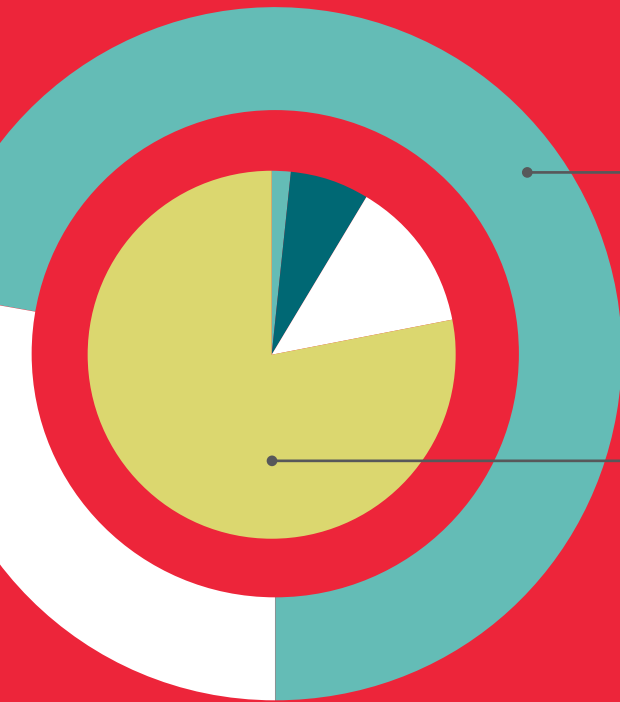


Integrity Vice Presidency

FY13 ANNUAL UPDATE



The Integrity Vice Presidency (INT) is an independent unit within the World Bank Group that has the unique function of investigating and pursuing sanctions related to allegations of fraud and corruption in Bank Group-financed activities. As an integral part of the Bank Group's overall Governance and Anti-corruption Strategy, INT performs a preventive function as well, working closely with other World Bank units and external stakeholders to mitigate risks through advice, training, and outreach efforts. Where the World Bank's own staff may be implicated in such misconduct, INT similarly investigates and acts in relation to those allegations. This is our fifth annual report as a Vice Presidency based on INT's new strategic framework, following the recommendations of a panel headed by Mr. Paul Volcker. The World Bank fiscal year 2013 runs from July 1, 2012 to June 30, 2013.

Download the Integrity App, free from iTunes, to identify and report fraud and corruption in World Bank financed projects.

Are we winning the fight against corruption?

World Bank President Jim Yong Kim

Since becoming President of the World Bank Group, I've met many people who care deeply about development and improving the lives of the poor. They often ask me if we are winning the fight against corruption, and I always answer "yes."

Thankfully, I have a number of reasons to stay optimistic about the global picture. Citizens' voices continue to act as a strong moderating force against corruption. In countries like Brazil, China, Russia, and Nigeria, among others, transparency has started to blossom. In other countries, we've funded successful projects that enable citizens to use their cell phones to monitor how their governments actually spend public funds. Our support for "publish what you pay" transparency initiatives has likewise made it easier to scrutinize the construction and extractive industries, both of which have historically been prone to fraud and corruption.

CEOs of major corporations tell us that cleaning up their businesses increases their profit margins. Many private sector firms now check the World Bank's list of debarred entities as part of their routine due diligence and business intelligence. When major international firms — like Siemens, Alstom, Oxford University Press, and SNC-Lavalin — admit wrongdoing and end up sanctioned or on the Bank's debarment list, it serves as a wake-up call to other companies that refusing to play by set rules will have serious, negative consequences. Better still, many firms on the debarment list have publicly claimed that they no longer engage in corruption and report others that do.

And yet, when Transparency International published its Corruption Barometer earlier this year, it represented a stark reminder of what we're up against. More than one out of four survey respondents said they had paid a bribe in the past 12 months during their interactions with public institutions or services. The survey also finds that the majority of people do not believe their government is effective at fighting corruption and that corruption in their countries is getting worse.

