to defraud the buying organisation;
  - iv. purchasing staff making personal gains at the expense of the supplier;
  - v. buyers blackmailing suppliers; and
  - vi. buyers misusing intellectual property.

44. In the same vein, it is no less obvious that, to be able to tackle a problem, it is necessary to clearly understand it. Therefore, in order to eliminate or reduce corruption in MDB projects, it is essential to explore the methods and techniques used by miscreants to misappropriate funds, and then make a fraudulent transaction look legitimate to auditors. This knowledge will contribute to developing adequate combat readiness and indicators to prevent fraud and corruption, as well as help to detect or unearth misdeeds, when they occur.
45. To this end, one must recall that the “project cycle” generally consists of three broad phases, each of which contains a number of stages:
- i. Pre-Tendering Phase [covering: identification of needs; planning/budgeting; and designing and/or defining project specifications];
  - ii. Tendering Phase [invitation to tender; bidding process; bid evaluation; and contract award];
  - iii. Post-Tendering Phase [contract implementation; supervision; and *post-evaluation*].
46. And, because all these stages are procurement-related, the term “procurement cycle” often corresponds to the entire project cycle. To outline the most common manifestations of corruption and fraud within the project cycle, therefore, one must examine and comprehend opportunities occurring during a number of key stages, namely:
- Identification of Needs
  - Project Preparation
  - Bidding and Contract Award
  - Contract Implementation
  - Contract Supervision
47. In this regard, the stages relating to the formation of the contract [i.e., from the *preparation of specifications* to *contract signature*], have been referred to as the “*tip of the iceberg*”, since they are the most regulated and transparent elements of the entire procurement process. Thus, such stages may be “relatively” less exposed to the risks of corruption. In contrast, the stages of *identification of needs* and *contract implementation* are less transparent, and have thus proved to have higher incidences of corruption, because they are usually not reflected in, or adequately covered by, procurement regulations. According to experts in the matter, the most frequent (or, rather the more obvious) forms of corruption in MDB-financed projects are the following:
- corruption in award procedures, usually involving bribes between government and contractor officials;

- fraud by contractors manifesting itself in the submission of false information to the procuring entity;
  - the “siphoning off” of loan proceedings by government officials for unauthorized use.
48. However, as indicated earlier, the truth remains that corruption can and does occur at any stage or phase of the process. Consequently, measures should be taken to address the attendant risks within the entire procurement cycle, regardless of its form or degree.

### A. Mechanisms/Symptoms observed during: Identification of Needs Stage

49. At this stage government decides what to buy. Normally, the laws on procurement and on public works establish that this decision must take into account the national development plan, technical programs, administrative support, the fiscal and financial calendar, maintenance requirements, and the short-, medium- and long-term goals and objectives, among other factors.
50. To the total exclusion of any real procurement planning, many agencies simply decide to acquire goods or services directly [Direct Purchase], without opening the bid opportunity up to competition. The usual justification (or rather, excuse) may be urgent needs that arise very late in the “planning” process. Although DP does not necessarily mean the occurrence of corruption, it can lead to inefficiencies [e.g., ***inflated prices***], and the signing of contracts with unknown companies, often owned by close relatives of the head of an agency, which have no experience in the field of work under consideration [***nepotism/cronyism***]. The symptoms may include:
- a) *Modified or falsified Needs*: Changing or falsifying needs is a common way of justifying purchases, works or services that are often unnecessary or disproportionate to actual needs. The decision may not necessarily follow a policy rationale, or meet an existing need, but rather follow the desire to bring benefits to an individual, or an organization. For example, demand is created for goods of little or no value to society to favour particular suppliers.
  - b) *“Tagged” Contract*: Sometimes decision-makers include in the budget a contract with a “certain”, prearranged contractor or supplier, in order to pay back old political favours, or kickbacks.
  - c) *Conflict of Interest*: Conflict-of-interest situations may lead to bias, and can affect the decision-maker's choice on the need for contracts that impact their old employers (***revolving doors***).
  - d) *Unnecessary, falsified or subjective Studies*: Studies are often indispensable in order to identify needs. However, sometimes unnecessary studies are carried out by a favoured firm but never delivered or claimed, even though advance payments would have been made. Or, the results of the initial study commissioned from a competent

organization are passed on to fictive firms that plagiarize them. In other cases, studies performed by the companies that have a relationship with the company or companies that will participate in the bidding process can falsely conclude that particular services or goods are needed. As such, these studies not only generate the need they are intended to identify, but also create an illicit advantage for a firm or a group of firms.

