



# FINANCIAL INVESTIGATION OF PUBLIC PROCUREMENT FRAUD

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## Abstract:

Public procurement process comprises one-third of all budget spending in the Republic of Serbia. According to the Public Procurement Office report, since its establishment in 2002, the government of Serbia has been making more and more investments in this area. Public procurement represents a very important process in which goods and services are purchased by various state-owned entities and governmental units. This process opens the space for committing fraud if it is not regulated or monitored adequately. The aim of this paper is to analyze the State Audit Institution report for the year 2020, which is publicly available, to synthesize the most widely recognized irregularities in this process, which could signalize possible red flags for procurement fraud, as well as to analyze the financial consequences of those deficiencies and whether responsible individuals are adequately sanctioned for it.

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## Keywords:

public procurement, fraud, public financial spending, forensic accounting.

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## 1. INTRODUCTION

Public procurement - was introduced in Serbia in 2002 based on the methodology and processes already established in the European Union Member States. The aim is to make the whole public procurement procedure efficient, economic and transparent. Public procurement Law has been amended several times in order to increase the efficiency of the process and to decrease corruptive practices in the public procurement. Public procurement office of the Republic of Serbia publishes annual reports of public procurement transactions in Serbian governmental entities and state-owned companies. Based on the analysis of those annual reports covering the period 2002-2019 we have found that the average number of suppliers submitting bids on one procurement contract has decreased. In the year 2019 the number of suppliers per contract was 2.5 (Public Procurement office, 2020). The Decrease in the number of suppliers reflects the decrease of competition in the public procurement process. So, fraudulent activities such as corruption and various manipulations could have taken place. This could influence the cost of procurement based on higher prices that state entities accept because there is a lack of competitors. Contracts are then realized at higher prices than the prices for the same products purchased by other entities when bids are submitted by many competitors. Procurement process in the state sector has been under control of State Audit Institution, which is responsible for the external control of the public procurement. State Audit Institution investigates each procurement contract through its planning, execution and purchases stages.