As the president of an institution whose existence is tied to public trust, I want to make it abundantly clear that the World Bank Group has zero tolerance for corruption. We are committed to supporting good governance efforts everywhere in the world. The value of setting the right tone at the top, and dealing forthrightly with problems when they emerge, cannot be underestimated. Countries with a better track record in fighting corruption have vocal leaders and solid institutions that are more capable of preventing illicit behavior before it happens. In six recent investigations of fraud and corruption affecting projects financed by the World Bank Group, the turning point came when the CEOs became personally involved in fixing the problems we raised.



DOMINIC CHAVEZ / WORLD BANK

“I want to make it abundantly clear that the World Bank Group has zero tolerance for corruption.”

A zero tolerance policy sounds harsh precisely because it is harsh. It is also firmly rooted in a reality filled with financial and political risks, and in which problems inevitably arise. Within this challenging context, the World Bank Group has set an ambitious target to eliminate extreme poverty by 2030. Some have argued that stringent efforts to root out fraud and corruption could undermine commerce, slow economic growth, and ultimately work against our goal to end poverty. I couldn't disagree more. In fact, I don't think we can end poverty unless we have clear, fair, and well-enforced rules that help improve the lives of the poor.

Now is the time to honestly assess what works in fighting corruption, where we still face obstacles, and how we can engage new groups in this process. One group we must engage is young people. Today, half of the world's population is under the age of 25. Across the world, youth have a fervent desire to combat corruption, because they are most often on the losing end of it. By drawing on the passionate morality of youth and the steady hand of those who are older and wise, I believe we can eliminate any remaining cultural complacency associated with corruption. In doing so, we will take a major step toward meeting our goals to end poverty and build shared prosperity for all.

Dealing with corruption in development: what works and what comes next?

World Bank Vice President for Integrity Leonard McCarthy

While the scope of fraud and corruption varies, it is often the poor who suffer the most. What we've seen over this past fiscal year through our investigations, audits, preventive engagements, and collaboration with members of our International Corruption Hunters Alliance (ICHA) is no different.

Sometimes, the poor are affected directly, like the citizens who had to pay kickbacks to the local manager of a community program in order to receive goods and services that were supposed to be free. Sometimes a corrupt official disregards his role to serve the public interest so that he can claim his "just reward"—in this instance, a holiday for him and his family paid for by the firm to which he steered a World Bank-financed contract. We have seen evidence of a firm willing to pay nearly US\$6.5 million in bribes so that it can guarantee becoming the winning bidder. Since companies are in the business of making money, they often try to recover the cost of paying bribes by cutting corners, reducing quality, and ultimately compromising the safety of their projects.

The State of Affairs

Development has inherent risks that we can't shy away from. Those who have the greatest need are also the most vulnerable. It is precisely because institutions may be weak, systems lacking, and resources scarce that countries turn to the World Bank for financial and technical assistance. Where lending is high or environments are fragile, we have to be especially vigilant.

When the World Bank received multiple complaints related to the procurement of a major power project in a fragile state, we were able to intervene in time, get the project back on track, and save \$5.8 million.