## B. Mechanisms/Symptoms: Project Preparation Stage

51. After the Identification of Needs, it is necessary to establish the project costs and then prepare the designs and/or schedule of supply requirements, specifications and other sections of the bidding documents. The purpose is to enable a thorough analysis and preparation of the administrative and technical documentation that must precede the invitation for bids.

### 1) Determining the Project Budget

52. At this stage corrupt acts can be committed through the deliberate misevaluation (***under-*** or ***over-valuation***) of the project estimates, e.g.:

- a) ***Undervalued Estimates***: Underestimation is frequent, and it usually occurs so that the proposal can easily be approved. To this end, the expected project benefits are maximised, while the costs are minimised. This engenders the risk of the need for supplementary funds at a later stage, which will subsequently inflate the initial cost. But, since it would already be too late to proceed otherwise, the additional costs are rarely negotiable, and are awarded to the winner of the initial contract, who, in turn, “returns the favour” to the decision-maker.
- b) ***Overvalued Estimates***: In situations with a high probability that a contract will be awarded, whatever the circumstances (e.g., due to the crucial nature of the goods or services in question), the estimates can be overvalued. The winning bidder will thus have a comfortable margin, part of which may be returned to the decision-maker, without increasing the initial contract sum. By the same token, there will be no suspicion of any “favours”, since the actual price ends up being quite close to the initial estimates.

### 2) Preparation of Project Specifications

53. After estimation of the Project Costs, it is necessary to set out (design and prepare) the Technical Specifications. During this stage, corrupt acts committed by public officials and potential contractors are especially hard to detect, because the latter are supposed to lack knowledge of the technical aspects of a particular project, viz.:

- a) ***Preference for a Single Supplier***: Bidding documents can be made to include hand-tailored specifications, which can only be met by a particular bidder, thereby making competition either impossible, or restricted. Another variation on this technique is to transmit the specifications prepared by the technical staff of the decision-maker to the bribing

company, which will then copy them into its bid. Consequently, it will submit to the decision-maker exactly what the latter wants.

- b) *Inaccurate Data*: Quite often, some information that would have been deliberately concealed, or omitted from the specifications made available to potential bidders, whereas only one or more “favoured” bidders would receive the correct data. The informed firm may neglect incorporation of a particularly costly requirement in its estimate and win the contract thanks to a bid that is lower than those of the competitors, but which provides for a higher margin, nevertheless.
- c) *Unnecessary complexity of Bidding Documents or Terms of Reference*: This technique is used to create confusion, and to hide corrupt behaviour, while making monitoring difficult. In such cases, it would appear reasonable to hire a consultant to simplify and make the bidding documents understandable. However, since the decision-maker's technical personnel is usually quite capable of understanding and explaining the said documents themselves, hiring the consultant constitutes a means to “**camouflage**” commission payments to the decision-maker, or his friends.
- d) *Excessive Technical Requirements*: Sometimes, the Technical Specifications may be so detailed and specific that it rules out the competition, by giving undue advantage to a bribing company. For example, requirements for specific certifications that could be unnecessary for, or irrelevant to, the evaluation of the bid. However, failure to fulfil this requirement can result in the disqualification of a bidder.

## C. Mechanisms/Symptoms: Bidding and Contract Award Stage

54. This stage begins with the bid advertisement and ends with the selection of the winning bid. Here again, different methods of corrupt behaviour can be observed, e.g.:

### 1) Invitation to Bid

- a) *Reduced Publicity*: One of the ways to make the bribing company win a contract is to reduce competition, by holding on to the Invitation for Bids (ITB), and keeping the project as a secret, for as long as possible. This technique involves:
  - non-publication of the ITB, by justifying it under a state secrecy law, exclusive rights, research or experimental work, or as additional supplies, or works;
  - publication of ITBs in media sources with limited circulation;
  - making the ITB public during holiday time, when most administrative offices would be closed; and

- sending the ITB to several companies, to make the competition appear real, whereas such companies may possess completely different areas of expertise; or to a limited number of companies, while blaming the mail system, afterwards.
- b) Unrealistic Deadlines: Sometimes ITBs may be disseminated with a short deadline for the presentation of applications, thus depriving bidders not so notified of the chance to submit a credible offer. As a result, only notified bidders can prepare the bidding documents. The shortened deadlines are often justified under false claims of urgent situations requiring a shorter tender period, but in fact, the objective is to exclude undesirable candidates. Time restrictions may also create a monopoly position for a bribing company, with the attendant inflated prices.

