

Integrity Management Toolbox for Zambian Water Sector SME

Description Integrity Risks

Version 2.0

Collusive bidding <small>Risks: Procurement and Contract Management</small>	False, duplicate or inflated invoicing <small>Risks: Project Execution</small>	Bribing at Customs <small>Risks: Administrative and Public Services</small>	Discretion in important decisions <small>Risks: Governance, Management and Controls</small>
Bribery or collusion to obtain main contract award <small>Risks: Procurement and Contract Management</small>	Overstating work, material or man-day requirements <small>Risks: Project Execution</small>	Bribing for registration, permits and licenses <small>Risks: Administrative and Public Services</small>	Manipulation of documents <small>Risks: Governance, Management and Controls</small>
Manipulation of bid specifications <small>Risks: Procurement and Contract Management</small>	Product substitution <small>Risks: Project Execution</small>	Illicit practices regarding tax payments <small>Risks: Administrative and Public Services</small>	Misuse of key positions <small>Risks: Governance, Management and Controls</small>
Leaking of bid information <small>Risks: Procurement and Contract Management</small>	Delay in project execution or completion caused by the project owner <small>Risks: Project Execution</small>	Unethical practices to gain access to public services <small>Risks: Administrative and Public Services</small>	Use of staff, vehicles and assets for private purposes <small>Risks: Governance, Management and Controls</small>
Manipulation of bids <small>Risks: Procurement and Contract Management</small>	Delay in project execution or completion caused by the contractor <small>Risks: Project Execution</small>	Speeding up judicial processes <small>Risks: Dispute Resolution</small>	Unclear roles, responsibilities and processes <small>Risks: Governance, Management and Controls</small>
Sole source awards <small>Risks: Procurement and Contract Management</small>	Bribes and interference to expedite and divert services <small>Risks: Project Execution</small>	Manipulation of evidence <small>Risks: Dispute Resolution</small>	Vandalism and theft by external actors <small>Risks: Governance, Management and Controls</small>
Fraudulent contractor qualification <small>Risks: Procurement and Contract Management</small>	Failure to meet contract specifications <small>Risks: Project Execution</small>	Illicit practices by the legal representation <small>Risks: Dispute Resolution</small>	Theft of money or assets by staff <small>Risks: Human Resources Management and Development</small>
Abuse of contract amendments <small>Risks: Procurement and Contract Management</small>	Fraudulent variation claims <small>Risks: Project Execution</small>	Insufficient complaints management & customer orientation <small>Risks: Customer Relations</small>	Staff transferring knowledge to competition <small>Risks: Human Resources Management and Development</small>
Sub-contract procurement <small>Risks: Procurement and Contract Management</small>	Concealment of financial status <small>Risks: Project Execution</small>	Non-cooperative customers <small>Risks: Customer Relations</small>	Staff colludes with customers <small>Risks: Human Resources Management and Development</small>



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Glossary

This glossary defines some of the most important terms with regard to integrity. The list is not exhaustive, but it helps to create common understanding of the listed terms among SME implementing the IM change process.

Bid	Contracting: Complete proposal (submitted in competition with other bidders) to execute specified job(s) within prescribed time, and not exceeding a proposed amount (that usually includes labour, equipment and material). The bid-receiving party may reject the bid, make a counter offer or turn it into a binding contract by accepting it. ¹
Bidding documents	The published advertisement or written invitation to bid, instructions to bidders, the bid form and the proposed contract documents including any acknowledged addenda issued prior to receipt of bids (synonym: tender documents). ²
Bid price	Price offered by bidder (contractor, supplier, vendor) for a specific good, job or service, and valid only for the specified period. ³
Bribery	The offering, promising, giving, accepting or soliciting of an advantage as an inducement for an action which is illegal, unethical or a breach of trust. Inducements can take the form of gifts, loans, fees, rewards or other advantages (taxes, services, donations, etc.). ⁴
Clientelism	An unequal system of exchanging resources and favours based on an exploitative relationship between a wealthier and/or more powerful 'patron' and a less wealthy and weaker 'client'. ⁵ In company relations, clientelism entails preferential treatment of contractors and suppliers by project owners as well as the preferential treatment of external stakeholders by SME. Such preferential treatments aren't linked to higher quality work or qualifications, but result from vested interests of individuals. Clientelism in company relations can lead to poor value for money in construction of infrastructure, in the implementation of maintenance contracts and in the supply of other services and goods.
Collusion	A secret agreement between parties, in the public and/or private sector, to conspire to commit actions aimed to deceive or commit fraud with the objective of illicit financial gain. ⁶
Contractor	Independent entity that agrees to furnish certain number or quantity of goods, material, equipment, personnel and/or services that meet or exceed stated requirements or specifications, at a mutually agreed upon price and within a specified timeframe to another independent entity called project owner. ⁷
Corruption	The abuse of entrusted power for private gain. Corruption can be classified as grand, petty and political, depending on the amounts of money lost and the sector where it occurs. ⁸
Embezzlement	When a person holding office in an institution, organisation or company dishonestly and illegally appropriates, uses or traffics the funds and goods they have been entrusted with for personal enrichment or other



activities.⁹

Fraud	To cheat. The act of intentionally deceiving someone in order to gain an unfair or illegal advantage (financial, political or otherwise). Countries consider such offences to be criminal or a violation of civil law. ¹⁰
Integrity	Behaviours and actions consistent with a set of moral or ethical principles and standards, embraced by individuals as well as institutions, that create a barrier to corruption. ¹¹
Integrity Risk	A risk is the chance of an event occurring that will have an impact on an institution's objectives. Integrity risks manifest themselves when an actor exhibits behaviours or makes decisions that are not supported by the institution's values. ¹² The titles of the Integrity Risks in this IM Toolbox often refer to the illicit behaviour itself.
Nepotism	Form of favouritism based on acquaintances and familiar relationships whereby someone in an official position exploits his or her power and authority to provide a job or favour to a family member or friend, even though he or she may not be qualified or deserving. ¹³
Petty Corruption	Everyday abuse of entrusted power by low- and mid-level public officials in their interactions with ordinary citizens, who often are trying to access basic goods or services in places like hospitals, schools, police departments and other agencies. ¹⁴
Procurement	A multi-step process of established procedures to acquire goods and services by any individual, company or organisation – from the initial needs assessment to the contract's award and service delivery. ¹⁵
Procurement Manager	Person responsible for the procurement process. He or she can be the project owner itself or someone hired to do this work.
Project Owner	Entity that initiates a project, finances it, contracts it out, and benefits from its output(s) ¹⁶ . A project official is an individual that works for the project owner.
Red Flags	Red Flags are generally defined as circumstances which could place a reasonable person on notice that illegal or improper conduct has occurred or may occur. A Red Flag does not mean that an action or transaction should immediately be terminated. It does mean that you should engage in an appropriate level of additional due diligence and investigation before moving forward. ¹⁷
Red Tape	Red tape is excessive regulation or rigid conformity to formal rules that is considered redundant or bureaucratic and hinders or prevents action or decision-making. It is usually applied to governments, corporations, and other large organizations. Red tape generally includes filling out paperwork, obtaining licenses, having multiple people or committees approve a decision and various low-level rules that make conducting one's affairs slower, more difficult, or both. Red tape can also include filing and certification requirements, reporting, investigation, inspection and enforcement practices, and procedures. ¹⁸



Subcontractor	Junior or secondary contractor who contracts with a prime contractor (and not the principal or owner of the project) to perform some or all of the prime contractor's contractual-obligations under the prime contract. ¹⁹
Supervisor	In this context a supervisor is a person responsible to supervise the project execution. Depending on his/ her specific task he/ she is referred to as a certifying consultant, surveyor (e.g. a quantity surveyor), etc. The various tasks can be done by different entities, e.g. by an architect hired for the project.
Tender offer	Bid or offer submitted in response to an invitation to bid or request for tenders. ²⁰

List of Abbreviations

BoD	Board of Directors (of Water Service Providers)
cewas	International centre for water management services
NGO	Non-Governmental Organisation
PF	Patriotic Front
SME	Small and medium-sized enterprise
TI	Transparency International
WIN	Water Integrity Network
W&S	Water & Sanitation
WSS	Water supply and sanitation service
ZMW	Zambian Kwacha
ZRA	Zambian Revenue Authority

A. Procurement and Contract Management

Fraud in bidding and awarding of contracts is a hotspot for corruption. Corrupt procurement can take many forms, for example tailoring project specifications to a corrupt bidder, providing insider information, limiting bid advertising, shortening bid periods and breaching confidentiality.²¹ It can also be the case that bidders collude and submit complementary bids for example. A bidder can as well include false statements in its bid or take advantage of information asymmetries and charge inflated prices for services and material. The concealment of financial status by the contractor or the project owner at the time of placing the contract can also be an integrity risk as well as the subcontracting of other firms.

A.1. Collusion among bidders

Category	Procurement and Contract Management
Description	<p>Contractors and suppliers in a particular trade or geographic area can conspire to rig bids or fix prices at artificially high levels. Where collusive bidding is well established, prices can rise substantially, in some cases by as much as several hundred percent.</p> <p>The most common methods of collusive bidding are:²²</p> <ul style="list-style-type: none"> • Complementary bidding: Complementary bids, also known as “protective,” “courtesy,” or “shadow” bids, are intended merely to give the appearance of a genuine bid and not to secure the buyer’s acceptance. Under this scheme, cooperating bidders agree to submit higher priced or deliberately defective bids to ensure the selection of the designated winner at inflated prices. In exchange, the winner might pay a percentage of its profits to the losing bidders, hire them as subcontractors, or allow them to win other high priced contracts. • Loser’s fee: Prior to tender submission, the competing contractors secretly agree that they will each include in their bid price an agreed additional sum of money representing the total estimated tender costs of all the competing contractors (in this context tender costs refer to the costs that arise from preparing a bid). Whichever contractor is awarded the contract will then divide this sum of money between all the unsuccessful contractors who will thereby recover their tender costs.²³ • Bid Rotation: Participants in a bid rigging scheme often rotate winning bids by geographic areas, by type of job or by time to give each member a chance to share in the spoils. • Bid Suppression: For bid rigging schemes to succeed, group members must prevent outside companies from bidding. This can be accomplished by paying off an interloper or by more forceful measures, such as threats or violence. The collusive group also can submit fabricated bid protests or coerce suppliers and subcontractors not to do business with the outsider in order to protect its monopoly. • Market Division: The cooperating companies may divide markets or product lines and agree not to compete in each other’s territory, or to do only so through collusive measures, such as submitting complementary bids.
Examples for Red Flags ²⁴	<p>Pricing red flags:</p> <ul style="list-style-type: none"> • Persistently high or increasing bid prices compared to cost estimates, price lists, previous prices similar jobs or industry averages • Wide variation in line item bid prices between bidders, without apparent justification