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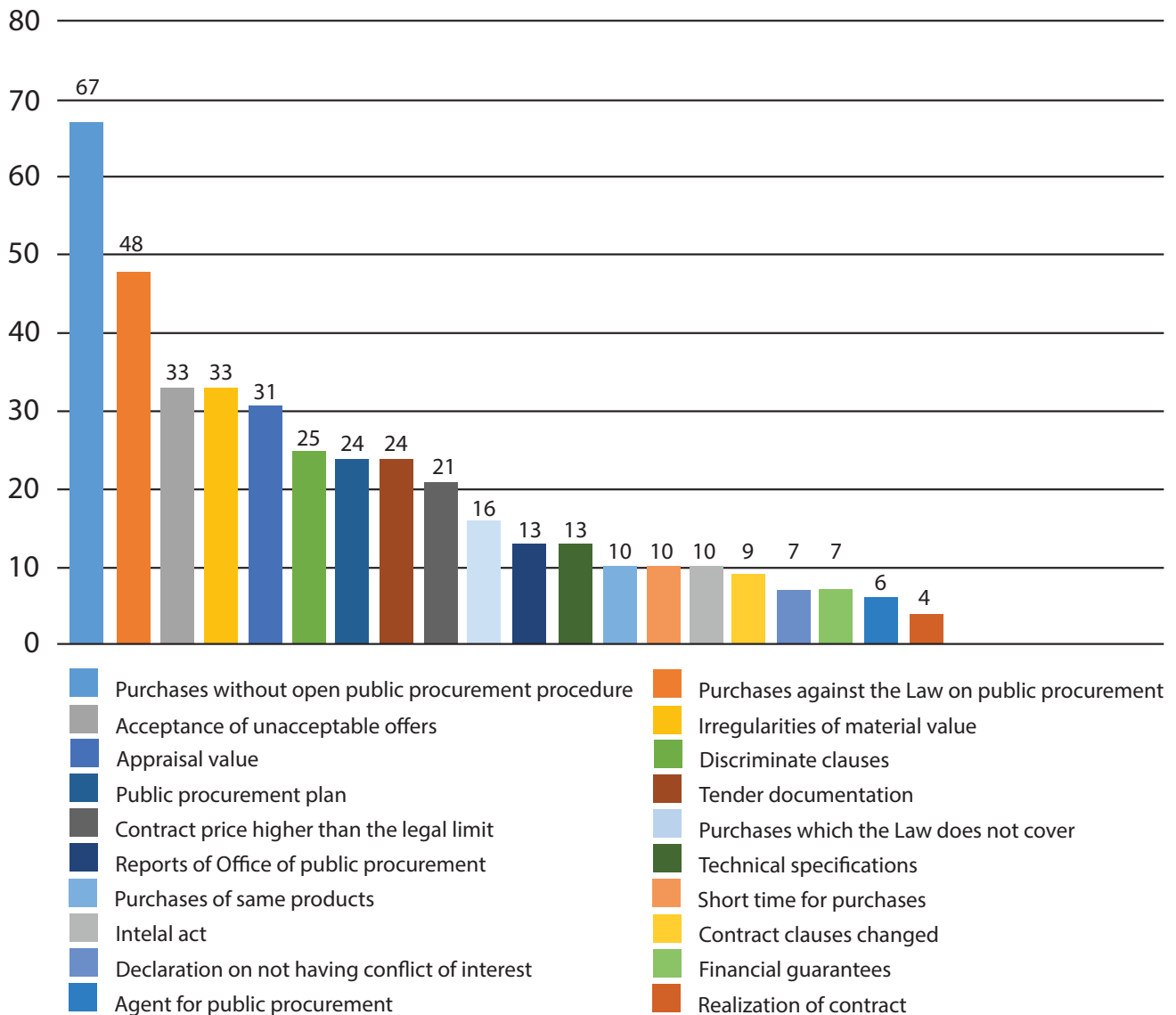


Besides investigating whether the whole process is in line with the Law, State Audit Institution also does the investigation of the effectiveness and purposefulness of the process, e.g. whether the purchased products and services are really needed by the state entity and in the quantities announced in the public procurement. In this paper, we are going to analyze 67 reports of State Audit Institutions for the period covering 2018 and 2019 and present some of the most common irregularities during the public procurement process conducted by the state institutions and other state-owned entities. Those irregularities should point out the elements or stages of the public procurement process which are the most vulnerable to misuse. In order to add value to our research, we will conduct an analysis of the Anti-corruption council's reports and present the results of the actions taken by the prosecutor's office based on criminal reports submitted

by the State Audit Institution and other authorized institutions. While examining this topic we rely on many research articles published in Serbia regarding white collar crime cases (Arežina, et.al, 2016) or published in the area of purposfulness of public procurement (Duin, et.al, 2017; Živković, 2017; Janković and Sretenović, 2015) or criminal procedures (Kostić, 2018; Kostić, 2020; Matić and Bošković, 2017; Spahić, 2014; Petković, 2010; Špiler 2018; Ostojić and Damjanović, 2013).

## 2. ANALYSIS OF PUBLIC PROCUREMENT REPORTS IRREGULARITIES FOUND IN THE PUBLIC PROCUREMENT PROCESSES BY THE STATE AUDIT INSTITUTION'S REPORTS EXPRESSED IN % IN THE YEAR 2020

Picture 1. Percentage analysis of public procurement process deficiencies of state institutions



Source: Author's own analysis based on State Audit Institution Report for 2020 from the web page <https://www.dri.rs>



- **Public procurement in which the process of public announcement has not been done comprises 67% of all irregularities found in the report.** This means that the highest percentages of financial resources that are allocated by the State budget to the various governmental entities are spent for products and services avoiding the process of public procurement, which is against the Law. Public tender is therefore won by the suppliers which are selected by the state institution in need of those products/services, which results in prices higher than those that could have been found if the public procurement process has been done properly and as a transparent procedure.

