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SUPPLIER INTEGRITY DUE DILIGENCE IN PUBLIC PROCUREMENT: LIMITING THE CRIMINAL RISK TO AUSTRALIA†

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Abstract

The potential for criminals and terrorism financiers to secure lucrative government contracts poses a risk to Australia's anti-money laundering, anti-corruption and counter-terrorism financing objectives. This article compares the customer due diligence measures that banks are required to implement to prevent money laundering and terrorism financing with the general supplier due diligence practices and processes of key Australian government departments and agencies. It identifies various weaknesses in current procurement practices relating to standard contracts and argues that these render Australian public procurement vulnerable to criminal abuse, threaten compliance with its sanctions regime and potentially undermine the crime combating objectives of its money laundering and terrorist financing laws. The article recommends that the national interest calls for a whole-of-government approach to improve supplier due diligence in public procurement.

I INTRODUCTION

Published figures suggest that Australian governments spend in excess of \$110 billion dollars each year on public procurement,¹ the purchase of goods, services and works by

† We acknowledge the support of the Data to Decisions Cooperative Research Centre (D2D CRC) regarding Big Data and enhanced analytical capacity for appropriate supplier due diligence. We also acknowledge the contribution of Christina Ward as research assistant; the officials of various procurement agencies who provided information; Jason Menz who kept a watch on current procurement activity for us; and Richard Coverdale, David Vaile and the editors and anonymous reviewers of the *Sydney Law Review* for their helpful comments. A very early draft report was submitted to the Attorney-General's Division in February 2014 in response to the call for public submission informing the *Statutory Review of the Anti-Money Laundering and Counter-Terrorism Financing Act (Cth) 2006*.

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¹ Protiviti conducted a review of federal procurement activity using data from AusTender and found that the government spent \$41.4 billion on public procurement in 2011/12: Protiviti, *Data Mining and Analysis of AusTender Data 2011-12* (Report, Department of Finance and Deregulation (Cth), February 2014) 2 <<http://www.finance.gov.au/sites/default/files/austender-data-analysis-2011-12.pdf>>. In excess of \$10 billion is spent by the Victorian government each year on public procurement: Independent Broad-Based Anti-Corruption Commission Victoria, *Operation Fitzroy* (Special Report, 2014) 5 <<http://www.ibac.vic.gov.au/news-and-publications/reports>>. State and local governments in NSW spend up to \$27 billion on public procurement each year: Chris Newman and Ingrid Burkett, *Social Procurement in NSW – A Guide to Achieving Social Value through Public Sector Procurement* (Social Procurement Action Group, October 2012) 6 <<http://www.socialenterprises.com.au/social-procurement-guide>>. \$19.45 billion was spent on

government departments, agencies and entities.² The large amounts involved in public procurement attract criminals and criminal behaviour.³ A range of probity measures are therefore employed to safeguard the procurement process, especially against corruption relating to the awarding of contracts. Appropriate supplier due diligence is one of the essential probity measures.

Due diligence is a broad concept that covers a range of checks that are performed to ascertain and confirm important facts and assess risk, generally relating to a proposed contract or course of action.⁴ This paper focuses on the checks that may be performed in the public contract award process relating to one particular risk, namely that the supplier may be linked to terrorism or crime, especially organised crime or corruption. For purposes of this article, this is referred to as “supplier integrity” risk. While this risk may be linked to general integrity and probity matters relating to the awarding of the contract, it also includes cases where an undesirable supplier does not use corrupt means to secure the contract.

This paper investigates supplier integrity due diligence practices in Australian public procurement and reflects responses to a set of questions that was circulated to Commonwealth, state and territory agencies in December 2013 and January 2014. The paper compares the customer due diligence (‘CDD’) measures that banks are required to implement to prevent money laundering and terrorist financing with the general supplier due diligence practices and processes of Australian government agencies. It also considers debarment and due diligence measures implemented internationally.

public procurement by government agencies bound by the *State Supply Commission Act 1991* (WA) and the *Public Works Act 1902* (WA) in 2011/12: Department of Finance (WA), *Who Buys What and How – An Overview of 2011-12 Western Australian Government Purchasing* (2012) 8 <www.finance.wa.gov.au/cms/uploadedFiles/Government_Procurement/Publications/Reports/wb_wh_2011_12_full_report.pdf?n=251>. \$4.05 billion was spent on public procurement by the South Australian government in 2013/14: Government of South Australia State Procurement Board, *Annual Report 2013-2014* (November 2014) <<http://www.spb.sa.gov.au/content/annual-report-2013-2014>>. \$10.9 billion is spent by the Queensland government on public procurement annually: Allie Coyne, ‘QLD agencies blowing out procurement costs’, *itnews* (online), 4 December 2013, <<http://www.itnews.com.au/News/366476,qld-agencies-blowing-out-procurement-costs.aspx>>.

² This definition of public procurement was adopted from OECD ‘Public Procurement Spending’ in OECD, *Government at a Glance 2013* (OECD Publishing, 2013) <http://dx.doi.org/10.1787/gov_glance-2013-44-en>. For ease of reference, departments, agencies and entities of the Australian federal, state and territory governments will all be referred to as agencies and collectively as Australian government agencies.

³ See, Jens Christopher Andvig, ‘Public Procurement and Organized Crime – Illustrated with Examples from Bulgaria, Italy and Norway’ (NUPI Working Paper 813, Norwegian Institute of International Affairs, 2012) <<http://www.nupi.no/content/download/368183/1253135/version/2/file/NUPI-WP--813-Andvig.pdf>>; European Commission, ‘EU Anti-Corruption Report’ (Report from the Commission to the Council and the European Parliament, 3 February 2014) 33 <http://ec.europa.eu/dgs/home-affairs/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report/index_en.htm>.

⁴ See, eg, Linda S Spedding, *Due Diligence and Corporate Governance* (Elsevier, 2004) 2–3.

II AML/CTF AND CDD IN FINANCIAL SERVICES

The CDD measures that reporting entities under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) ('*AML/CTF Act*')⁵ must implement, to identify, mitigate and manage the risk of customers abusing their systems to launder the proceeds of crime or finance terrorism, provide a starting point for this discussion. These measures indicate the types of checks that might reasonably be expected to form part of public procurement processes, to mitigate similar risks.

For the purposes of this article, the discussion focuses on the CDD measures that banks employ to meet international standards and comply with Australian law. It is however important to note that these obligations extend to all reporting institutions, including small businesses in the relevant sectors.

Traditionally banks employed various measures to check a prospective customer's identity and to mitigate credit risk, where the customer requested credit. With the advent of mass banking, the risk of criminal abuse of banking services, especially by money launderers and terrorism financiers, increased. As a consequence the global community adopted anti-money laundering and counter-terrorism financing ('AML/CTF') standards which in turn guide the shape and form of national AML/CTF regimes.⁶ These regimes are aimed at disrupting the criminal business model by stemming criminal money flows and ultimately seizing criminal assets and funds. AML/CTF regimes include laws that criminalise money laundering and terrorism financing, national financial intelligence units that receive reports of suspicious matters and analyse them, close international intelligence and law enforcement cooperation.⁷ They also rely on CDD monitoring and record-keeping measures that banks and other reporting institutions must implement and duties to report related suspicious and unusual transaction to the relevant financial intelligence unit.⁸

A International CDD Standards for Banks

AML/CTF standards are set by the Financial Action Task Force ('FATF'), the global intergovernmental standard-setting body with an AML/CTF and anti-proliferation financing mandate. Other standard-setting bodies have also set standards that are relevant to specific types of regulated financial institutions. The Basel Committee on

⁵ Reporting entities are businesses that provide a designated service as defined in s 6 of the *AML/CTF Act*. The designated services cover a broad range of business activities undertaken in the bank and non-bank financial services industry as well as the bullion and gambling industries.

⁶ This framework is also employed to support international actions against proliferation of weapons of mass destruction and other related threats to the international financial system: Financial Action Task Force, 'International Standards on Combating of Money Laundering and the Financing of Terrorism & Proliferation – the FATF Recommendations' (February 2012) 7 <<http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatf-recommendations.html>> ('*FATF Recommendations*').

⁷ *Ibid* 12 [3], 13 [5], 24 [29], 27–30 [36]–[40].

⁸ *Ibid* 14–15 [10], [11], 19 [20].

Banking Supervision, for example, has issued specific guidance on CDD to banks.⁹ These standards are generally directed at countries and regulators who are required to implement them through binding national laws.¹⁰

More than 180 jurisdictions have endorsed the AML/CTF standards set by FATF, known as the *FATF Recommendations*.¹¹ Country-level compliance with the *FATF Recommendations* is assessed by the global community and significant non-compliance may lead to blacklisting and financial sanctions.¹² In the case of banks, both large and small, the *FATF Recommendations* have substantially translated into embedded banking compliance practice.¹³

FATF's Recommendation 10 requires countries to compel financial institutions and designated non-financial businesses and professions to undertake the following CDD measures in a number of circumstances, including when establishing business relations:¹⁴

- (a) identify the customer and verify the customer's identity using reliable, independent source documents, data or information;
- (b) identify the beneficial owner,¹⁵ and take reasonable measures to verify the identity of the beneficial owner, to ensure that the institution is satisfied that it knows who the beneficial owner is. In relation to legal persons and arrangements this means that the institution should also understand the ownership and control structure of the customer; and

⁹ Basel Committee on Banking Supervision, 'Sound Management of Risks Related to Money Laundering and Financing of Terrorism' (Bank for International Settlements, January 2014) <<http://www.bis.org/publ/bcbs275.htm>>.

