

CONFIDENTIAL

May 2011

CRIMES RELATED TO CORRUPTION

1. INTRODUCTION

A number of specific crimes, ranging from embezzlement and fraud to cover quoting, fronting, extortion and price fixing, are closely related to corruption and may often involve elements of corruption. These crimes all share dishonesty as a central element and therefore affect the trust relationship with stakeholders.

2. EMBEZZLEMENT

Embezzlement involves the theft of resources by persons entrusted with authority over and control of such resources.

- For example, hospital staff members steal medicines and sell the stolen medicines to private pharmacists.
- Another example is a stationery officer stealing printer cartridges to sell to friends.

3. FRAUD

Fraud is the unlawful, intentional making of a misrepresentation that causes actual or potential damage to another.

In other words, fraud involves the deliberate making of a misrepresentation that results in harm to another.

This may include actions, inaction or behaviour by any person or entity that deceives others into providing a benefit that would not normally accrue to the person or entity.

Some examples of fraud are:

- Employees deceive an employer about the possession of certain qualifications or years of experience.
- Officials claim additional kilometres on travel allowances.

- Employees take sick leave when not ill.
- Business people falsify quality or standards certificates knowing that they would not otherwise be awarded a government contract for their low-quality goods.
- Business consultants submit claims for services that they have not rendered or charge additional for hours not worked.
- Public officials draw up international contracts in such a way that they receive some sort of personal gain therefrom, for example, the money is paid into a foreign bank account in the public official's own name.
- Officials draw up specifications for a tender to favour particular suppliers (deceiving others), from whom the officials receive a kickback (overlap with corruption).
- Employees change figures to claim more overtime or allowances than those to which they are entitled.
- Officials invent fully paid "official visits", locally and abroad but they take the family for a nice holiday.

3.1 FRONTING

Fronting is a form of fraud, which is committed to win government business, or to obtain a higher price for goods and services. Fronting entails a deliberate circumvention or attempted circumvention of the B-BBEE (Broad Based Black Economic Empowerment) Act and the Codes. It commonly involves reliance on data or claims of compliance, based on a misrepresentation of facts.

Fronting may be described as:

- Tokenism, which is the superficial inclusion of historically disadvantaged individuals.
- Falsely claiming to be a majority black-owned company, having black economic-empowerment ownership in your company, or having black staff occupying top management positions.

Fronting practices include:

- **Window-dressing:** This involves previously disadvantaged people being appointed or introduced to an enterprise on the basis of tokenism, but -
 - being discouraged or inhibited from substantially participating in the core activities of an enterprise; and
 - being discouraged or inhibited from substantially participating in the stated areas.

- **Benefit diversion:** This involves the economic benefits that an organisation has received for having B-BBEE status not flowing to previously disadvantaged people in the ratio specified by law.
- **Opportunistic intermediaries:** This involves enterprises that have concluded agreements with other enterprises in order to leverage the opportunistic intermediary's favourable B-BBEE status in circumstances in which the agreement includes:
 - Significant limitations or restrictions on the identity of the opportunistic intermediary's suppliers, service providers, clients or customers;
 - maintenance of their business operations in a context reasonably considered improbable having regard to resources; and
 - terms and conditions that are not negotiated at arms-length, on a fair and reasonable basis.

The following is an example of fronting by an opportunistic intermediary:

- A white-owned company used to supply schoolbooks to a provincial education department.
- The government now wants the schoolbooks to be supplied by a black-owned company.
- A black-owned firm starts an agency, buys the books from the white-owned company, sells them to the education department and adds a fee based on its BEE credentials.
- Nothing really changes, except that the books are more expensive, and the black owners are richer and have gained some business experience.

Public officials and BEE verification agencies have to report cases of fronting to the Department of Trade and Industry (DTI).

3.2 COVER QUOTING

Cover quoting, or bid rigging, is a form of fraud that may occur during the quotation or tender process.

- For example, a procurement officer may collude with an external supplier, who submits multiple quotes and, through this process, is assured of being granted a contract.

Cover quoting may also entail all companies in which someone is involved submitting tenders for the supply of goods or services. Tender prices are shared and, therefore, not truly competitive, often leading to a higher price being paid.

4. EXTORTION

Extortion involves placing illegitimate pressure on another party in the form of a threat of harm to provide a benefit, material or immaterial to a public servant, another person or an entity in exchange for acting (or failing to act) in a particular manner.

The threat may even be that some third party will suffer injury. The accused (X) must intend his words in order for them to operate as a threat, while also intending that Y will see the threat as such.

