

BENEFICIAL OWNERSHIP INFORMATION IN PUBLIC PROCUREMENT

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BENEFICIAL OWNERSHIP INFORMATION IN PUBLIC PROCUREMENT

WHAT IS PUBLIC PROCUREMENT?

Public procurement is the purchase of goods, work, or services by any department or agency of government. As part of minimum reassurances during a purchase, most customers want to know who they are buying from. This is true when businesses purchase goods, work, or services (procurement), as well as when governments do so (public procurement). Twelve percent of global GDP was spent on public procurement in 2018¹, with lower income countries tending to spend more proportionally², amounting to USD 13 trillion per year³.

As a significant amount of taxpayer money is spent on public procurement, governments owe it to their citizens to procure efficiently, to ensure a high quality of service delivery, and to safeguard public interests. Most procurement is regulated by both international and national legal frameworks and guided by processes that ensure fair, equitable, transparent, competitive, and cost-effective buying. This typically involves the requirement to issue public tenders for contracts whose value exceeds a certain threshold, for which private companies compete. A contract awardee is subsequently selected along objective criteria.

Due to the amount of money and multitude of stakeholders involved, the complexity of the process, and the close interaction between the private sector and public officials⁴, procurement is the largest corruption risk for governments⁵. Specifically, significant corruption risks arise from conflicts of interest

between those who award contracts and those who receive them⁶.

WHAT IS A BENEFICIAL OWNER?

A beneficial owner is defined as the natural person i.e. a real, living person, who can be found at the end of an ownership chain of entities, usually companies. Often there is just a single link between a beneficial owner and a company, but sometimes it can include long and complex ownership chains of multiple legal entities.

A beneficial owner is a person who ultimately has the right to some or all the shares of a legal entity's income or assets, or the ability to control its activities.

Owning or controlling a company comes with rights, such as limiting liability, as well as responsibilities to customers, shareholders, governments, regulators, and other businesses. Knowing the beneficial owner of a company helps identify where decisions are made and who should be held accountable.

Beneficial ownership (BO) differs from legal ownership. Companies can own or control other companies and are known as legal persons i.e. the company can be a party to a contract or take on debt like a natural person can.

¹ Erica Bosio and Simeon Djankov, "How large is public procurement?", *World Bank Blogs*, 5 February 2020, <https://blogs.worldbank.org/developmenttalk/how-large-public-procurement>

² Simeon Djankov, Federica Saliola, and Asif Islam, "Is public procurement a rich country's policy?", *World Bank Blogs*, 1 December 2016, <https://blogs.worldbank.org/governance/public-procurement-rich-country-s-policy>

³ "How governments spend: Opening up the value of global public procurement", *Open Contracting Partnership (OCP)*, 2020, <https://www.open-contracting.org/what-is-open-contracting/global-procurement-spend/>

⁴ OECD, "Preventing Corruption in Public Procurement".

⁵ "OECD Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials" OECD, (Paris: OECD Publishing, 2014), <http://dx.doi.org/10.1787/9789264226616-en>

⁶ "Report from the Commission to the Council and the European Parliament: EU Anti-Corruption Report", *European Commission*, 3 February 2014,

http://ec.europa.eu/dgs/home-affairs/e-library/documents/policies/organized-crime-and-human-trafficking/corruption/docs/acr_2014_en.pdf

WHY IS TRANSPARENCY OF BENEFICIAL OWNERSHIP IMPORTANT?

Beneficial Ownership Transparency (BOT) reveals how companies and other legal entities or arrangements, such as trusts, are owned and controlled by their beneficial owners.

Knowing who the beneficial owner of a company is (sometimes referred to as an Ultimate Beneficial Owner) means that the activities of the company can be linked to a real person who can be held accountable for its actions. Where this information is not known, this creates significant risk because who is ultimately controlling the company remains unknown, which means you do not know if this company is one that you wish to work with, for example dealing with a company that is ultimately controlled by a sanctioned individual.