¹⁰ *FATF Recommendations*, above n 6, 108 [1].

¹¹ *Ibid* 7.

¹² Legal Department, International Monetary Fund, 'Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) – Report on the Review of the Effectiveness of the Program' (11 May 2011) 82–84 <<http://www.imf.org/external/np/pp/eng/2011/051111.pdf>>.

¹³ Full compliance is still evasive as evidenced by the fines that are regularly imposed on banks for non-compliance. For example, US authorities imposed a USD 1.92 billion penalty on HSBC in 2012 for severe failings in its AML/CTF and sanctions compliance: Office of Public Affairs, *HSBC Holdings Plc. And HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement* (11 December 2012) United States Department of Justice <www.justice.gov/opa/pr/2012/December/12-crm-1478.html>. In addition to forfeiting \$1.256 billion as part of its deferred prosecution agreement with the US Department of Justice, HSBC also agreed to pay \$665 million in civil penalties. This record penalty was soon exceeded by the USD 8.9 billion penalty levied on BNP Paribas in 2014 for evasion of US economic sanctions: Office of Public Affairs, *BNP Paribas Agrees to Plead Guilty and to Pay \$8.9 Billion for Illegally Processing Financial Transactions for Countries Subject to U.S. Economic Sanctions* (30 June 2014) United States Department of Justice <<http://www.justice.gov/opa/pr/2014/June/14-ag-686.html>>.

¹⁴ *FATF Recommendations*, above n 6, 14 [10]. Other cases include: when carrying out occasional transactions: (i) above the applicable designated threshold of USD/EUR 15,000; or (ii) that are wire transfers in the circumstances outlined in the Recommendations; when there is a suspicion of money laundering or terrorist financing; and, when the institution has doubts about the veracity or adequacy of previously obtained customer identification data.

¹⁵ See below Part II B *Beneficial Ownership*.

- (c) understand and, as appropriate, obtain information on the purpose and intended nature of the business relationship.

Recommendation 10 also requires ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship. This is to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile and the source of the funds.

While institutions may require customers to disclose information, banks cannot rely on such disclosure alone. They are required to undertake additional, independent processes to verify the information.¹⁶ Compliance with the CDD measures in Recommendation 10 should be implemented using a risk-based approach.¹⁷ This means that both countries and institutions must assess their money laundering and terrorism financing risks and adopt appropriate, proportional risk mitigation responses. Where the FATF or such assessments identify higher risk, enhanced CDD measures must be adopted.¹⁸ In the case of lower risks, countries and institutions may adopt simplified measures.¹⁹

The CDD measures are not only aimed at identifying customers but also at understanding their financial position and the money laundering and terrorism financing risk that they may pose. If the bank identifies a suspicious or unusual transaction, it should be investigated and, where appropriate, reported confidentially to a national financial intelligence unit without tipping-off the customer.²⁰

B Beneficial Ownership

Identification and verification measures are generally aimed at establishing the identity of the customer and at reasonably verifying that identity. CDD measures are however also concerned with establishing beneficial ownership of a corporate entity or legal relationship. As legal arrangements and corporate entities may obscure the identity of beneficial owners, CDD measures should identify the individuals who actually control or benefit from the entity, whether directly or indirectly.

According to the FATF's general glossary, the beneficial owner is the natural person or persons who ultimately own or control a customer and/or the natural person or

¹⁶ Financial Action Task Force, 'FATF Guidance: Politically Exposed Persons (Recommendations 12 and 22)' (June 2013) 18 [77] <<http://www.fatf-gafi.org/media/fatf/documents/recommendations/Guidance-PEP-Rec12-22.pdf>>.

¹⁷ *FATF Recommendations*, above n 6, 15 [10]. See Louis de Koker, 'The 2012 Revised FATF Recommendations: Assessing and Mitigating Mobile Money Integrity Risks Within the New Standards Framework' (2013) 8(3) *Washington Journal of Law, Technology & Arts* 165, 173-177.

¹⁸ For guidance on the risk assessment and indicators of higher and lower risk see the interpretive notes to Recommendations 1 and 10: *ibid* 31-3, 59-67.

¹⁹ Where there is proven low risk, regulators may consider excluding products and services from AML/CTF obligations: Financial Action Task Force, 'FATF guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion' (February 2013) 18 [37] <http://www.fatf-gafi.org/media/fatf/documents/reports/AML_CFT_Measures_and_Financial_Inclusion_2013.pdf>.

²⁰ *FATF Recommendations*, above n 6, 19, [20], [21]; Louis de Koker, 'The FATF's Customer Identification Framework: Fit for Purpose?' (2014) 17 *Journal of Money Laundering Control* 281.

persons on whose behalf a transaction is being conducted. The concept also includes those persons who exercise ultimate effective control over a legal person or arrangement.²¹ Beneficial ownership checks entail probing not only the shareholders of a corporation but any beneficial ownership rights that may be exercised through a layer of corporate entities or trusts, whether through direct shareholding or other means.²² Banks are required to take reasonable steps to identify beneficial owners and the international community is committed to support banks by increasing beneficial ownership transparency.²³

C Politically Exposed Persons

The CDD measures in the *FATF Recommendations* are not limited to the identification of customers and beneficial owners. They also require checks to determine whether a customer holds, or is closely linked to persons who hold, senior public positions.²⁴ Such people are known as Politically Exposed Persons ('PEPs') and PEP measures are intended to strengthen national and international anti-corruption frameworks.²⁵

FATF's Recommendation 12 requires countries to compel banks to have the following measures in place in relation to foreign PEPs:

²¹ *FATF Recommendations*, above n 6, 110.

²² *Ibid* 110 n 50. The FATF allows countries to base their concept of "controlling interest" on a threshold percentage of shares or interest held, for example 25% of the issued shares: at 60 n 30.

²³ See, eg, Department for Business Innovation & Skills, 'Transparency & trust: Enhancing the transparency of UK company ownership and increasing trust in UK business - Government response' (UK Government, April 2014) and G20, 'G20 High-Level Principles on Beneficial Ownership Transparency' (November 2014) <http://www.g20australia.org/official_resources/g20_high_level_principles_beneficial_ownership_transparency#sthash.rMwmCqvf.dpuf>.

²⁴ In the FATF's general glossary PEPs are defined as individuals who are or have been entrusted with prominent public functions, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations and important political party officials. The definition extends to persons who are or have been entrusted with a prominent function by an international organisation. The definition of PEPs is not intended to cover middle ranking or more junior individuals in any of those categories, but PEP checks should extend to family members and close associates of PEPs: *FATF Recommendations*, above n 6, 119–20.

²⁵ Financial Action Task Force, 'Best Practices Paper: The Use of the FATF Recommendations to Combat Corruption' (October 2013) 22-3 [24] <<http://www.fatf-gafi.org/media/fatf/documents/recommendations/BPP-Use-of-FATF-Recs-Corruption.pdf>>; Louis De Koker, 'Applying Anti-Money Laundering Laws to Fight Corruption' in Adam Graycar and Russell G. Smith (eds), *Handbook of Global Research and Practice in Corruption* (Edward Elgar, 2011) 340; Kim-Kwang Raymond Choo, 'Politically Exposed Persons (PEPs): Risks and Mitigation' (2008) 11 *Journal of Money Laundering Control* 371; Kim-Kwang Raymond Choo, 'Challenges in Dealing with Politically Exposed Persons' (Trends and Issues in Crime and Criminal Justice, Paper No 386, Australian Institute of Criminology, February 2010) <http://www.aic.gov.au/media_library/publications/tandi_pdf/tandi386.pdf>; Joy Geary, 'PEPs – Let's Get Serious' (2010) 13 *Journal of Money Laundering Control* 103; George Gilligan 'PEEPing at PEPs' (2009) 16 *Journal of Financial Crime* 137; Greenberg et al, *Politically Exposed Persons: A Guide on Preventive Measures for the Banking Sector* (The World Bank, 2010).

- (a) maintain appropriate risk management systems to determine whether the customer or beneficial owner is a PEP;²⁶
- (b) obtain senior management approval for establishing (or continuing, for existing customers) such business relationships;
- (c) take reasonable measures to establish the source of wealth and source of funds; and
- (d) conduct enhanced ongoing monitoring of the business relationship.

In cases of a higher risk business relationship with domestic PEPs, financial institutions are also required to apply the measures set out above.²⁷

D Sanctions Lists

Where the United Nations Security Council has determined the existence of a threat to international peace, breach of the peace, or an act of aggression its Charter authorises the Council to decide on measures to be taken to maintain or restore peace and security.²⁸ Members of the United Nations are legally bound to accept and carry out these measures.²⁹ These measures may include economic and financial sanctions against individuals, entities or countries. The *FATF Recommendations* support the United Nations sanctions regime by requiring countries to freeze the funds or other assets of parties designated under the Security Council's or the country's sanctions regime and to ensure that no funds or other assets are made available, directly or indirectly, to or for the benefit of, any such person or entity.³⁰ These sanctions are generally imposed for terrorist or terrorism financing activity or in order to prevent, suppress and disrupt the proliferation of weapons of mass destruction and its financing.