- **48% of all irregularities are done against the Law.** This shows the intentional misuse of the Law and the whole process (failure to ensure competition in the process, wrong procedures conducted and false/missing documentation).

- **33% of all cases represent the acceptance of bids that are not in line with public procurement contract.** It shows the acceptance of bidder whose products or services are not in line with the public procurement documentation and plan.

- **33% of all cases represent irregularities with material effects** (procurement of products, goods and services that are not included in the contract, invoicing at a higher price than the price submitted by the bidder, invoices without quantities and prices per product specified and payments made at a higher price than the one specified in the contract).

- **31% of all contracts analyzed contain the false estimated value.** The estimated value has not been supported by the market analysis which involves price analysis, quality and warranty analysis and analysis of other characteristics regarding the products purchased and offered in the process.

Estimated value was found to be quite different than the market price, usually much higher.

- **25% of all contracts contain discriminant clauses** In order to limit the competition in the public procurement, many governmental institutions impose discriminant clauses in the tender documentation. Those clauses contain details that are not important for that public procurement case or which are so rare that only one bidder can fulfill.

- **Plan of public procurement has been the main irregularity in 24% of cases.** Plan has not been announced at the online Procurement Portal or changes of the plan have not been announced.

- **Tender documentation has been irregular in 24% of cases.** Some of the irregularities are presented, as follows:

- In the tender documentation no quantities of the product are specified
- Tender documentation does not contain price specifications;

- There is no technical specification in tender documentation:
- Short time period for the contract execution in the tender documentation:
- Object of tender has not been segmented by different products which limits competition per contract:
- No changes in tender documentation are done by the state institution when needed.

- **Increase in contract price has been found in 21% of cases,** those increases are even higher than the price limited by the law.

- **16% of all irregularities are in the domain of purchases to which the Law does not apply.** State institution does not prepare the plan of public procurement and no competition in process is used. Procurement contracts are given to the specific bidder.

- **Quarter reports contain irregularities in 13% of cases.** Quarterly reports are not submitted to the Public Procurement Office during the specified deadline. Submitted reports do not present financial aspect of realized procurement contracts within the institution and the realization is lower than what real transactions have indicated.

- **Irregular technical specification is found in 13% of reports.** Technical specifications are not in line with the purchaser plan and not in line with the real needs of the purchaser. Contracts do not contain adequate specifications of product features which are not aligned with the Law on public procurement (standards, attests, type of the product, supplier)

- **Purchases of identical products make 10% of all contracts.** This group of irregularities includes the cases in which the purchaser makes a number of various purchases during the year which are of the same type and which, in the total sum, cross the limits defined by the law, and for which public procurement procedure should be implemented.

- **Reduced timeline in contracts make 10% of irregularities found,** which has a purpose of decreasing competition in the public purchases because the bidders lack time to prepare for the tender procedure, which in turn results in favorized supplier winning the bid.

- **Not having the internal act to regulate public purchases comprises 10% of all irregularities** state entities do not have the act or it has not been published online on the state web page.

- **9% of cases increased value of contract is considered irregular.** Contract value increases until it reaches the legal limit but the price increase is not supported by the document.

- **Declaration of conflict of interest is missing in 7% of cases.** A Member of the committee for the public purchases needs to sign the declaration stating that he/she is not exposed to the conflict of interest with the bidders.



- **Inadequate financial guarantees comprise 7% of all cases.** Lack of financial guarantees, which are specified in the tender documents to protect the interests of state institutions in case of failure by the bidder, is considered to be a serious offense.

- **6% of irregularities are found in the area of not having an individual trained for the public procurement process.** Not having a person specialized for public procurement is found in all of the cases where other irregularities are also observed.