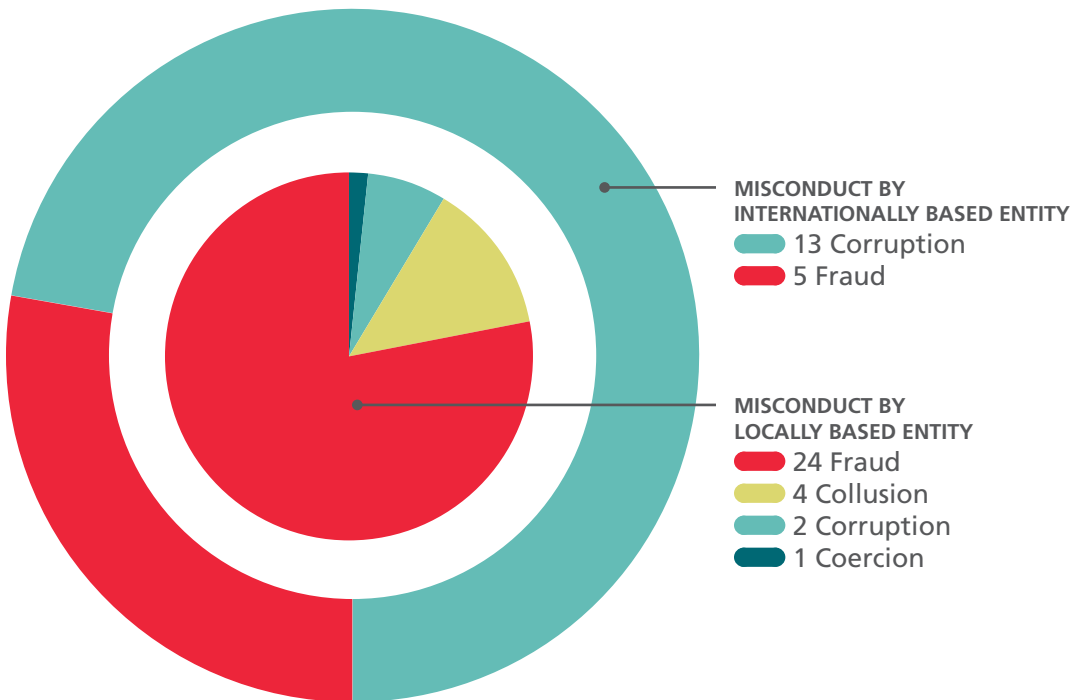


SIMONE D. MCCOURTIE / WORLD BANK

For example, infrastructure support accounts for 35 percent of total assistance to client countries, representing the World Bank’s largest business line. In this sector we’ve seen examples of some engineering and construction firms abusing mobilization payments, which are intended to help defray the initial high cost of moving large equipment on site. In some of our most prominent cases this past fiscal year, we found that often the biggest chunk of bribes came out of mobilization payments, which can be returned as cash and distributed among corrupt players. Ensuring that mobilization payments are used for the intended purposes of the project and not being funneled elsewhere will be the challenge of supervision. This type of insight is of interest to country authorities who want to rein in corruption.

Strengthening health systems and helping countries to achieve universal health care are also central elements of the Bank’s work. Since 2000, the World Bank has provided \$26.64 billion to health programs. Unfortunately, investigations have uncovered drugs lacking the active ingredient, embezzled funds intended for HIV/AIDS awareness activities, and a cartel of pharmaceutical firms bidding on contracts inflating prices and paying bribes. In the next fiscal year, World Bank prevention and health experts will roll out a comprehensive review of the sector that will inform new threat assessments, project preparation checklists, and other effective precautions.

The World Bank’s Integrity Vice Presidency substantiated 49 cases in FY13



Corruption cases are usually the ones that grab headlines, revealing systematic lapses in ethical behavior and a disregard for the public good. Nearly half of the active investigations we have (41 of 86) involve allegations of corruption. Fifteen of the 49 cases we substantiated last fiscal year involved corruption as the primary violation. In 13 of the 15 cases, the bribe was paid by a firm based outside the country in which the project was being implemented. **While projects tainted by corruption may be implemented in developing countries, our efforts to curb corruption need to be more global.** Developed countries are not exonerated from perpetuating the problem. Looking at the World Bank's list of debarred entities (www.worldbank.org/debar), more than half are headquartered in industrialized countries. This dictates that more work may need to be done in such countries to address wrongdoing involving corporations which reside in their jurisdictions.