Many countries and regions maintain their own sanctions that may extend to parties that are not on the Security Council's list. Banks maintain compliance mechanisms to ensure that cross-border transactions comply with the sanctions laws of relevant countries. For example, when an Australian bank transfers money on behalf of a client to the United States it must ensure that it complies with the sanctions regimes of Australia as well as the United States.³¹ The regimes differ because they reflect different national and foreign policies. The United States for example has a long-standing trade embargo

²⁶ These measures may include obtaining a declaration from the client regarding their PEP status, but institutions are not allowed to rely only on such statements: Financial Action Task Force, above n 16.

²⁷ *FATF Recommendations*, above n 6, 16 [12].

²⁸ *Charter of the United Nations* art 39.

²⁹ *Ibid* art 25.

³⁰ *FATF Recommendations*, above n 6, 13 [6], [7].

³¹ Barry E Carter and Ryan M Farha, 'Overview and Operation of US Financial Sanctions, Including the Example of Iran' (2013) 44 *Georgetown Journal of International Law* 903; Meredith Rathborn, Peter Jeydel and Amy Lentz, 'Sanctions, Sanctions Everywhere: Forging a Path through Complex Transnational Sanction Laws' (2013) 44 *Georgetown Journal of International Law* 1055.

of Cuba while Australia and Cuba have a cordial relationship.³² A contravention of US sanctions can prove very costly for a non-US bank.³³

In practice banks have to check whether any current or prospective customers, beneficial owners, controllers, agents, business parties, or senders or receivers of funds are listed on a Security Council list or on a relevant country or other non-United Nations sanctions list.

E Australian CDD Measures

Australia is a long-standing member of the FATF and, since 2009, also a member of the Basel Committee on Banking Supervision. Its AML/CTF legal framework is largely compliant with the current FATF and Basel standards.

The Australian AML/CTF framework is set out in the *AML/CTF Act* and detailed in the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1) (Cth)* ('*AML/CTF Rules*'). Part 7 of the *AML/CTF Act* requires banks and other regulated entities (known as reporting entities) to implement AML/CTF programs. The *AML/CTF Rules* detail the matters that should be addressed by these corporate compliance programs. Non-compliance holds serious legal risks for banks that can incur significant criminal and civil penalties if they fail to adhere to the AML/CTF laws.³⁴

In 2013 the Australia government signalled its intention to increase its level of compliance with the current *FATF Recommendations*, in particular to address the lack of rules relating to PEP measures and the limited requirements to prove beneficial ownership. Australian law did not compel banks to apply the FATF's PEP measures.³⁵ In practice however, banks performed these checks to mitigate their reputational risk and to meet the requirements of their international banking counterparts. There were furthermore no requirements to take reasonable measures to understand the control structure of customers that were legal persons or arrangements and no comprehensive requirement to identify and verify the beneficial owners of such clients. While such

³² Department of Foreign Affairs and Trade, *Cuba Country Brief* Australian Government Department of Foreign Affairs and Trade <<http://www.dfat.gov.au/geo/cuba/Pages/cuba-country-brief.aspx>>.

³³ Rathborn, Jeydel and Lentz, above n 31; United States Senate Permanent Subcommittee on Investigations, United States Senate, *US Vulnerabilities to Money Laundering Drugs, and Terrorist Financing: HSBC Case History* (2012) 5 <www.hsgac.senate.gov/download/report-us-vulnerabilities-to-money-laundering-drugs-and-terrorist-financing-hsbc-case-history>. See also Office of Public Affairs, *HSBC Holdings Plc. And HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations*, above n 13.

³⁴ *AML/CTF Act* s 174(4), provides for a maximum civil penalty for a body corporate of \$17 million and \$3.4 million for an individual.

³⁵ Choo, 'Politically Exposed Persons (PEPs): Risks and Mitigation', above n 25; Gilligan, above n 25; Geary, above n 25; Choo, 'Challenges in Dealing with Politically Exposed Persons', above n 25; AUSTRAC and Attorney-General's Department (Cth), 'Considerations of Possible Enhancements to the Requirements of Customer Due Diligence' (Discussion Paper, May 2013) 24 <<http://www.ag.gov.au/Consultations/Documents/Consultation%20on%20possible%20enhancements%20to%20the%20requirements%20for%20customer%20due%20diligence/Consultation%20Paper%20-%20Consideration%20of%20possible%20enhancements%20to%20the%20requirements%20for%20customer%20due%20diligence.PDF>>.

enquiries had to be made in higher risk cases, it was not certain whether the requirement compelled reporting entities to look beyond the structure of a corporate client that was a subsidiary.³⁶ After a consultative process, PEP and beneficial ownership rules were adopted and these came into effect on 1 June 2014.³⁷

The general CDD measures of Australian banks also respond to national and international sanctions. The Australian Department of Foreign Affairs publishes the Consolidated List, which includes all persons and entities subject to UN Security Council or Australian autonomous sanctions.³⁸ More than 5000 persons and entities are currently listed on the Consolidated List. Australian banks must review their customers and other relevant parties continuously against that list, as changes occur regularly.

III PUBLIC PROCUREMENT AND SUPPLIER INTEGRITY RISK

In general, governments do not appear to conduct the same level of due diligence on their suppliers that they compel financial institutions to conduct in relation to their customers.³⁹ Some governments and international institutions have however adopted specific measures to prevent corrupt and criminal suppliers from obtaining contracts. The following discussion will briefly outline blacklisting and debarment processes as prominent examples of such measures.

³⁶ AUSTRAC and Attorney-General's Department (Cth), above n 35, 17–19.

³⁷ *Anti-Money Laundering and Counter-Terrorism Financing Rules Amendment Instrument 2014 (No. 3)* (Cth) amending *AML/CTF Rules*. For details of enforcement policy during the initial transition phase see *Policy (Additional Customer Due Diligence Requirements) Principles 2014* issued by the Minister for Justice under s 213 of the *AML/CTF Act*.

³⁸ The list can be found at <http://www.dfat.gov.au/international-relations/security/sanctions/pages/consolidated-list.aspx>. Australia's autonomous sanctions regime framework is formed by the *Autonomous Sanctions Act 2011* (Cth) along with the *Autonomous Sanctions Regulations 2011* (Cth). See also the countermeasure powers in the *AML/CTF Act* s 102. The export of UNSC-sanctioned goods from Australia are controlled by the *Customs Act 1901* (Cth) and the *Customs (Prohibited Exports) Regulations 1958* (Cth) while imports of such goods are controlled by the *Customs (Prohibited Imports) Regulations 1956* (Cth). Travel bans and restrictions are enforced via the *Migration (United Nations Security Council Resolutions) Regulations 2007* (Cth).

³⁹ European Commission, above n 3, 33:

Ownership of bidders and sub-contractors is very rarely checked in public procurement procedures. In at least one Member State legislation allows public contracts to be concluded with companies that have anonymous shareholders, while at the same time not offering sufficiently strong safeguards against conflict of interests.

A Debarment

1 European Union

A number of countries and international institutions have extensive blacklisting or debarment arrangements barring dishonest and unreliable suppliers from public procurement programs.⁴⁰

In 2004 the European Union adopted a procurement directive making debarment of those convicted of offences such as corruption offences, fraud to the detriment of the financial interests of the European Communities or money laundering compulsory in the European Union.⁴¹ This framework was strengthened and clarified when the European Union adopted a new procurement directive in 2014.⁴² Amongst others things the new directive broadened the category of contraventions and offences to include terrorism and terrorism financing offences. If a contracting authority is aware that a prospective supplier has been convicted for one of the relevant offences it must exclude that person or entity from participating in a public procurement procedure.⁴³ The 2014 directive extends the obligation to exclude to a company where the person convicted by a final judgment is a member of the administrative, management or supervisory body of that company or has powers of representation, decision or control in relation to the company.⁴⁴ Initial procurement due diligence is heavily reliant on self-declaration by bidders, but the Directive envisages extensive verification by, and in relation to, the winning bidder.⁴⁵

⁴⁰ For a comparative analysis of the debarment regimes operated by the European Union, the United Kingdom, the United States, the Republic of South Africa and the World Bank see Sope Williams-Elegbe, *Fighting Corruption in Procurement: A Comparative Analysis of Disqualification or Debarment Measures* (Hart Publishing, 2012).

⁴¹ *Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts and Public Service Contracts* [2004] OJ L 134/114, art 45..

⁴² *Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on Public Procurement and Repealing Directive 2004/18/EC*, [2014] OJ L 94/65 ('*Directive 2014/24/EU*).