Extortion is thus the process of forcing someone to do something by threatening them with negative repercussions if they were not to comply.

- For example, a health official threatens to close a restaurant based on fabricated health transgression unless the owner provides the public health official with regular free meals.
- Another example of extortion is a person being forced to pay a monetary benefit to a border official in order to enter or leave a country.

The difference between corruption and extortion can be explained as follows:

- In a case of extortion, a benefit is handed over as a result of illegitimate pressure.
- In a case of corruption, on the other hand, a benefit is handed over voluntarily and there is no undue pressure on the person to whom the benefit is handed (that is, the person being corrupted) to perform the act.

Not only individuals, but also large organisations may also be subjected to extortion.

5. INSIDER TRADING

Insider trading involves the use, for personal gain, of privileged information and knowledge that a person possesses as a result of his or her position. The person (or a third party) obtains or accrues an unfair benefit through use of the privileged knowledge.

- For example, a local government official, as a result of his or her particular office, has knowledge of residential areas that are to be rezoned as business areas. He or she informs friends and family in order for them to acquire the residential properties with a view to selling these as business properties at a premium.

6. PRICE FIXING

Price fixing or anti-competitive practices occur when competitors enter into an agreement to keep prices at a specific level (normally resulting in a higher cost to the consumer).

Such practices are unlawful in terms of the Prevention of Corrupt Activities Act and have also been specifically criminalised in the Competition Act of 1998.

In addition, the Competition Act makes it an offence for competitors to agree not to approach each other's markets or to collude during tendering processes.

An example of price fixing follows:

- A group of contractors who routinely compete in the same market secretly agree to share the market between them. The contractors pretend to compete on all major tenders, but will in advance secretly agree which of them should win each tender.
- The contractor who is chosen by the other contractors to win a tender will prior to tender submission notify the others of its tender price. The other contractors will then tender at a higher price to ensure that the preselected contractor wins the tender.
- The winning contractor would therefore be able to achieve a higher price than if there had been genuine competition for the project. If sufficient projects are awarded, each contractor would have an opportunity to be awarded a project at a higher price.
- This arrangement is kept confidential from the project owners on various projects.
- The project owners believe that the tenders are subject to genuine open competition, and that they are achieving the best available price.
- In reality, however, the project price is increased.

7. MISCONDUCT OR IRREGULAR BEHAVIOUR

The repercussions of various forms of misconduct or irregularities may be as severe for organisations and society as those flowing from corruption and related crimes. Irregularities refer to the breach or circumvention of organisational policies and procedures.

7.1 LACK OF PRODUCTIVITY

Lack of productivity is a form of misconduct at work, which results in money being wasted. Being deliberately unproductive includes all kinds of activity that prevent the organisation from operating at its peak performance and reaching its objectives.

Examples of a deliberate lack of productivity are:

- Employees pretending to be ill and staying away from work (overlap with fraud).
- Employees reporting for work, but going shopping and attending to private matters during working hours – for example, people who undertake part-time studies and use their official working hours as study time without permission, and who use official staff (for example, a secretary being used to type a thesis) and official equipment (telephone, vehicle, photocopier, stationery, etc.) for private interests.

- Managers being unwilling to take responsibility for their actions or for leadership decisions. Irregularities are ignored and misconduct is tolerated at the cost of the company.
 - **Source:** “*Quiet corruption exacts a hefty toll on Africa*”, Business Report, 16 March 2010.

7.2 MALADMINISTRATION/MISMANAGEMENT

Maladministration occurs when, for example, a municipality is administered poorly, or a municipality's administration has failed completely.

The main test of whether there has been maladministration is whether an official has acted reasonably in accordance with the law, the policies of the organisation for which he/she works and generally accepted standards of administration.

Some examples of maladministration are:

- Administrative irregularities, such as short circuiting prescribed procedures or ignoring internal control measures.
- Unfairness, bias and partiality.
- Unfair discrimination.
- Refusing to supply correct and complete information.
- Unnecessarily or deliberately delaying the completion of tasks.
- Rudeness.
- Unwillingness to treat a complainant as a person with rights.
- Refusing to answer reasonable questions honestly and fully.
- Neglecting to inform a complainant of his/her rights or entitlements.
- Knowingly supplying misleading or inadequate advice.
- Ignoring valid advice.
- Overruling of considerations that would produce an uncomfortable result for the decision maker.
- Offering no redress or manifestly disproportionate redress to complainants.
- Failing to monitor compliance with adequate procedures and control measures.

Dr Janette Minnaar-van Veijeren | Founder of ProEthics

T: +27 12 452-3500 | E: janette@proethics.co.za