Although the average person tends to view corruption as more serious, **the negative impact of fraud on development cannot be overlooked.** First, fraud can result in poorly implemented projects. Firms that falsify their bids may very well be unqualified to implement multimillion dollar projects. This year we had at least three cases deriving from complaints about the poor quality of services in projects. The implicated firms had either falsified their financial information or past experience. In one investigation, when a government tried to cash a performance guarantee following overly extended project delays, the guarantee turned out to be false. As part of their contracts, firms working on large projects provide performance guarantees backed by banks; governments can collect on the guarantees in the event a firm does not deliver as promised. In this case, it turned out that the firm had stolen the name of another legitimate firm. The World Bank has already sanctioned one firm and the others are in the sanctions process.

More troublesome is that fraud can be the smoke that indicates the bigger problem is a fire. In a recent case, a subcontractor was hired as a conduit to pay bribes and given a fraudulent contract to cover up payments made to public officials. The subcontractor received close to US\$500,000, half of which was paid up-front. When we investigated, it became apparent that the subcontractor did not do any work beyond making photocopies, for which it even billed separately.

Knowing that each allegation we receive represents a potential act of injustice, we face difficult choices in selecting which allegations warrant a full investigation. Last fiscal year, the Integrity Vice Presidency (INT) received 449 complaints about possible fraud or corruption in World Bank-financed projects. We opened 89 new investigations based on these complaints because of the seriousness of the allegations, the credibility of the complaint, and the presence of corroborating evidence. We also took into consideration whether they involved high-risk sectors and projects, systems prone to corruption, if there was a critical reputational risk to the World Bank, or where large sums of money were at risk.

Investigations help protect World Bank funds, provide insight about how to better prevent similar problems in the future, and can result in sanctions. Detecting and

preventing problems before they happen is preferable to dealing with them after the fact. However, sanctions are important because they help maintain equilibrium in business ethics and discourage potential wrongdoers from acting on their intentions. In fiscal 2013, The World Bank debarred 47 entities (and their affiliates), preventing them from participating in future Bank-financed projects and activities. To give a sense of the effect a sanction can have, the SNC-Lavalin debarment also rendered 196 affiliates ineligible to do business with the World Bank. Thanks to the cross-debarment agreement we have with the Asian Development Bank, the Inter-American Development Bank, the European Bank for Reconstruction and Development, and the African Development Bank, 295 entities were jointly declared ineligible. The word “sanctions” is a strong deterrent, but in dealing with corrupt entities, it is fitting to quote Huguette Labelle, Chair of the Board of Transparency International: “When you put your fingers in the meat grinder of corruption, the whole body goes.”

What We’ve Seen Work in the Fight against Corruption

The corrupt economy can be as fast-paced, global and sophisticated as the above-board one. Investigating a firm headquartered in North America that replicates the corrupt scheme it successfully implemented in Asia in the Middle East presents a number of logistical and legal challenges. Our investigations today are more complex than ever before, and the strong partnerships we have with national anti-corruption and law enforcement authorities ever more important.

National authorities share information with the World Bank when their investigations touch upon Bank-financed projects. In addition to generating some of the biggest corruption cases worldwide, the U.S. Foreign Corrupt Practices Act (FCPA) has led to a number of leads in World Bank investigations. Often a condition to the amnesty or reduced sanctions granted by the U.S. Department

of Justice stipulates that the party in question cooperate fully with other enforcement bodies and international financial institutions such as the World Bank. As a result of such disclosures, we’re wrapping up investigations on two companies for fraud on contracts worth US\$41.5 million.

Strong partnerships with national authorities not only facilitate World Bank investigations, but contribute to heightened rule of law in countries. When a World Bank investigation leads us to believe the laws of a member country have been broken, we refer those findings to the relevant authorities. The World Bank can prevent a firm or individual from participating in future projects through its sanctions, but criminal investigations are the jurisdiction of national authorities. Ten referrals the World Bank made this past fiscal year have prompted national authorities to launch their own investigations, and in the case of Sweden, have already led to convictions. These successes are tempered by the difficulty we face in getting some countries to act on referrals. The World Bank will continue to put the spotlight on this matter to induce more meaningful responses to referrals.

