Are governments doing business with criminals and terrorist financiers?

De Koker, Louis

Governments compel financial institutions and high-risk businesses to implement detailed customer due diligence measures to ensure that they do not finance terrorist activities or enable criminals to launder money. Governments, however, do not necessarily perform equivalent measures in relation to government contractors to protect public procurement processes against similar abuse. There is evidence that tax funds may find their way to criminal enterprises and even to terrorist organisations.

Public procurement makes up a significant part of national economies, generally corresponding to 10-25 per cent of a country's GDP. In 2012/13, the public sector in the United Kingdom, for example, spent approximately £230 billion on procurement of goods and services. Most authorities adopt anti-corruption measures in relation to public procurement to guard against bribery and collusive bidding. These measures may, however, not be sufficiently robust to protect these processes against money laundering and terrorist financing abuse.

In 2010 the Subcommittee on National Security and Foreign Affairs Committee on Oversight and Government Reform of the US House of Representatives produced a report on the supply chain management practices of the US Department of Defense in Afghanistan. The report, entitled *Warlord, Inc: Extortion and Corruption along the USA Supply Chain in Afghanistan* highlighted the US Department of Defense's outsourcing of security of the supply chain in Afghanistan to questionable contractors. The security arrangement for the $2.16 billion trucking contract fuelled an extensive protection racket operated by a network of warlords, strongmen, commanders and corrupt Afghan officials. It enriched criminal enterprises in Afghanistan, but, according to the report, also potentially presented a significant source of funding for insurgents.

In the case of countries such as Afghanistan and Iraq, the general fog of war and the lack of infrastructure and records complicate the undertaking of appropriate supplier due diligence measures. The risks, however, do not only stem from the external environment in those countries. The findings of the Special Inspector General for Afghanistan Reconstruction (SIGAR) indicate that some of the risks are linked to the approach procuring agencies adopted in relation to contractor due diligence.

In various reports to the US Congress SIGAR raised concerns regarding the risk that the US Army was awarding procurement contracts in Afghanistan to supporters of the insurgency, including supporters of the Taliban, the Haqqani network and al-Qaeda. As a consequence, procurement rules were tightened and measures were adopted to mitigate the risks. SIGAR also identified 43 suppliers to the Army, recommending their suspension and debarment. According to SIGAR, these recommendations were based on detailed supporting information that the listed individuals and companies were providing material support to the insurgency in Afghanistan. In its July 2013 quarterly report to the US Congress an exasperated SIGAR reported:

But the Army rejected all 43 cases. The Army Suspension and Debarment Office appears to believe that suspension or debarment of these individuals and companies would be a violation of their due process rights if based on classified information or if based on findings by the
Department of Commerce. I am deeply troubled that the USA military can pursue, attack, and even kill terrorists and their supporters, but that some in the USA government believe we cannot prevent these same people from receiving a government contract. I feel such a position is not only legally wrong, it is contrary to good public policy and contrary to our national security goals in Afghanistan.

In a November 2013 letter, SIGAR raised the matter again with the US Secretary of Defense, noting that no action has yet been taken to suspend and debar the 43 contractors. It also noted a further example where a listed entity was sub-contracted to a sensitive project despite the improved procurement rules.

It is difficult to imagine the extent of regulatory, supervisory and general political outrage and the legal consequences if a bank, especially one based in a G20 country, was found to maintain accounts for any such entities or negligently allowed funds to flow to warlords linked to the Taliban or al-Qaeda.

Inadequate supplier due diligence is not confined to US Government agencies. A 2014 European Commission report investigated corruption levels in the European Union as well as anti-corruption measures implemented by its members. The report estimated that corruption costs the European economy EUR 120 billion per year, an amount that is nearly equal to the annual budget of the European Union (Report from the Commission to the Council and the European Parliament EU Anti-Corruption Report, 2014). Despite the significant corruption risks, the report found that ownership of bidders and sub-contractors is very rarely checked in public procurement procedures. It is commendable that the EU report recommended that such checks be done.

A recent study of supplier integrity due diligence measures by Australian government agencies found similar weaknesses in general public procurement processes (De Koker and Harwood "Supplier Integrity Due Diligence in Public Procurement: Preventing the Flow of Australian Tax Dollars to Criminal Suppliers", Deakin University, 2014). While the principle of supplier integrity due diligence is recognised in Australia and indications are that appropriate steps are taken in relation to high-value contracts, there is little evidence of clear, consistent and effective policies and practices. The study found that the due diligence focus of Australian public procurement officials mainly falls on the financial health of prospective suppliers, primarily to mitigate the risk that a supplier will be unable to deliver on the contract. While more extensive checks are undertaken for high-value contracts, ultimate control and beneficial ownership, crime links and even political links of suppliers are not generally and consistently probed. Where such matters are considered, a statement of facts produced by the prospective supplier normally suffices. The list of matters that must be declared is, however, not necessarily comprehensive, and the assurances that are provided are not generally independently verified. Many government contracts are awarded without checking whether the supplier or any of its beneficial owners are listed on the Australian consolidated list of sanctioned persons and entities maintained by the Australian Department of Foreign Affairs and Trade. Neither are checks performed to consider whether suppliers or their beneficial owners have been blacklisted by a foreign government or by an international body for fraud or corruption.

It is submitted that governments should urgently improve the quality and consistency of contractor due diligence practices. When effective integrity checks are not performed, unscrupulous suppliers, including government officials, are able to access and abuse public
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procurement. Such abuse is often accompanied by an increase in costs of procurement and a decrease in the quality of supplied goods and services. Contractor due diligence should therefore be improved to support the integrity of procurement processes.

These improvements are, however, also required to ensure that public procurement processes do not undermine the anti-money laundering (AML) and counter terrorist financing (CTF) objectives of governments. The failure to properly screen contractors threaten the effectiveness of AML/CTF laws. AML/CTF measures are designed to disrupt the business models of criminal groups and terrorist organisations by denying them the opportunity to fund their activities and launder their criminal proceeds through the legitimate financial and business sector. This broad objective is undermined if criminals and terrorist financiers can win public contracts. This not only enables them to use taxpayer funds to finance criminal activities but also provides them with an appearance of public respectability that may facilitate their access to formal financial and professional services.

When governments design improved processes, they would do well to mirror appropriate aspects of the AML/CTF customer due diligence measures that banks are required to implement. It is submitted that basic procurement due diligence measures should probe beneficial ownership of contractors and possible links that those owners and contractors may have with public officials and domestic and foreign Politically Exposed Persons. In addition, the beneficial owners and contractors should be screened against criminal records, national and international sanctions lists and relevant suspension and debarment lists. Such screening should not only be done when a bid is assessed but should be done continuously as control and the status of the beneficial owners may change during the duration of the contract. The government should furthermore have the right to terminate the contract should evidence pointing to unacceptable integrity risks emerge.

Increased measures are required to shield public procurement and economic activity in general from criminal abuse. The objectives of the money laundering and terrorist financing framework are undermined when lax controls facilitate criminal access to such significant sums of taxpayer funds.