⁴³ *Ibid.* The EU Anti-Corruption Report found that all Member States had mandatory debarment or exclusion rules and lists in place that excluded bidders from tenders when final court convictions for corruption have been handed down against them: European Commission, above n 3, 34. The lists are however not necessarily public. According to the report (34):

Member States are not required to publish debarment lists, and they generally do not publish such lists. In many Member States contracting authorities have cross-access to their internal debarment databases. International debarment lists are, as a rule, not considered as a basis for exclusion in EU Member States.

⁴⁴ *Directive 2014/24/EU*, art 57(1).

⁴⁵ *Directive 2014/24/EU*, art 59, 60 and 61. The Directive also require contracting authorities to consider any evidence that an excluded bidder provides regarding remedial and other steps that were taken that may be sufficient to demonstrate its reliability despite the existence of a relevant ground for exclusion. Where such evidence is assessed as sufficient, the person concerned shall not be excluded from the procurement procedure. See *Directive 2014/24/EU*, art 57(6); Erling Hjelmeng and Tina Søreide, 'Debarment in Public Procurement: Rationales and Realization' in Gabriella M Racca and Christopher R Yukins (eds), *Integrity and Efficiency in Sustainable Public Contracts: Balancing Corruption Concerns in Public Procurement Internationally* (Bruylant, 2014) 215.

The Scottish Government has gone further than many EU members and also mandated debarment of suppliers for a number of domestic offences related to organised crime and bribery.⁴⁶ For all contracts over a threshold value potential suppliers are required to fill out a pre-qualification questionnaire addressing both mandatory and discretionary grounds of ineligibility to tender.⁴⁷ This process of vetting suitable suppliers is separate and distinct from the process of awarding the contract. Only suppliers deemed suitable after the vetting process proceed to the award stage to have their bid judged on criteria such as value for money.⁴⁸

2 United States of America

The United States operates an extensive federal system of suspension and debarment relating to federal procurement and non-procurement programs such as grants and assistance.⁴⁹ Suspension may be based on indictments, information or adequate evidence of relevant offences, contract fraud, embezzlement, theft, forgery, bribery, poor performance, non-performance, or false statements. It is a temporary action that takes effect immediately and may last up to one year. Debarment may be based on convictions or civil judgments for integrity offences, on other evidence of unacceptable behaviour, such as serious violations of the terms of a government contract, or on evidence of any other cause that is so serious and compelling that it affects the present responsibility of a contractor.⁵⁰ The period of debarment is decided on a case by case basis.

⁴⁶ *Public Contracts (Scotland) Regulations 2012* reg 23 and *Utilities Contracts (Scotland) Regulations 2012* reg 26. For a list of the offences leading to mandatory ineligibility see Scottish Procurement, 'Scottish Procurement Policy Note' (SPPN 1/2012, 5 April 2012) 8–9 <<http://www.scotland.gov.uk/Resource/0039/00391314.pdf>>.

⁴⁷ Scottish Procurement, *Selection and Award Criteria* (24 April 2014) The Scottish Government <www.scotland.gov.uk/Topics/Government/Procurement/buyer-information/spdlowlevel/routetwotoolkit/developdocumentsroutetwo/selectionandawardcriteria>.

⁴⁸ Scottish Procurement, above n 47.

⁴⁹ *Federal Acquisition Regulations*, 48 CFR §§ 9.400 – 9.409 (2013); *Grants and Agreements*, 2 FCR § 180 (2014) together with agency regulations implementing that guidance; Pascale Hélène Dubois, 'Domestic and International Administrative Tools to Combat Fraud & Corruption: A Comparison of US Suspension and Debarment with the World Bank's Sanctions System' (2012) *University of Chicago Legal Forum* 195; Daniel I. Gordon, 'Reflections on the Federal Procurement Landscape' (2012) 54(7) *The Government Contractor* 51; Jessica Tillipman, 'A House of Cards Falls: Why 'Too Big to Debar' is All Slogan and Little Substance' (2012) 80 *Fordham Law Review Res Gestae* 49; Jessica Tillipman, 'Suspension and Debarment: the Congressional War on Contractors' (2012) 45 *George Washington International Law Review* 235; United States Government Accountability Office, 'Suspension and Debarment: Some Agency Programs Need Greater Attention, and Governmentwide Oversight Could be Improved' (Report to Congressional Committees, 31 August 2011) 4-5 <<http://www.gao.gov/products/GAO-11-739>>; Williams-Elegbe, above n 40, 56-64. The authors gratefully acknowledge the comments of Professors Daniel Gordon and Christopher Yukins of the George Washington University Law School on this overview of the US procurement system, but are responsible for all views expressed.

⁵⁰ The key question is whether the contractor is "presently responsible". The factors that should be considered to determine present responsibility are listed in the *Federal Acquisition Regulations*, 48 CFR § 9.406-1 (2013). If a supplier has engaged in criminal behaviour in the past but employed sufficient remedial steps to prevent a recurrence, for example by dismissing the offending employees and by adopting an effective compliance management framework, the agency may hold

The decision whether to suspend or debar a person is made at an agency level by a Suspending or Debaring Official. Agencies have a broad discretion to determine the reach and extent of the suspension or debarment. It may be limited to a unit or part of the business of a supplier or may extend to all of its business and may even extend to affiliates of the supplier.⁵¹ If an agency does suspend or debar a supplier, the decision applies to all other federal agencies.⁵² Since 1986 the Interagency Suspension and Debarment Committee monitors and coordinates the government wide system of suspension and debarment.⁵³

In the past names of excluded parties were listed on the Excluded Parties List System. The list is now published via the federal System for Award Management.⁵⁴ Federal contracting officers must review these lists prior to awarding a government contract. An agency may not solicit offers from, award contracts to, or consent to subcontracts with these suppliers, unless the agency head determines that there is a compelling reason to do so.⁵⁵

3 *The World Bank Group*

The World Bank Group also operates a debarment regime that leads to the exclusion of suppliers that have engaged in sanctionable conduct, including fraud, corruption, coercion, collusion, or obstruction in connection with a World Bank Group-financed project.⁵⁶ The Bank's Suspension and Debarment Officer makes an initial determination, including a recommended sanction, based on evidence submitted by the Integrity Vice Presidency. If the determination is opposed by the supplier, the Bank's independent

that the supplier is "presently responsible" and that it should therefore not be subjected to suspension or debarment.

⁵¹ The Government Accountability Office reported in 2011 that approximately 29,000 cases were listed in the Excluded Parties List System in the period from 2006 to 2010: United States Government Accountability Office, above n 49, 8.

⁵² Brian Young, 'Ready for Primetime? The Interagency Suspension and Debarment Committee, the Nonprocurement Common Rule, and Lead Agency Coordination' (2012) 4 *William & Mary Policy Review* 110.

⁵³ Ibid; United States Government Accountability Office, 'Suspension and Debarment: Characteristics of Active Agency Programs and Governmentwide Oversight Efforts' (Testimony before the Committee on Oversight and Government Reform, House of Representatives, 12 June 2013) <<http://www.gao.gov/products/GAO-13-707T>>.

⁵⁴ United States Government, *System for Award Management* <www.sam.gov/portal/public/SAM>.

⁵⁵ *Federal Acquisition Regulations*, 48 CFR § 9.405(a) (2013).

⁵⁶ Dubois, above n 49; Frank A Farello Jr and Conrad C Daly, 'Suspension and Debarment: Coordinating the Fight Against Corruption Among MDBS: The Past, Present and Future of Sanctions' (2013) 45(2) *George Washington International Law Review* 253; Hans-Joachim Priess, 'Suspension and Debarment: Questionable Assumptions: The Case for Updating the Suspension and Debarment Regimes at the Multilateral Development Banks' (2013) 45(2) *George Washington International Law Review* 271; Christopher R. Yukins 'Cross-Debarment: A Stakeholder Analysis' (2013) 45(2) *George Washington International Law Review* 219; World Bank Office of Suspension and Debarment, 'Report on Functions, Data and Lessons Learned 2007-2013' (2014) <<http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/ORGUNITS/EXTOFFEVASUS/0,,contentMDK:23584747~menuPK:9601822~pagePK:64168445~piPK:64168309~theSitePK:3601046,00.html>>

Sanctions Board reviews the matter.⁵⁷ The Board must determine whether it is “more likely than not” that the supplier engaged in a sanctionable practice. If such a finding is made, the Board imposes a debarment sanction on the supplier, which may be extended to the supplier’s affiliates, successors and assigns. The decision of the Board is final and non-appealable.

The World Bank Group’s debarment sanctions are published on its website and are recognised by other multilateral development banks under a cross-debarment regime.⁵⁸ Suppliers must be checked against the debarment lists before contracts are awarded.

On 18 February 2015 three Australian entities were listed on the World Bank’s cross-debarment list.⁵⁹

B The OECD Convention of Combating Bribery of Foreign Public Officials in International Business Transactions

The OECD also supports debarment or disqualification from public procurement as a means to combat international corruption. In 1997 the OECD adopted the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. This Convention has been adopted by the 34 OECD members, including Australia, and also by seven non-members (Argentina, Brazil, Bulgaria, Colombia, Latvia, Russia, and South Africa).⁶⁰ Each party to the Convention must ‘consider the imposition of additional civil or administrative sanctions upon a person subject to [criminal] sanctions for the bribery of a foreign official.’⁶¹ The official commentaries on the Convention suggest that such sanctions may include, among others things, ‘temporary or permanent disqualification from participation in public procurement or from the practice of other commercial activities’.⁶² Australia does not have such an exclusion or debarment sanctioning regime.⁶³

⁵⁷ If the supplier requests or the chair of the Sanctions Board regards it as appropriate the Board may hold an administrative hearing. The Board considers the evidence presented to it as well as mitigating circumstances for example whether the supplier cooperated with the Bank to investigate the conduct and whether appropriate remedial action was taken.