How does the World Bank define fraud and corruption?

See definitions at www.worldbank.org/sanctions

Similarly, the World Bank's Negotiated Resolution Agreement (NRA) not only helps us conclude cases faster and save resources, but also generates new leads by requiring continued cooperation with our investigations. Disclosures are admissions of wrongdoing, backed by supporting documentation so they provide the World Bank with very credible information about the entities and individuals involved. Although the Bank will not sanction the NRA participant for disclosed past misconduct beyond the terms of the NRA, we have mounted additional investigations into the related consortium partners, subcontractors and agents, as well as referred matters to government authorities to take action.

In FY13, for the first time since its inception, the World Bank Group's Sanctions Board published all its fully reasoned final decisions. Doing so ensures that the sanctions system remains transparent, predictable and accessible for future respondents, academia and the general public. Publishing the factual findings in each case and the reasons for sanctioning the respondent provide for a better understanding of the prohibited practices and thus serve as a deterrent. For example, the Sanctions Board's FY13 decisions reaffirmed the liability of an employer for its employees under the doctrine of respondeat superior. This doctrine applies if an employer at the time of the sanctionable practice does not have adequate controls in place to prevent misconduct and if the employee, when committing a sanctionable practice acted within the course and scope of his employment and was motivated at least in part to benefit the company. If large corporations more vigorously applied this principle, they could maximize good governance in their operations and expand the pool of clean bidders in development projects.

One-hundred-sixty-seven states are parties to the UN Convention against Corruption. Since 2010 new or tougher legislation in the UK, China, Switzerland, the US, and Canada has been enacted. Yet no country is free of corruption. **Implementing and enforcing laws has always been more difficult than drafting them. However, the current international legal framework already provides a solid platform from which to combat corruption.**

China amended its laws to criminalize overseas bribery in 2011. In 2012, Russia ratified the OECD Anti-Bribery Convention, and amended its anti-corruption law, prohibiting certain public officials from keeping money in foreign banks, and obliging listed state corporations and public officials to explain sources of income to finance real estate and other acquisitions. This past July, Brazil passed a new law that creates civil and administrative liability, and provides for significant financial penalties for companies that bribe foreign public officials. Given these developments and on the back of referrals we made to client countries, we are working to build closer partnerships with enforcement authorities in these countries.

This fiscal year we had success using laws in a country that permit aggrieved entities to access records filed in related court cases. In one case, the World Bank convinced a company to produce records by noting that, if it did not, the Bank would request the information through a public court filing under a court records access statute. The

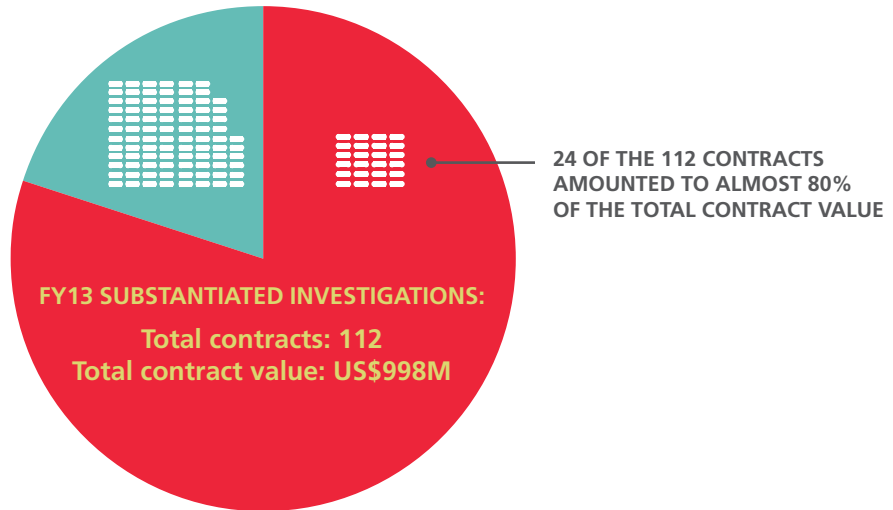
company, wishing to avoid publicity, agreed to provide the requested documents. For the first time, courts in another country recognized the World Bank as an aggrieved entity in a criminal investigation which had stemmed from information we provided. The Bank may now be able to recover misappropriated funds that were held in that country's banks. The Bank was able to achieve these successes without waiver to and in a manner that respected the Bank's privileges and immunities. Furthermore, the decision sets an important legal precedent for other international organizations fighting corruption. In light of these successes, the World Bank and others might be able to use similar options in other jurisdictions.

