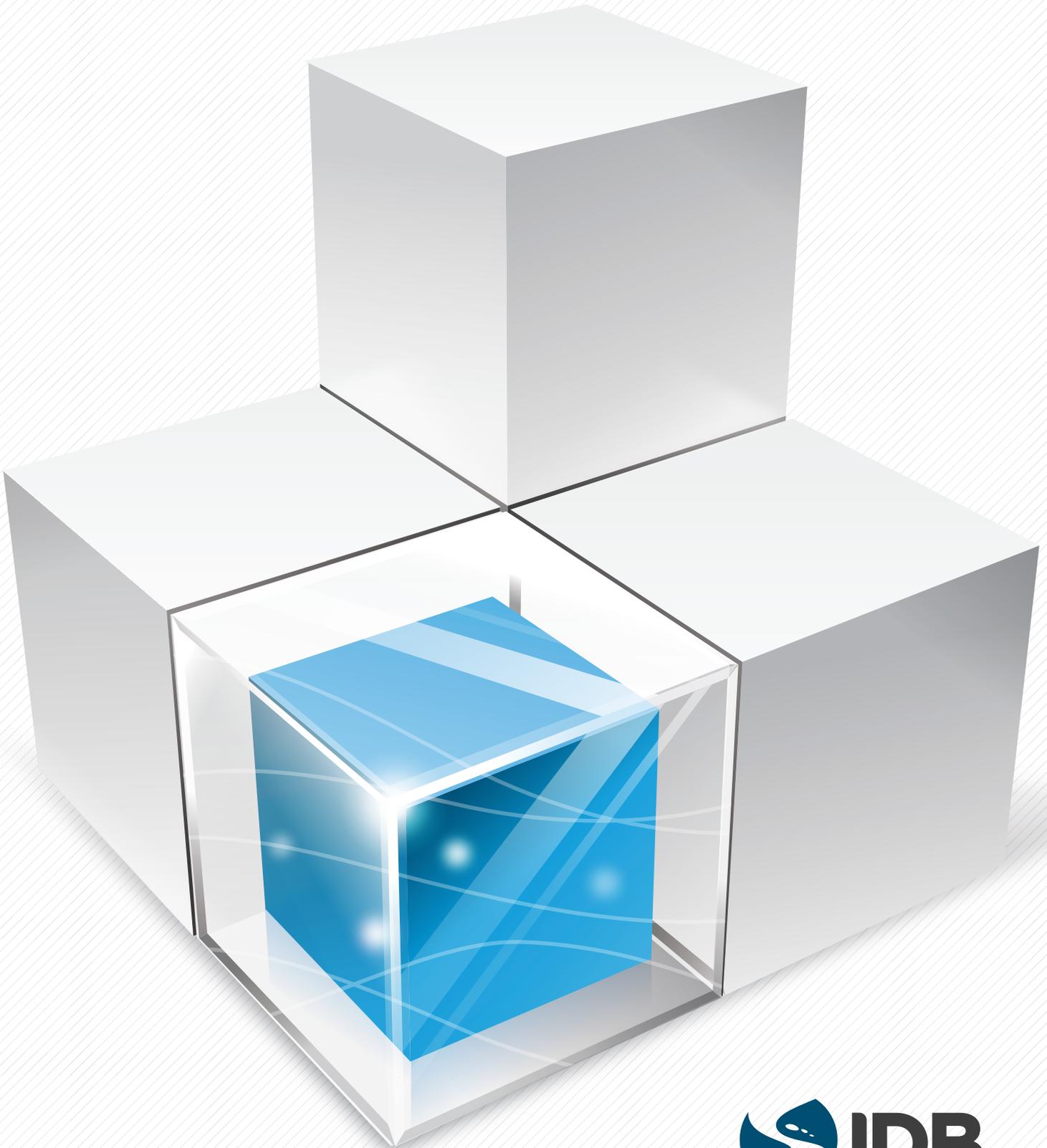


OFFICE OF INSTITUTIONAL INTEGRITY AND SANCTIONS SYSTEM

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## ACRONYMS

ACI	Institutional Capacity Assessment
ADB	Asian Development Bank
AfDB	African Development Bank
AUG	Office of the Executive Auditor
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
IDB	Inter-American Development Bank
IDD	Integrity Due Diligence
IFC	International Finance Corporation
IFI	International Financial Institution
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
MDB	Multilateral Development Banks
MIF	Multilateral Investment Fund
NSG	Non-Sovereign Guaranteed
OECD	Organization for Economic Co-Operation and Development
OFC	Offshore Financial Centers
OII	Office of Institutional Integrity
ORP	Office of Outreach and Partnerships
PCU	Project Coordinating Unit
SGO	Sovereign Guaranteed Operations
SLA	Service Level Agreement
SNC	Sanctions Committee
SO	Sanction Officer
SOC	Statement of Charges
ROI	Reports of Investigation
UN	United Nations
WBG	World Bank Group

## I. INTRODUCTION

- 1.1. This Annual Report reflects the work of the **Office of Institutional Integrity (OII)**, the **Sanctions Officer (SO)** and the **Sanctions Committee (SNC)**, which together are responsible for overseeing the management of integrity risk at the Inter-American Development Bank (IDB) Group<sup>1</sup>. As such, they constitute a “second line of defense” in a risk management context. Their work complements that of the operational and corporate staff of the IDB Group, who, as the “first line of defense”, are directly responsible for identifying, assessing and mitigating integrity risk, in accordance with the relevant IDB Group policies and procedures.
- 1.2. In a broader sense, however, this Annual Report reflects the contributions of many other stakeholders to the integrity of Bank Group-financed operations. In 2015, key partners in this collective effort included executing and enforcement agencies in borrowing member countries, private companies, civil society organizations, and members of the general public. The work summarized in this report would not have been possible without their cooperation. In many cases, they acted as whistleblowers, facing the challenges and risks of reporting wrongdoing or providing testimony in connection with investigations.
- 1.3. The report is structured in three sections, in addition to this introduction. The first provides an overview of the roles and responsibilities of OII, the SO and the SNC. The second summarizes their achievements and shortcomings during 2015, and their anticipated challenges and opportunities in 2016. The third presents data regarding specific outputs during 2015.

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<sup>1</sup> The IDB Group comprises the IDB, the Multilateral Investment Fund (MIF), and the Inter-American Investment Corporation (IIC).

## II. OVERVIEW

### A. Origins and Rationale of the Integrity Function at the IDB Group

- 2.1 The 2001 adoption by the Board of Executive Directors of the report on “Strengthening a Systemic Framework against Corruption for the Inter-American Development Bank” (Systemic Framework) marked an important milestone in the development of the IDB Group’s stance against corruption. Since then, the IDB Group has made important investments to ensure that the integrity of its operations remains paramount. The Systemic Framework provided the IDB Group with a solid foundation to address the limitations on development caused by corruption. This study was the result of sweeping changes in the anti-corruption field that started with the 1996 Inter-American Convention against Corruption. Subsequently, the anti-corruption field has seen continued evolution, including the 1997 Organization for Economic Co-operation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, and the 2003 United Nations (UN) Convention against Corruption.
- 2.2 Central to the Systemic Framework was the fiduciary responsibility of the Bank Group to ensure that its funds are used for their intended purposes, a mandate that is explicit in the Agreement Establishing the Inter-American Development Bank. The Systemic Framework emphasized the need to consider integrity in the design and execution of operations, but also recognized the need for a mechanism to address allegations of fraud and corruption. To that end, the Office of the Executive Auditor (AUG) was initially charged with the responsibility for carrying out investigations of such matters. The IIC adopted a Mechanism to Combat Fraud and Corruption in 2001.
- 2.3 By 2003, the number of allegations related to fraud and corruption received by the Bank Group had increased to a degree that called for the creation of a specialized unit responsible for addressing and investigating such allegations hence, the creation of the Office of Institutional Integrity (OII). In 2006, the Bank decided to expand due diligence in connection with private sector operations to cover integrity matters, and OII was mandated to oversee its implementation.

- 2.4 Between 2007 and 2008, the Systemic Framework was reviewed by external consultants, led by former US Attorney General Dick Thornburgh. In 2009, the IDB Board of Executive Directors and Management agreed on an action plan to implement the recommendations of this review, comprising the inclusion of OII in the organizational chart of the Bank as a separate and independent office, and the creation of a two-tier adjudicative system comprised of the SO and the SNC, and regulated in Sanctions Procedures that ensure a fair process for investigated parties. Similar systems currently exist at the World Bank Group (WBG), the African Development Bank Group (AfDB Group), the Asian Development Bank (ADB), and the European Bank for Reconstruction and Development (EBRD and together with WBG, AfDB Group, ADB, and IDB Group, the Multilateral Development Banks (MDBs). The IIC's Management and Board of Executive Directors formally linked the IIC with the Bank's integrity function in approving the IIC's updated Framework to Prevent Combat Fraud and Corruption in 2011.
- 2.5 The implementation of the action plan and subsequent reforms, including a 2015 amendment of the Sanctions Procedures<sup>2</sup>, were part of the Agenda for a Better Bank, critical to the Ninth General Capital Increase and to the development effectiveness of IDB Group Operations. As such, OII and the Sanctions System fulfill a fiduciary role that is essential to the achievement of IDB Group objectives and to protecting its reputation.