	<ul style="list-style-type: none"> • Bid prices drop when a new or infrequent competitor enters <p>Bidding red flags:</p> <ul style="list-style-type: none"> • Rotation of winning bidders by job, type of work or geographical area • The same companies always bid, the same companies always win and the same companies always lose • A bidder brings multiple bids to a bid opening and submits its bid only after determining who else is bidding. • Unusual bid patterns, e.g. identical or similar bids, bids with round numbers, high price on one line item in one bid and a low price on the same line item in another bid by the same bidder etc. • Losing bidders are hired as subcontractors or suppliers • Contractor includes subcontractors in its bid that are competing for the prime contract • Joint venture bids by firms that usually bid alone • Qualified contractors fail to bid and become subcontractors, or one bidder withdraws and becomes a subcontractor • A significant number of bidders who buy bid packages do not submit bids • Losing bids do not comply with bid specifications, or only one bid is complete and other bids are poorly prepared or defective • Losing bidders are unknown in the industry or cannot be located in business or telephone directories or on the internet • A bidder makes any reference to industry-wide or association price schedules or statements indicating that a particular customer or contract “belongs” to a certain vendor etc. <p>Documentary red flags:</p> <ul style="list-style-type: none"> • Physical similarities in bids or proposals submitted by different bidders indicating that all of the bids might have been prepared by the same party, e.g. identical stationery layout, common addresses, personnel, same calculations, same handwriting, etc. • Bids or proposals contain white-outs or corrections indicating last minute price changes • Multiple losing bidders submit defective, forged or sequential bid securities, or securities purchased at the same bank on the same day etc.
Examples	<ul style="list-style-type: none"> • [I]n W&S service provision ... field staff often pointed to the procedures by which professional engineering staff award and implement construction contracts with private firms. Two processes operate to subvert fair and honest contracting in W&S services: contractor cartels and political influence in contractor selection. [...] One contractor described the process as follows: ‘A group of [contractors] meet on the weekend in the office. We have a list of contracts being offered by. We draw names out of a bag to see who will be the winner for each contract. That person decides what he will bid for the contract, and everyone else bids something higher than that.’²⁵ • It is also common for private suppliers of pipes, chemicals and other inputs, consultants and contractors to collude among themselves, take turns in bid-winning or to mark up pricing. Collusion and the falsification of records are often known to the procurement official who receives a kick-back for his/her silence.²⁶ • A group of contractors who routinely compete in the same market secretly agree to share the market between them. They will each apparently compete on all major tenders, but will in advance secretly



	<p>agree which of them should win each tender. The contractor who is chosen by the other contractors to win a tender will then notify the others prior to tender submission as to its tender price. The other contractors will then tender at a higher price so as to ensure that the pre-selected contractor wins the tender. The winning contractor would therefore be able to achieve a higher price than if there had been genuine competition for the project. If sufficient projects are awarded, each contractor would have an opportunity to be awarded a project at a higher price. This arrangement is kept confidential from the project owners on respective projects who believe that the tenders are taking place in genuine open competition, and that they are achieving the best available price.²⁷</p>
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A.2. Bribery and/or collusion between bidders and project owner

Category	Procurement and Contract Management
Description	<p>The bidder bribes or colludes with the project owner in order to obtain the main contract award. The collusion can also be a result of clientelism – the preferential treatment of partners.</p> <p>The bribery or collusion of project owner and favoured bidder can lead to different illicit practices by project owners in order to contract their favoured bidder. The project owner can tailor bid specifications, leak confidential bid information, manipulate other bids or start unnecessarily large projects in order to award its favoured bidder. These practices result in sole source awards and change order abuse (abuse of contract amendments).</p> <ul style="list-style-type: none"> • Manipulation of bid specifications: Project officials can tailor the specifications in the requests for bids or proposals to favour a particular bidder and to exclude others, often as the result of corruption.²⁸ • Leaking of bid information: Project officials can leak confidential information, including budgets and estimates, preferred solutions or competing bids, to help a favoured bidder prepare its bid. Leaking of bid information can be related to change order abuse.²⁹ • Manipulation of bids: In a poorly controlled bidding process, project officials can tamper with bids after receipt to ensure that a favoured contractor is selected.³⁰ • Initiation of large projects: Unnecessarily large or complex projects are initiated by government officials or persons in authority in order to make money by requesting favoured contractors to add percentages to their contract sums (these additional percentages are given to the government official when the favourite bidder wins the contract). • Sole source awards: “Sole source award” means that there is only one person or company that can provide the contractual services needed.³¹, Improper sole source contract awards (also known as “direct contract” awards) are commonly used to avoid competition and steer contracts to favoured bidders. Such awards can be accomplished by simply ignoring competitive bidding requirements, by falsifying sole-source justification data or by splitting purchases to avoid competitive bidding thresholds. Multiple sole source awards to the same company (particularly such awards just below the competitive bidding threshold) and sole source awards in contravention to the provisions of the procurement plan are of special concern. The failing to develop “second sources” for replacement items, spare parts or services that must be purchased from the original supplier or a single source is



	<p>referred to as “hidden sole sourcing”.³²</p> <ul style="list-style-type: none"> • Change order abuse: Contract amendments, also known as “variation orders” or “change orders”, can be manipulated to facilitate corruption or fraud schemes. For example, a contractor, acting in collusion with project officials, can submit a very low bid to win a contract, knowing that promptly thereafter the officials will approve a change order to increase the price, allowing the contractor to recover its profit and fund bribes.³³
<p>Examples for Red Flags</p>	<p>Red flags for manipulation of bid specifications:³⁴</p> <ul style="list-style-type: none"> • Specifications are significantly narrower or broader than in previous similar requests for bids • Close similarity between the specifications and the winning bidder’s product or services • Project defines request by using brand name rather than generic description • Indications or allegations that the winning bidder prepared the contract specifications • Fewer than the normal or expected number of bids • High number of contract awards to one bidder • Complaints from losing bidders that the specifications are tailored to a competitor • Award to other than the lowest qualified bidder <p>Red flags for leaking of bid information:³⁵</p> <ul style="list-style-type: none"> • Winning bid is just under the next lowest bid • Bid is too close to budget, estimate or preferred solution • Inadequate bidding procedures, e.g., acceptance of late bids, non-public bid openings, taking breaks during the bid opening (to provide the opportunity to share the content of certain bids and to amend others), etc. • Late bidder is the winning bidder • A questionable agent, “consultant” or “middleman” is involved in the bidding process • Project officials and a bidder communicate or meet during the bidding process <p>Red flags for manipulation of bids:³⁶</p> <ul style="list-style-type: none"> • Inadequate controls over the opening, recording and handling of bids • Highly subjective or unbalanced evaluation criteria that can be used to manipulate the bid scores • Complaints of changes to bids after they are received • Some bids are rejected because of allegedly missing components • Unusual changes to or “errors” in the scoring of bid • Missing or inadequate documentation to support the recommendation for contract award, e.g., the failure to rank bid prices • All bids are voided for “errors” in contract specifications and the job is re-bid <p>Red flags for initiation of large projects:</p> <ul style="list-style-type: none"> • Complex project design • Several contractors and/or subcontractors <p>Red flags for sole source awards:³⁷</p> <ul style="list-style-type: none"> • Inadequate justification or documentation for sole source awards • Sole source awards in contravention to the provisions of the procurement plan



	<ul style="list-style-type: none"> • Split purchases to avoid competitive bidding requirements • Multiple sole source awards above or just below sole source limits to certain contractors • Awards below the competitive bid threshold followed by change orders that exceed such limits • Request for bids mailed to only one contractor • Repair or maintenance contracts tied to the original bid winner or a single supplier <p>Red flags for change orders:</p> <ul style="list-style-type: none"> • Poorly justified or documented change order requests and approvals • A pattern of low bid contract awards followed by change orders that increase the price of the contract • A pattern of sole source contract awards just below the competitive bidding threshold, followed by change orders that increases the price above the threshold • One or a few contractors receive a disproportionately high number of change orders compared to other contractors or to prior similar contracts • Known culture of corruption among project officials and inspectors • Weak controls and lax procedures regarding the review and approval of change orders, e.g., the same official certifies the need for the change order and approves it
Examples	<ul style="list-style-type: none"> • A former employee of an international IT firm reported that the company had won a major contract because its agent had bribed Project Officials to tilt the hardware and software specifications to match the company's products. In fact, the former employee said, the Project team allowed the firm to draft the specifications itself, which the firm had done with some care to avoid making the scheme too obvious. To compound the fraud, the employee disclosed, the IT firm colluded with its prime "competitor" to divide the work on the contract and to submit collusive bids on successor projects. As a result of the various manipulations, the firm was able to secure a contract for almost 30% above the competitive price.³⁸ • A project owner appoints an architect to design a project. One of the competing contractors who is tendering for the project bribes the architect to provide a design with which only that contractor can fully comply. The bribe is the promise by the contractor of significant future work for the architect. The architect provides an appropriate design. The contractor submits a price that is higher than it would have been had there been a genuine competitive tender, and higher than several of the other tenders. The architect recommends to the project owner that the relevant design was in the project owner's best interests and that the compliant contractor should be appointed, even though its tender is not the cheapest, as only it fully complies with the tender design. In fact, to the knowledge of the architect, one of the cheaper tenderers bidding to an alternative design would have adequately suited the project owner's needs. The project owner follows the architect's advice and awards the contract to the compliant contractor.³⁹ • A project owner intends to place a contract with a contractor which it frequently uses. It wishes to ensure that the price obtained from the contractor is a market price. It therefore requests quotations from two other contractors. It leads these contractors to believe that they have a chance of winning the project. However, the project owner always



intends to award the contract to its favoured contractor. The price of one of the other bidding contractors is the lowest. The project owner discloses this lowest price to its favoured contractor and requires it to match the price. The favoured contractor does so and is awarded the contract. The other contractors therefore waste their tender costs.⁴⁰

- During a special audit of the Utility's procurement function, a losing bidder reported that a junior member of the Bid Evaluation Committee (BEC) told it that other members of the BEC had removed required documents from its bid in order to disqualify the company. The bidder claimed that other sources told it that the BEC did this in order to facilitate the award of the contract to another firm as the result of corruption. The bidder insisted that its bid was complete and showed the auditors a retained copy of its bid which included all of the required documents. The auditors reviewed the Utility's procurement files and Bid Evaluation Report, which indicated that the complainant and other losing bidders were disqualified because bidding documents were incomplete. The auditors contacted the other losing bidders who also insisted that their bids had been complete when submitted. None of the losing bids could be located in the procurement files. Finally, the auditors discovered that the score of the winning bidder had been arbitrarily raised to defeat the one remaining competitor. As a result of their findings, the auditors recommended that the Utility adopt more transparent procurement procedures, including public bid openings, reading out the contents of bids at the opening and permitting a losing bidder to be briefed on the reasons that its bid was unsuccessful.⁴¹
- A senior government official who is in charge of the construction of new infrastructure projects wishes to enrich himself. He/ she therefore decides to initiate a project, which could conceal a major bribe for himself. In order to maximise the bribe potential, he/ she ensures that the design will result in a project, which is unnecessarily large and complex. He/ she then informs a major contractor that he/ she will ensure that the contractor is awarded the project on a non-competitive basis if the contractor includes in the contract price a payment for him personally of an amount equal to 30% of the contract price. The contractor agrees. The contract is awarded and the contractor pays the official.⁴²
- The head of corporate procurement for an international development agency became progressively more concerned as she witnessed the award of more than 20 sole source contracts for IT services to a small start-up company, totalling more than \$4 million over three years, processed at the personal direction of a senior executive. Eventually she reported the matter to the donor's internal investigations unit, which found the following. The first contract was for \$49,000, just under the \$50,000 competitive bidding threshold, followed quickly by two other sole source contracts for a little more than \$100,000 each, well above the threshold. These funds were paid for a report on the usefulness of the internet, the contents of which, the investigation revealed, were clipped entirely and verbatim from existing websites, except for minor edits to remove the evidence of the actual source of the materials. The investigators found that it took a little more than one day to locate, download and print the documents, which were contained in two, one-inch ring binders. The IT firm, however, billed for three months of staff time for what it claimed was "original research" on the topic. The IT



	<p>company then forwarded the entire proceeds for the internet study to an account designated by the senior executive. Thereafter, the firm received numerous additional sole source contracts for IT staffing services, most well above the source threshold.⁴³</p> <ul style="list-style-type: none"> • A “representative” of a Project Implementation Unit (PIU) paid an unannounced visit to a US company that was bidding for a \$25 million agricultural testing laboratory, and told it that it would win the contract if it hired the rep as a “consultant” to help prepare its bid. The rep said his consulting fee would be 20% of the contract value, which he admitted would share with project officials. The US company was intrigued, but was troubled by the size of the bribe request; more specifically, it wondered how it could afford to pay a 20% commission and still be lowest qualified bidder. The rep replied that the project would issue change orders after the contract award to drop certain line items that called for expensive humidity and temperature control equipment, allowing the bidder to “low ball” this item in its bid, be the low bidder, and still have sufficient funds to pay the bribe. Additional change orders would be processed as necessary to cover the cost of bribes.⁴⁴
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A.3. Fraudulent contractor qualification