⁵⁸ World Bank, *World Bank Listing of Ineligible Firms and Individuals* <<http://web.worldbank.org/external/default/main?theSitePK=84266&contentMDK=64069844&menuPK=116730&pagePK=64148989&piPK=64148984>>. The cross-debarment regime provides for the mutual recognition of debarment sanctions imposed by the various banks: Yukins, above n 56; Farello and Daly, above n 56.

⁵⁹ World Bank, above n 60.

⁶⁰ OECD, *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* <<http://www.oecd.org/corruption/oecdantibriberyconvention.htm>>.

⁶¹ *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*, opened for signature 17 December, [1999] ATS 21 1997 (entered into force 15 February 1999) art 3.

⁶² OECD, ‘Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and Related Documents’ (2011) 15 [24] <www.oecd.org/daf/anti-bribery/ConvCombatBribery_ENG.pdf>. ‘Member countries’ laws and regulations should permit authorities to suspend from competition for public contracts enterprises determined to have bribed foreign public officials in contravention of that Members’ national laws’: at 6 [XI.i)].

⁶³ For further discussion see below Part IV A 3 *Steps to Meet Foreign Bribery Standards*.

IV AUSTRALIA'S PROCUREMENT SYSTEM

An overview the Australian public procurement system is helpful to frame the discussion of aspects of Australian public procurement practices.

At the federal level procurement is governed by a set of mandatory rules issued by the Finance Minister under s 105B(1) of the *Public Governance, Performance and Accountability Act 2013* (Cth) ('*PGPA Act*'), entitled the *Commonwealth Procurement Rules* ('*CPR*'), and other government policies which intersect with the procurement function. The *CPR* are supplemented by accountable authority instructions which the secretary of an agency may issue under s 20A of the *PGPA Act* to ensure compliance with the *CPR* and related policies.⁶⁴ Individual agencies are responsible for their own business decisions and for ensuring that procurement processes are carried out in accordance with the *CPR*.

Supplier integrity due diligence is only briefly considered in the *CPR*. It appears under the "value for money" award criteria, as part of the requirement that Commonwealth resources be used in an ethical manner.⁶⁵ In relation to suppliers, ethical use of resources requires that:

Relevant entities must not seek to benefit from supplier practices that may be dishonest, unethical or unsafe. This includes not entering into contracts with tenderers who have had a judicial decision against them (not including decisions under appeal) relating to employee entitlements and who have not satisfied any resulting order. Officials should seek declarations from all tenderers confirming that they have no such unsettled orders against them.⁶⁶

Procurement in the states and territories is governed in a similar way. Rules and guidelines are set by either the executive, an independent procurement board or both, through a mix of delegated legislation, statutory directions and policies.⁶⁷ Implementation

⁶⁴ *CPR* 7 [2.5], 10 [2.12]. The *CPR* are also supplemented by web-based guidance developed by the Department of Finance and Resource Management Guides: at 7 [2.4].

⁶⁵ *Ibid* 13 [4.4b].

⁶⁶ *Ibid* 18 [6.7].

⁶⁷ In the ACT public procurement is governed by the *Government Procurement Act 2001* (ACT) and *Government Procurement Regulation 2007* (ACT) supplemented by procurement circulars endorsed by the Procurement Board. In NSW it is governed by the *Public Works and Procurement Act 1912* (NSW) and *Public Works Procurement Regulation 2014* (NSW) supplemented by the NSW Procurement Policy Framework (Version 3, NSW Procurement Board, 1 October 2014) and directions issued by the NSW Procurement Board. In the Northern Territory it is governed by the *Procurement Act 1995* (NT) and *Procurement Regulations 2014* (NT) supplemented by the Northern Territory Procurement Code (Procurement Policy Unit (NT), 10 February 2011) and procurement directions issued by the Minister; In Queensland it is governed by the Queensland Procurement Policy (Queensland Government, June 2013) which is given force under the *Financial and Performance Management Standard 2009* (Qld) and *Financial Accountability Act 2009* (Qld) and supplemented by procurement guidelines published by the Department of Housing and Public Works. In South Australia it is governed by the *State Procurement Act 2004* (SA) and *State Procurement Regulations 2005* (SA) supplemented by the Procurement Policy Framework (State Procurement Board (SA), January 2014) and State Procurement Board policies and guidelines. In Tasmania it is governed by Treasurer's Instructions made under the *Financial Management and Audit Act 1990* (Tas). In Victoria it is governed by policies set by the Victorian Government

is generally left to agencies, however in some jurisdictions procurements of certain types of goods and services or procurements over particular value thresholds are managed centrally.

A Supplier Integrity Practices of Key Australian Agencies

The authors reviewed publicly-available information about supplier due diligence rules and procedures in Australian public sector procurement. This included the relevant laws, policies, rules and reports of anti-corruption bodies. To enrich the understanding of the current measures the authors decided to approach key procurement agencies at the federal, state and territory levels to enquire, as an initial scoping exercise, whether certain integrity due diligence measures were consistently employed in relation to suppliers in standard contract procurement processes.

After a review of procurement governance at the federal, state and territory levels, nine agencies were identified that were either responsible for public procurement policy or compliance, or for a significant portion of the public procurement, in each of the relevant jurisdictions.⁶⁸ The use of purposive sampling for the selection of these respondents was deemed appropriate as the enquiry was not intended to record comprehensively all current practices but to provide an indicative sense as to whether certain supplier integrity due diligence measures are regularly and consistently performed.

Given the dearth of public information about supplier integrity due diligence measures in Australia the enquiry was designed as exploratory and as informing the design of a comprehensive survey, if the initial data and responses justified a broader study.

The authors compiled a list of open-ended questions that were designed to probe whether certain integrity due diligence measures are typically conducted by agencies in respect of suppliers before a contract is awarded or concluded. The procurement authorities were asked whether it was a standard feature of their procurement due diligence practices to undertake any of the following steps, or whether they advised agencies or departments to undertake these:

- company searches on corporate suppliers;
- credit checks on suppliers;
- police checks or other security clearances on suppliers or persons linked to suppliers;
- checks to determine beneficial ownership of corporate suppliers;

Procurement Board under the *Financial Management Act 1994* (Vic). In Western Australia it is governed by the *State Supply Commission Act 1991* (WA) and the policies issued under that act; however the State Supply Commission has been absorbed into the Department of Finance. In Queensland, the procurement staff working in the agencies are employed by the Department of Finance.

⁶⁸ Department of Finance, Cth; Shared Services Procurement, ACT; NSW Procurement, NSW; Department of Business, NT; Procurement Transformation, Department of Housing and Public Works, Qld; State Procurement Board, SA; Procurement and Property, Department of Treasury and Finance, Tas; Partnerships Victoria and Strategic Sourcing, Department of Treasury and Finance, Vic; Procurement Office, Department of Finance, WA.

- checks on potential links between suppliers, public servants and/or politicians (domestic or foreign);
- checks whether a supplier or any beneficial owner may have been debarred by any other public authority internationally;
- checks whether a supplier may appear on the consolidated sanctions list of the Department of Foreign Affairs and Trade; and
- checks whether a supplier appears on any formal or informal blacklist of suppliers that may be maintained by a public authority in their state or territory.

If they relied on self-declaration by suppliers as an alternative, or in addition, to conducting checks, information regarding the undertakings or warranties and any relevant verification practices were requested.

Letters explaining the research and inviting responses to the questions were forwarded to the senior officers of the agencies by email in December 2013. To facilitate a frank disclosure of the relevant information, the authors undertook not to attribute statements to any official or agency.

Five agencies responded by email to the initial request (55.5% response rate). These responses provided perspectives from the Commonwealth, the Australian Capital Territory, New South Wales, Tasmania and Western Australia.

To ensure that the authors had correctly captured the responses received and to ascertain whether these reflected similar practices in other jurisdictions a draft report was circulated in February and March 2014 to the nine agencies initially approached, inviting responses and corrections. Officials from the Commonwealth, New South Wales, Northern Territory, Queensland, South Australia, Tasmania and Western Australia responded (a 77.7% response rate). The respondents generally confirmed the correctness of the information in relation to their agencies.⁶⁹

The draft report and findings were also presented by the authors and discussed at a meeting of the Chief Procurement Officer Forum of the Victorian Government Purchasing Board in June 2014. The Victorian officials agreed with the description of the current supplier integrity due diligence practices in the draft report. The overall rate of oral or written response to the draft report is therefore 88.8%, while all nine agencies either provided an initial response or responded to the draft report.