## **B. MDBs Uniform Framework for Preventing and Combating Fraud and Corruption**

- 2.6 In 2006, the MDBs, the European Investment Bank (EIB) and the International Monetary Fund (IMF) adopted a harmonized approach to integrity matters by signing *The Uniform Framework for Preventing and Combating Fraud and Corruption* (Uniform Framework). This Uniform Framework standardized the definitions of "Prohibited Practices" for which entities and individuals could be sanctioned.
- 2.7 This harmonization effort was further solidified by the 2010 *Agreement on Mutual Enforcement of Debarment Decisions* signed among the MDBs (Cross-Debarment Agreement), which allowed for any entities or individuals sanctioned by an MDB to be

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<sup>2</sup> Information on the amendments introduced in 2015 is included in other sections of this report.

subsequently excluded from participating in activities financed by all of the other MDBs. This raised the stakes of corruption and other Prohibited Practices, generating a deterrent effect. The Cross-Debarment Agreement is today effective for all the MDBs and more than 600 corporations and individuals have been cross-debarred by the participating MDBs, out of which 100 originated from debarments imposed by the IDB Group.

- 2.8 The harmonized approach to integrity matters was the result of a task force that developed a consistent and harmonized approach among MDBs to increase the effectiveness of each institution's efforts to combat corruption in their activities. The elements of the Uniform Framework have been, and continue to be further developed by the MDBs, acting collectively and within each institution's own policies and procedures. As a result of these harmonization efforts, the MDBs and the European Investment Bank have harmonized sanctioning guidelines and principles for the treatment of corporate groups.

### **C. Prohibited Practices**

- 2.9 IDB Group efforts to manage integrity risk are grounded in the concept of Prohibited Practices. This concept is reflected in the following harmonized definitions.

## PROHIBITED PRACTICES

**Corrupt Practice:** “Offering, giving, receiving, or soliciting, directly or indirectly, anything of value to influence improperly the actions of another party.”

**Fraudulent Practice:** “Any act or omission, including a misrepresentation, that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation.”

**Coercive Practice:** “Impairing or harming, or threatening to impair or harm, directly or indirectly, any party or the property of the party to influence improperly the actions of a party.”

**Collusive Practice:** “An arrangement between two or more parties designed to achieve an improper purpose, including influencing improperly the actions of another party.”

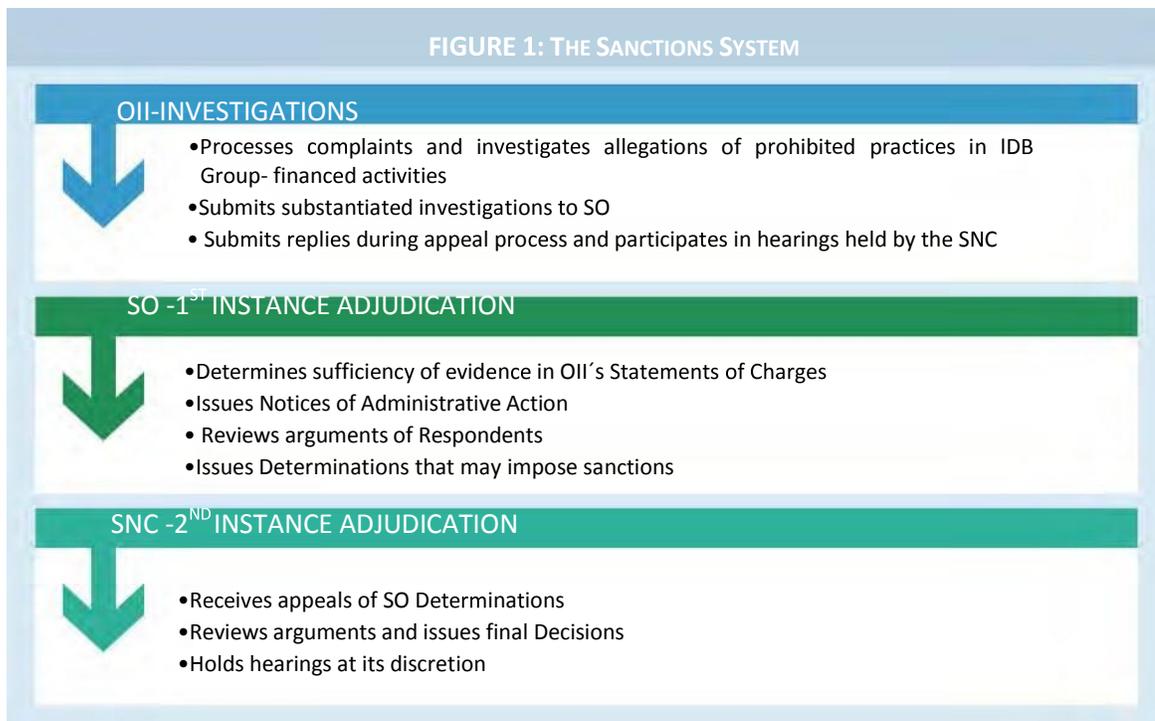
**Obstructive Practice:** “(a) Deliberately destroying, falsifying, altering or concealing evidence material to the investigation or making false statements to investigators in order to materially impede a IDB Group investigation into allegations of a corrupt, fraudulent, coercive or collusive practice; and/or threatening, harassing or intimidating any party to prevent it from disclosing its knowledge of matters relevant to the investigation or from pursuing the investigation” or (b) “Acts intended to materially impede the exercise of the Bank’s inspection and audit rights.”

### D. The Sanctions System

#### Investigative Office

- 2.10 OII is an independent office of the IDB that reports directly to the President of the IDB. It also reports its activities and results to the Audit Committee of the Board of Executive Directors of the IDB (the Audit Committee).
- 2.11 OII’s investigative activities are the first step of the Sanctions System. OII’s investigative work is the input for the adjudicative work of the SO and the SNC (see Figure 1).

FIGURE 1: THE SANCTIONS SYSTEM



2.12 OII investigations seek to determine whether an external party has engaged in Prohibited Practices in an IDB Group financed activity. OII investigations are generally triggered by complaints. However, OII may undertake investigations based on information that it uncovers proactively or that is publicly available. Investigations can relate to any activities financed by the IDB Group, including corporate procurement.

2.13 The investigative process is divided into three phases: (i) Pre-Investigation, which includes complaints processing and preliminary inquiries; (ii) Full Investigation; and (iii) Post- Investigation.

2.14 **Pre-Investigation Phase.** Complaints originate from various sources (including IDB Group employees, third parties, and anonymous sources) and can be received through a number of different reporting channels, (including e-mail, the OII website, a telephone hotline, and in-person reporting).<sup>3</sup> Complaint processing involves two separate tasks: (i) creating records of complaints in the Case Management System; and

<sup>3</sup> Information on how to report fraud and corruption can be found at:  
<http://www.iadb.org/en/topics/transparency/integrity-at-the-idb-group/how-to-report-fraud-and-corruption,2872.html>

(ii) assessing the relevance of complaints as they relate to OII's mandate. OII determines relevance by assessing whether the complaint:

- concerns a Prohibited Practice;
- relates to activities financed or to be financed by the IDB Group; and
- provides sufficient information to be credible.

2.15 If a complaint meets the initial assessment criteria, OII converts it into an allegation and commences a preliminary inquiry. If a complaint does not meet the threshold criteria, OII closes the case, but may refer it to relevant departments or other organizations for possible action.

2.16 During a preliminary inquiry, the intake unit determines whether a full investigation is warranted. OII makes this assessment by consulting with relevant IDB Group staff, conducting preliminary interviews of complainants and witnesses, and considering various factors, including:

- the egregiousness of the alleged wrongdoing;
- the viability of the investigation;
- the amount of loss or harm resulting from the alleged wrongdoing;
- the possibility of systemic problems;
- the likelihood that the subject engaged in similar conduct in other IDB Group- financed activities; and
- time-sensitivity of the underlying activity.

2.17 The information gathered through this process enables OII to better understand the allegation's potential impact on the IDB Group financed activity, its development objectives, and its beneficiaries. It also helps OII determine whether the allegation merits the resources that would be invested in a full investigation.

2.18 **Full Investigation Phase.** Once OII converts a preliminary inquiry into a full investigation, a team of investigators – usually two – is assigned. This team conducts a fact-finding exercise that may involve, among other things, expert consultations, interviews, document reviews, site inspections, and audits. The investigation team seeks

to corroborate facts by obtaining evidence from multiple sources that collectively inform OII's conclusions. Based on this evidence, the Chief of OII determines whether the evidence gathered supports a finding that the subject of an investigation is more likely than not to have engaged in a Prohibited Practice.