Category	Procurement and Contract Management
Description ⁴⁵	<p>A bidder furnishes false documentation regarding plant and equipment, labour and the company’s qualifications in order to win a contract.</p> <p>Common false statements can include false statements regarding a firm’s:</p> <ul style="list-style-type: none"> • Financial condition (false financial statements, inflated sales amounts or account balances, etc.) • Prior experience and qualifications • Employees’ educational or professional credentials • Proposed consulting staff: A consulting or engineering firm can include a highly qualified consultant or chief engineer in its proposal in order to win a contract, then replace that person with a less qualified, much less expensive person after the contract award. The savings can be used to fund bribes. This is a very common scheme, and is often done with the knowledge and approval of corrupt project officials.
Examples for Red Flags ⁴⁶	<p>General red flags of false statements and claims:</p> <ul style="list-style-type: none"> • Discrepancies between statements and claims and supporting documentation or test and inspection results • Absent, inadequate or apparently altered supporting documentation • Contractor refuses or fails to provide supporting documentation • Unreasonable claims or statements compared to observed performance, prior contracts or industry standards <p>Red flags of false or forged bid securities or manufacturers certificates:</p> <ul style="list-style-type: none"> • Bid security or certificate is missing issuer’s signatures or reference number • Same security or certificate submitted several times for different bids • Identical or similar securities or certificates are submitted purportedly from different banks or companies • Securities have different appearance (format, logo, quality of paper, etc.) from known authentic document
Examples	

A.4. Inflated prices for services and material

Category	Procurement and Contract Management
Description	<p>The technical nature of the water sector, where companies with highly skilled staff engage with public authorities that are frequently understaffed and lack adequate capacities, results in significant asymmetry of information. The technical complexity inherent to designing and constructing water infrastructure makes it difficult for public officials to negotiate contracts or identify technical deficiencies in bids for infrastructure and other projects. Companies can abuse this lack of capacity, using their technical knowledge to manipulate contract specifications or the quality of work required, in order to increase their returns.⁴⁷ This is often the case, when there is no competitive tender. However, inflated prices for services and material may be accepted because the bidder bribes or colludes with the project owner (see A.2).</p> <p>In competitive bidding inflated prices for services and material may be accepted if staff and suppliers collude to exclude other bidders (for example because of 'non-compliance' or other reasons that are difficult to verify). During the design stage, required materials for projects or repair contracts may be intentionally estimated higher so that those involved can keep the extra money (see also A.1).</p>
Examples for Red Flags	<ul style="list-style-type: none"> • Prices paid for materials and equipment are above the prices at shops and markets • Prices paid for services are above the standard price • Persistently high or increasing bid prices compared to cost estimates, price lists, previous prices similar jobs or industry averages • Wide variation in line item bid prices between bidders, without apparent justification
Examples	<ul style="list-style-type: none"> • A project owner and a contractor are negotiating a design and build contract. There is no competitive tender and the project owner is, to the knowledge of the contractor, relying on the contractor to put forward a reasonable proposal. In its written proposal to the project owner, the contractor deliberately specifies an overly sophisticated design. The contractor is aware that an alternative cheaper design would be adequate for the project owner's purposes but does not inform the project owner of this possibility. The contractor's intention is that the project owner will accept the sophisticated design as it will result in a higher overhead recovery and profit for the contractor. The project owner places the contract with the contractor.⁴⁸ • Another scheme involved an overbilling and kickback scheme, in which a corrupt confederate would supply goods to the government at grossly inflated prices and then kick back a portion to Abacha [Nigeria's president from 1993-1998] and his confederates.⁴⁹

A.5. Subcontract procurement

Category	Procurement and Contract Management
Description	<p>Subcontracts can be awarded as an exchange for bribes or other gifts. Firms can also agree – before submitting bids for the main contract – that the company with the winning bid will engage the other company as a subcontractor. Subcontracting can also be a favour to another company in exchange for submitting higher bids (see also A.1).</p> <p>The subcontracting can also be a result of clientelism – the preferential treatment of partners. It can be the case for instance that the procurement</p>



	manager/ project officer colludes with a subcontractor to recommend the latter to the contractor (see also B.9).
Examples for Red Flags	<ul style="list-style-type: none"> • Award goes to other than the lowest qualified bidder • Firms that have participated in the tender for the main contract are subcontracted by the firm that submitted the winning bid
Examples	<ul style="list-style-type: none"> • Subcontracting can also facilitate collusion, for it can be a way of dividing the profits realized from bid rigging. Testimony in a criminal prosecution of collusion in roads contracting in Oklahoma revealed such a scheme. Competitors of the Boce Company allowed it to win a tender “without having to fight,” and in exchange Boce agreed to subcontract all the work in one region to a competitor.⁵⁰ • A procurement manager of a contractor is required to organise the hire of cranes for one of the contractor’s projects. Crane hire companies are at that time giving discounts of approximately 25% off their published hire prices for long-term hires. The procurement manager and two friends set up a company (‘Craneco’) which is registered in the names of the two friends. Half the shares in Craneco are secretly held as nominee for the procurement manager. Craneco obtains a quote including discount from a crane hire company. The procurement manager obtains the published rate sheets (excluding discounts) from two other crane companies. Craneco supplies a written quote to the contractor to supply the cranes at a rate slightly lower than the published rates of the two other crane companies, but at a higher rate than the rate quoted to Craneco. The procurement manager uses the two rate sheets and the quote from Craneco as three competitive quotes, and awards the contract for the supply of cranes to Craneco. These documents are placed on the procurement file, creating the false impression that there has been genuine competitive pricing, and that the hire contract has been awarded to the cheapest supplier. Craneco makes a profit. The procurement manager does not disclose to the contractor his interest in Craneco. The contractor pays more for the hire than it would have done if the contract had been awarded, including discount, to one of the other crane hire companies.⁵¹

A.6. Concealment of financial status

Category	Procurement and Contract Management
Description	<p>The project owner does not adequately disclose his/ her financial status at the time of placing the contract. Financial statement fraud is deliberate misrepresentation, misstatement or omission of financial statement data for the purpose of creating a false impression of an organization's financial strength. It includes:</p> <ul style="list-style-type: none"> • Falsification, alteration, or manipulation of financial records, supporting documents, or business transactions • Intentional omissions or misrepresentations of events, transactions, accounts, or other significant information from which financial statements are prepared • Deliberate misapplication of accounting principles, policies, and procedures used to measure, recognize, report, and disclose economic events and business transactions • Intentional omissions of disclosures or presentation of inadequate disclosures regarding accounting principles and policies and related

	<p>financial amounts</p> <p>Project owners might decide to conceal their financial status if they know that otherwise, the contractor is unlikely to accept the contract or to begin works. Although the project owner knows that he/ she is in financial difficulties and knows that the project is likely to encounter financial difficulties, he/ she hides this information from the contractor. It can also be the case that the project owner runs into financial difficulties during the execution of the project without notifying the contractor.</p>
Examples for Red Flags	<ul style="list-style-type: none"> Complaints from winning bidders Unfinished works
Examples	<ul style="list-style-type: none"> A project owner places a contract with a contractor. At the time of placing the contract, the project owner is in serious financial difficulty. It believes that it is quite likely that it will go into receivership prior to completion of the contract and will therefore be unable to pay the contractor in full for work done. The project owner does not disclose its financial status to the contractor at the time of placing the contract. The project owner is aware that if it does disclose its financial difficulties, the contractor is unlikely to commence work.⁵² During a project, a project owner runs into financial difficulties and realises that it will be unable to complete payment to the contractor. The project owner nevertheless induces the contractor to finish the works by falsely assuring the contractor that it will be paid.⁵³

B. Project Execution

Corruption and fraud in project execution can take different forms. In the implementation process contractors may ‘sweeten up’ the review committee (or staff in charge of the selection process) with lavish entertainment in exchange for certifying their work or turning a blind eye to construction shortcomings (TI & WIN 2008). Contractors may falsify invoicing or bribe in order to cover up project delays. It can also be the case that customers or the project owner interfere to expedite and divert services. The project owner may pass on costs, although the contractor has met contract specifications. It also occurs that the contractor faces higher costs or receives low value for money because subcontractors and supervisors collude.

B.1. False, duplicate or inflated invoicing

Category	Project Execution
Description	In order to increase its profit, the contractor provides the project owner or the subcontractor provides the contractor with false (invoices for goods or services not rendered), duplicate (the good or service is repeatedly invoiced) or inflated (the good or service is invoiced higher than it should be) invoices. In some cases, the contractor might have to increase prices in order to recover the money used to pay bribes.
Examples for Red Flags	<p>General red flags:</p> <ul style="list-style-type: none"> Weak controls over the review and payment of invoices Discrepancies between contract or purchase order, receiving documents and invoices Discrepancies between contractor’s billings and supporting documents Invoice is in a round number amount if that is unusual Total payments to a contractor exceed total contract or purchase order



	<p>amounts</p> <p>Red flags of false invoices:</p> <ul style="list-style-type: none"> • No receiving report for invoiced goods or services • Invoiced goods or services cannot be located in inventory • No purchase order for invoiced goods or services <p>Red flags of duplicate invoices:</p> <ul style="list-style-type: none"> • Multiple payments in the same time period in the same or similar amount to the same or related vendors, on the same invoice or purchase order or for the same or similar goods or services. • Multiple invoices with the same description of goods or services, amount, invoice number, purchase order number or with the same date. • Total amount paid to vendor exceeds invoiced amounts. <p>Red flags of inflated invoices:</p> <ul style="list-style-type: none"> • Invoice prices, amounts, item descriptions or terms exceed or do not match contract or purchase order terms, receiving records or inventory or usage records
Examples	<ul style="list-style-type: none"> • An earth-moving sub-contractor signs a contract with the contractor to remove unsuitable material from site and to replace it with suitable material. The earth-moving sub-contractor will be paid by the load. The contractor appoints a quantity surveyor to count on site the number of loads removed and replaced by the earth-moving subcontractor. Each load will have a written load certificate, which will be signed by the earth-moving sub-contractor and counter-signed by the quantity surveyor. The manager of the earth-moving sub-contractor agrees with the quantity surveyor that the quantity surveyor will falsely certify more loads than the earth-moving sub-contractor actually undertakes. In return, the earthmoving sub-contractor will pay the quantity surveyor 30% of the payment received by the earth-moving sub-contractor for each false load. The quantity surveyor certifies 20 false removals and 20 false replacements. The earth-moving sub-contractor submits both its genuine and its false certificates to the contractor for payment. The contractor pays in full, resulting in an illicit profit to the earth-moving subcontractor. The earthmoving sub-contractor pays the quantity surveyor his/ her share.⁵⁴