A broader challenge is that of shell companies: these are companies that only exist on paper, and that do not have any real operations or employees. Creating a shell company in a jurisdiction without company ownership disclosure requirements and transferring stolen assets to this company makes it difficult to follow the money between the stolen assets and their anonymous owners.

Shell companies in these jurisdictions facilitate organised crime, corruption, and tax evasion by making their owners anonymous. Setting up shell companies in multiple jurisdictions can make investigations even more complicated and challenging, as it allows people to pick and choose laws from different countries to suit their purposes. A study by the World Bank found that 70% of grand corruption cases studied involved the use of anonymously owned companies⁷.

WHY IS THE USE OF BENEFICIAL OWNERSHIP IN PUBLIC PROCUREMENT SO IMPORTANT?

Typically, governments have procurement policies that aim to prevent corruption and fraud as well as foster fair, equitable competition, and transparency to deliver value-for-money services for taxpayers. Without knowing the beneficial owners of a company bidding on a tender, it is difficult to ensure that these policies are being met.

Corruption and fraud in public procurement: How beneficial ownership information can help?

Beneficial ownership information and transparency can have both direct and indirect benefits for procurement. It can improve procurement directly by using BO data to enhance the information recorded by procurement systems about people and organisations, in order to help make decisions and conduct analysis. Indirectly, BOT strengthens procurement on a systemic level.

The use of BO data cases for improving procurement directly can broadly be divided into three categories:

- Preventing corruption and fraud by detecting actors (both buyers and sellers) trying to subvert existing legislation and the contracting procedure for personal gain;
- Improving services through increased competition; and
- Enhanced due diligence; verifying eligibility of suppliers for preferential procurement to meet horizontal policy objectives.

⁷ *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It*. World Bank. 2011. <https://openknowledge.worldbank.org/handle/10986/2363>

In all cases, BO data can be used to enhance information and help decision makers to realise procurement policy goals. BO information, when combined with other datasets such as contracting and spending data, can also be used to analyse to the extent to which the implementation of a procurement policy has been successful.

Corruption

Here we define corruption in procurement as involving the abuse of power of office to steer a contract to a specific bidder without detection. This can be done in numerous ways. At early stages in the contracting process, bids can be tailored to benefit specific suppliers, in some cases to the extent that procurement does not go to tender and is directly awarded. A tender period may be shortened to make it difficult for a range of legitimate bids to be submitted, or inside information may be shared with particular bidders.

At the award of a contract to a particular supplier and as the contract is created, corruption can involve awarding the contract to a company that, according to the set objective criteria, should not win. It can also involve inflating contract values or including favourable contractual terms, such as removing repercussions for the failure to deliver. As corruption involves the abuse of power of those involved in the procurement process, there is always a link and a conflict of interest between those involved and the companies that win. This can involve the payment of bribes in exchange for contracts as well as links between those assigning contracts and the contract awardees (for instance, a right to profits of the winning company). Public procurement is the most common purpose of all bribes.

Fraud

Fraud in procurement can be due to false representation, failure to disclose information, and abuse of position. Here, procurement fraud is defined as efforts to subvert the procurement process without the knowledge and complicity of officials. This can be done by multiple bidders co-conspiring to rig a bid as a cartel. Most procurement legislation forbids collusion and canvassing in order to ensure fair competition. Companies can rig bids by, for instance, suppressing bids (thereby decreasing competition and likely inflating price), or by cover bidding (submitting fake bids in order to steer the selection towards a specific bid). Procurement systems should raise red flags when fraud is suspected, but fraud can be very difficult, as well as time and resource consuming, to detect. Red flags are not proof of wrongdoing, but suggest an investigation of the case is necessary. Companies can also fail to disclose information that allows procurement agencies to conduct proper due diligence, or misrepresent themselves to match the profile of the seller that a buyer is looking for.

All forms of corruption and fraud in procurement have negative effects on competition, value-for-money, and the delivery of services. Not only is this a waste of taxpayer money, but it can also mean collapsing bridges, fake medicines, or protective equipment for medical personnel that is not fit for purpose, undermining trust in government and democracy.