While the World Bank does not tolerate corruption in its projects and activities, neither do we avoid difficult situations. Effective preventive efforts play a large role in our ability to work in difficult situations. In the past fiscal year, our preventive services team worked with one hundred project task teams, identifying high-risk projects in the pipeline, briefing new Country Directors and Managers about potential issues in their portfolios, and building precautions against fraud and corruption into high-risk projects. We helped strengthen the grievance redress mechanism in the Ministry of Health in Afghanistan and developed an integrity toolkit for the roads sector in India.

The investigations we substantiated in 2013 involved 112 contracts worth approximately US\$998 million, up from 84 contracts and US\$178 million in 2012. This is because investigations are increasingly focusing on large value contracts; 24 of the 112 contracts amounted to almost 80% of the total contract value. This past fiscal year, approximately \$422 million spread across 34 contracts were not awarded to companies bidding on World Bank-financed projects because the wrongdoing was detected prior to contract award. World Bank staff and local project implementation unit officials undertaking procurement due diligence were effective in preventing 23 of these tainted contracts being awarded. Approximately 89%, or \$374 million of the \$422 million, was subsequently awarded to other vendors. In one case involving a \$46 million contract, the World Bank did not fund the project while the remaining \$2 million in contracts were either cancelled or have not yet been awarded.

When problems do arise, we deal with them. For example, one of the World Bank project teams received multiple complaints related to the procurement of a major power project in a fragile state, we were able to intervene in time. The project was hampered by a number of issues: two separate contracts for completing identical work; companies that were supposed to be competing against each other, but off the record one planned to be the subcontractor for the other and; a supervision consultant who had been intimidated by local police when he visited the project site. Our preventive services team proposed quick, cost-effective solutions. Eliminating one of the duplicate contracts saved US\$5.8 million. Asking the supervision consultant to provide GPS date-stamped photos helped ensure work was being completed, while also allowing him to monitor thousands of kilometers of power lines in areas that were hard to access without compromising his safety.

Investigations are increasingly focusing on large value contracts



Close engagement between our preventives services team and project teams ensure that risk analyses and lessons learned from investigations inform the Bank's business decisions. This feedback loop is especially important in high-risk operations such as the one mentioned above. Sometimes, and despite our best preventive, operational, and investigative efforts, the World Bank cannot continue to fund a project which has become plagued by corruption. Although this outcome is as disappointing for us as it is for our clients, we are committed to promoting and protecting the integrity of our development projects.

We likewise believe in holding our own staff to the highest standards. Since September 2012 the World Bank has discharged from service eight staff whose serious misconduct included fraud, corruption or collusion. While the vast majority of the Bank's 13,064 staff abide by its rules and ethical standards, we cannot let the actions of a few damage the reputation of an institution whose people work every day to reduce poverty.

What Next?