B.2. Overstating work, material or man-day requirements

Category	Project Execution
Description	In order to increase its profit, the contractor or the subcontractor overstates work, material or man-day requirements of the requested good or service. Cost engineers, commonly referred to as quantity surveyors, falsely increase the quantities of certified works in order to obtain extra money from the contractor. The project owner pays for the overstated materials or services. The contractor provides only the necessary amount of materials or services and pockets the payments for the overstated elements or shares it with the cost engineer.
Examples for Red Flags	<ul style="list-style-type: none"> Costs are higher than indicated in the procurement bid or than the estimated costs mentioned in the contract
Examples	<ul style="list-style-type: none"> In a repair contract, staff may report that 200 m of pipe need replacement when only 100 m are actually faulty. Funds are budgeted for the full length, and the cost of the extra 100 m of pipe can be pocketed.⁵⁵ A subcontractor is appointed by a contractor on a day-works basis to undertake work, which the subcontractor knows, will take approximately 100 man-days to complete. The subcontractor informs the contractor that the work will require 150 man-days. The subcontractor deliberately over-states the man-day requirement in order to achieve a higher price from the contractor. The contractor accepts the subcontractor's estimate of 150 days. The subcontractor completes the work using 100 man-days. The subcontractor invoices the contractor for 150 man-days of work and attaches time-sheets for the work. 100 man-days of time-sheets are correct. 50 man-days of time-sheets are falsified so as to support the amount invoiced. The contractor pays the invoiced amount.⁵⁶ A plumbing sub-contractor is requested by the contractor to repair a toilet. After inspecting the toilet, the plumbing sub-contractor ascertains that the repair could be completed by the supply of a replacement washer. The plumbing subcontractor, with the intention of securing a higher price, falsely informs the contractor that several new parts are necessary. The contractor agrees. The plumbing subcontractor replaces the parts and invoices the contractor for the work carried out. The invoice is higher than it would have been had only the washer been replaced. The contractor pays the invoiced amount.⁵⁷ A contractor is instructed by the architect appointed by the project owner to carry out a variation to the works. The contract entitles the contractor to an extension of time and additional payment in this circumstance. The contractor submits a written claim in respect of the variation to the architect, which deliberately exaggerates the manpower, materials, equipment and time required to carry out the variation. In the case where the architect indicates to the contractor that he/ she is inclined to reduce the contractor's claim, the contractor offers the architect a bribe if he/ she will approve the full claim. The architect does so.⁵⁸

B.3. Failure to meet contract specifications

Category	Project Execution
Description	<p>A contractor can commit fraud by falsely claiming to have completed a contract according to its specifications when it knows that it did not. In some cases, the contractor might lower the quality of products. This practice is also called product substitution. Substitution is particularly common and damaging in contracts calling for expensive, high-grade materials that can be replaced by less expensive, similar appearing products. The illegal substitutions can be made by the contractor acting alone or in collusion with corrupt supervisors or project owners.</p> <p>Construction, operation and maintenance may be carried out by the contractor or subcontractors. Both types of ‘investments’ carry integrity risks related to the fulfilment of contract specifications:</p> <ul style="list-style-type: none"> • Staff may lack motivation to carry out their tasks (repair work, checks or cleaning of pipes, etc.). To cover this up they may collude with colleagues – e.g. with staff receiving complaints about service quality in their work area – to avoid that their under-performance is noticed. • Subcontractors on the other hand may collude with staff to cover-up that they haven’t fulfilled their contractual obligations (e.g. that they have only done parts of the repairs/measures/cleaning tasks/etc. that they were supposed to do or even that they may not have done anything at all). As a consequence of the collusion between the contractor and the subcontractor, the insufficient quality of the work done may significantly increase costs for operation and maintenance or, in the worst case, the entire task and investment has to be redone.
Examples for Red Flags	<ul style="list-style-type: none"> • Discrepancies between contract specifications and invoices and supporting documents or test and inspection results • Absent, inadequate or altered supporting documentation submitted by the contractor with its request for payment • Apparently altered or fabricated test and inspection results • Failed tests or inspections • Contractor or project officials insist on choosing sites for inspections • Inadequate testing procedures; contractor conducts its own tests • Contractor resists inspection of its books and records • Reports or history of corrupt payments or gifts by the contractor to inspection personnel • Discrepancy between product’s specification and actual appearance (e.g. “new” product appears to be used) • Apparent substandard goods or works • Continued acceptance of poor quality of goods and services and unfinished tasks • Complaints from users and technical problems in certain parts of the network • Increased or accelerated product failures or repair costs • Indications from the contractor’s records that it did not incur costs necessary to comply with contract specifications, e.g. the contractor failed to purchase materials, lease equipment or hire labour to do the work for which it billed; or the contractors’ records indicate it purchased products or raw material that was not compliant with specifications
Examples	<ul style="list-style-type: none"> • Oversight officials are bribed or extort payments to ignore instances when specifications are not adhered to (e.g. depth of pipe work, foundation materials) or works are not completed, or when lower quality

	<p>materials are used (e.g. type of pipes), and provide fraudulent documentation. Typically these practices help contractors minimize costs and result in sub-standard works, affecting sustainability and quality of WSS service delivery.⁵⁹</p> <ul style="list-style-type: none"> • A scaffolding sub-contractor contracts to provide a specified quantity of scaffolding to a project for a fixed price and for a fixed duration. Before the contract period for supply has expired, the scaffolding sub-contractor, without the knowledge of the contractor, removes part of the scaffolding. The scaffolding sub-contractor does not inform the contractor that some scaffolding has been removed nor does it make any deduction for the scaffolding removed. It invoices the contractor for the full fixed price. The contractor pays in full.⁶⁰ • A detailed review of several donor-financed health sector projects revealed numerous instances of the substitution of substandard medical equipment and materials used in the construction of hospitals. Previous similar reviews and investigations revealed that such schemes are often implemented through bribes of relatively small gifts and favours paid by the suppliers to local inspectors to induce them to accept the substandard equipment. In the most egregious cases of fraud, the suppliers often are empty “shell companies” set up by Project Officials for the sole purpose of obtaining the supply contracts and profiting from the substandard goods.⁶¹
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B.4. Fraudulent variation claims

Category	Project Execution
Description	The contractor can ask the certifying consultant to issue variation claims so that work, which has initially not been included in the contract specifications is added. These variation claims can be fraudulently increased by the consultant (in collusion with the contractor) so that the extra money is shared between the certifying consultant and the contractor.
Examples for Red Flags	<ul style="list-style-type: none"> • Alterations to initial contract specifications • Works are later added to the contract
Examples	<ul style="list-style-type: none"> • A contractor carries out work, which is not in compliance with the contract specification. Under the contract, the architect is responsible for issuing variations. The contractor offers the architect a bribe if he/ she confirms in writing that the work was carried out pursuant to a variation issued by the architect, and is therefore acceptable. The architect does so.⁶²

B.5. Bribes to cover up project delays

Category	Project Execution
Description	Project delays are often caused by delayed delivery of materials. In order to avoid project delay penalties the contractor offers bribes to the project owner for instance .
Examples for Red Flags	<ul style="list-style-type: none"> • The contractor is not billed for damages for delays in project execution or completion
Examples	<ul style="list-style-type: none"> • Fraudulent justification of delays: In this case the purchaser or employer, in exchange for a bribe, ignores delays in delivery or



	<p>completion of contract execution and waives the penalties that should have been applied.⁶³</p> <ul style="list-style-type: none"> • A contractor has been delayed in completing the project. Two reasons could account for the delay. The first is the delayed delivery of materials by one of the contractor's suppliers for which delay the contractor is responsible under the contract and for which he/ she would be liable to pay liquidated damages to the project owner. The second is a change to the specification for which delay the project owner is responsible under the contract and for which the contractor would be entitled to receive an extension of time and additional cost. The contractor is aware that the whole or part of the actual cause of the delay is the supplier delay. However, the contractor submits a written claim to the architect appointed by the project owner which alleges that the whole delay was attributable to the change in specification. The architect accepts the contractor's claim, and awards the contractor an extension of time and additional payment. The project owner pays the additional payment.⁶⁴
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B.6. Bribes and interference to expedite and divert services

Category	Project Execution
Description	Bribes by customers are made to secure or expedite services, like household connections, repair work, information or other. ⁶⁵ Bribes or acts of interference by customers, project or public officials can also be made in order to deviate services to which the interfering person is not entitled, e.g. in order to obtain services that were initially planned for another purpose, typically for development aid.
Examples for Red Flags	<ul style="list-style-type: none"> • Preferential treatment of certain customers • Preferential treatment of public officials • Preferential treatment of contractor who sites a water project in a public official's home area • Public officials involve themselves in decisions related to W&S provision so that projects are changed for their personal benefit • Infrastructure projects do not cover the area initially designed to be covered • Complaints by customers that the works performed at their place takes much longer than at other places
Examples	<ul style="list-style-type: none"> • In areas that are served by piped water systems, there are again allegations of collusion between contractors and those with influence in the community so that the water system passes near their homes. Indeed there were cases of unnecessary deviations to accommodate certain homesteads while no such favour is accorded to institutions and other heavily populated areas.⁶⁶ • A project that was meant to serve North Sakwa stalled after pipes had been laid and the infrastructure was almost completely laid because of political sabotage and due to interference by the local leadership who wanted changes in design to serve their areas of interest.⁶⁷

B.7. Delayed, reduced or refused payments

Category	Project execution
Description	The project owner knowingly and illicitly delays or refuses due payments to the contractor. It can also be the case that the project owner intended to withhold a part of the payment at the moment of placing the contract. The project owner can also bribe the consultant to delay the issuance of a payment certificate because they do not have sufficient funds at the time the claim for payment is received. In some cases, a project or public official asks for a fee from the contractor to ensure that payment certificates are paid quickly.
Examples for Red Flags	<ul style="list-style-type: none"> Contractors complain about delayed or outstanding payments Contractors complain about delayed issues of payment certificates Contractor gets extorted to pay a fee in order to receive a payment certificate
Examples	<ul style="list-style-type: none"> The project owner offers the architect a future appointment on another project if the architect delays the issue of payment certificates which are due to the contractor. The architect agrees.⁶⁸ A contractor has properly completed the works and is entitled to receive a final certificate. The engineer appointed by the project owner refuses to issue the final certificate to the contractor unless the contractor pays him 5% of the final certificate value.⁶⁹ A project owner owes a contractor payment of the contract price. The contractor has completed the contract works to the correct specification and within the allotted time. There is no dispute between the project owner and the contractor. The project owner informs the contractor that it will pay the contractor 80% of the contract sum immediately in full and final settlement. The project owner further states that, if the contractor does not accept this proposal and wants to recover the full amount, the contractor will have to sue the project owner for payment and the project owner will make the litigation as long and as costly as possible. The project owner is a large company which could bear the cost of protracted litigation. The project owner knows that the contractor would be unable to do so. The contractor agrees to accept the reduced payment.⁷⁰ A contractor is due the final payment on a project. The project owner's representative informs the contractor that he/ she will not authorise the release of the final payment unless the contractor makes an extra payment to the project owner's representative personally. The contractor makes the payment. The project owner's representative authorises the release of the final payment.⁷¹

B.8. False rectification costs or passing on of costs

Category	Project execution
Description	It can be the case that additional costs arise for the contractor although he/ she has met contract specifications. The project owner for example imposes false rectification costs on the contractor or tries to pass on the costs of delay in project execution or completion to the contractor, even if the delay was caused by the project owner.
Examples for Red Flags	<ul style="list-style-type: none"> False accounting by project owner Contractor provides goods or services without delay, but is asked to

	pay the project owner damages for delay
Examples	<ul style="list-style-type: none"> • A contractor has completed the works and applies for final payment. Under the contract, the architect appointed by the project owner is required to specify outstanding defects. The project owner persuades the architect to include, in the schedule of defects, additional purported defects which in fact are not outstanding. The project owner then sets off the alleged cost of rectification of these defects against the balance due to the contractor. The contractor disputes the deduction. The project owner informs the contractor that, if the contractor does not accept the reduced sum, then he/ she will have to litigate or arbitrate to get the remainder from the project owner. The contractor cannot afford litigation, so he/ she accepts the reduced amount.⁷² • A contract entitles the contractor to an extension of time and payment of loss and expense in the event of specified delays caused by the project owner. The contract also provides that the contractor should pay liquidated damages to the project owner in the event of specified delays caused by the contractor. Under the contract, the engineer appointed by the project owner determines questions of delay and loss and expense. The works are delayed by the project owner. The contractor applies to the engineer for an extension of time and ascertainment of loss and expense. The project owner and engineer are aware that the contractor is entitled to both. The project owner agrees with the engineer that the engineer should refuse the contractor's claim and should instead issue a certificate requiring the contractor to pay the project owner liquidated damages for delay. The engineer does so.⁷³