- **Inadequate realization of public procurement contract is found in 4% of all the investigated cases.** Contract value has been increased or not supported with the adequate procedures.

Report analysis shown in the previous section of the paper supports the idea that irregularities in the public procurement are quite often in all of the stages from inception until contract realization. The highest percentage of all public procurements is not done as a transparent procedure (67%).

### 3. PROSECUTION OF PUBLIC PROCUREMENT FRAUD CASES

In the next section Purpose report will be analyzed together with the report on control and realization of public procurement cases in Serbia announced in the year 2020 by the Anti-corruption council. The Report consists of the data gathered through Higher prosecutor offices in Serbia located in Belgrade, Niš, Kraljevo and Novi Sad. The Report represents data about different stages of public procurement fraud cases within those offices (Anti corruption council, 2020).

#### 1. Special anti corruption department report for Belgrade in the year 2018 and 2019

**Table 1.** Author analysis according to the Purpose report, report on control and realization of public procurement cases in Serbia in 2018 and 2019 from the Anti-Corruption Council of the Republic of Serbia

Type of case	Total
Perpetrators prosecuted for public procurement fraud	176
Pre criminal proceedings	95
Decision on dismissal of criminal charges	70
Order for conducting the investigation	3
Proposal for the lawsuit of responsible persons	14
Acquittal- setting free from the charge of an offense	1
Conditional sentences	4

#### 2. Special anti-corruption department report in the city of Novi Sad in the year 2018 and 2019

**Table 2.** Author analysis according to the Purpose report, report on control and realization of public procurement cases in Serbia in 2018 and 2019 from the Anti-Corruption Council of the Republic of Serbia

Type of case	Total
Criminal charges pressed	31
Pre criminal proceedings	15
Decision on dismissal of criminal charges	5
Order for conducting the investigation	2
Evidence analysis and evaluation before opening the proceeding with the Higher prosecutor office	3
Referred to the jurisdiction of other office	3
Convictions	1
Acquittal	1

#### 3. Report of Special department for anti-corruption in the city of Niš in 2018 and 2019 as a part of Higher prosecutors office

**Table 3.** Author analysis according to the Purpose report, report on control and realization of public procurement cases in Serbia in 2018 and 2019 from the Anti-Corruption Council of the Republic of Serbia

Type of case	Total
Legal cases in the stage of analysing evidence for the court, additional evidence collected to support the allegations	15
Criminal charges dismissed by the prosecutor's office	8
Criminal charges submitted to prosecutor office	2
Cases resulted in conviction	3

#### 4. Report of Special department for anti-corruption in Kraljevo city in 2018 and 2019:

**Table 4.** Author analysis according to the Purpose report, report on control and realization of public procurement cases in Serbia in 2018 and 2019 from the Anti-Corruption Council of the Republic of Serbia

Type of case	Total
Legal cases in the stage of analysing evidence for the court, additional evidence collected to support the allegations	9
Convictions	1
Case rejected	1



The results show that in all 4 prosecutors offices we can find only a small number of convictions of public procurement fraud (5 cases only), but there is a large number of cases in procedure.

#### 4. CONCLUDING REMARKS

Based on our best knowledge from the reports of State Audit Institution and Anti-corruption council a conclusion can be made that efficient strategies against irregularities in public procurement can be operationalized only if all state institutions follow legal requirements when going through public procurement procedures and that controlling governmental institutions make irregular and unannounced controls of this process and impose heavy sanctions on perpetrators. New Law on Public Procurement that came into effect on July 2020 imposes new regulation in line with the EU directives (Law on Public procurement). The Law follows the new online portal of public procurement, all offers are sent electronically and procedures are followed transparently. This could lead to the prevention of public procurement irregularities and fraud and to the increase of competition in the process. The Results of the implementation of new Law on Public Procurement will be announced in the future when State Audit Institution prepares a new report. Future researchers are encouraged to extend the research in this area.

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