- 2.19 **Post-Investigation Phase.** If this standard has been met, OII prepares one or more Statement(s) of Charges (SOC). A SOC must attach the evidence that supports such findings, together with any exculpatory evidence. These documents are sent to the SO, and are the focus of the first instance of the adjudication phase of the Sanctions System.
- 2.20 In addition, if a sanction determined by the SO is appealed to the SNC, OII participates as a party in the resulting process. In this capacity, OII prepares a reply to the Respondent's appeal and provides any information or materials required by the SNC. OII will also take part in any hearings held in connection with such appeals, which may require OII to deliver oral arguments or examine any witnesses appearing at the hearing.
- 2.21 In addition, following a full investigation, the investigators assigned to the case will work with the prevention team to prepare, as required, a report of investigation for the relevant Managers and operational staff.

### The Sanctions Officer

- 2.22 The SO is a Bank staff member appointed by the President of the IDB, in consultation with the Audit Committee. The SO reports his activities and results to the Audit Committee. The SO determines whether there is sufficient evidence to support OII's investigative findings and if warranted, imposes sanctions. As part of that review, the SO evaluates the sufficiency of the evidence submitted by OII, assesses the investigated party response, and may request information or materials from OII or the Respondent.
- 2.23 The SO issues five types of Determinations. All determinations are based on the standard of preponderance of the evidence.<sup>4</sup>

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<sup>4</sup> According to the Sanctions Procedures, the standard of preponderance of the evidence means that it is more likely than not that the respondent has engaged in a Prohibited Practice

1. Notices of Administrative Action (Notices);
2. Determinations of Insufficient Evidence;
3. Determinations of Sufficient Evidence, in which the SO determines that a finding of a Prohibited Practice is supported by a preponderance of the evidence and imposes a sanction on the Respondent;
4. Determinations of Temporary Suspension, in which the SO temporarily suspends a party from eligibility to participate in, or be awarded, additional contracts with IDB Group funds; and,
5. Determinations of Expiration of Statute of Limitations.

2.24 **Notices of Administrative Action (Notice).** The SO issues a Notice after reviewing OII's SOC, and determining that it is more likely than not that the Respondent engaged in a Prohibited Practice. The main purpose of a Notice is to notify the Respondent of the commencement of administrative sanctions proceedings and to provide the Respondent an opportunity to respond to OII's SOC.

2.25 **Determinations of Insufficient Evidence.** After reviewing OII's SOC, the SO may determine that there is insufficient evidence in a case, and issue a partial or total dismissal of the allegations, or exclusion of Respondents included in the SOC. In case of a total dismissal, and after consulting with the Chairperson of the SNC, the SO issues a Determination concluding that the evidence submitted by OII is insufficient to support a finding of a Prohibited Practice. In these cases, proceedings against Respondents are concluded without prejudice. The SO can also issue Determinations of Insufficient Evidence when the Respondent responds to OII's SOC, and provides information to determine that there is insufficient evidence to support a finding of a Prohibited Practice.

2.26 **Determinations of Sufficient Evidence.** After reviewing the Respondent's Response, if the SO finds that it is more likely than not that a Prohibited Practice has occurred, the SO issues a Determination recording his findings and imposes a sanction on the Respondent.

2.27 **Determinations of Temporary Suspension.** The SO may determine, in consultation with the Chairperson of the SNC, to temporarily suspend a party from eligibility to

participate in, or be awarded additional contracts for Projects, while investigations or sanctions proceedings are ongoing. The SO considers such determinations upon recommendation of OII with the submission of substantial evidence that supports an allegation of a Prohibited Practice. The SO will issue these types of determination when it is concluded that the award of contracts to the concerned party or its participation in additional Projects could result in significant harm to the Bank Group or a Bank Group-financed Project.

- 2.28 **Determinations of Expiration of Statute of Limitations.** The SO issues these determinations in cases where the Prohibited Practices happened more than ten years prior to the submission of the SOC. In this case, the SO issues a Determination dismissing the allegations and terminating the sanctions proceedings.
- 2.29 After the SO issues a Notice, the Respondent has 60 days for submitting a Response. The SO assesses the submissions delivered by the Respondent and OII, and issues a Determination. If the SO finds that a Prohibited Practice is supported by a preponderance of the evidence, he issues a Determination of Sufficient Evidence reporting his findings and imposing a Sanction on the Respondent. On the contrary, if the SO finds that a Prohibited Practice is not supported by a preponderance of the evidence, he issues a Determination of Insufficient Evidence reporting his findings, dismissing the allegations, and terminating the proceedings.
- 2.30 If the Respondent does not submit a Response within 60 days, the SO considers that the Respondent has admitted the allegations set forth in the Notice and will issue a Determination with a sanction. In such case, the Respondent cannot appeal the SO's Determination and the Determination becomes final.
- 2.31 The sanctions imposed by the SO (and the SNC, in the second instance) are based on the Sanctioning Guidelines, which were adopted by the SO and the SNC. They are in line with the harmonized General Principles and Guidelines for Sanctions.

## SANCTIONS

According to the Sanctioning Guidelines, the base sanction is a three-year debarment period that can be enhanced and/or reduced from a range of one to seven years based on a set of mitigating and aggravating factors to be considered by the SO and the SNC. The SO and the SNC may impose the following sanctions:

- Reprimand
- Debarment for a determined period
- Permanent debarment
- Conditional debarment
- Conditional non-debarment
- Debarment with conditional release
- Restitution of funds or impositions of fines

### The Sanctions Committee and its Executive Secretariat

- 2.32 The SNC is an independent seven-member committee (four members external to the IDB Group, and three Bank staff members with an alternate IIC staff member), assisted by an Executive Secretariat. The President of the IDB appoints the members of the SNC and its Executive Secretary and, in consultation with the Audit Committee of the Board, designates a Chairperson of the SNC from among its members. The SNC serves as the second and final instance of the adjudication phase of the Sanctions System.
- 2.33 The SNC adjudicates cases in which Respondents have contested a Determination issued by the SO. The SNC is responsible for ensuring that the appeals process is followed (Appeals Processes) and for issuing final Decisions (Substantive Output).
- 2.34 **Substantive Output.** The SNC can decide cases either through three-member panels (two external members and one Bank staff) or through a full Committee, with a required quorum of five members. The SNC reviews the written submissions made by OII and the Respondents, and can hold hearings where OII and the Respondents have the opportunity to address the SNC directly. When hearings are held, the Chairperson of the SNC generally convenes a full Committee quorum.

- 2.35 The SNC analyzes whether the evidence supports the conclusion that a Prohibited Practice occurred and, if so, what sanction to impose. All Committee Decisions are final and cannot be appealed.
- 2.36 **Appeals Processes.** The Executive Secretariat serves as a registry for the SNC, and manages all notices and submissions related to the SNC's proceedings and Decisions. These include, in addition to other *ad hoc* submissions and communications, receiving appeals from Respondents and replies from OII and notifying the parties of such submissions. The Executive Secretary is also in charge of certifying Respondents' failure to file an appeal and drafting SNC Decisions.
- 2.37 The Executive Secretariat manages the publication of sanctions, including those imposed by the IDB, as well as those imposed by other MDBs and recognized by the IDB Group under the Cross Debarment Agreement. In addition, the Executive Secretariat communicates Determinations of Temporary Suspension issued by the SO to relevant units within the IDB Group.

## **E. The Prevention Function**

- 2.38 While the Sanctions System addresses the possibility that Prohibited Practices may have occurred in IDB Group Operations, OII's preventive activities seek to identify and mitigate integrity risk and any reputational impact to the IDB Group related to such risk. Prevention activities consist primarily of:
- advising IDB Group operational units regarding specific operations;
  - sharing lessons learned from investigations with operational staff;
  - providing training to internal and external stakeholders;
  - designing tools to gather and assess information that may indicate the presence of integrity risks; and
  - contributing to the development of policies that improve the IDB Group's ability to detect and reduce integrity risk.

2.39 **Advice Regarding Non-Sovereign Guaranteed Operations.** The IDB Group manages integrity risks in Non-Sovereign Guaranteed (NSG) Operations<sup>5</sup> primarily through Integrity Due Diligence (IDD). IDB Group guidelines require project teams to conduct IDD for each NSG operation, and to update that due diligence throughout the life of the project. IDD is a process that may vary in scope depending on the nature of the operation or parties involved, but it generally involves the steps summarized in figure 2 below.



<sup>5</sup> For purposes of this report on 2015 activities, NSG Operations are loans, guarantees, equity and other financing provided by the Structured and Corporate Finance Department (SCF) and the Opportunities for the Majority Sector (OMJ) of the Bank, as well as the Inter-American Investment Corporation (IIC) and the Multilateral Investment Fund (MIF). These units – SCF, OMJ, IIC and MIF – are collectively referred to as the “NSG Windows”. As of January 1, 2016 NSG operations will be processed and approved by the IIC and the MIF.