Example: Red flags, corruption, and fraud in COVID-19 procurement

In the global rush for medical and personal protective equipment during the COVID-19 pandemic, many governments enacted emergency procurement legislation that prioritised speed of procurement at the expense of traditional safeguards. In the interest of speed, many countries replaced more time-consuming tender processes – aimed at securing fair competition and price effectiveness – with direct awards⁸. Governments that dispensed with safeguards against fraud and corruption in their emergency procurement legislation sooner or later saw cases of fraud, corruption, and conflicts of interest. Dozens of procurement cases related to faulty or not-fit-for-purpose protective equipment have emerged during the COVID-19 crisis, many of which have been linked to previously unidentified conflicts of interest with politically exposed persons (PEPs). It is widely acknowledged that more could have been done to prevent fraud and corruption (for instance, by tracking the BO of contracted companies in an effort to “keep the receipts”⁹ and that emergency procurement can be both fast and open)¹⁰.

In the UK, research by the New York Times revealed that of USD 22 billion spent in 1,200 published contracts, USD 5 billion went to politically connected companies.

The contracts analysed included a company receiving its first of nearly USD 274 million in protective equipment contracts within three weeks of being set up, and a number of companies that delivered materials that were deemed unusable by the National Health Service¹¹. A government audit report found many instances where departments “failed to document the justification for using emergency procurement, why particular suppliers were chosen, or how any potential conflicts of interest had been identified and managed”¹². Due to the lack of transparency, it is unclear whether corruption has occurred, but it is clear that with so many companies involved in procurement with politically connected ownership, there should have been red flags raised to prompt closer inspection and documentation of potential issues.

In the Netherlands, the public prosecutor charged two men with defrauding the German government in a facemask contract. The pair had set up a website with false information about facemask production and received a deposit of EUR 880,000 of a EUR 4.4 million contract for 11 million facemasks, but delivered none¹³. The supposed supplier, when visited by the buyers, knew nothing about the contract¹⁴. The fact that the company’s ownership was different from that of the bank account should have raised red flags.

⁸ “Tackling Coronavirus (COVID-19): Contributing to a Global Effort”, OECD, n.d., <https://www.oecd.org/competition/COVID-19-competition-and-emergency-procurement.pdf>

⁹ “Keeping the Receipts: Transparency, Accountability, and Legitimacy in Emergency Responses”, International Monetary Fund (IMF), 2020,

<https://www.imf.org/~media/Files/Publications/covid19-special-notes/en-special-series-on-covid-19-keeping-the-receipts.ashx>

¹⁰ “Emergency procurement for COVID-19: Buying fast, smart, and open”, Open Contracting Partnership (OCP), n.d., <https://www.open-contracting.org/what-is-open-contracting/covid19/>

¹¹ Jane Bradley, Selam Gebrekidan, and Allison McCann, “Waste, Negligence and Cronyism: Inside Britain’s Pandemic Spending”, New York Times, 17 December 2020,

<https://www.nytimes.com/interactive/2020/12/17/world/europe/britain-covid-contracts.html>

¹² “Investigation into government procurement during the COVID-19 pandemic”, National Audit Office, 26 November 2020, 11, <https://www.nao.org.uk/wp-content/uploads/2020/11/Investigation-into-government-procurement-during-the-COVID-19-pandemic.pdf>

¹³ “Prison sentences of up to 4 years have been demanded for fraud with face masks”, Openbaar Ministerie, 17 June 2020, <https://www.om.nl/actueel/nieuws/2020/06/17/celstraffen-tot-4-jaar-geest-voor-fraude-met-mondkapjes>

¹⁴ “Fraud with 11 million face masks, suspects detained longer”, RTL Nieuws, 22 April 2020,

<https://www.rtlnieuws.nl/nieuws/nederland/artikel/5099281/oplichting-mondkapjes-fraude-nederlands-duo-duitse-overheid>

Conflict of interests

BO information can help check for conflicts of interests that may escape more superficial checks by identifying links between those holding positions of power, such as PEPs or procurement authorities, and the (hidden) ownership and control of companies. When a red flag is raised, signalling a bid may have a potential conflict of interest, additional checks can be built in to ensure contracts are awarded fairly. If the BO data is structured and machine-readable, these checks can be automated, saving procurement officers time and making procurement more efficient. For instance, it can be combined with PEP data to identify their involvement in supplier companies (see example above).