The story of the Padma Bridge project in Bangladesh is well known, but less so the lessons learned from the case. The World Bank received credible evidence of high-level corruption among Bangladeshi government officials, SNC- Lavalin executives and private individuals related to the Padma Multipurpose Bridge Project. We provided our evidence to the Bangladeshi government to investigate the matter, and pending additional corrective actions, would continue financing the project. When these conditions were not met, the Bank cancelled the US\$2.1 billion credit. When

the government of Bangladesh asked the Bank to reconsider its decision, an external panel of international anti-corruption experts was brought in to make an independent assessment of the Bangladesh Anti-Corruption Commission's investigation. The panel's findings also concluded the investigation was not full and fair. Ultimately, Bangladesh withdrew its credit request. In Canada, the Royal Canadian Mounted Police launched their own investigation of SNC-Lavalin and prosecutions are underway.

Among a number of very pertinent observations, the report prepared by the external panel noted that "the other companies involved in the bidding process did not have enough incentives to publicly disclose information in their possession about illegal activities." The Padma Bridge investigation is a reminder that the private sector needs stronger incentives to run their businesses cleanly, that we should better communicate the incentives that do exist, and that we could be more effective in fighting corruption if we better encourage and protect whistleblowers.

A recent conversation with a leading chartered accountant underscored what incentivizes the private sector to run their businesses with integrity. He contended that corruption erodes trust, which leads to the public and governments to call for more regulation; when regulation proliferates, the cost of doing business goes up. Businesses end up competing more on price than brand, so customer loyalty goes down and gross margins come under pressure. Employees who are under that kind of pressure are unhappy, and either leave or are less productive, making the firm as a whole less productive. One solution is a recommendation by the Padma Bridge expert panel that the World Bank should "engage in a dialogue with companies involved in its operations to discuss how best to prevent unfair competition through illegal payments."

The corporate compliance concept—a strong tone at the top, policies and systems to prevent and deal with fraud, corruption, and ethical lapses, employee education and training, and effective due diligence of third parties including suppliers and subcontractors—needs to penetrate more deeply. The experience of the World Bank's Integrity Compliance Office, which determines whether ineligible entities can be reinstated at the end of their debarment period, has shown similar gaps. According to the office, many small and medium sized enterprises (SMEs) are unfamiliar with corporate compliance principles or lack the financial resources to implement a comprehensive program. We are bringing in civil society counterparts to help develop resources specifically designed for SMEs so that the message of clean business reaches firms of all sizes.

Among the cases we substantiated in the past fiscal year, more people reported instances of fraud than corruption. Presumably at least part of the reason is that hard evidence of fraud is easier to come by, and the personal risk involved is lower. Offering whistleblowers enhanced protection against retaliation could encourage more people to come forward, especially to report possible corruption. The external panel of experts in the Padma Bridge case recommended that the World Bank consider offering monetary rewards for information to help whistleblowers overcome

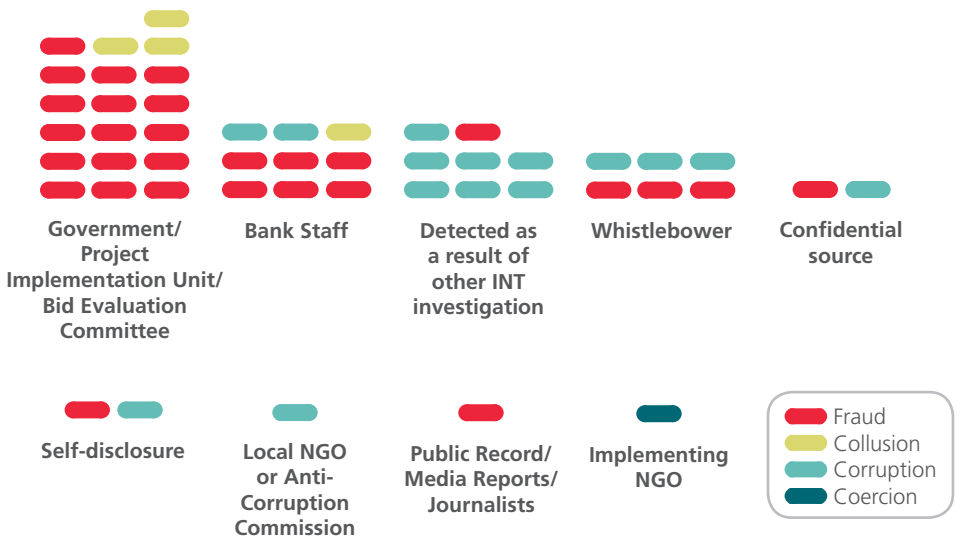
some of the barriers they face. The idea is similar to the U.S. Dodd-Frank Act of 2010, which authorizes rewards to individuals who offer high-quality original information that leads to an enforcement action in which more than US\$1 million in sanctions is ordered. Not surprisingly, paying for information is a controversial topic. The example in the U.S. and the recommendation by the Padma Panel would be particularly relevant to governments looking for innovative ways to deal with pervasive, high-level corruption.