- 2.40 IDB Group guidelines require project teams to gather information regarding the use of certain corporate structures by counterparties, and to identify and mitigate risks associated with offshore financial centers (OFCs). This additional information is used to identify indicators of tax evasion and other illicit acts (e.g., money laundering and corruption) that are frequently associated with OFCs.
- 2.41 OII advises project teams, management and the respective Board or Donors Committee in connection with individual operations. Such advice relates to the identification, assessment and – when those risks are heightened or significant – the mitigation of integrity risks or impact on the reputation of IDB Group.
- 2.42 **Advice Regarding Sovereign Guaranteed Operations (SGO).** For SGO, integrity risk management is focused on identifying, during the design and implementation phases of a program, weaknesses and vulnerabilities that could allow for members of executing agencies, bidders, suppliers, contractors, consultants or other participants in IDB Group financed operations to engage in Prohibited Practices or unethical behavior.
- 2.43 Integrity risk management in SGO operations is the collective responsibility of sector and fiduciary specialists and their supervisors, and is embedded in the project risk management process. OII helps teams fulfill this responsibility by advising on the identification and valuation of risk indicators, and making recommendations regarding risk mitigation strategies. OII may provide such advice in response to specific consultations, but more frequently participates in SG operations when risks have been identified through an investigation or other means.
- 2.44 **Advice Regarding activities of other IDB Units.** OII also provides advice to other IDB Group units upon request. Such units have included the Office of Outreach and Partnerships (ORP), the Finance Department, the Corporate Procurement Division and the MIF in connection with its technical cooperation operations. OII's advice to such units generally involves the identification, assessment and – when appropriate – the mitigation of integrity risks and its reputational impact.
- 2.45 **Reports of Investigation and Advisory Notes.** OII extracts lessons learned from investigations regarding the identification and mitigation of integrity risks. OII shares this

knowledge with operational staff through reports of investigation (ROIs) and Advisory Notes – joint products of the investigative and preventive teams of OII. ROIs are prepared following completion of an investigation. They communicate any deficiencies or weaknesses in an IDB Group financed operation that were identified during the investigation and suggest concrete areas of action to address them. Advisory Notes, on the other hand, communicate time-sensitive indicators of integrity risk to operational staff and management during the course of an investigation and recommend immediate actions to address imminent risks.

- 2.46 The findings and conclusions reflected in ROIs may be shared with the relevant government authorities responsible for implementing or overseeing implementation of the affected IDB Group financed operation. In addition, OII, the SO or the SNC may recommend sharing information with enforcement authorities.
- 2.47 **Training to Internal and External Stakeholders.** OII provides training for two broad purposes: (i) increasing awareness of the Bank’s integrity framework and the responsibilities of IDB Group employees, executing agencies, beneficiaries of IDB Group financing and private sector entities; and (ii) building internal and external capacity to manage integrity risk in IDB Group operations. OII’s training materials are informed by applicable policies and procedures, and incorporate case studies from investigations and prevention consultations.
- 2.48 **Development of New Tools.** OII works with operational units to develop tools to manage integrity risk and add value to specific projects (e.g., enhanced due diligence of corporate structures).
- 2.49 **Policy Development and related work.** As required, OII works on updating integrity-related policies and procedures and regularly contributes to other IDB Group policies to ensure that the integrity concerns are clearly articulated in operational policies.

### III. REFLECTIONS ON 2015 AND CHALLENGES AND OPPORTUNITIES FOR THE YEAR AHEAD

- 3.1 2015 was a year in which high-profile corruption scandals erupted in many countries around the world. Latin America and the Caribbean were not spared, but the scandals that did erupt in the region were often notable for the robust response of national authorities. These responses included successful investigations of senior public officials and large national and multinational corporations in connection with serious allegations of corruption. These enforcement actions by national authorities – and the social unrest that accompanied the scandals – thrust the topic of anti-corruption and transparency to the forefront of public discourse. That discourse increasingly connects the issues of corruption, impunity and corporate ethics with concerns about the legitimacy of institutions and sustainable development. It also illustrates the direct connection between the IDB Group’s commitment to highest ethical standards with its commitment to improving lives in the region.
- 3.2 These developments also reinforce the need for OII, the SO and the SNC to improve continuously their processes – to reconsider whether the IDB Group has adequate safeguards to identify and address integrity risks, and respond appropriately when such risks materialize. Considering these questions in light of the work of OII, the SO, and the SNC during the last few years, some themes have emerged:
- i. Further reflection is required on how OII is called upon to support the IDB Group not only with respect to investigating and combatting Prohibited Practices – the foundational concept of the Sanctions System – but also with respect to a much broader set of considerations that underlie assessments of integrity risk (e.g., the risk of negative tax impacts, conflicts of interest, waste or misappropriation of resources.)
  - ii. More work is required to design mechanisms for identifying and addressing integrity risks and to embed them in the processes for the design, execution, and supervision of the operations to which such risks relate.

- iii. Where safeguards are in place, they must be calibrated to focus efforts on the most significant risks or violations, to have the greatest impact at the lowest cost.
- 3.3 Within this context, the following paragraphs describe in more detail the achievements and shortcomings of OII, the SO and SNC in 2015, and highlight the challenges foreseen for the year ahead.

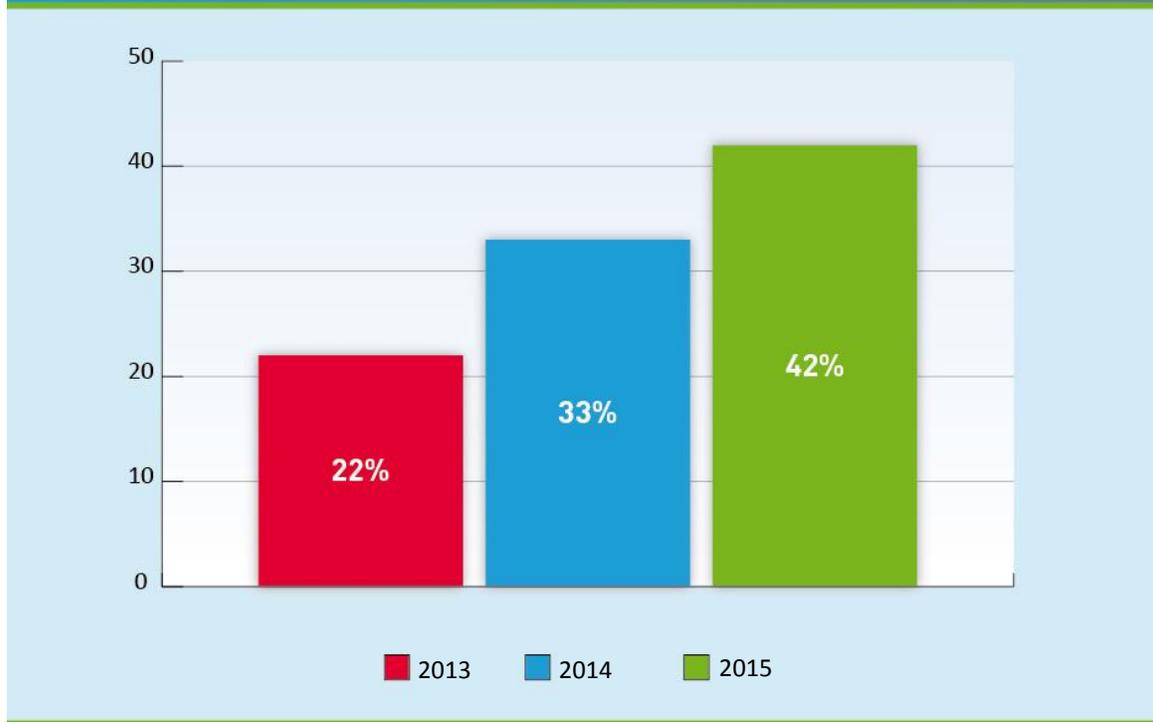
## A. Challenges and Opportunities of the Sanctions System

### OII Investigative Activities

- 3.4 **Demand Side of Corruption and High Impact Cases.** The IDB Group Sanctions System was conceived as and remains primarily a reactive mechanism, focused largely on the “supply side of corruption”. That is, it precludes companies or individuals that engage in fraud and corruption from repeating their wrongdoing in IDB Group financed activities. IDB Group’s ability to tackle the “demand side of corruption” has therefore been perceived as limited. If evidence of fraudulent or corrupt activities by public officials comes to the attention of OII, such matters may be referred to law enforcement authorities in the appropriate countries. However, the IDB Group will not impose sanctions on such public officials –though it may, and has sanctioned, IDB financed consultants that exercise public functions related to the execution of IDB financed projects.
- 3.5 Nevertheless, corruption and other Prohibited Practices in IDB Group-financed projects undermines the credibility of institutions involved in the execution of such projects and has a reputational impact on the Bank Group. This reality has led the IDB Group to seek avenues to tackle both sides of corruption.
- 3.6 Recognizing the importance of this issue, in 2015, and based on lessons learned from investigations completed in previous years, OII reassessed how it was allocating its resources towards investigations, to identify the types of investigative activities that could yield the most relevant integrity related lessons learned for operational colleagues.