B.9. Bribery and/or collusion between subcontractors and supervisors

Category	Project Execution
Description	In some cases, certain aspects of the requirements for services (e.g. installations, repair work, measurements, etc.) and goods (e.g. equipment like pumps, pipes, etc.) might not be in the competence of the company, making it necessary for them to subcontract other companies. Besides collusion between the contractor's staff and subcontractors (see B.3) it can also be the case that the subcontractor bribes and/or colludes with its supervisor (e.g. a quantity surveyor) in order to meet agreed standards of services and goods. As a consequence of this fraud, the contractor does not receive value for money. Insufficient quality may significantly increase costs for operation and maintenance or, in the worst case, the entire task and investment has to be redone.
Examples for Red Flags	<ul style="list-style-type: none"> • Continued acceptance of poor quality goods and services and unfinished tasks by the supervisor • Contractor complains about poor quality goods and unfinished tasks
Examples	<ul style="list-style-type: none"> • An earth-moving sub-contractor signs a contract with the contractor to remove unsuitable material from site and to replace it with suitable material. The earth-moving subcontractor will be paid by the load. The contractor appoints a quantity surveyor to count on site the number of loads removed and replaced by the earth-moving subcontractor. Each load will have a written load certificate, which will be signed by the

	<p>earth-moving subcontractor and counter-signed by the quantity surveyor. The manager of the earth-moving subcontractor agrees with the quantity surveyor that the quantity surveyor will falsely certify more loads than the earth-moving subcontractor actually undertakes. In return, the earthmoving subcontractor will pay the quantity surveyor 30% of the payment received by the earth-moving sub-contractor for each false load. The quantity surveyor certifies 20 false removals and 20 false replacements. The earth-moving subcontractor submits both its genuine and its false certificates to the contractor for payment. The contractor pays in full, resulting in an illicit profit to the earth-moving subcontractor. The earthmoving subcontractor pays the quantity surveyor his/ her share.⁷⁴</p> <ul style="list-style-type: none"> • A roofing subcontractor installs a waterproof roof membrane. The membrane is accidentally perforated during installation, which means that it could leak. The membrane needs to be approved by the contractor’s supervisor before it is covered over. The membrane should be rejected and replaced owing to the perforations. The subcontractor offers to make a payment to the supervisor if he/ she certifies that the sub-contractor’s defective membrane is watertight. The supervisor accepts. The payment is made by the subcontractor to the supervisor and the supervisor issues the certificate. The subcontractor submits the certificate to the contractor, and obtains full payment for the defective membrane. Neither the subcontractor nor supervisor discloses to the contractor that the membrane is defective.⁷⁵
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C. Administrative and Public Services

SME often face corrupt requests by public officials when dealing with administrative and public services. Unethical practices to gain access to public services, bribing for registration, permits and licenses, as well as bribing at customs are very common. Regarding tax payments, SME can be drivers of corruption as well as victims of tax preparers and inspectors.⁷⁶

C.1. Illicit practices regarding tax payments

Category	Administrative and Public Services
Description	With regard to tax payments, SME can be drivers as well as victims of a lack of integrity. Where SME are drivers of corruption, they can manipulate the tax return or bribe tax inspectors in order to avoid tax payments. Tax preparers and inspectors might take advantage of the complexity of the tax system to confuse SME. Furthermore, a lack of accounting knowledge can (unintentionally) lead to wrong tax declarations.
Examples for Red Flags	<p>General red flags for avoiding tax payments:</p> <ul style="list-style-type: none"> • SME management lives above its income-standard • SME makes profit above average <p>Red flags for manipulated tax returns:</p> <ul style="list-style-type: none"> • The tax return has too many rounded numbers (especially when itemising deductions like business expenses, unreimbursed employee expenses, job hunting costs, etc.) • Not all taxable income is reported <p>Red flags for illicit practices of tax preparers and inspectors:</p> <ul style="list-style-type: none"> • The tax preparer convinces the SME to claim unreasonably high deductions



	<ul style="list-style-type: none"> The tax preparer reports income that doesn't line up with SME reportings
Examples	

C.2. Unethical practices to gain access to or to speed up public services

Category	Administrative and Public Services
Description	<p>SMEs often face difficulties in the form of requests for unofficial payments from so-called natural monopolies or “network industries” or they pay bribes in order to speed up administrative services or avoid customs. The following three forms are common:</p> <ul style="list-style-type: none"> Unethical practices to gain access to public services: SMEs confront requests from private sector entities that provide public services, such as the supply of electricity, water or gas. Since SMEs cannot run their business without these services and lack bargaining power due to limited consumption, they have to play according to the rules imposed on them.⁷⁷ Bribing for registration, permits and licenses: Bribes are paid in order to speed up registration processes and the issuance of permits and licenses. Payments can also occur in order to obtain unofficial permits and licences. Bribing at customs: Bribes are often paid in order to speed up services from the customs division or in order to avoid levies on goods and tolls on transport demanded by police, customs or local government officers at roadblocks or at the border. In some cases, customs clearance agents assist the company in clearing goods.
Examples for Red Flags ⁷⁸	<p>Red flags of unethical practices to gain access to public services:</p> <ul style="list-style-type: none"> Undue delays in giving connections Unusually high connection costs <p>Red flags of bribing for registration, permits and licences:</p> <ul style="list-style-type: none"> Registration process/issuance of permit or licence takes unusually short time Registration costs/costs for issuance of permit or licence are higher than usual Payments due to a public authority are issued to an individual <p>General red flags of bribing at customs:</p> <ul style="list-style-type: none"> Misrepresentation or inconsistencies in the application or during the due diligence process Unusually rapid border transit times <p>Red flags in case of assistance by a customs clearance agent:</p> <ul style="list-style-type: none"> The agent has a bad reputation in the business community A customs official recommends the representative The agent makes unusual requests such as a request to backdate or alter documents The agent asks for commissions that are substantially higher than the “going rate” The agent asks for payment by unorthodox or convoluted means such as through strange bank accounts outside the country where the services are being offered The agent requests unusually large bonuses or substantial up-front payments The agent appears to be unqualified or understaffed or has no infrastructure and trained staff

	<ul style="list-style-type: none"> • The agent has a record of clearing goods through remote or notoriously corrupt customs posts and overpromises on expeditiousness or promises unusually rapid border transit times • The agent does not belong to relevant professional associations • The agent is unable to provide a verifiable company reference
Examples	

D. Dispute Resolution

In Zambia companies often do not trust the judicial system, and the enforcement of contractual and property rights by the judicial systems is not taken for granted. A survey published in the World Economic Forum Global Competitiveness Report 2012-2013 revealed that the judiciary system is sometimes influenced by members of government, citizens, or companies. SMEs may offer bribes to speed up judicial processes, manipulate evidence or be victims of illicit practices by their legal representation.⁷⁹

D.1. Speeding up judicial processes

Category	Dispute Resolution
Description	SMEs offer bribes to court members so that they speed up judicial processes.
Examples for Red Flags	<ul style="list-style-type: none"> • Prompt settlement of judicial processes • Judicial officers living above standard
Examples	

D.2. Manipulation of evidence

Category	Dispute Resolution
Description	Evidence can be manipulated in order to influence the judicial process. The manipulation of evidence includes concealment of documents and submission of false supporting documents, supply of false witness evidence, supply of false expert evidence, bribery or blackmail of witnesses.
Examples for Red Flags	<ul style="list-style-type: none"> • Inconsistencies in submitted documents • Incomplete documentation • Contradictory witness or expert evidence • Witness changes opinion or refuses to appear in court
Examples ⁸⁰	<ul style="list-style-type: none"> • Submission of incorrect or misleading contract claims, pleadings or particulars: In a contract claim, or during dispute resolution proceedings (such as mediation, adjudication, arbitration or litigation), the claimant submits claims, pleadings or particulars which he/ she knows to be false, or does not believe to be true, or of which he/ she is reckless as to their accuracy. For example a loss and expense claim where the extension of time claim on which the loss and expense claim is based is incorrect or the amount of loss and expense claimed is overstated. • Concealment of documents: In a contract claim, or dispute resolution proceeding, a claimant deliberately does not disclose to his/ her opponent, or to the dispute resolution tribunal, documents which are, or may be, damaging to the claimant's case. Such documents include for example timesheets, which would undermine the claimant's case that labour and equipment were working on a particular item of work.

	<ul style="list-style-type: none"> • Submission of false supporting documents: In a contract claim, or dispute resolution proceedings, a claimant submits the following supporting documents as genuine and accurate when he/ she knows that they are false, or does not believe them to be true, or is reckless as to their accuracy. For example cost records, which incorrectly state the cost of items, or include items or work, which were not provided. • Supply of false witness evidence: In dispute resolution proceedings, a witness as to fact gives evidence on behalf of the claimant (whether by way of affidavit, witness statement or orally) that he/ she knows to be false, or does not believe to be true. Such evidence by the witness includes for example stating that a fact had been orally agreed between representatives of the claimant and the opponent, when he/ she knows that this fact had not been agreed, or is not sure whether or not it had been agreed. • Supply of false expert evidence: In dispute resolution proceedings, a claimant appoints an expert to provide an opinion on an aspect of the claimant's case. The expert's initial report, prepared confidentially for the claimant, is unsupportive of the claimant's case. The claimant makes it clear to the expert that his/ her appointment will continue only if the expert amends his/ her report to make it favourable to the claimant's case. The expert does so. He/ she believes the amended view to be arguable, but presents it in the report as his/ her most favoured view, and as the correct view, when this is not his/ her belief. The report is then submitted as expert evidence in the proceedings and the expert witness gives oral evidence in accordance with it. Both the expert and the claimant are aware that the expert does not believe his/ her evidence to be true. The success of the claim and counterclaim in the proceedings depends on the outcome of the expert evidence. • Bribery of witness: A claimant offers a witness a percentage of any future award by the arbitrator in the claimant's favour if the witness gives false evidence in support of the claimant in the arbitration. The witness accepts, and provides a false witness statement and false oral evidence both of which support the claim and undermine the counterclaim. • Blackmail of witness: The respondent in an arbitration owes money to the claimant. The respondent tells a witness that he/ she will be dismissed as an employee of the respondent unless he/ she gives false evidence in support of the respondent in the arbitration. The employee gives the false evidence and as a result the respondent wins the arbitration, and does not need to pay the claimant.
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D.3. Illicit practices by the legal representation

Category	Dispute Resolution
Description	SME can be beneficiaries or victims of illicit practices by their legal representation. The legal representation can take advantage of the SME by over manning or excessive billing. On the other hand, lawyers might accept to collude with the SME in exchange for bribes or other gifts.
Examples for Red Flags	Red flags for legal representation taking advantage of SME: <ul style="list-style-type: none"> • Costs are higher than usual • Number of lawyers working on the case is high compared to the level of complexity of the case

	<ul style="list-style-type: none"> • Law firm asks for money to pay for works or research that does not appear to be relevant to the case • Legal representative living above standard <p>Red flags for collusion of lawyer and SME:</p> <ul style="list-style-type: none"> • Experts or witnesses complain that their statement has not been accurately reproduced
Examples ⁸¹	<ul style="list-style-type: none"> • Over manning by law firm: A contractor appoints a law firm to act in an arbitration on its behalf. The partner in the law firm who is head of construction sees the arbitration as a major opportunity to make money and allocates four lawyers to the arbitration when he/ she knows that two lawyers would be sufficient. The partner advises the contractor that this number of lawyers is necessary owing to the complexity of the case and the volume of the work. The contractor accepts this advice. The partner quotes the contractor an hourly rate for each of the lawyers. Monthly bills are submitted by the law firm to the contractor and these are paid by the contractor. • Excessive billing by lawyer: A lawyer working on an arbitration for a project owner bills more hours to the project owner than the lawyer actually spent working on the case. • Complicity by lawyer: The lawyer involved in drafting the witness statement is aware that the witness does not believe his/ her evidence. However, despite this knowledge, the lawyer continues to draft the witness statement on the basis that it is true, and allows the witness statement to be put forward in support of the claimant's case.