The enquiry focused on supplier due diligence in relation to standard contracts. More extensive integrity checks are normally undertaken in the case of high value procurements. This is also the case in relation to contracts that are security-sensitive, especially those that hold national security implications. It is also relevant to note that, in sectors where prequalification of suppliers is practised, the prequalification processes sometimes provide a framework for a higher level of supplier scrutiny.⁷⁰

⁶⁹ One respondent provided more granular additional information and two respondents engaged the researchers about the impact of potential changes to address the risks identified by the report. Another respondent stated that they reviewed the report and, though they did not have any comments, they retained the right to comment on specific statements.

⁷⁰ This refers to the practice of governments maintaining a list of suppliers in a particular sector (often construction) who meet certain minimum criteria and with whom they will contract exclusively.

The following concerns emerged regarding key integrity due diligence measures.

1 *Checks for Ownership and Control*

According to the agencies, they obtain some information regarding control of corporate suppliers, such as identifying the directors and sometimes the shareholders. However, no indication was given that the ownership and control of corporate or trustee shareholders are consistently and thoroughly probed. It was furthermore evident that much reliance is placed on self-declaration.⁷¹

Effective checks for beneficial ownership are important because they form the basis for other due diligence checks and because allowing the ultimate owners of suppliers to remain unidentified increases the risk of corruption and procurement abuse.⁷² Whilst the State, Territory and Federal governments have public service codes of conduct in place that prohibit conflicts of interest,⁷³ offending conduct is easily hidden behind corporate structures, trusts and other legal arrangements that may conceal the identity of the beneficial owner. Domestic and foreign criminals may use similar tactics to avoid detection. It is therefore imperative to probe ownership and control of corporations, trusts and similar legal arrangements.

One respondent admitted that a lack of knowledge of corporate structures amongst government procurement officials made it difficult to implement due diligence measures that probe corporate control and beneficial ownership. Training in this regard is therefore a vital step in improving current practices.⁷⁴ It is furthermore important to consider the implementation of public registers of beneficial ownership of corporations and of trusts to facilitate transparency and support verification.⁷⁵

⁷¹ See below Part IV A 4 *Reliance on Supplier Declarations*.

⁷² For a discussion of beneficial ownership in the context of financial services, see above Part II B *Beneficial Ownership*.

⁷³ See, eg, Public Sector Standards Commissioner (Vic), *Code of Conduct for Victorian Public Sector Employees* (No.1) 2007 [3.2], [3.7], which requires that public service employees do not allow family or other personal relationships to improperly influence their decisions, maintain a strict separation between work-related and personal financial matters and declare and avoid conflicts of interest. The code is binding on all public sector employees: *Public Administration Act 2004* (Vic) s 61(3). The absence of appropriate supplier due diligence measures was a factor that enabled employees of the Victorian Transport Department to secure a number of lucrative contracts to the value of at least \$25 million with the Department via front companies: Independent Broad-Based Anti-Corruption Commission Victoria, *Operation Fitzroy* (Special Report, 2014) 86 <<http://www.ibac.vic.gov.au/news-and-publications/reports>>.

⁷⁴ One agency shared an example of informative internal staff bulletins that were designed to improve the level of understanding of procurement officers of corporate structures.

⁷⁵ The FATF requires countries to improve the level of information about beneficial ownership of legal persons, trusts and similar legal structures: *FATF Recommendations*, above n 6, 22 [24], [25]. Such a register must be structured in a manner that balances transparency and legitimate rights to confidentiality of beneficial owners. For relevant principles and measures see Department for Business Innovation & Skills, above n 23 and G20, above n 23.

2 Checks Against the Department of Foreign Affairs' Consolidated List of Sanctions

None of the agencies indicated that suppliers were consistently checked against the Department of Foreign Affairs' Consolidated List of sanctioned persons and entities.⁷⁶ At a federal level, the Department of Finance stated that it provides information that would enable Commonwealth agencies to perform such checks. It was, however, not clear whether such checks are consistently done. At a state and territory level the responses indicated a low level of knowledge regarding the potential relevance of the sanctions regime to procurement and there was no indication that such checks were regularly undertaken.

Current practices in relation to standard procurement contracts do not adequately mitigate the risk that the relevant agencies could unknowingly breach international obligations or national law by doing business with persons who are subject to Security Council or Australian sanctions.⁷⁷ If a procurement contract is concluded with a sanctioned person or entity, Australia and the procuring agency could be exposed to significant legal, diplomatic and reputational risk.

3 Steps to Meet Foreign Bribery Standards

The authors found no evidence of clear and systematic practices to ensure that those convicted of foreign bribery were consistently identified through public procurement supplier integrity checks.

Australia is a signatory to the OECD Anti-Bribery Convention.⁷⁸ As a signatory it is subject to peer review of its compliance with the Convention. These peer reviews are conducted by the OECD Working Group on Bribery. The second report on Australia was published in 2006.⁷⁹ It found that Australia did not have 'formal rules for disqualifying companies or individuals from contracting with the Australian government where they have been convicted of the bribery of foreign public officials.'⁸⁰ Neither did the government 'maintain blacklists of firms convicted of criminal offences, including foreign bribery or any other corruption or fraud-related offences.'⁸¹ While the government maintained that a conviction or clear evidence of contravention would constitute sufficient grounds for an agency to consider refusing to award a public procurement contract to a person or entity,

⁷⁶ See above Part II D *Sanctions Lists* and E *Australian CDD Measures*.

⁷⁷ *Charter of the United Nations Act 1945* (Cth) s 4, *Autonomous Sanctions Act 2011* (Cth) s 8.

⁷⁸ See above Part III B *The OECD Convention of Combating Bribery of Foreign Public Officials in International Business Transactions*.

⁷⁹ Working Group on Bribery in International Business Transactions, 'Australia: Phase 2 — Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions' (OECD, 4 January 2006) <<http://www.oecd.org/daf/anti-bribery/anti-briberyconvention/35937659.pdf>>.

⁸⁰ *Ibid* 52 [162].

⁸¹ *Ibid* 52 [164].

no practical case could be cited where a conviction for, or clear evidence of, foreign bribery had actually had that effect.⁸²

The OECD Working Group recommended that Australia should consider introducing formal rules and policies so that government procurement contracts could be denied as a sanction for foreign bribery in appropriate cases. The examiners furthermore recommended that contracting agencies should include provisions that would allow for the termination of contracts in appropriate cases.⁸³

In the 2008 follow-up report on the implementation of the 2006 recommendations,⁸⁴ the OECD Working Group noted its disappointment in learning that its 2006 recommendations had not been adopted.⁸⁵ The Australian government, however, maintained that the current framework was sufficient and that it did 'not think it appropriate to specify particular offences as grounds for termination as this might have the effect of unintentionally excluding other offences or circumstances which might appropriately lead to termination.'⁸⁶

The OECD Working Group published its third report on Australia in 2012.⁸⁷ Although Australia had reformed its procurement framework since 2006, the report found that debarment of those convicted of foreign bribery remained discretionary and that it was largely left to individual agencies to develop their own policies on how this form of bribery was to be investigated and managed.⁸⁸ The OECD Working Group remained concerned that the absence of government-wide guidelines may lead to situations where agencies overlook these offences. They were also concerned that lack of guidance may result in agencies failing to check whether a supplier had been debarred by the cross-debarment regime of the World Bank.⁸⁹ The report therefore repeated the 2006 findings by recommending 'that Australian procuring agencies put in place transparent policies and guidelines on the exercise of their discretion on whether to debar companies or individuals that have been convicted of foreign bribery.'⁹⁰

⁸² Ibid 52-3 [165].

⁸³ Ibid 53-4.

⁸⁴ Working Group on Bribery in International Business Transactions, 'Australia: Phase 2 — Follow-up Report on the Implementation of the Phase 2 Recommendations — Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Revised Recommendation on Combating Bribery in International Business Transactions' (OECD, 29 August 2008) <<http://www.oecd.org/daf/anti-bribery/anti-briberyconvention/41305864.pdf>>

⁸⁵ Ibid 5 [10].

⁸⁶ Ibid 22.

⁸⁷ OECD Working Group on Bribery, 'Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Australia' (OECD, 12 October 2012) <<http://www.oecd.org/daf/anti-bribery/Australiaphase3reportEN.pdf>>.

⁸⁸ Ibid 48 [148]. Responses to our enquiry did not provide evidence that individual agencies had developed or implemented such policies.

⁸⁹ Ibid at 48 [149].

⁹⁰ Ibid at 46. For example, in 2011 the Department of Defence awarded a contract to a supplier who was debarred in the United States without knowing of, and giving consideration to, that debarment. Its integrity checks relied on self-declarations of specific facts but failed to require foreign debarment status to be disclosed: Fiona Hudson, 'Navy gives job to banned contractor', *The Advertiser* (online), 23 November 2011 <<http://www.adelaidenow.com.au/news/national/navy->

While the authors do not argue that persons who are subject to foreign debarment should automatically be excluded from Australian public contracts, such debarment is a relevant factor that procuring agencies should be aware of and consider.