- 3.7 As a result of this self-assessment, OII concluded that it must prioritize two types of investigations. The first type relates to those investigations arising in connection to allegations that involve executing agency officials, such as those that identify conflicts of interest or corruption. These were found to present the highest potential harm to development projects because executing agencies possess the widest spheres of influence over project execution. Inherently, executing agency officials are responsible for establishing procurement priorities and are entrusted to manage the selection and execution of contracts under any given project. With control over millions of dollars in development financing and direct control of procurement and implementation decisions, the risks presented by corrupt officials are more widespread and severe. Recognizing these risks, OII will prioritize such allegations, even if in some instances there is an absence of sanctionable parties, to identify vulnerabilities and communicate them to operational staff and improve the design and execution of development projects.
- 3.8 The second type relates to those investigations arising in connection with allegations that solely involve private actors but that can have an adverse impact in IDB Group financed projects, such as those that relate to artificial non-competitive offers resulting from collusive agreements or to delays in the delivery of goods and works as a result of fraudulent practices. Through the use of the Sanctions System, such private actors are restricted from conducting future business on Bank-financed projects, effectively reducing long term integrity risks posed by the respective sanctioned parties. In addition, the investigations will also help generate lessons learned about red flags that in the future may help with the early identification of similar Prohibited Practices.
- 3.9 On the basis of these conclusions, OII has been calibrating its triage, to incrementally shift its focus and resources towards these two types of allegations. The shift towards investigations implicating those in positions of influence over IDB-financed resources is illustrated in the Figure 3 below and in the subsequent investigative summaries.

FIGURE 3: SUBSTANTIATED INVESTIGATIONS INVOLVING THE “DEMAND SIDE OF CORRUPTION” PER YEAR<sup>6</sup>



3.10 This shift in focus does not imply that OII will not investigate less complex cases involving fraudulent practices. In many instances, such cases have proven to be relevant to executing agencies or IDB Group staff that raised the respective allegations to the attention of OII. Responding to such allegations in a timely manner enables executing agencies and operational colleagues to move forward with specific procurement related decisions and reinforces the IDB Group’s adherence to the highest ethical standards and its “zero tolerance” to fraud and corruption. OII will therefore investigate many of these cases, but in aggregate will seek to minimize the time and costs allocated to such investigations so, to the extent available, it can direct more resources to the types of investigations highlighted above.

<sup>6</sup> Some investigations resulted in charges against private actors only, excluding executing agency officials. Reasons for this include the inapplicability of sanctions proceedings to public officials or the lack of sufficient evidence to charge executing agency consultants, despite the existence of significant integrity concerns. In these cases, OII worked closely with operational colleagues and Bank counterparts to remedy integrity risks.

## Case Study 1

### Undisclosed Conflicts of Interest to Benefit Related Parties

#### **Allegation**

OII received an allegation stating that: a) the Financial Specialist of a Project Coordinating Unit (PCU) owned a consultancy firm (Firm A) that received contracts under the program to identify, design and execute sustainable business plans for beneficiaries; b) the Financial Specialist and Firm A requested bribes from other firms and program beneficiaries in order to expedite payments and “sell” business plans that would be used to obtain financing from the program; and c) Firm A submitted false documentation in its proposal.

#### **Investigation Findings**

OII substantiated the allegation that the Financial Specialist abused his position by favoring Firm A and that he and Firm A committed fraudulent practices when they failed to disclose the existence of a conflict of interest emanating from a family relationship between the Financial Specialist and the owners and managers of Firm A.

OII also substantiated that Firm A committed a fraudulent practice when it submitted false previous experience that the PCU failed to identify.

Furthermore, the investigation also disclosed that two other consultants assigned to the PCU had similar conflicts of interest. OII identified that the Project Coordinator and the Legal Advisor of the PCU and another consultancy firm (Firm B) also committed fraudulent practices when they failed to disclose their relationship.

OII did not find sufficient evidence to demonstrate that the Financial Specialist engaged in corrupt practices.

Significant to the integrity of the program, OII found that the three PCU members were involved in key aspects of the management of the program to include the award and supervision of contracts.

#### **Harm to the Program**

The PCU members’ actions caused damage to the Bank’s operations by affecting the credibility of the selection processes conducted under the program. Their actions also denied the borrower and the Bank of competitive processes from which the borrower could have obtained the most qualified consultancy firms from the available market.

The hiring of consultancy firms owned by related parties affected the credibility of the program. While OII was unable to substantiate allegations of corruption, the fact that the firms in question were hired to identify, design and execute sustainable business plans for beneficiaries, calls into question whether the firms could have designed and executed business plans that channeled funds to the PCU members.

## Case Study 2

### Abuse of Position to Further Personal Interests

#### **Allegation**

OII received an allegation stating that the Project Coordinator of a PCU had used a third party company to award himself contracts for small projects designed to have a rapid impact in the reduction of crime, violence and insecurity on small communities in a borrowing member country.

#### **Investigation Findings**

OII substantiated allegations that the Project Coordinator committed fraudulent practices when he created and submitted to the program fake offers in connection with the award of 12 contracts for supervision of works, execution of small works and the supply of goods.

In order to award the contracts, the Project Coordinator formed collusive agreements with third parties who assisted in orchestrating the supposed competitive processes and execution of services. Each of the contract awards resulted in direct financial benefits for the Project Coordinator and a company co-owned by him.

Additionally, the Project Coordinator created a false contract and invoices for a small works contract in order to charge the program 30% over the actual costs of services provided by an unwitting third party contractor. The 30% difference was then channeled to the company co-owned by the Project Coordinator, at a loss to the program.

#### **Harm to the Program**

The Project Coordinator's actions caused damage to the Bank's operations by affecting the credibility of the procurement processes conducted under the program. The Coordinator's actions denied the borrower and the Bank of competitive processes from which the borrower could have obtained the most qualified candidates and contractors from the available market at a competitive price.

The Project Coordinator's actions also resulted in the borrower and the Bank approving payments for supervision services and construction work not executed.

The Project Coordinator's actions further damaged the operations of the IDB Group when local media reported details of the prohibited practices committed by the Project Coordinator and questioned the integrity of the program.

3.11 **The year ahead.** In 2016, OII will continue to conduct its investigations as efficiently as possible, emphasizing the following:

- i. continued use of its complaint and triage system to prioritize investigations that provide insight into wrongdoing committed by those entrusted with the execution of IDB Group financed activities and those that relate to complex schemes that negatively impact development projects; and
- ii. the use of negotiated resolutions when the investigated parties are willing to provide credible and actionable information that help identify systemic integrity risks<sup>7</sup>.

3.12 In terms of challenges, OII foresees the following:

- i. given the current environment of budgetary constraints coupled with a recent increase in more complex investigations, it will be difficult to maintain the efficiencies gained in the different phases of the investigation (described in Section IV below);
- ii. for the same reason, OII anticipates seeing a reduction in substantiated cases; and
- iii. with regard to less complex cases, OII will increasingly advance investigations through the use of investigative methods that can be accomplished without the need of field missions.

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<sup>7</sup> The Sanctions Procedures were amended in June 9, 2015 and authorize OII to engage in negotiated resolution in such cases where the investigated parties agree to provide evidence that facilitates the IDB Group's understanding of systemic integrity risks affecting IDB Group-financed activities.

### SO and SNC Adjudicative Activities

- 3.13 The IDB Group's Sanctions System is at the forefront among MDBs. Amendments introduced to the Sanctions Procedures in 2015 enhanced the system even further by providing respondents with the opportunity to contest the charges brought forward against them, prior to the decision by the SO.
- 3.14 The changes are well justified from a due process perspective and should not increase the cost of the Sanctions System. They are expected to allow for a more robust first tier review, potentially reducing the number of appeals to the SNC.
- 3.15 **The year ahead.** The new system will require adaptation from both the SO and the SNC. The SO will be keeping pace with an additional number of procedural steps and a more complex decision making scenario, where multiple submissions will have to be reviewed.
- 3.16 The SNC will have to adapt to possible changes in appellate litigation, as the arguments submitted during the appeal process will address the submissions by both parties and the determinations made by the SO during the first instance review. Aware of the Bank's budgetary constraints, both units will continue to strive to maintain current levels of efficiency.

## B. Challenges and Opportunities of the Prevention Function

### OII Prevention Activities related to Sovereign Guaranteed Operations

- 3.17 **Strengthening Integrity Safeguards.** Currently, the most relevant integrity safeguard for SGO is the Sanctions System. This system provides the Bank with an effective mechanism to address allegations of Prohibited Practices and to impose sanctions on those individuals or companies that are found to have engaged in any such practice.