This data can be used by governments to help make decisions on contract awards, and may also be published and used by the general public to hold the government to account. The publication of BO information of suppliers also serves as a deterrent. For its Social Fund and its Regional Development Fund, the EU uses ARACHNE, an “integrated IT tool for data mining and data enrichment”¹⁵ for due diligence, which uses a commercial BO dataset but is not published for public oversight. Both Ukraine and Slovakia collect BO data themselves in central registers. Slovakia collects BO data specifically for procurement and publishes it for public oversight. Ukraine has implemented BOT across all sectors of the economy and collects BO information on all legal entities, and uses this data to check for conflicts of interest in procurement.

Collusion and bid-rigging

BO data can also help detect certain forms of bid rigging. The submission of bids from different companies that share ownership is often not illegal. In the interest of fairness and non-discrimination, procurement officers are very unlikely to be able to make contract award decisions based on ownership – and may be legally prevented from doing so. In many cases, they do not collect or access ownership data at all. However, what is illegal under antitrust legislation in most jurisdictions, though certainly not all, is if companies are operating as a cartel, artificially inflating prices, price gouging, or colluding and canvassing with other companies. This can sometimes be difficult to prove, so a procurement system should be able to identify when multiple bids share (beneficial) ownership, and raise red flags for closer inspection of these bids.

The US Government Accountability Office’s (GAO) review of 32 cases of defence procurement identified cases of “price inflation through multiple companies owned by the same entity to falsely create the appearance of competition”¹⁶. If fake bids are submitted through firms with a common owner, this is much harder to detect without BO data.

¹⁵ “ARACHNE risk scoring tool”, European Commission, 2020, <https://ec.europa.eu/social/main.jsp?catId=325&intPagId=3587&langId=en>

¹⁶ “Defense Procurement: Ongoing DOD Fraud Risk Assessment Efforts Should Include Contractor Ownership”, United States Government Accountability Office (GAO), November 2019, 2, <https://www.gao.gov/assets/710/702890.pdf>

CONCLUSION

BO data is essential in order to know with whom one is doing business. Using BO data in procurement to help make decisions and conduct analysis can help achieve a range of procurement policy objectives. It can help prevent corruption and fraud, limit wastage, improve service delivery, and help establish bidder eligibility in strategic procurement, which are essential to the appropriate expenditure of public funds. Full transparency over who owns and controls companies in a jurisdiction can also improve procurement indirectly and systemically. BOT reduces operational and financial risk within an economy and improves the business environment overall.

In order to get the maximum potential impact of BO data in procurement, the data should be collected, verified, and published centrally by governments; procurement should not just be combined with BO data, but with BOT. Many governments that already collect data centrally do not seem to be systematically using this data in their procurement processes. Given that over 100 countries have committed to implementing central and public BO registers¹⁷, and some of them, like EU member states, are legally bound to do so, it would be an obvious step for governments to make use of BO data in order to improve their procurement processes. As BOT is implemented in a growing number of jurisdictions, this will increase the availability of data on foreign entities globally that may be used in procurement processes.

BOT is useful in many different policy areas in government, and centralised registers allow governments to use BOT in each of these areas. Given the global shift towards BOT, it would make sense to integrate it into procurement reform. BOT is not a panacea for challenges in procurement, but a relatively basic, necessary and underused step that can help improve procurement.

If governments collect, verify, and publish their data in machine-readable structured formats, the data is interoperable and can be joined with other datasets for analysis, or incorporated into automated processes, in addition to allowing civil society organizations and investigative journalists to join forces and provide support to the Public Procurement Authority and Purchasing Entities; that should help procurement officers do their jobs. As a number of initiatives have already demonstrated, the challenges to implementation are, indeed, surmountable.

¹⁷ "Worldwide commitments and action", Open Ownership, n.d., <https://www.openownership.org/map/>