

| Red Flags in Public Procurement

Public Procurement



TSI ref. 23SI05

- = government purchases of goods, works and services from an external source through a tendering process.
- = supposed to be an open, competitive process that follows a clear structure. That is the way to get value for public money and to encourage economic development.
- Deviations from openness and competition, by contrast, may indicate that politicians or public officials are manipulating the process in order to steer contracts to associates, friends, political allies or for own favor.



Public Procurement Fraud



TSI ref. 23SI05

- = type of fraud that occurs in the procurement of goods and services in private companies and government institutions.
- = not easy to detect because of the many parties involved, and various stages of the procurement life cycle.
- In some countries 70% of corruption cases originate from the purchase of goods and services.



Red Flags



TSI ref. 23SI05

- Red Flags, Warnings signs and indicators are multiple detected and known.
- Prevention and controls can be supported by IT—the indicators must be developed and handed over to IT by human beings, correct data – machine learning, algorithm, AI.
- E-Procurement can support and prevent one part of the process (partly preparation, tendering, awarding, partly contracting).
- Fraudsters will focus on implementation, delivery, invoicing, payment ...



ARACHNE - RISK SCORING TOOL



TSI ref. 23SI05

- Developed by the European Commission in close cooperation with some Member States.
- The Commission services aim at supporting managing authorities responsible for the European Structural and Investment Funds by providing the Arachne Risk Scoring Tool to identify effectively and efficiently most risky projects, contracts, contractors and beneficiaries, necessary for their management verifications.



ARACHNE - RISK SCORING TOOL



TSI ref. 23SI05

- Arachne is based on internal and external data.
- Internal data (projects, beneficiaries, contracts, contractors and expenses) are extracted by the managing authority from their local computerized systems and uploaded.
- External data are provided by two external service providers.
- The first database contains financial data as well as shareholders, subsidiaries and official representatives of over 200 million companies.
- The second database is composed of a list of politically exposed persons, sanction lists, enforcement lists and adverse media lists.



ARACHNE - RISK SCORING TOOL



TSI ref. 23SI05

- Arachne identifies more than 100 risk indicators, which are grouped into 7 risk categories such as procurement, contract management, eligibility, performance, concentration, other and reputational and fraud alerts.
- Arachne should substantially increase the level of prevention and detection and the fight against irregularities and fraud.



Public Procurement Cycle



TSI ref. 23SI05

- The Need
- Financial Authority
- Request For Proposal
- Invite Tenders
- Pre-Qualification Questionnaire
- Tenders
- Qualifying
- Evaluation
- Negotiation
- Contract Award
- Manage Contract
- Approval And Payment
- Sign Off



Public Procurement Fraud



TSI ref. 23SI05

- Can happen on every stage of the Cycle.
- Can include public officials (e. g. employee – supplier collusion).
- Can happen without participation of public officials (e. g. Cartels and Bid-Rigging).



Public Procurement Fraud

Procurement fraud schemes



Bribery

An employee favors a vendor in exchange for money, goods, or services



Conflict of interest

A vendor is selected based on a personal relationship



Bid rigging

Collusion between vendors to manipulate bids



Product substitution

A contractor swaps out promised goods for other, cheaper ones



Price fixing

Vendors collude to manipulate prices, often to inflate costs

Some Examples

- **Employee / supplier collusion:**
- Employee arranges for a good or service with a vendor at either a higher cost than needed, or with a cheaper product. That vendor then “kicks back” money or gifts to the employee for the inflated deal terms.
- **Conflicts of interest:**
- An employee hands a deal to a family member or friend either as a favor or for financial reward, without reporting the close relationship.

Some Examples

- **Fake or shell companies:**
 - An employee creates a fake company by using a strawman and issues payments to it.
 - Can be used by bidders to pretend competition.
- **Inflated bills / substandard work:**
 - Acceptance of underdelivery - substandard work or failure to meet requirements.

Some Examples

- **Mismatched Invoices:**
 - Vendors or suppliers create additional invoices to increase the amount they are paid.
 - This can be done independently, or with a colluding member of the organization.
- **Unusually Low Bids:**
 - Several bids, but only one is the obviously low bid – WHY???
 - A late bidder is the lowest bidder – INSIDE INFORMATION???

Collusion among contractors

- **Cartels and Bid-Rigging:**
- Cartels are formed when companies collude with their competitors to increase or maintain prices, divide geographical territories, customers or projects between themselves, agree to limit production, and/or engage in bid rigging.
- Bid rigging occurs when bidders agree among themselves to eliminate competition in the procurement process, thereby denying the public a fair price.

Collusion among contractors

- **Hard facts:**
- Some bids are exceptionally low or high.
- Some withdraw their bids during the tender process.
- Submission of suspicious bids (bids from fake companies).
- Certain contractors don't bid whom you would expect to.
- Only one bid covers all requirements and the others are poor.
- Winning bidder sub-contracts some work to the losing bidder or a non-bidder.
- = More than one "Red Flag" – a pattern is visible.

Collusion between procurer and bidder



TSI ref. 23SI05

- **Hard facts:**
- Unusual tender specifications (“30 years experience” in a specific business area).
- Requirements / specifications - only one company will meet (maybe for a special reason, if justified and transparent).
- Late bids accepted.
- Changes during the bidding process.
- Some kind of relationship.
- Unusual alterations during the contracting phase.