- 3.18 From a preventive perspective, this safeguard precludes sanctioned parties from further committing Prohibited Practices and may also help dissuade others from engaging in such practices. However, the Sanctions System does not, by itself: (i) make it more difficult for other parties to be in a position to commit a Prohibited Practice, or (ii) help detect other violations.
- 3.19 To achieve these important preventive objectives, in recent years, OII has been providing advisory services to manage integrity risk in relation to the design and execution of SGO. While some of these attempts have led to successful experiences, these continue to be conducted in an ad-hoc manner. In assessing how to surpass this shortcoming, OII concluded that to mainstream integrity risk management, it is necessary to embed integrity risk management tools in the risk management framework of the Institution and increase efforts to raise awareness and promote a risk management culture.
- 3.20 Consequently, during 2015, OII participated in a working group responsible for designing a tool to assess the institutional capacity of executing agencies (ACI for its Spanish acronym). Specifically, the ACI will enable the Bank to gather information, identify, assess and mitigate risks associated with the institutional capacity of executing agencies. As part of this endeavor, OII provided input on indicators that can assist in identifying weaknesses and vulnerabilities that could increase the integrity risk of a project, such as the existence of prior OII investigations in projects previously executed by the same agency or the absence of systems to manage conflicts of interests of those responsible for the execution of a project.
- 3.21 **Responsiveness.** By their nature, investigations and sanctions are lengthy processes not designed to provide immediate resolutions for operational staff and executing agencies faced with procurement decisions. Investigations are fact gathering exercises. They require desk reviews, field missions to interview witnesses and to conduct inspections and audits, as well as concrete actions to confront investigated parties with the evidence gathered and provide them with an opportunity to provide explanations. The sanction procedure also incorporates steps to afford respondents due process, including an opportunity to appeal the decision of the SO in front of the SNC. As such, several months or even years may elapse from the time an allegation is received by OII

until the time a sanction is imposed. This may lead to a perception that OII does not provide timely responses to integrity concerns that operational staff may bring forward during the execution of operations.

- 3.22 To effectively support the Bank's operational work, OII is assessing allegations with a twofold approach. To begin with, OII considers whether an investigation is warranted and proceeds accordingly. Simultaneously, OII considers whether it can provide expert advice to operations through a consultation process handled by the prevention staff. As illustrated in the subsequent summaries, this approach has proven to be effective in reducing integrity risks.

### Case Study No. 3

#### Cost overruns as a sign of potential fraud

##### **Allegation**

A Project Team Leader contacted OII because significant cost overruns in a high-profile project she supervised led her to suspect that a contractor and, potentially, the executing agency were engaging in fraudulent practices. The issue was highly sensitive because the delay in the project was at the center of public attention and the Executing Agency insisted on a response to its no objection request for a proposed amendment that would recognize the additional costs.

##### **OII's Response**

OII analyzed the information and decided to open a preliminary inquiry. Simultaneously, it provided advice to the Team Leader on steps that could be taken immediately to assess and mitigate the risks. The recommendations included: (i) the hiring of an independent consultant to review the works completed but not yet approved for payment by the Bank, and (ii) conducting a market analysis to review the rationality of amendments already requested by the contractor.

##### **Results**

The recommendations were implemented and helped the Project Team determine that some of the increased costs did not have a technical justification and that the prices for some items included in the amendment were well above market prices. Upon further consultation with OII, the Team Leader used the results to declare some expenses ineligible. Meanwhile, the investigation remains under review.

## Case Study No. 4

### Corruption allegations in procurement processes at a PCU

#### **Allegation**

A Project Team Leader reported to OII information he had received from a third party complainant, who believed a member of a PCU was abusing his position by manipulating several procurement processes for his own benefit. The Project Team Leader inquired whether OII would open an investigation and, if so, whether the investigation would be a reason to deny the Bank's "no objection" to pending contract awards.

#### **OII's response**

As a first step, OII informed the Team Leader that, as standard practice, the existence of an investigation based on allegations of a Prohibited Practice would not automatically lead to the suspension of a Project and could not be used as a justification to deny the no objection of procurement processes.

As a next step, and in order to assist the Team Leader and the Bank in assessing the risks, OII offered to participate in a supervision mission, where it would conduct an Integrity Risk Review (IRR) of the Project. Without addressing the specific allegations, the IRR identified several integrity related concerns, to include: (i) weaknesses in the internal control environment at the PCU, including the lack of segregation of duties and failures in processes established to protect the integrity and confidentiality of bids; (ii) weaknesses in the documentation of procurement and financial processes; and (iii) lack of mechanisms to identify assets financed by the Project and their location.

#### **Results**

Based on the IRR findings and other information gathered by the Project Team, OII and the Project Team concluded that the integrity risk of the project was high and the project execution mechanism needed to be reviewed to incorporate mitigation measures. Issues were raised with the relevant government authorities and changes to the execution mechanism are being discussed.

## Case Study No. 5

### Fraudulent bid in connection with a high profile procurement process

#### Allegation

A Team Leader and Procurement Specialist reported to OII that they had identified irregularities in an offer and related evaluation report for a multi-million dollar road contract, which led them to suspect that the recommended winning bidder had engaged in prohibited practices.

#### OII's Response

Within a matter of weeks, OII's intake team analyzed the information and concluded that the winning bidder's offer raised serious integrity concerns regarding the true identity, capability and resources of the recommended winning bidder. The red flags included: (i) inconsistencies in regard to previous experience; (ii) no documentation to support the claim that the bidder was a subsidiary of a large corporation in the region; (iii) inconsistencies in the letters of credit that called into question their authenticity; (iv) indications of a non-disclosed intention to subcontract the works; and (v) financial statements that put in question the bidder's financial capacity to manage the contract. If allowed to move forward, the issues identified could have had significant implications for the execution of the works.

#### Results

OII decided to open a full investigation. While the mere existence of an investigation did not exclude the company from the procurement process, the prevention team shared the initial findings with the Project Team, which was then able to flag said inconsistencies to the executing agency. As a result of the inconsistencies and discussions between the Project Team and the executing agency, the Bank denied the no objection to award the contract and the process was retendered with the goal of finding a qualified bidder.

- 3.23 **Lessons Learned from Investigations.** One of the guiding principles of the Updated Institutional Strategy is efficiency and effectiveness. This principle calls for the incorporation of lessons from past experiences into new operations. In line with this principle, during 2015, OII continued to prepare and share with Management and operational staff reports of substantiated investigations with findings and recommendations. The purpose of these reports is to raise awareness of vulnerabilities that may affect Bank financed Projects and to propose measures that may assist in mitigating risks or in quickly identifying problems when they occur. For every report of investigation, OII discusses operational integrity related recommendations with the

relevant units. Together, these units and OII have identified the need to have a more systematic approach to address the recommendations.

3.24 **The Year Ahead.** In 2016, the OII preventive team will continue to:

- i. closely coordinate with the investigative team to give timely and actionable operational responses to allegations, while allowing investigations to follow their course;
- ii. work with the investigative team to extract lessons from investigations and provide feedback and recommendations to operations; and
- iii. make contributions to strengthen risk management tools available for SGO so that these can be used as an avenue to identify, assess and mitigate integrity risk.

3.25 The biggest challenge continues to be the need to mainstream integrity risk management in SGO. To address this challenge, OII will:

- i. continue to advance its training activities to increase awareness of investigative results and integrity risks in IDB Group-financed projects;
- ii. explore alternative methods for communicating investigative results; and
- iii. follow the implementation of the ACI to ensure that the integrity aspects are being considered. OII will also provide advice to project teams as issues arise.

#### **OII Prevention Activities related to Non-Sovereign Guaranteed Operations**

3.26 **Supporting the Merge-Out.** In connection with the merge-out of all IDB Group NSG operations into the IIC, OII provided support to ensure that IIC operational policies, manuals and procedures require consideration of integrity issues and appropriately assign responsibility for such consideration to investment officers, IIC Management, and OII, which will continue to provide advice. To establish a solid framework for such advice, OII also supported the development of a service level agreement (SLA) with the IIC, including by deploying efforts to properly cost the services to be provided by OII. The SLA will be completed in 2016.

- 3.27 **Offshore Financial Centers.** During the course of 2015, at the request of the President of the IDB and Chairman of the Board of Executive Directors of the IIC, OII engaged in a strategic dialogue with the Executive Directors of the IDB and the IIC regarding the risks arising from complex corporate tax structuring in general and the use of jurisdictions that do not comply with the standards set forth by the Global Forum on Tax Transparency and the Financial Action Task Force (defined in IDB Group guidelines as OFCs) in NSG operations. IDB Group concerns arise from the negative effects that tax evasion and abusive tax avoidance have on sustainable development. The strategic dialogue included a technical briefing by OII, presentations by national authorities with roles in international organizations, including the United Nations (UN) and OECD, and a workshop with the participation of comparator institutions and academic and compliance experts. The dialogue is expected to result in policy reforms that will be adopted by the IIC in 2016. These reforms are geared to strengthen IIC's response to the use of OFCs and to enhance safeguards that explicitly address the structural integrity of IIC counterparties, so as to ensure that financed projects are not designed to evade or abusively avoid taxes.
- 3.28 In parallel with the strategic dialogue, OII developed an enhanced due diligence practice for identifying and mitigating tax-related risks arising from the use of cross-border structures. This new practice is limited in scope, and has been adopted as an informal pilot pending the outcome of the strategic dialogue. This enhanced due diligence has been applied to cross-border structures that use OFCs, and to structures that do not use OFCs but that present other risk indicators (e.g. very complex structures, use of shell companies or use of low or no tax jurisdictions). This expanded due diligence requires a much more detailed assessment than had been conducted previously and its implementation has resulted in the identification and mitigation of risks related to practices that could affect the taxes paid by IDB Group counterparties in project host countries.