## 2) Bidding Process

- a) Difficult Conditions for obtaining Bidding Documents: Sometimes conditions for obtaining the bidding documents (BDs) may enable only a limited number of bidders to do so. For example, BDs may have to be obtained exclusively in person, without any possibility for mailing them to potential bidders. Or, the costs for obtaining the BDs may be excessive.
- b) Abuse of Confidentiality Clauses: A company may pay to obtain inside information about minimum and maximum price thresholds, average-offer prices, and project evaluation criteria, and, as a result, can obtain the contract formally without any other irregularity. Although corruption in the divulgence of information is difficult to prove in court, it is also difficult for a company to be sure that it is the only buyer - “...**the value of 'confidential' information is inversely proportional to the number of people who possesses it...**” Besides, it has no judicial guarantee of obtaining what it has paid for [unless the courts were to be corrupt, themselves].
- c) Split Contracts: In some cases, large contracts can be split up into several smaller ones, in order to be exempt from an open bidding process, and thence avoid the legal obligations regarding bid publication. As a result, these contracts can be awarded to “ghost” companies. In this instance, although bills would be submitted under various company titles, in reality all the work would be undertaken by the one company. For example, instead of purchasing a large quantity of personal computers in one process, the contract may be split into several smaller-value lots, and acquired through Direct Purchase, thereby avoiding an open tendering process.
- d) Collusive Agreements: Sometimes companies that could have been regularly selected may collude together, or conspire with procuring entities, to secure contracts without having to compete, in the real sense. This practice enables them to share markets, by splitting contracts among the group, according to agreed criteria (work planning, difficulty of the work, deadlines, etc.). As a result, those in collusion increase their bid prices to be able to “compensate” their colleagues who may not have

been selected [***because of artificially losing bids***], or not presenting offers [***through subcontracting or various forms of compensation***] and the decision-maker [***via commissions***].

### 3) Bid Evaluation and Award

- a) Short-Listing/Prequalification: When short-listing and prequalification are applicable (in order to limit the number of competitors), according to their previous experience (etc.), a company may pay a bribe to be included in the list.
- b) Biased Criteria: Decision makers may be biased due to bribes, or conflicts of interest. This corrupt behaviour may remain unnoticed, when selection criteria stated in tender documents are vague enabling the classification of bids to be changed, and leaving room for subjective evaluation of bids and biased assessments.

## D. Mechanisms/Symptoms: Contract Implementation Stage

55. Acts of corruption can also occur once the contract has been awarded. The following forms of misappropriation can transpire during the implementation of the contract:

- a) Lower Quality: Winning bidders/contractors may compensate bribes [and other extra financial outlays] through poor quality, defective (or inferior) specifications compared to those in the contract. Also, it can happen that contracts are awarded, and prices agreed upon based on the capacity of an international company, whereas, in reality, the work will be carried out by personnel from local companies, who may lack the relevant experience and qualifications. Another example is delivery of goods of lower quality compared to those specified in the contract. Lower quality is difficult to detect, especially in works, since its consequences do not appear immediately.
- b) Change/Variation Orders: Sometimes after the award, substantive changes may be introduced to the contract, such as changes in specifications, or cost increases. But it can also happen, that a supplier would be asked to change the order, for a less expensive product, just before delivery. Since the product would have already been billed, and the scheduled price is higher than that of the goods delivered, the supplier would post a credit voucher (or cheque equal to the difference), to an account in a name not identical, but so similar to that of the authority, that a “mistake” can easily be made. To make this technique successful, the authorised purchaser must be in collusion with the person in charge of verifying the goods supplied, since they would not conform to the items on the invoice.
- c) Sub-Contracting: The involvement of a large number of firms, either as members of a consortium (to which a contract would have been awarded), or as sub-contractors, is a convenient way to dissimulate acts of corruption. For, the risks for corruption become higher when a cascade

sub-contracting system takes place, that is, sub-contractors themselves sub-contract out work, since there is often little or no vigilance over the selection of the sub-contractor. Such cascaded contracting can be used to produce amounts to be remitted afterwards to the decision-maker, through using the methods of **false invoices** or **undeclared work**.

- d) **False Payment Claims**: Contractor's claims can be false, inexistent or inaccurate, and nonetheless, they are filed and protected by those in charge of supervising or controlling them. A claim may be considered false in the case of the submission of invoice for the services not rendered, goods not delivered, or deliveries of lower quality than that specified in the contract, as well as false documents during the bid, or in an effort to get the invoice paid.
- e) **Double (or Multiple) Payments**: Another recurring mechanism is the paying for a study, which would already have been received, but under another title, and for which payment would already have been settled. This practice, known as "**recycling**", can be quite profitable, is easy to use (even on several occasions), but hard to detect without knowledge of the existence of the initial study, which would have been issued under a different name.
- f) **Late Payments**: Late payments of invoices, postponement of payments to have prices reviewed, in order to increase the economic value of the contract.