E. Customer Relations

Good customer relations can be of benefit as SMEs are highly dependent on its customers. It can for example increase customer loyalty and allow businesses to obtain feedback on how to improve their products and services, which in return can have good effects on a SME's reputation. Insufficient complaints management and customer orientation pose a risk when failures, unethical behaviour or illicit practices don't get reported to the ones responsible. Customers may refuse to cooperate, however it can also be the case that customers accuse the company of corruption in order to blackmail them.

E.1. Insufficient complaints management & customer orientation

Category	Customer Relations
Description	Without proper complaints management, SMEs lose their ability to control and manage risks because failures, unethical behaviour and illicit practices don't reach those responsible. Furthermore, consumers are unable to seek redress due to the lack of effective complaint mechanisms and lack of awareness about the rights and responsibilities of providers and consumers.
Examples for Red Flags	<ul style="list-style-type: none"> • Low responsiveness of SME to customer complaints • No regular reporting about complaints from customer care to management
Examples	<ul style="list-style-type: none"> • Although many companies have received substantial funding and capacity building [...] they still fail to adequately respond to complaints.⁸² • Without effective complaint mechanisms, and where awareness about the rights and responsibilities of providers and consumers is lacking,

	<p>poor householders are unable to seek redress.⁸³</p> <ul style="list-style-type: none"> • Sydney Water’s ability to exert and control authority was obstructed by a deficient complaint system and inadequate risk management processes. Audit plans are influenced by the examination of existing records. In the absence of a robust process of complaint capture, Sydney Water Internal Audit was hampered in its development and prioritisation of audit plans.⁸⁴
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E.2. Non-cooperative customers

Category	Customer Relations
Description	<p>The responsibility of a SME in the water sector is the provision of goods or services such as consultancies, engineering and construction. The customer can be a water utility, a company, an NGO or a private person. In return, the customers have responsibilities towards the SME, which include the timely payment of bills or transparent tendering. Customers may not be willing to fulfil their obligations towards the company if they are the drivers of illicit behaviour or if they have a negative image of the SME (e.g. because of quality of services, experiences in the interaction with the SME, negative reports about the SME in local newspapers and radios, etc.). Furthermore a bad reputation of the SME makes it difficult to tap into the potential for cooperation with clients reporting illicit practices of staff.</p> <p>However, sometimes, it can also be the case that customers use accusations of corruption as a means to blackmail the SME.</p>
Examples for Red Flags	<ul style="list-style-type: none"> • Unpaid bills • Delay in paying bills • Low cost recovery • False accusations of corruption • Tempering with equipment • Forging of checks
Examples	<ul style="list-style-type: none"> • An undue payment, required in order to get an electricity supply connection [or any other kind of good or service], is obviously a burden [for the company].⁸⁵

F. Financial Management

Efficient and effective management of money is important for the SME’s operations. There are a number of integrity risks regarding financial management. Employees using different methods to get higher checks and staff working in the payroll department manipulating the company’s payroll account can have significant consequences for a SME. A common way to cover up fraud or theft of money is to falsify financial documents and accounts. SME can also be victims of external actors. As they are usually in a weak position to get loans it might be attractive for a SME to respond to dubious loan offers.



F.1. Payroll fraud

Category	Financial Management
Description	Large amounts of money flow through a company's payroll account. The potential for fraud is significant, and the consequences can be devastating. Employees can make use of payroll schemes by manipulating the amount on their check or reproducing the check somehow to cash a check more than once. Another concern for businesses is the employees who work in the payroll department. If there are no controls in place, the payroll employees can not only inflate their checks but also grant bonuses and extra vacation time. One method of theft in the payroll department involves creating a "ghost" employee on the payroll. This "ghost" doesn't exist but the company will send checks that are collected by the "ghost's" creator. ⁸⁶
Examples for Red Flags	<p>Red flags for falsified time sheets:</p> <ul style="list-style-type: none"> • Similar employee names entering and leaving the system at about the same time • More than one employee's hours increasing for no apparent reason • More employees doing overtime for no apparent reason and with no apparent result <p>Red flags for ghost employees:</p> <ul style="list-style-type: none"> • Employee files that have missing personnel file information • A number of employees with the same mailing address, or using post boxes as mailing addresses • More than one employee using the same bank account for the deposit of wages • Employees with no withholding taxes, insurance, or other normal deductions
Examples ⁸⁷	<ul style="list-style-type: none"> • Payroll manipulation is common where pays are calculated on any sliding basis, whether time or piecemeal work. The most common example of this is employees clocking on early and clocking off late to increase the number of hours for which they are paid. The fraud does not need to be hidden as the payments are recorded as legitimate expenses. Verification is often overlooked when more senior employees are submitting claims, when it is less likely that the claim will be questioned by a junior employee. The most common forms of the fraud are: Falsifying time sheets to increase the hours 'worked'; have someone else clock you in and out when you are not there, or simply waiting around for some time before clocking off, to increase the recorded hours 'worked'; physically adjusting the time on the clock when you clock in and out; falsifying the type of work done to be paid a better rate on the different work; and falsifying qualifications to be placed on a higher wage rate. • A ghost is a fictitious employee added to the payroll. Wages or salary is paid to the ghost and is taken by the perpetrator. The larger the company is, the more difficult it gets to detect ghost workers, particularly when employees are spread over a number of separate geographic locations and where the payroll function is centrally controlled. This scheme is possible when the officer authorizing wage payments will not recognize the ghost's name on the payroll list. Or that officer could be the perpetrator. Hiding the fraud is not necessary as the payments are made and recorded as legitimate operational expenses. By inserting a ghost into the payroll system, that ghost will be paid a wage, and the

	wage can be collected by the perpetrator.
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F.2. Falsification of financial documents and accounts

Category	Financial Management
Description	<p>The falsification of financial documents (invoices, checks, expense reports etc.) and accounts is common practice to cover up fraud and theft of money or assets. Moreover, the falsification of financial documents is a typical example of a means to circumvent procedures and delegated authority in order to embezzle funds. Inappropriate billing and accounting systems make it easier to cover up such illicit practices.</p> <p>Fictitious invoices and over-billing are fraud schemes often appearing in the company's acquisition function. The purchasing function of a business includes the acquisition of goods and services for the business. The acquisition function is especially vulnerable to fraudulent transactions because it involves the disbursement of company funds. It is where most cash leaves the company. Purchasing fraud probably contributes the largest fraud risk to most enterprises.</p> <p>Using manual or inadequate electronic systems for accounting makes it easier to manipulate data and embezzle funds. This is further aggravated if fraudulent documentation, accounting and reporting by those managing finances aren't controlled and audited properly.⁸⁸</p>
Examples for Red Flags	<p>General red flags falsification of financial documents:</p> <ul style="list-style-type: none"> • Questionable invoices • Inadequate payment documentation • Lots of corrections in manual cash books or pristine records – i.e. a manual cashbook that looks as if they have been written on the same day <p>Red flags for fictitious invoice / fictitious vendor:</p> <ul style="list-style-type: none"> • Photocopied invoices or invoices that have been tampered (e.g., sections have been "whited out" and typed over) • Invoice numbers from the same vendor that occur in an unbroken consecutive sequence • Invoices from companies with a P.O. Box address and/or no phone number • Invoices from companies with the same address or phone number as an employee • The amount of each invoice from a particular vendor falls just below a threshold for review • Multiple companies that have the same address and phone number • Vendor names that appear to be a "knock-off" of well-established businesses (i.e., names spelled very similarly to well-established businesses) <p>Red flags of falsified accounts:</p> <ul style="list-style-type: none"> • Records not being kept up to date • Budget monitoring reports showing inconsistent behaviour between line items • Lots of corrections in manually written accounts
Examples	<ul style="list-style-type: none"> • Another fictitious invoice scheme is for an individual to arrange for invoices to be sent to and paid by a company but the invoicing business does not exist. A bank's marketing and advertising director allegedly arranged for another individual to submit bills for advertising



	<p>that had been placed in a trade publication but the trade publication did not exist. This type of scheme often involves collusion with the vendor and purchasing or accounts payable personnel.⁸⁹</p> <ul style="list-style-type: none"> • Over-billing is a method where the individual submits an inflated or altered invoice for payment. The overpayment is then diverted, paid to the employee, or an accomplice. A 61-year-old employee of a national retail chain was indicted for defrauding his employer of more than \$2 million. He was an employee for more than 15 years and was responsible for leasing building to house the company's stores. On 22 leases, he altered the documents, including the forgery of letters to the company for fictitious legal and maintenance services. He also altered the company's copy of the leases so that the billings for these services would match the leases.⁹⁰ • Check tempering: This involves employees using company checks to pay themselves. The simplest and most popular way this is done is by employees simply writing a check to themselves and depositing it in their account. Often this includes the employee forging the signature of the person authorized to write checks. Another way employees tamper with checks is by reissuing the company's old outstanding checks but altering the payee to themselves. The company in this case has already recorded the check and deducted the cash accordingly so when the check is deposited by the employee, there isn't any good indication that something has gone wrong.⁹¹ • Manipulation of expense report: When an unscrupulous employee submits his/her expense report, they may include additional expenses that were either never incurred or not of a business nature, and be reimbursed for those items.⁹² • The invoices [...], totalling \$25,500, which Mr Makucha submitted to Mr Harvey for payment by Sydney Water, were a ruse concocted between Mr Makucha and Mr Harvey so that Mr Makucha could obtain money from Sydney Water for his personal use. To the knowledge of both Mr Harvey and Mr Makucha, the invoices falsely represented that they were for the sale of buildings to Sydney Water.⁹³
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F.3. Loan scam

Category	Financial Management
Description	<p>SME often rely on credits when the company is created, to expand the business or to buy new equipment. However, it might be difficult for SMEs to present the necessary guarantees to receive a credit from a reliable institution. This might put SMEs in the need to responds to dubious credit offers.</p> <p>A "loan scam" usually occurs when a person or enterprise replies to an advert for a fast loan and will have their application approved regardless of their credit history. Before they receive the loan, they are told they must pay an upfront fee to cover insurance for the loan. Once this fee is paid, the victim does not hear from the company again and the loan is never received.</p> <p>Loan scams, however, can also consist of obstacles as to receive a loan such as large amounts of documentation, unaffordable interest rates, or requested bribes.</p>
Examples for Red Flags	<ul style="list-style-type: none"> • The lender is not interested in the businesses credit history • Fees are not disclosed clearly or prominently • Lender is not registered

	<ul style="list-style-type: none"> • A lender who asks to directly pay an individual • Excessive requirements to obtain a loan
Examples	<ul style="list-style-type: none"> • Corrupt bank officials are often targeted to approve loans that do not meet basic financial criteria, and therefore cannot be collected later on.⁹⁴ • As money floods into the city, many small businessmen in Bangladesh cannot secure bank loans. They face what they say are unreasonable demands from the state-owned banks for huge amounts of collateral, masses of documentation, interest rates as high as 19 percent, and finally “speed money” – a bribe for the bank official worth 10 percent of the loan value. Meanwhile, corrupt bankers are funnelling loans worth billions of taka to businessmen backed by the country’s political bosses, accepting forged documents and waiving the collateral rules. In August the central bank unearthed a 36 billion taka (\$43 million) loan scam at the country’s largest bank, Sonali Bank Ltd, where loans were granted to a little-known business house without the minimum collateral required as security. [...] Loan scandals like this rob banks of the profits and capital needed to back fresh lending, and it is SME that pay the price. As of June 30 unpaid or non-performing loans in the banking system, called “classified loans” in Bangladesh, totalled 290 billion taka (\$3.4 billion), and thousands of cases involving billions of taka were tied up in the courts as the banking authority tried to recover money from loans gone bad. [...] Shahin said [SME] hardly ever default on loans, yet they become the victims in the banking scandal. “Had the money (given to Hallmark Group) been granted as loans to the SME, they could have flourished as businesses and generated more employment. Corruption is really undermining the future of the country,” he said.⁹⁵ • The very top rung of some of India's public sector banks and financial institutions have been arrested by the Central Bureau of Investigation for allegedly sanctioning loans in return for bribes.⁹⁶

G. Governance, Management and Controls

Good governance, management and controls are vital for the performance of SME because they allow monitoring the actions of management and directors and thereby mitigating integrity risks. Discretion in important decisions can for example generate loopholes for corruption on both management and lower levels. Similarly key positions can get misused for corrupt practices and have negative effects on the behaviour of staff. The authority of decision makers can also be misused when utilising vehicles and assets for private purposes and delegating tasks to staff that serve their own purposes. Generally speaking, unclear roles, responsibilities and processes increase integrity risks.