In addition to the absence of a comprehensive debarment system, the authors found no evidence of the systematic capturing and sharing of data on suppliers that proved dishonest or unreliable. Such information, to the extent that it is recorded, seems to reside mainly in the personal knowledge of procurement officials and could be lost when those officials retire or resign. An unscrupulous supplier may therefore be engaged by the same agency at another time or may be engaged by other agencies, especially agencies in other states or territories, without consideration of the supplier's past conduct.

4 *Reliance on Supplier Declarations*

The current system of supplier due diligence overwhelmingly relies on the supplier's own declarations of their debarment status and compliance with legal norms.

Whilst self-declarations have an important role to play in due diligence processes, they have limitations. They rely on suppliers being honest and having a full understanding of the matters to be declared, which can sometimes be quite technical. Where such declarations are only required once, before the award of contract, the ongoing integrity of the supplier during delivery of the contract may not be sufficiently monitored. Changes that take place may or may not have to be declared and, if they have to be declared, may not be declared fully and correctly.

It is therefore important to have processes to verify the correctness and comprehensiveness, current and ongoing (where relevant), of the supplied information. No respondent detailed a consistent practice of auditing supplier declarations.⁹¹

This passive approach to supplier due diligence can be contrasted with the recommendations in the Federal Government's *Sustainable Procurement Guide*. It recommends that questionnaires, used to assess supplier sustainability, should be repeated annually and that audits should be undertaken for higher risk contracts both at the supplier selection stage and as part of the ongoing contract management.⁹²

gives-job-to-banned-contractor/story-e6frea8c-1226202986672?nk=822a323b3a223cb152d467230eacaa92>.

⁹¹ But see, *CPR* 21 [7.22b]. This requires a clause to be included in contracts allowing for audit by the ANAO 'when relevant'.

⁹² Australian Government Department of Sustainability, Environment, Water, Population and Communities, 'Sustainable Procurement Guide' (2013) 47, 49 <<http://www.environment.gov.au/system/files/resources/7b8df2bd-3bb9-49cc-b417-5f2eb6e0ce37/files/sustainable-procurement-guide.pdf>>.

V IMPROVING SUPPLIER INTEGRITY DUE DILIGENCE

The agencies' responses discussed above suggest that attention needs to be given to improving public procurement supplier integrity due diligence. Criminal threats to public procurement indicate that such attention is urgent.

There is growing international and Australian concern about criminal threats to procurement processes, including targeting by organised crime and the impact of fraud and corruption on public procurement.⁹³ Such crimes undermine the integrity of the contract award process and interferes with the primary objective of public procurement, that is, to acquire the goods, services or works on the best possible terms.⁹⁴

It is hard to estimate with any degree of accuracy the current level of involvement of organised crime and corruption in public procurement as these are generally secretive activities.⁹⁵ However, a 2014 European Commission report that investigated corruption levels in the European Union as well as anti-corruption measures implemented by its member states (*EU Anti-Corruption Report*) estimated that corruption costs the European economy EUR 120 billion per year, an amount that is just a little less than the annual budget of the European Union.⁹⁶

Corruption concerns in Australia are rising. The increasing number of prominent corruption investigations saw Australia fall four points and lose two rankings in Transparency International's Corruption Perceptions Index 2013. Australia continued its fall into 2014 when it slipped outside the Index's list of top ten countries viewed as "clean".⁹⁷ This is of particular concern given the gaps in Australia's anti-corruption regime.

⁹³ European Commission, above n 3; PricewaterhouseCoopers, 'Global Economic Crime Survey: The Australian Story' (2014) 13: 'Globally, procurement fraud is now one of the 'Big 5' economic crimes, with 33 per cent of Australian respondents experiencing this type of fraud in the past 24 months.' See also Victorian Ombudsman, 'Conflict of Interest in the Victorian Public Sector – Ongoing Concerns' (March 2014); Independent Commission Against Corruption (NSW), 'Corruption Risks in NSW Government Procurement' (December 2011); Corruption and Crime Commission (WA), 'Report on Fraud and Corruption in Procurement in WA Health: Dealing with the Risks' (June 2014).

⁹⁴ The best possible terms includes such variables as quality, timeliness, cost (more than just the price), minimizing business, financial and technical risks, maximizing competition, and maintaining integrity: Khi V Thai, 'Public Procurement Re-examined' (2001) 1.1 *Journal of Public Procurement* 9, 27.

⁹⁵ Andvig, above n 3, 33 <<http://www.nupi.no/content/download/368183/1253135/version/2/file/NUPI-WP--813-Andvig.pdf>>. 'Corruption is shadowy and secretive by nature.': Transparency International, *Corruption Perceptions Index 2013* (2013) <www.transparency.org/cpi2013/results>. Sylvia Varnham O'Regan, *Australia Drops in Global Corruption Index* (3 December 2010) SBS <www.sbs.com.au/news/article/2013/12/03/australia-drops-corruption-ranking>.

⁹⁶ European Commission, above n 3, 3.

⁹⁷ Transparency International, above n 95. Michaela Whitbourn, 'Calls for Federal ICAC as Australia Slips Outside Top 10 'Clean' Countries in Global Corruption Ranking', *The Sydney Morning Herald* (online), 3 December 2014 <<http://www.smh.com.au/federal-politics/political-news/calls-for-federal-icac-as-australia-slips-outside-top-10-clean-countries-in-global-corruption-ranking-20141203-11ygwk.html>>. Transparency International Australia's executive director Michael Ahrens cited 'the prosecution of Security and Note Printing Australia executives, and the findings of ICAC in relation to Eddie Obeid and corruption in the NSW state government' as reasons for the fall: O'Regan, above n 95. See, eg, Independent Commission Against Corruption New South Wales, *Current Investigations*, ICAC <<http://www.icac.nsw.gov.au/investigations/past>>.

For example, Australia's enforcement of anti-corruption laws under the *Criminal Code Act 1995* (Cth) was criticised in the OECD's *Phase 3 Report*, which found it concerning that only one out of 28 foreign bribery referrals to the Australian Federal Police led to a prosecution.⁹⁸

Organised crime also poses a serious threat to Australia. Australia's National Security Strategy identifies serious and organised crime as a key national security risk,⁹⁹ and it is estimated to cost AUD \$15 billion annually.¹⁰⁰ Worryingly, the Australian Crime Commission's 2013 report on organised crime notes an emerging trend of criminal organisations diversifying into legitimate business.¹⁰¹ Complex business structures are used to conceal criminal interests and legitimate businesses become vehicles to launder money and hold the proceeds of crime. The structures and schemes used are getting increasingly sophisticated and are being devised and implemented with the help of professional advisers.¹⁰² As the AML/CTF regime in Australia inches its way to effectiveness, opportunities for money laundering, in particular, may see more criminal players enter the public procurement space.

These general facts inform government action against corruption and organised crime. It is submitted that they also justify an improved framework for public procurement supplier integrity due diligence.¹⁰³

A Objectives of improved supplier due diligence

The primary aim of supplier integrity due diligence checks is to support the integrity of the procurement process. If effective integrity checks are not performed, unscrupulous suppliers are able to access and abuse public procurement. Such abuse is often

investigations/investigationdetail/198>; Independent Broad-Based Anti-Corruption Commission Victoria, above n 73.

⁹⁸ OECD Working Group on Bribery, above n 84, 19 [42]; ABC, 'Australia 'failing' to Tackle Bribery by Multinational Companies: OECD', *ABC News*, (7 January 2014) (Greg Hoy) <www.abc.net.au/news/2014-01-06/australia-accused-of-failing-to-tackle-bribery-among-multinatio/5187070>. In addition, improvements to the anti-corruption regime that were considered in 2011 have not received legislative attention to date. See Attorney General's Department, Criminal Justice Division, 'Divisions 70 and 141 of the Criminal Code Act 1995 - Assessing the 'facilitation payments' defence to the Foreign Bribery offence and other measures' (Public Consultation Paper, Australian Government, 15 November 2011).

⁹⁹ Australian Crime Commission, 'Organised Crime in Australia 2013' (July 2013) 8.

¹⁰⁰ *Ibid* 6.

¹⁰¹ *Ibid* 7. The Victorian Law Reform Commission is considering proposals to mitigate this risk. See Victorian Law Reform Commission, 'Use of Regulatory Regimes in Preventing the Infiltration of Organised Crime into Lawful Occupations and Industries: Terms of Reference' (31 October 2014) <<http://www.lawreform.vic.gov.au/projects/regulatory-regimes-preventing-infiltration-organised-crime/use-regulatory-regimes>>.

¹⁰² *Ibid* 14.

¹⁰³ The Scottish example is of interest. The Scottish Organised Crime Taskforce set up a short life working group called the Public Sector Procurement Group to look at ways to prevent organised crime groups obtaining public contracts. The Scottish Government, *Public Sector Procurement Group*, The Scottish Government <<http://www.gov.scot/Topics/archive/law-order/organised-crime/soc/PublicSectorProcurement>>.

accompanied by an increase in costs of procurement and a decrease in the quality of supplied goods and services.

In addition, for the reasons discussed below, these processes should be improved with the explicit, but secondary, objective of supporting the government's commitment to combat organised crime, the financing of terrorism and corruption more broadly.