## E. Mechanisms/Symptoms: Contract Supervision Stage

- a) **Biased Decisions**: Contract supervisors and auditors (where applicable) may be "bought" or biased due to conflicts of interest. As a result, they close their eyes to false claims, certificates, changes in quality, specifications etc.
  - b) **Inability or Failure to Apply Penalties**: Sometimes it is impossible to apply sanctions for violations of specific conditions, due to the deliberate omission of relevant clauses (for example, penalty clauses for missed deadlines, modified orders, etc.), from the contract, or the unwillingness of the decision-maker to enforce them.
56. Consequently, faced with this mountain of information about the actors, situations, symptoms, and mechanisms of corruption in public procurement, it would appear obvious that the issue of what MDBs can do to tackle the behaviour (in its various forms and types) should not remain in the realm of rhetoric. This is because the anticorruption agenda has already pointed the way forward. For, in the view of anticorruption activists, "**...when international agencies are found to have financed corrupt transactions, they - not the consumers - must bear appropriate responsibility for outstanding loans and credits...**"
57. However, without having to apply such an extreme solution, it should be recognised that, to an extent, the role of MDBs in public procurement is

complex. On the one hand, they fund projects and bear the main responsibility for defining, planning and supervising them. Whereas, on the other hand, the mandates, powers and jurisdictions of MDBs are, in most cases, limited. For example, the MDBs, as administrative organizations, can exercise administrative sanctions. They do not, however, have the *subpoena* powers, or the prosecutorial prerogatives of governmental agencies. The success of MDB efforts in fighting corruption must rely, to a great extent, on cooperation with national law enforcement, other agencies, as well as with other organisations.

58. To improve aid effectiveness through better coordination mechanisms, the donor aid community initiated [2003] an *Aid Effectiveness High Level Forum* (HLF) in Rome. In the Paris Declaration, adopted as an outcome of the Second HLF [2005], donors agreed on commitments with respect to governance, transparency and mutual accountability. During the Third HLF in Accra, [September 2008], an issue of the lack of transparency on how official donor monies were being spent was raised, which was later included in the final resolution: “*The Accra Agenda for Action*”.
59. In discussing the role of MDBs in reducing corruption, specialists in the matter distinguish between efforts aimed at the **micro level** – [i.e., in projects and programs financed by MDBs]; those aimed at the **middle level** – [i.e., within society, nationally], and those appropriate for the **macro level** – [in relations and transactions among countries, globally]. According to such experts, the most efficient strategy for MDBs in combating corruption would be to focus on only the micro level [i.e., through improved project implementation supervision] and the macro level [i.e., international coordination of anti-corruption efforts].
60. Under those circumstances, combating corruption within society, in each country, should not be an MDB responsibility, but, rather that of the government, which should be better equipped to put in place its own checks and balances. MDBs can and should help countries (that so request it) to support national efforts at reducing corruption [e.g., by conducting reforms of the civil service, or of budgetary and financial management systems], and by strengthening international cooperation and coordination in combating corruption], but it is not appropriate to make reducing corruption across an entire country the centrepiece of MDB response thereto.
61. The core of the MDB response to corruption should be focussed on better supervision, controlling, and auditing of their financing – for, that is where they can manage (through their internal procedures) how these loans are used, and thence take necessary steps in case of their misallocation. Other critics believe that MDBs/IFIs must review their control mechanisms to eliminate any shortcomings, and either carry out the oversight function themselves, or involve outside expertise to do so. They should realize that a problem exists and take the necessary steps to reduce the harm caused by corruption in development projects.
62. In this connection, recent measures put in place by MDBs to fight corruption have been corroborated by the results of a KPMG survey, according to which

certain measures [e.g., **internal management controls**, **internal auditing**, etc.], greatly improve the chances for discovering fraudulent and corrupt acts, viz.:

Item/Measure/Source of Discovery	Potential
Internal Controls	59%
Internal Auditors	47%
Notification by Customer	38%
Accident	32%
Anonymous Letter	28%
Notification by Supplier	13%
Notification by Police	12%
Notification by Employee	10%
Notification by Government	10%
External Auditor	3%