G.1. Discretion in important decisions

Category	Governance, Management and Controls
Description	Corruption thrives in situations with important decisions (high volume of money, decisions that affect people with different interests, etc.) being made and uncontested discretion cover expenditures and reasoning from the eyes of colleagues and the public. Such discretionary power can be used as an opportunity and incentive to gain illegal benefits. Discretion in important decisions generates loopholes for corruption at management levels but can



	also jeopardise integrity at lower levels. Research shows that the higher the degree of discretion, the higher the incidence of bribery. ⁹⁷
Examples for Red Flags	<ul style="list-style-type: none"> • Staff is informed only after important decisions have been taken • Some staff can take important decisions (e.g. concerning investments, hiring or procurement) without having to consult with colleagues
Examples	<ul style="list-style-type: none"> • Decision makers or powerful stakeholders seek to protect their interests and maintain their positions of power by, for example, withholding information and excluding other relevant stakeholders from dialogue and decision making.⁹⁸ • Corruption is about making choices: accepting a bribe, falsifying water meter readings, allowing excessive abstraction of water, overlooking wastewater dumping or the use of substandard material in dam construction. Technical solutions and control decrease the discretion of individual actors, thus making such choices more difficult and risky. Although aiming for water integrity is more an ethical matter than a technical, such solutions turn into a very efficient tool, which serve to limit opportunities for unethical practices to arise.⁹⁹ • Corruption will tend to emerge when an organization or person has monopoly power over a good or service which generates rent, has the discretion to decide who will receive it (thus on how rents will be allocated), and is not accountable.¹⁰⁰

G.2. Misuse of key positions

Category	Governance, Management and Controls
Description	<p>Members of higher management levels have access to SME resources and can take decisions fairly independently. Weak SME governance and the lack of oversight, discretion in decision-making and collusion with procurement officers, human resources or financial staff, are some of the factors that can allow managers to siphon and embezzle funds or pursue private interest through unethical decisions.</p> <p>In institutions where corruption is rampant at the decision-making level, the day-to-day behaviour of staff is also affected. Employment conditions (for example salary or location of the SME) or inadequate selection procedures may result in a lack of commitment and capacities of staff in management positions (including the managing directors). Employees are strongly influenced in their own behaviour by the way their managers and immediate supervisors behave. Managers are in a particularly strong position to either encourage or minimise corrupt conduct.</p>
Examples for Red Flags	<ul style="list-style-type: none"> • Change of lifestyle of staff in key positions – spending patterns do not match their income • Lots of relatives of staff in key positions are employed by the SME or work as contractors for the SME
Examples	<ul style="list-style-type: none"> • Chief Engineers might embezzle funds.¹⁰¹ • There is a risk that a commercial manager is influenced by external stakeholders in negotiating agreements with customers e.g. on repayment of arrears.¹⁰²

G.3. Use of staff, vehicles and assets for private purposes

Category	Governance, Management and Controls
Description	Managers may misuse their authority to pressure staff to handle tasks that are private business ventures or that are favours to friends and partners. Managers and staff can also access SME assets like vehicles or land to use them to support political campaigns, for private travel or to hold events, for example. It might also occur that employees misuse company assets for secondary employment.
Examples for Red Flags	<ul style="list-style-type: none"> • Vehicle log books not maintained in an appropriate level of detail • Staff always claims to be busy with other tasks for the same person
Examples	<ul style="list-style-type: none"> • [...] Directors pursue private interests in influencing operational decisions: In one case, the BoD put pressure on the Management to permit an ally to plant maize on the area of a treatment plant, arguing this would not interfere with the operation of the treatment plant, 5) In one case, a Director demanded from the technical manager to reconnect a commercial customer due to vested interests/ relationships.¹⁰³

G.4. Unclear roles, responsibilities and processes

Category	Governance, Management and Controls
Description	Clearly defined roles, responsibilities and processes (administrative, management, supervision, operation, checks and balances, etc.) provide the basis to hold those who engage in illicit practices responsible – this applies particularly for boards and senior management. They provide guidance on authorisation for decisions of staff in different positions within the SME or board members as well as how and where others (e.g. colleagues) need to be involved to take decisions. Gaps (e.g. how is the board accountable to the shareholders, missing, unclear or double reporting lines, etc.) in the governance of an SME provide opportunities for individuals to misuse their positions for their personal benefit. At the same time such gaps can result in a situation where individuals are not held accountable – e.g. if it is not clear who needs to evaluate the sanctioning or not of somebody. The core problem of utility governance is that these contracts or agreements are often violated or incomplete. This provides leeway for opportunistic behaviour, i.e. actors may maximise their individual benefit at the expense of the SME and/or the public.
Examples for Red Flags	<ul style="list-style-type: none"> • SME has no corporate governance guidelines • Several processes are not clearly defined / no guidance or standard operating procedures available for key processes • Roles and responsibilities of several employees are not defined clearly • Split supervision arrangements / responsibilities for supervision are not clearly assigned to specific positions
Examples	<ul style="list-style-type: none"> • Poor governance, which continues to be experienced in the water services sector, directly translates to poor management and subsequently underperformance. The sector continues to be characterised by inefficiencies in operations, poor customer service, and low cost coverage. Thus, there is need to strengthen governance with specific focus on leadership and management.¹⁰⁴ • The core problem of Corporate Governance is incomplete/lack of enforcement of contracts between stakeholders (BoD, employees,

	<p>management, suppliers, consumers, shareholders, etc.). Each stakeholder pursues its own interests which are not necessarily in line with the company/sector interest. Incomplete/not enforced contracts provide leeway for stakeholders for opportunistic behaviour (i.e. corrupt practices) to maximise their individual benefit at the expense of the company/public. This leads to a deadweight loss and undermines sector performance.¹⁰⁵</p> <ul style="list-style-type: none"> • Accordingly, rules of corporate governance have the objective to reduce the leeway and motivations for opportunistic behaviour. A strong corporate governance framework: 1. Provides proper incentives for the BoD and management to pursue objectives in line with the company's and public interest, 2. Strengthens the accountability and integrity of staff, suppliers and consumers on the day-to-day transaction level, i.e. it makes it hard to give and receive bribes, 3. Injects transparency and accountability at the decision-making level.¹⁰⁶
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H. Human Resources Management and Employment

The lack of human resources management and good employment conditions may affect the performance of SME because staff is for example unqualified or lacks motivation. Theft of money or assets by staff, staff transferring knowledge to competition, staff colluding with customers or suppliers may be the result of bad human resources management. Unsatisfying employment conditions as well as lack of transparency in remuneration processes may lead to further illicit practices by staff. A SME's performance may also suffer from poorly qualified staff owed to the preferred recruitment and promotion of relatives and friends.

H.1. Theft of money or assets by staff

Category	Human Resources Management and Employment
Description	Unethical behaviour of staff can take many forms, such as theft of money or resources. Embezzlement and other kinds of financial fraud are perhaps the most common kind of employee theft. It can also occur that employees take home company assets to resell them for his or her personal benefit. Small businesses tend to fall prey to this swindle because they don't have the controls (monitoring of company assets, inventory system) in place to prevent it. ¹⁰⁷
Examples for Red Flags	<ul style="list-style-type: none"> • Money, equipment or materials frequently disappear from within the SME premises
Examples	<ul style="list-style-type: none"> • Larceny is defined as the unlawful taking of personal property with intent to deprive the rightful owner of it permanently. This is the type of theft that involves an employee outright stealing cash or property from the employer. It is differentiated from embezzlement by the fact that embezzlement refers to theft by someone who is in a position of trust and legally allowed access to the cash or items they are stealing. Both of these types of theft are characterized by the fact that they occur after money has been received by the business which is different from skimming (see below).¹⁰⁸ • Skimming is another form of theft that can be cash or property, but what makes it distinct is the point in time at which it occurs. Skimming specifically refers to the removal of cash from an organization before it has been recorded and is therefore referred to as an, "off-the-books" crime. Skimming can be done by any employee that has access to

	incoming cash before it is recorded and this often includes salespeople, tellers, and cashiers. From a business perspective skimming can be far more impactful than larceny or embezzlement. This is because it is much harder to detect missing cash that has never been recorded. ¹⁰⁹
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H.2. Staff transferring knowledge to competition

Category	Human Resources Management and Employment
Description	<p>For almost every successful SME, its competitiveness is tied to one or more types of intellectual property, whether as technological inventions, creative expressions, corporate identity and brand recognition, proprietary know-how, or in some other form.</p> <p>Theft of confidential information and trade secrets by staff and its transfer to the competition can be just as damaging to a business as embezzlement or other employee fraud.¹¹⁰</p> <p>Examples of intellectual property that is at risk of being transferred to the competition include:¹¹¹</p> <ul style="list-style-type: none"> • Customer lists • Industrial designs • Permits, mineral rights, licences • Environmental studies • Agreements and contracts • Patents, know-how, trade secrets • Trademarks and brands • Business processes • Product pricing models
Examples for Red Flags	<ul style="list-style-type: none"> • Meetings of staff with members of competing companies • Competing companies release similar product/services after company staff left the SME and started to work for the competition
Examples	<ul style="list-style-type: none"> • Disgruntled former employees can hurt their former employers in many ways [...]. The business world is full of tales of ex-employees going off to found new companies: Intel Corporation and SAP AG, for example, were founded by former employees of Fairchild Semiconductor and IBM, respectively.¹¹²

H.3. Staff colludes with customers

Category	Human Resources Management and Employment
Description	An employee colludes with a customer (who owes money to the company) and receives money in exchange for discounts or lower bills.
Examples for Red Flags	<ul style="list-style-type: none"> • Low levels of cost recovery • Questionable invoices • Inadequate payment documentation
Examples ¹¹³	<ul style="list-style-type: none"> • Where colluding parties are external to, rather than employed by, the defrauded entity, these are most commonly suppliers (48 percent) and customers (22 percent), according to the 2011 analysis. Consultants and subcontractors make up the majority of the balance. • An individual, in his late 20s, committed a fraud worth over \$25 million. He worked for a minerals company for more than four years, gaining the trust of senior management to such an extent that he was given responsibility for both hedging the price of minerals in the market and

	<p>accounting for it in the back office. As a policy, the company did not seek to make a profit from hedging, but rather to guard against losses in a turbulent market. The fraudster, deemed a very smart, hardworking, and honest employee, colluded with the company’s customers and passed discount to them. He covered the discounts passed to customers by transferring profits from his illicit market speculation activities, accruing huge sums for himself as a “kick-back”.</p>
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H.4. Staff colludes with supplier