Much has been said about the role of the private sector in fighting corruption, but governments share equal responsibility. The World Bank has long advocated that good governance and strong, accountable institutions are the cornerstones of integrity. Countries struggling with corruption can look to a number of examples where others have turned things around.

- For the past ten years, the Indonesian Corruption Eradication Commission (KPK) has aggressively tackled corruption, handling 332 high-profile cases—of which 169 have been processed in court—and recovering assets equivalent to more than US\$80 million. Recognizing the importance of teaching integrity, the KPK has promoted initiatives such as “honesty shops” where customers pay by depositing what they owe into a box.
- The Philippines launched a successful public tip-off campaign, catching tax evaders and smugglers who defrauded the government. The “Pera ng Bayan” or People’s Money Program allows citizens to use social network tools to report corruption, but also to praise civil servants who perform their duties well.

Who reported what?

FY13 Substantiated Investigations by Sanctionable Offence and Detecting Party



- The World Bank supported Colombia's initiative to create a new High Level Reporting Mechanism to clamp down on the demand side of bribery. Instances of bribe solicitations in government procurement are handled by a special office that can quickly resolve issues, ensure effective law enforcement, and place instances of corruption under the public spotlight.
- Saudi Arabia has opened a Discharge Account into which people can deposit any money they believe has been unjustly taken. The fund has accrued more than US\$63 million and is being used to fund social loan programs for low-income people.

Countries are also successfully using e-government to reduce opportunities for corruption. The Independent Advisory Board (IAB), which advises the World Bank on the functioning of INT, advocates more widespread use of technology. Following a visit to India last November, the Bank-funded BHOOMI project caught their attention. The project helped computerize almost 20 million records of land ownership, protecting the authenticity and integrity of records to the benefit of 6.7 million farmers in Karnataka. The IAB also noted how the Central Vigilance Commission is using e-government tools to enhance transparency and empower citizens against corruption.

In the same vein, we have leveraged technology to aid the fight against corruption, developing an Integrity App to facilitate complaint reporting; an interactive learning platform to guide national authorities through a simulated corruption investigation; and an online program in which investigators and project staff switch roles to model a high-risk project and subsequent investigation.

At the World Bank one of our top priorities is combatting corruption, to better protect our projects and support client countries. Corruption consistently ranks among the top risks to our business. Through the Integrity Vice Presidency, we've established strong relationships with the countries mentioned above, and will continue to support country-driven efforts through mechanisms like the World Bank's International Corruption Hunters Alliance (ICHA). ICHA helps us comprehend the true state of corruption around the world is, invigorate the actions of prosecutors and investigators, design counter strategies against criminal enterprises, and promote the rule of law.

Corruption is, as Huguette Labelle argues, the common denominator among social destabilization, violence, illicit trade, money laundering, crumbling infrastructure, and other ills that befall development. It destroys opportunities, perpetuates and deepens inequalities, and depletes national wealth. That is why solutions, effective responses in client countries, blueprints for prevention, and successes in enforcement should underwrite the global onslaught against corruption in 2014 and beyond. We hope this report helps galvanize such efforts.

Ann McCarthy