Example – Contracts



TSI ref. 23SI05

- A company submitted an attractive low bid for a municipal lucrative repairs contract, with the full intention of submitting further multiple variations during the contract term to compensate for the initial low bid.
- The contract was awarded and the company targeted the contracts manager with excessive gifts and hospitality. This led to the manager feeling indebted to the company and inclined to return the favor through manipulating contract variations.
- Knowing his authorization level was EUR 50.000, the contracts manager split a quote for EUR 250.000 into 5 separate bids to avoid supervisory-level authorization.



Example – Contracts



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- **Result:**
- Tactics also included duplicate fraudulent invoices and inferior product substitution, which resulted in a poor service and greater health and safety risks, all at the added expense to the public prize.



Example – Payments

- A municipality procured a buildings maintenance contract worth several million Euros. As the contract neared the extension period, a performance review was conducted and found that the contract was significantly overspent to the value of 3 million Euros.
An internal investigation revealed that several contract managers had utilized a number of different budgets, which masked the overspend.

Example – Payments

- **Result:**
- The underlying issue was identified as a lack of communication between the different departments involved in the entire 'procure to pay' process. This resulted in a failure of governance and reconciliation between what was procured and what was actually spent over the contract term.

Example – Processes



TSI ref. 23SI05

- A major of a municipality is very keen that a certain contract is awarded to a particular company and implores the procurement officer to do so. The owner of the company is the brother-in-law of the major, the company does not have extensive experience in the area of work. It puts the procurement officer under significant pressure to write the technical specification in a way that supports the major's request.
- **Result:**
- This practice is not transparent, is illegal and puts the municipality at risk of significant reputational damage.



Example – Fake documents

COMPANY REGISTER of XY-COUNTRY

Company Name: ABC Ltd.

Register No: 007799ak

Company Address: 1100 Vienna, Markus Street 121

Managing Director: Franz Huber, 10.08.1978

Shareholder: Fritz Huber, 17.06.1981

Hans Huber, 01.10.1955

Company not existing

Correct company name ABCD Ltd.

Fake register number

Markus Street ends with No. 109

Markus Street 121 exists, but in 1010 Vienna

Wrong birth date

Correct name – Friedrich Huber

Hans Huber died 3 years ago

Example – Tender document

Tender document

Preconditions

Company: 20 years of experience
in the specific field

Materials: specifications, only one
company will meet

Employees of
company certain certifications
required

Other requirements: only one company will meet

There might be good reasons to go for a specific company (trust, good experiences in the past, promote local businesses and others)

BUT

It can also lead to close relationships, a kind of monopoly position, less competition, higher prices and others

Reasons have to be transparent and justified

Example – Offer document

Offer document 1

Specification Material/Goods, dimensions, diameter etc.	Units Number, meter, hours, square meter	Price (€)	Total (€)
Marble slabs, 25x25x4 cm, grey, A quality, including transport	9.440	4,50	42.480
Assembly with skilled workers	380	18	6.840

Offer document 2

Specification Material/Goods, dimensions, diameter etc.	Units Number, meter, hours, square meter	Price (€)	Total (€)
Marble slabs, 25x25x4 cm, grey	9.500	3,20	30.400
Assembly	400	14	5.600

Offer 2 is cheaper - but

A quality is missing

Transport not included,
price will be increased
during contracting phase

Workers are cheaper,
but they are not skilled

Example – Offer document

Offer document

Specification Material/Goods, dimensions, diameter etc.	Units Number, meter, kilo, hours, square meter	Price (€)	Total (€)
Marble slabs, 25x25x5 cm, white, A quality	12.500	5,40	56.250
Quick cement	650	7,50	4.200

The offer looks good - but
there are calculation errors

Total price of slabs is
€ 67.500.- . Incorrect
multiplication $12.500 \times 4,50$

Total price of cement is
€ 4.875.- . Incorrect
multiplication $560 \times 7,50$

These errors were introduced intentionally. During contracting or invoicing phase errors will be discovered and the supplier will argue that this should have been pointed out earlier by the client

Example – Invoice

INVOICE No 115/2024

We will invoice for our work
performed in June 2024:

Net € 27.400.-

VAT € 5.480.-

Total € 32.880.-

Only Flat rate bill

No specifications or details

No possibility to compare with
positions in the offer/contract

NOT ACCEPTABLE

Example – Invoice

INVOICE No 115/2024

We will invoice for our work
performed in June 2024:

Net € 27.400.-

Payments to sub-contractors

Net € 10.500

VAT € 7.580.-

Total € 45.480.-

Same characteristic,
inadequacies

In addition – Sub-contractor
Was not mentioned in the
offer or contract
Who is the sub-contractor
What kind of work was
performed?

NOT ACCEPTABLE

Example – Invoice

INVOICE No 115/2024

We will invoice for our work
performed in June 2024:

Net € 27.400.-

VAT € 5.480.-

Total € 32.880.-

Please transfer the total amount
within 7 days to our bank account

BIC: HEBACY2NXXX

IBAN: CY17 0020 0128 0000 0012 0052

Same characteristic, inadequacies

You are dealing with a Slovenian
company

The well-known business account is at
UNICREDIT Banka Slovenija

Why should the money be transferred
to Hellenic Bank in Cyprus

NOT ACCEPTABLE

And there are many
other ways to cheat

Public Procurement Fraud



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<https://evropskasredstva.si/evropska-kohezijska-politika/prijava-krsitev-na-skodo-eu/>

- Links to
- OLAF - European Anti-Fraud Office
- CCP - Komisija za preprečevanje korupcije
- Police
- European Public Prosecutor's office
- European Delegated Prosecutor's office in the Republic of Slovenia



Thank you for your attention

Manfred Elmecker, Gerhard Levy



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