## Case Study No. 6

### Changes in Related Party Transaction to Mitigate Risk of Base Erosion

OII was consulted with regard to a proposed corporate loan to Company 1, located in Country A (an IDB Borrowing Member Country). Company 1 sold certain goods in Country A. A significant portion of those goods were imported, and those import purchases were routed through Company 2 – a corporation with the same shareholders as Company 1 and established in Country B, a jurisdiction that imposed no tax on foreign source income. Company 2 (a shell company with no offices or employees) would purchase the imported goods and resell them to Company 1.

OII advised the project team that these related party transactions could be used by the shareholders of Company 1 to obtain a tax windfall that would reduce tax revenues in Country A. This could be done if Company 2 sold the goods at inflated prices, which would reduce Company 1 profits and taxes, while increasing Company 2's untaxed profits.

OII recommended including contractual provisions that would ensure that these related-party sales were made at an arms-length basis. The risk was resolved when – after discussing the issue – the client volunteered to make its import purchases directly from Company 1. Such change will likely represent an increase in tax collected in Country A.

- 3.29 **Expansion of Due Diligence Reviews.** The implementation of the enhanced due diligence to address tax issues contributed to a broader trend in NSG consultations toward more expansive due diligence reviews. Similar expansions have occurred in connection with anti-money laundering/counter financing of terrorism risks, where detailed reviews are more common, often informed by the Financial Action Task Force reviews of the jurisdiction where IDB Group financed activities take place, as well as mitigation of risks through contractual language drafted by IDB Group attorneys and OII. This qualitative expansion – which has improved risk identification but which requires more time and expertise to complete – has accompanied a quantitative increase in the number of consultations handled by OII (see figure 16 in section IV).
- 3.30 The scope and quantity of IDD related consultations has increased further as a result of demand for such advice from nonoperational units of the IDB Group, including ORP, the Finance Department and Corporate Procurement. The expanding scope and quantity of integrity consultations is also resource-intensive and a judicious assessment of its

relevance is required to avoid undue costs. The demand for such advice, however, is a sign of an institutional culture in which many units feel responsible for addressing integrity issues, and in which the substance of those risks is carefully considered.

3.31 **The year ahead.** In 2016, OII will focus its prevention activities related to IIC operations in the following areas:

- i. reinforcing the IIC's constructive culture regarding integrity risks during a period of institutional change;
- ii. finalizing the negotiation of the SLA for the provision of OII preventive and investigative services to the IIC; and
- iii. preparing with IIC Management a revised framework (policies and guidelines) that addresses the issues of integrity due diligence at the project and corporate structure levels.

3.32 In terms of challenges, OII foresees the following:

- i. a risk of overextension in an environment of budget constraints, given the increasing scope and number of integrity due diligence consultations and the likely need to assist in the preparation of guidelines applicable to different business lines; and
- ii. the need to develop new approaches to address changes in the operational scope of the reformed IIC (e.g., the integrity risks presented by equity operations).

## **IV. 2015 OUTPUTS**

- 4.1. This section presents numerical data and a brief description of the work that OII, the SO and the SNC carried out during 2015.

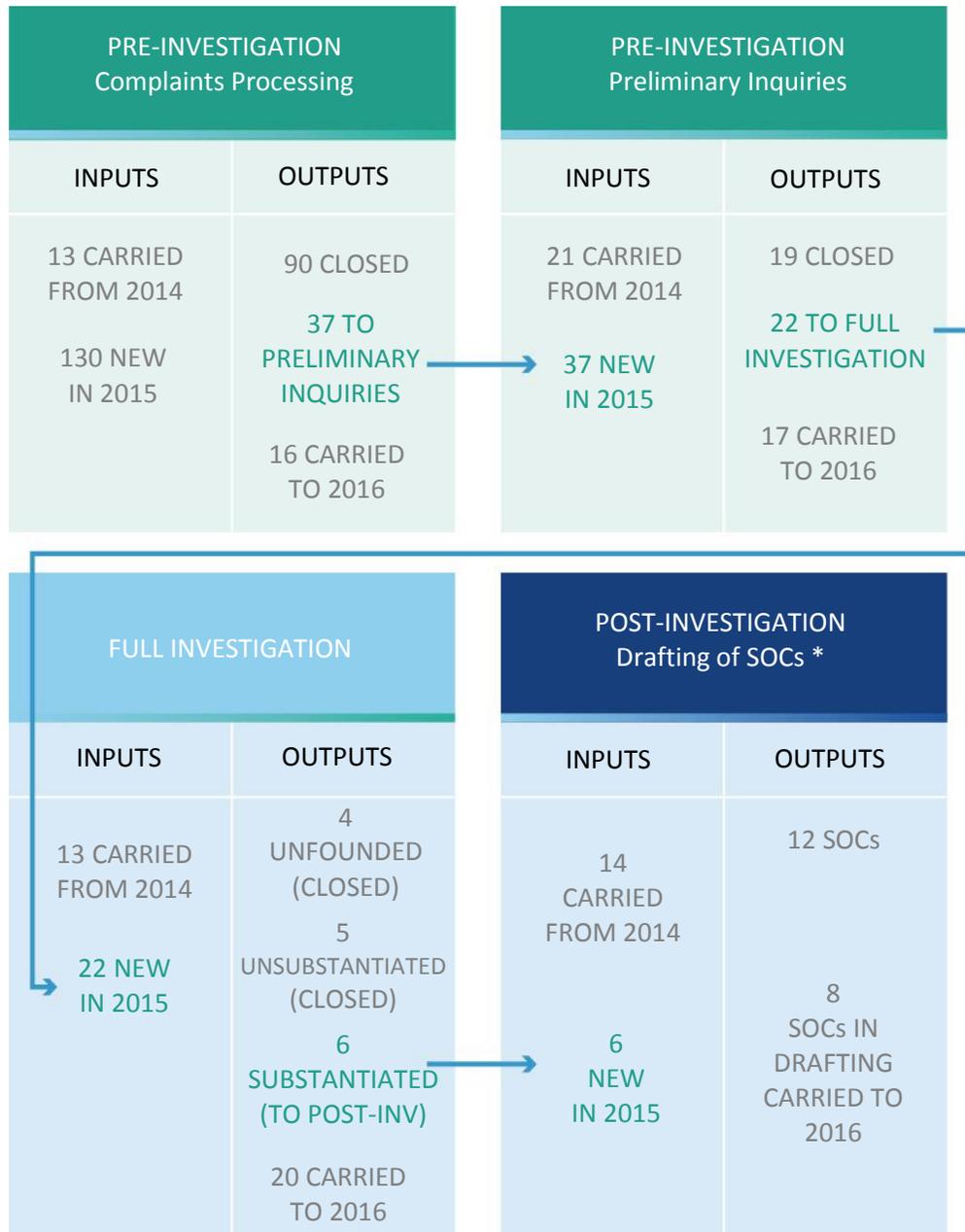
### **A. Sanctions System Outputs**

- 4.2. During 2015, as summarized below, OII, the SO and SNC carried out various activities to advance the objectives of the Sanctions System.

#### **OII Investigative Outputs**

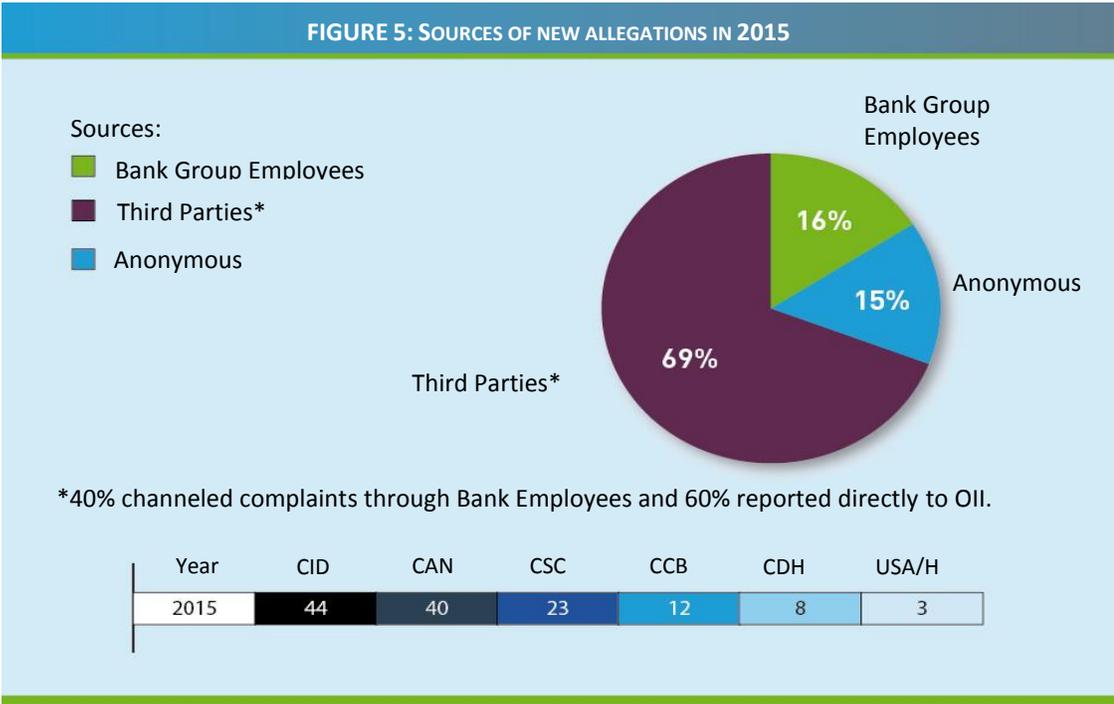
- 4.3. As described below, in 2015 OII: (i) improved the efficiency with which it manages its caseload, (ii) reduced resources spent to process less complex fraud investigations, and (iii) demonstrated an increasing focus on uncovering prohibited practices and related integrity risks posed by executing agencies officials.