The failure to properly vet the award of public contracts threatens the effectiveness of Australia's AML/CTF policy and laws. AML/CTF measures are designed to disrupt the business models of criminals and terrorist organisations by denying them the opportunity to fund their activities and launder their criminal proceeds through the legitimate financial and business sectors. They aim to close the door similarly to corrupt politicians and officials who wish to hide the proceeds of corruption. This objective is undermined if criminals and terrorism financiers can win public contracts. This not only enables them to use tax dollars to fund criminal activities but also provides them with an appearance of public respectability that may facilitate their access to formal financial and professional services. Financial institutions running due diligence checks on the business may regard the government contract as evidence pointing toward the legitimacy and respectability of the business. The effectiveness of the Australian AML/CTF regime depends not only on the financial system but on all the key actors in the economy working in unison to reduce opportunities to engage in these crimes. AML/CFT objectives are threatened when the government fails to implement what it compels the private sector to do.

Corruption, fraud and other crimes in public procurement also impose costs on private industry. The presence of corruption has a number of negative effects. It is anti-competitive, distorts market signals and wastes the significant investments made by private actors in submitting competitive tenders. The use, by organised crime, of government contracts as a front for money laundering businesses is also anti-competitive. Supported by illicit cash flows, these businesses can undercut competitors by making unprofitably low bids, as profit may not be the primary motivator for obtaining public contracts. The deleterious effect that money laundering activities of organised crime groups have on legitimate businesses has been noted by the Australian Crime Commission.¹⁰⁴ It is submitted that improving supplier integrity due diligence could lead to significant savings for both the government and private industry.

Finally, there is a moral argument. Paul Craig puts the argument this way in *Administrative Law*: '[t]he very power to grant contracts should be able to be utilized to advance socially desirable objectives, precisely because such authorities cannot be and should not be politically neutral towards such matters.'¹⁰⁵ There is a moral responsibility on governments to ensure that they do not knowingly or unknowingly do business with criminals, thereby facilitating criminal schemes and increasing the risk of public procurement processes being corrupted.

Some experts argue that public procurement should not be used to promote non-procurement related goals (what have been called horizontal policies), such as combating

¹⁰⁴ Australian Crime Commission, above n 99, 6.

¹⁰⁵ Paul Craig, *Administrative Law* (Sweet and Maxwell, 7th Ed, 2012) 123-4.

crime.¹⁰⁶ The primary supporting argument for this proposition is that, '[g]overnment would truly be acting in the public interest if it were to act just like another commercial organization motivated by commercial considerations.'¹⁰⁷ However this argument belies an obvious fallacy; private actors, including commercial organisations, do take social, environmental and industrial consideration into account in their purchasing decisions. When the utility gained from these attributes outweighs the increased cost, private actors will judge the more expensive item to represent better value for money. To use a classic image of market economics, the invisible hand will translate these preferences into increased production of ethical, sustainable or local goods and services.¹⁰⁸ Governments should therefore not rule out the promotion of horizontal policies through public procurement, as it may prove a very effective and efficient way to promote desirable social goals.¹⁰⁹

Current Australian public procurement processes are already designed to promote a number of horizontal policies. In the *CPR*, the concept of value for money is explained to include considerations of environmental sustainability and the foreword to the *CPR* sets out the government's commitment to improving access to small and medium sized enterprises and indigenous and disability enterprises.¹¹⁰ Public procurement in Australia is used to enforce gender discrimination legislation and to encourage the participation of indigenous and disabled persons in the workforce.¹¹¹ This is on trend with international practice. Almost 70% of OECD countries use public procurement to support small and medium enterprises and 76% have a green procurement policy.¹¹² Using procurement to

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- ¹⁰⁶ For a summary of the arguments for and against using public procurement as a policy lever see Christopher McCrudden, *Buying Social Justice: Equality, Government Procurement & Legal Change* (Oxford University Press, 2007) 114–128. The use of the phrase 'horizontal policies' to refer to objectives that are not related to acquiring the goods, services or works on the best possible terms was coined in Sue Arrowsmith and Peter F Kunzlik (eds), *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions* (Cambridge University Press, 2009).
- ¹⁰⁷ McCrudden, above n 106, 115 citing AS Miller, 'Government Contracts and Social Control: A Preliminary Inquiry' (1955) 41 *Virginia Law Review* 27, 54.
- ¹⁰⁸ Arrowsmith and Kunzlik (eds), above n 106.
- ¹⁰⁹ Sue Arrowsmith, 'Public Procurement as an Instrument of Policy and the Impact of Market Liberalisation' (1995) 111 *Law Quarterly Review* 235, 245. Arrowsmith notes that public procurement is 'a valid and valuable tool for the implementation of social policies; and one which should not be denied to government without convincing justification': at 247–8
- ¹¹⁰ *CPR* 13 [4.5e.], 3.
- ¹¹¹ McCrudden, above n 106, 7; Australian Government Department of Families, Housing, Community Services and Indigenous Affairs, 'Workplace Gender Equality: Procurement Principles and User Guide' (Procurement Connected Policy, 1 August 2013) 1 <http://www.dss.gov.au/sites/default/files/documents/08_2013/workplace_gender_equality_procurement_principles_user_guide5_0.pdf>; Australian Government Department of Employment 'Indigenous Opportunities Policy Guidelines 2011' (December 2014 version) 4-5 <<http://docs.employment.gov.au/documents/indigenous-opportunities-policy-guidelines>>; Minister for Finance and Deregulation, *Commonwealth Procurement Rules*, 1 July 2012, 37. One of Queensland's six principles of government procurement principles is '...to advance the Government's economic, environmental and social objectives...': Queensland Government, 'Queensland Procurement Policy' (June 2013) 1, Principle 4.
- ¹¹² OECD, 'Strategic public procurement' in OECD, *Government at a Glance 2013* (OECD Publishing, 2013) <http://dx.doi.org/10.1787/gov_glance-2013-46-en>.

support the government's objectives to combat organised crime, the financing of terrorism and corruption would therefore fit well within the current approach.

B Data-driven solutions

Appropriate due diligence processes are information intensive, requiring amongst others access to up-to-date data on corporate control structures, beneficial ownership, PEPs, sanctions and foreign debarment measures. During the course of the research project various government officials raised concerns regarding the human resources and financial costs of improved due diligence measures. Although similar concerns of banks in relation to AML/CTF measures did not receive much sympathy from AML/CTF regulators,¹¹³ the concern is valid. Banks are currently using comprehensive information and data solutions to support CDD processes. Government agencies could use similar systems to limit reliance on human resources. It is submitted however, that a more effective approach lies in utilising the Australian Government's focus on enhanced data analytics capability to develop an efficient whole-of-government risk-based supplier due diligence system.¹¹⁴ An opportunity exists for a solution to be developed that would serve the customer and supplier integrity data needs of AML/CTF reporting entities and government agencies, thereby limiting costs for all stakeholders.

VI CONCLUSION

The international community and the Australian government are highly concerned about organised crime, money laundering and terrorist financing and the need to ensure integrity in public procurement. This article identifies gaps in current Australian procurement rules and practices that render Australian public procurement vulnerable to criminal abuse, threaten compliance with its sanctions regime and potentially undermine the crime combating objectives of its money laundering and terrorist financing laws.

This article, it is submitted, provides justification for a comprehensive consideration of current supplier due diligence practices in Australia and of practical and affordable ways to increase their effectiveness. While public procurement activity is significant in Australia, appropriate risk mitigation measures are not necessarily complex or expensive to implement. Supplier integrity risks can for example be managed and mitigated by aligning supplier due diligence processes of government agencies with the AML/CTF CDD measures that banks are required to implement.

Whilst the various Australian government bodies and their agencies can take individual steps to improve their processes, a disjointed approach will tend to leave gaps and create inconsistencies that can be exploited. It is therefore submitted that the national

¹¹³ For perspectives on costs, see Milind Sathye, 'Estimating the Cost of Compliance of AMLCTF for Financial Institutions in Australia' (2008) 15 *Journal of Financial Crime* 347.

¹¹⁴ See Australian Government Information Management Office, *Australian Public Service Big Data Strategy* (Commonwealth of Australia, August 2013) <<http://www.finance.gov.au/big-data>>; Australian Government, *Australian Public Service Better Practice Guide for Big Data* (Commonwealth of Australia, January 2015) <<http://www.finance.gov.au/big-data>>.

interest calls for a whole-of-government approach, preferably spanning federal, state and territory, and local government levels. The design of an improved framework should ideally be informed by a more comprehensive understanding of current supplier risk assessment and mitigation practices in relation to standard as well as higher risk procurement contracts. The findings of the exploratory scoping of procurement practices of key Australian agencies in this article can serve to inform the drafters of a more comprehensive empirical study of practices and attitudes.

When designing an appropriate framework thought must be given to the implementation of a national debarment regime, to the establishment of a national public register of beneficial interests in corporations and trusts and to ensuring that data regarding unreliable and dishonest suppliers is captured, analysed and shared across all levels of government. Given the data required to enhance procurement integrity, it is important to also consider data management. It is submitted that enhanced data analytics and appropriate data solutions can support public procurement processes and make comprehensive risk-based supplier due diligence an affordable and practical policy option for Australia.