63. Therefore, the strengthening of **whistle-blowing policies** by AfDB and other MDBs is a step in the direction of reinforcing internal controls. According to specialists, this measure must be sustained through the promotion of an anti-corruption culture in the institution. Codes of ethics and of conduct should be reinforced and widely disseminated to staff, as well as the personnel of borrower implementation agencies. Also, the Bank must devote sufficient resources to the procurement function, including adequate staff numbers, combined with the specialised training thereof. Staff training in procurement should include modules on the forensic detection of fraudulent and corrupt acts. And, Bank BOS missions should be equipped and encouraged to focus at length on fraud and corruption issues, to duly inform and empower suppliers, contractors and consultants with regard to the combat against these.
64. The issues of management controls should be extended to the recruitment process, whereby the watchword should be rigour, and (why not?), psychological profiling to expose any characteristics that could be indicative of a fraudster mentality. Furthermore, the Bank should ensure the planning of a job rotation scheme [including project execution agencies], with the view to precluding stagnation, as experts believe that personnel who would have served between 10 to 25 years on the job are the most likely to commit acts of corruption.
65. In terms of the techniques to be emphasised in the procurement process, procurement planning must be held high. In this regard, the knowledge of spend analysis must be taught to Bank staff in charge of procurement auditing, especially as a part of post-review missions. To this end, some elements may serve as pointers to fraud and corruption, viz.: the amount of money spent per year; the number of contracts placed yearly; the total number of suppliers used per year; the number of contracts placed with each supplier per annum; the number of contracts placed for the same or similar commodity per year; the number of contracts of high value as compared to those of medium or low value, etc.
66. Another well-tried technique is the segregation of duties and authority levels within the organisation [applicable to execution agencies, as well]. This, typically, may involve delineating clear authority levels for preparation of bidding documents; bid evaluation; contract award; goods receipt or

works/services sign-off; and payment; etc. Indeed, to clearly monitor supplier performance, through service level agreement, monitoring and evaluation, etc. In this regard, suppliers must be properly informed about the acceptable quality levels, by key performance indicators.

67. The process of procurement audit itself must involve a formal vulnerability (or risk management) review. In this respect, the procurement auditor must highlight situations of non-compliance, distinguishing between mere incompetence, and outright fraud. The audit must analyse how to prevent a recurrence of the same acts. The audit must reward employees for discovering or reporting fraud, or at least praise them. The audit must not cover up such instances. The guilty must be punished publicly (whether internally, or externally).
68. Also, MDBs must coordinate and follow up on proven cases of fraud, with criminal proceedings. Barring such criminal pursuit, MDBs must create a common data base for blacklisting government officials involved in proven cases of fraudulent and corrupt practices. In such cases, and for first offenders, officials should face stern disciplinary action, including demotion, at the very least. On the other hand, in the case of hardened recidivists, MDBs must “disbar” such individuals from employment on projects financed any donor.
69. At any rate, the major donors have set the tone with respect to the need for MDB action against corruption in public procurement. In this instance, in November 2005 the former US President George Bush signed into law legislation urging stricter anti-corruption controls in MDBs. This law contained provisions requiring financial disclosure by development bank employees, similar to that required for U.S. government officials and members of Congress; improvement of the quality and oversight of development bank loans; strengthening of whistleblower policies; and support of the independence and efficacy of the audit functions. It has generally been agreed that that the law “...**would help reduce the endemic corruption that has plagued MDB projects, but only if implemented fully and effectively by the boards of the MDBs...**”
70. In concluding, it is imperative that MDBs should keep funding projects, and even in countries with high level of corruption, since the poorest people in the world quite often live exactly in those countries where corruption is indeed a real problem for society, as a whole.
71. But in so doing, MDBs should sustain country assistance programs focusing on governance and anti-corruption issues in order to ensure borrower compliance with anti-corruption measures. Besides, MDBs must establish monitoring mechanisms to ensure that development financing is spent for the intended purpose, with remedial measures in place in cases of misallocation or misuse.

### III. APPLICABLE LESSONS

72. The fairly extensive content and volume of material available in the public domain concerning fraud and corruption in public procurement [and the need to combat such social ills], are such that there will be no need for additional studies on the theme.
73. On the other hand, given this availability, the Bank may wish to take the opportunity to organise intensive training of staff in procurement, with special emphasis on the forensics of detection of fraudulent and corrupt acts. Furthermore, post-review and audit missions on procurement must be empowered and alerted on vigilance concerning corruption. The donor community must assist borrower governments in strengthening their management controls, with the view to eradicating corrupt and fraudulent acts.
74. Besides, donors must insist on the creation by borrowers of special fast-track tribunals to handle proven cases relating to fraud and corruption on development projects. Finally, donors must insist that guilty parties be punished publicly, including demotion and/or the freezing of assets thereof, as well as disbarment from working on other donor projects.

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