Category	Human Resources Management and Employment
Description	Suppliers invoice for more goods or services than were delivered or supplied, or invoice at a higher price than originally quoted. The employee authorises payments for overpriced and/or non-existent goods or services and receives a ‘kickback’ (such as a cash payment) in return from the supplier. The collusion can also serve the purpose of covering up the supply of low-quality material.
Examples for Red Flags ¹¹⁴	<ul style="list-style-type: none"> • Questionable invoices • Inadequate payment documentation • Mismatch between documented and actual assets • Purchasing agent handles all matters related to a vendor even though it might be outside or below his or her normal duties • Vendors who receive an inordinate amount of business from the company for no apparent business reason • Vendor salesmen make frequent, unexplained visits to purchasing personnel • Prices from a particular vendor are unreasonably high when compared to others • Quality of goods or services received from a vendor is low • Tips or complaints from other employees or honest vendors • Key contracts awarded with no formal bid process • Purchase of excess goods
Examples	<ul style="list-style-type: none"> • Consider a long time employee who is suddenly struggling with making ends meet at home. Through many years of service in the procurement department, he/ she has gained the trust of co-workers, established personal relationships with vendors, and has an intimate knowledge of the controls system and any gaps that may exist. Almost effortlessly, he/ she could approach a vendor to inflate invoices and direct surplus payments to his/ her personal bank account. Such collusion is common in procurement frauds.¹¹⁵

H.5. Relatives and friends preferred in recruitment and promotions

Category	Human Resources Management and Employment
Description	If nepotism and favouritism are entrenched in human resources management, decisions won’t be merit based or driven by qualifications of staff/applicants anymore. This could for example mean that BoD members, management or Human Resources staff are exploiting their positions to award jobs and promotions, or to provide favours to friends or family members, even though they may not be qualified or deserving. This results in poorly qualified staff

	and/or overstaffing and, in some cases, this may go as far as the hiring of 'ghost workers' (friends or relatives who do not work in the SME but are on its payroll).
Examples for Red Flags	<ul style="list-style-type: none"> No guidelines or recruitment procedures in place Several staff from the same family Poorly supported disqualifications of job applications Lots of staff that does not meet job requirements Lack of or non-compliance with HR guidelines
Example	<ul style="list-style-type: none"> An employee (convenor/panel member/other) manipulating selection procedures to secure the appointment of a close friend or family member.¹¹⁶ A selection panel member failing to declare a conflict of interest and acting to advance the interests of an applicant who is a close friend or a relative.¹¹⁷ The convenor of a selection committee appointing members to the selection panel whom they can influence in order to ensure their favoured candidate will be selected.¹¹⁸ Staff, including senior managers, are often selected because of their political connections rather than their management abilities or technical skills.¹¹⁹ Managers often do not have the skill to manage, even if they had autonomy and authority to manage, which often they do not.¹²⁰

H.6. Unsatisfying employment conditions

Category	Human Resources Management and Employment
Description	Lack of motivation of staff makes them prone to engage in corrupt practices. If there is no reward for good performance, staff may seek to 'reward' themselves. The same applies for insufficient salaries that do not allow staff to cover living costs. As a consequence staff may look for opportunities to 'top-up' their salaries. Inadequate employment conditions can foster corrupt behaviour among staff.
Examples for Red Flags	<ul style="list-style-type: none"> Frequent complaints of employees No system to deal with complaints No system for rewards and incentives in place or lower level staff is excluded from rewards and incentives Low salary levels
Examples	<ul style="list-style-type: none"> Lack of motivation of staff makes them culpable to corrupt practices. There is no system in place to reward exceptional performance over and above their monthly dues. There is no bonus for meeting targets say in connections or revenue collection. The attitude of most of the staff has not changed from that of public service making it even more difficult to operate at optimal levels.¹²¹ Payments are not simply made at the end of each two- to three-year posting. As one staff member explained: If I want your position I can get help from someone to have you transferred out, even if you have been there less than two years. You will be told that "someone" wants your post and is willing to pay a certain amount for it. If you can pay more than that, you will keep your post.¹²²

H.7. Lack of transparency in remuneration processes

Category	Human Resources Management and Employment
Description	In the context of a pay system, transparency means providing enough information for employees and managers to understand how the pay system operates. But some organisations, especially those in the private sector, provide employees with little or no information. A lack of transparency in remuneration processes can lead to discretionary payments to staff or management and makes it difficult to detect such practices. If remuneration does not depend on staff or management performance, this can also lead to lower motivation and employee morale. ¹²³
Examples for Red Flags	<ul style="list-style-type: none"> • No remuneration guidelines • Unmotivated personnel • Unjustified variations in remuneration of staff members having a comparable position • Unjustified variations in the remuneration of men and women having a comparable position
Examples	<ul style="list-style-type: none"> • Poor management, overstaffing, and promotions based on seniority or political connections ensure that it is very difficult to recruit good staff, and if some do join, it is equally difficult to retain them because of lack of job satisfaction, poor working environment, and absence of incentives for good performance.¹²⁴ • Despite a move toward greater transparency of executive remuneration, workers are becoming more dissatisfied, not less. The Association of Mineworkers and Construction Union’s (AMCU) recent demand for double pay reflects the reality of this statement. The gap between high income and low income earners has widened according to the 2013 Executive Directors: Practices and Trends report released by PricewaterhouseCoopers. The lack of legislative regulation on how executive remuneration is calculated could be one of the reasons why this gap continues to grow in the face of severe economic instability. The report highlights the fact that the new Companies Act does not specifically outline how directors should be remunerated.¹²⁵

I. Framework Risks

Lack of enforcement of integrity regulations, complex and fast-changing regulatory frameworks as well as high levels of bureaucracy complicate a SME’s work and pose different integrity risks. It can for example drive SME to work in the informal sector where they are more vulnerable to unethical behaviour. Illicit practices by foreign companies and companies owned by non-indigenous Zambian communities may also pose an integrity risk to SME. Besides these framework risks SME might be victims of vandalism and theft by external actors.

I.1. Lack of enforcement of integrity regulations

Category	Framework Risks
Description	The regulatory framework defines and regulates how SME are supposed to be governed and operated to provide goods and services. While a sound, transparent, integrity-related regulatory framework offers guidance for SME, lacking clarity and gaps in water sector and other (e.g. procurement) policies, regulations and guidelines open loopholes for illicit practices and undue influence of sector institutions and third parties that affects service providers

	negatively. Even if a regulatory framework is existent, it needs to be effectively enforced. Otherwise the incentives to implement the legal requirements remain low and illicit behaviour is not prosecuted.
Examples for Red Flags	<ul style="list-style-type: none"> • Illicit behaviour such as bribery or corruption is considered to be normal business behaviour • Low confidence in regulatory and enforcement bodies
Examples	<ul style="list-style-type: none"> • Tackling corruption and strengthening business integrity when large parts of important economic activity are carried out outside officially regulated structures is vexing for governments, especially since the relationship between corruption and the informal sector is ambivalent. Corruption nurtures informality. Excessive regulation and the entry points for corruption that it provides further exacerbate arbitrariness in regulation and entry costs and drives economic activity into informality [according to MGCD 2012, 89% of employed persons in Zambia were in informal employment in 2008]. At the same time, the lack of legal protection and the desire to dodge regulations makes the informal sector a particularly easy prey for extortion and solicitation of bribes by corrupt officials, thereby helping to sustain petty corruption among tax collectors, local police, environmental inspectors and other officials. Where the informal sector competes with formal businesses, this also may encourage others to follow suit in order to reduce regulatory burdens and compete on an equal footing.¹²⁶

1.2. Complex and fast-changing regulatory framework

Category	Framework Risks
Description	If the regulatory framework changes fast, it can happen that SME are unaware of new laws and regulations they are supposed to implement. Complex and fast-changing regulatory frameworks can also lead to confusion among public institutions or officials, providing loopholes for illicit behaviour.
Examples for Red Flags	<ul style="list-style-type: none"> • Many companies operate in the informal sector • Unclear or patchy policy formulations
Examples	<ul style="list-style-type: none"> • Evidence was gathered from SMEs engaged in the following sectors: Irish potatoes, dairy, fishing, pineapples and oranges, to build the evidence base. It emerged that current challenges include poor coordination of the SMEs activities; inadequate private and public dialogue at the county level; poor enforcement of regulatory legislations; and knowledge gap about national and county-level policies' interface.¹²⁷

1.3. High Level of Bureaucracy

Category	Framework Risks
Description	Long and complicated administrative procedures can lead SME to operate in the informal sector. Companies of the informal sector are not protected by the law, which makes them more vulnerable to illicit practices.
Examples for Red Flags	<ul style="list-style-type: none"> • Transition from an older water policy to a new one on-going (major shifts of responsibilities planned but not yet implemented fully) • Lots of laws and regulations finalized but not gazetted

Examples	<ul style="list-style-type: none"> Tackling corruption and strengthening business integrity when large parts of important economic activity are carried out outside officially regulated structures is vexing for governments, especially since the relationship between corruption and the informal sector is ambivalent. Corruption nurtures informality. Excessive regulation and the entry points for corruption that it provides further exacerbate arbitrariness in regulation and entry costs and drives economic activity into informality. At the same time, the lack of legal protection and the desire to dodge regulations makes the informal sector a particularly easy prey for extortion and solicitation of bribes by corrupt officials, thereby helping to sustain petty corruption among tax collectors, local police, environmental inspectors and other officials. Where the informal sector competes with formal businesses, this also may encourage others to follow suit in order to reduce regulatory burdens and compete on an equal footing.¹²⁸
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1.4. Illicit practices of foreign companies and companies owned by non-indigenous Zambian communities

Category	Framework Risks
Description	<p>Foreign companies from non-OECD countries increasingly investing in Zambia, particularly China but also India, are not constrained by domestic anti-corruption legislation and codes of conduct. When investing in Zambia, they are often willing to engage in bribery and other corrupt practices, particularly in the procurement and natural resource sector, in order to secure market access, win concessions and secure tenders for large-scale infrastructure investments.¹²⁹ Illicit practices of businesses owned by non-indigenous Zambian communities are also common.¹³⁰ These practices pose a direct risk to Zambian SME, as they perpetuate corruption and lead to contracting of foreign businesses rather than Zambian.</p>
Examples for Red Flags	<ul style="list-style-type: none"> Contracts going to foreign rather than Zambian businesses
Examples	

1.5. Vandalism and theft by external actors

Category	Governance, Management and Controls
Description	Theft and vandalism of assets and material by external stakeholders can have severe impacts on the performance of an SME.
Examples for Red Flags	<ul style="list-style-type: none"> Frequent instances of theft and vandalism
Examples	<ul style="list-style-type: none"> Challenges in low-income areas are vandalism and the theft of hardware (often carried out by informal water vendors fearing competition).¹³¹ As droughts become more frequent and water shortages worsen, Kenya is seeing an increase in water thefts and other water-related crime, police records show. The most common crimes are theft, muggings and illegal disconnections of water pipes by thieves who collect and sell the water. Many of the crimes occur in urban slums, which lack sufficient



	<p>piped water. [...]Police statistics show that in Kibera – Nairobi’s largest slum with over one and a half million inhabitants – there are as many as 75 reported incidences of water-related theft daily.¹³²</p> <ul style="list-style-type: none">• A water company has lost pipes and valves worth more than Sh200 million to vandals. The thieves are making a fortune by selling the pipes to unscrupulous scrap metal dealers. Last year the Mombasa Water Supply and Sanitation Company lost hundreds of pipes, valves, bolts, manhole covers and a large volume of water, all valued at Sh200 million. Managing director Alome Achayo said on Thursday that this year alone the vandals had struck 10 times, causing damage to infrastructure worth Sh10 million and water losses of Sh10 million. In the recent incidents, pipes covering six kilometres in the upmarket Nyali suburb had been stolen. The vandals also made away with pipes covering one kilometre along the Makupa Causeway.¹³³
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