FIGURE 4: OII's INVESTIGATIVE CASELOAD FOR 2015



\* The input and output columns for post-investigation/drafting SOC may not have the same totals, because a substantiated investigation can result in multiple SOC's, and multiple substantiated investigations may be merged into a single SOC.

4.4. **Pre-Investigations – complaints processing:** In 2015, OII received 130 new complaints – an average of more than two per week. As shown in Figure 5, these complaints arose from all of the regions of the IDB. As in previous years, these complaints originated overwhelmingly from third parties, with the majority of such third parties channelling their complaints through Bank employees. OII considers this to be a direct result of the relationships that Bank employees in Country Offices have with executing agencies and local communities. Anonymous complaints increased by 5%, but several complainants who initially reported anonymously later agreed to reveal their identity and further cooperate with the investigation. This evidences that through its intake process, OII was able to gain the trust of the complainants by ensuring confidentiality and responding to their concerns.



4.5. Out of the 143 complaints (130 + 13 carried over from 2014) addressed by OII, 90 were closed. Of these, 62 were closed because the complaint did not involve a Prohibited Practice, 15 because the information was insufficient or not credible, and 13 because the complaint did not relate to a Bank-financed activity.

4.6. Data from 2015 suggests efficiency gains arising from the pre-investigation phase, which is fulfilling its purpose of filtering out complaints that fall outside OII’s mandate or

otherwise do not merit full investigations. In fact, the percentage of complaints that were not converted into preliminary inquiries (63%) is consistent with the percentages observed since the intake unit was introduced (69% in 2014 and 61% in 2013), and an improvement from the 25% figure not converted before the system was in place (2011 and 2012). This filtering enables investigators to focus their efforts on investigations that are more likely to be substantiated and/or where prohibited practices have a more damaging impact on the respective projects (see Section III above).

- 4.7. **Full Investigations.** Data from 2015 also shows some efficiency gains in the full investigation phase. On average, full investigations were completed in less than nine months and full investigations remaining open and carried over into 2016 were open for an average time of six months. These figures are explained, in part, by the low number of carry over cases at the start of 2015, which allowed investigators to dedicate resources to new investigations. Additionally, OII increasingly processed less complex fraud investigations in a timely manner through the use of expedited letters to confront Respondents with findings and request explanations (“show cause letters”) in place of subject interviews that would normally take place during investigative missions.
- 4.8. These efficiencies will likely not be sustained next year due to budgetary constraints and an increase in complex investigations at the pre and full investigation phases. These cases include allegations of corruption and conflicts of interest by executing agency officials and collusion by bidders. In 2015, complex investigations accounted for 33% of completed full investigations. At the start of 2016, 40% of all full investigations carried over from 2015 are complex. OII expects to see the number of complex full investigations increase based on the number of complex cases carried over in the pre-investigation phase. The increased emphasis on complex investigations is expected to create a greater demand on OII’s resources and likely impact process times in the year ahead.
- 4.9. **Post-Investigations.** As shown in Figure 6, in 2015 OII submitted to the SO 12 SOC’s, a number consistent with submissions in 2014 and 2013.<sup>8</sup> OII replied to seven appeals. No hearings were held by the SNC.

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<sup>8</sup> This does not reflect the resubmission of a case that OII previously submitted in 2014.

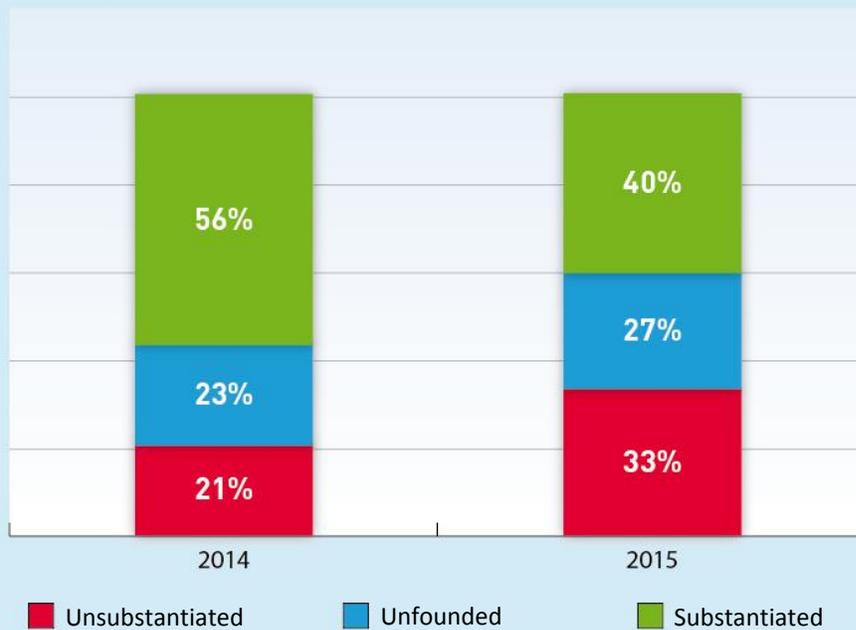
FIGURE 6: POST-INVESTIGATION ACTIVITIES		
Post-Investigation Activities		
	2014	2015
SOCs submitted to SO	11	12
OII Replies	8	7
Hearings	6	0

4.10. **Response time.** In 2015, OII continued to improve on its efficiency as measured by time spent on investigations. The median time spent during the Pre-Investigation and Full Investigation phases in 2015 is listed below.

FIGURE 7: TIME SPENT ON INVESTIGATIONS AT EACH INVESTIGATION PHASE		
Pre-Investigation Phase		
Complaints Processing	2014	2015
Closed	60 days	36 days
Converted to preliminary inquiry	121 days	41 days
Preliminary Inquiries		
Closed	298 days	193 days
Converted to full investigation	216 days	125 days
Full Investigations Phase		
Unfounded and unsubstantiated	234 days	265 days
Substantiated	290 days	252 days

4.11. The time spent in full investigations was well below the 290-day target that was included as one of OII's corporate performance indicators in the context of the Bank's Results Based Budgeting metrics. It is worth noting that many variables extrinsic to investigations, such as availability of documentation and witnesses, affect the duration of investigations and that, overall, OII's performance in this area is generally consistent with its comparators.

FIGURE 8: FULL INVESTIGATION OUTCOMES 2014-2015



- 4.12. **Substantiated cases.** While there was a significant drop in substantiated cases as compared to 2014, the rate of substantiation remains significantly higher than in 2013 (25%). In addition, 67% of investigations not substantiated were considered complex, implicated executing agency officials in prohibited practices and yielded important lessons learned to inform operational units and to advise on integrity risk management. When processing these complaints, OII assessed that there were credible indicators of a prohibited practice and that a response to allegations potentially affecting the integrity of entire projects warranted investigation, even when the probability of access to critical evidence was assessed as low.
- 4.13. Of the substantiated cases, five involved fraudulent practices, and one involved collusive practices. Importantly, one fraud investigation uncovered conflicts of interest among three officials in an executing agency where the officials were found to have favored companies owned by related parties and failed to disclose said conflicts of interest.

## SO Outputs

- 4.14. The SO's 2015 activities relate to cases processed under the previous and the current Sanctions Procedures. The following are the SO's results during 2015.
- 4.15. **Statements of Charges (SOC).** During 2015, the SO received 13 SOC's and one Request for Temporary Suspension (RTS) from OII.<sup>9</sup> These SOC's were added to 6 SOC's<sup>10</sup> that were the carryover from 2014, totaling 19 SOC's and one RTS for review during the year. During 2014 the SO received 12 SOC's, which were also added to the carryover of 6 SOC's from 2013.
- 4.16. **Determinations.** During 2015, the SO issued 79 Determinations; 54 under the previous Sanctions Procedures and 25 under the current Sanctions Procedures.<sup>11</sup> One of these determinations was of insufficient evidence and one related to a Temporary Suspension. During 2014, the SO issued 27 Determinations, representing an increase of 193 percent. This upsurge is due to an increase in the number of respondents per case, mostly on collusion related cases, which are more complex.

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<sup>9</sup> This number includes one re-submission by OII.

<sup>10</sup> These SOC's were submitted under the previous Sanctions Procedures and were denominated Notices of Administrative Action (NAAs). The term SOC is used in this report for ease of reading.

<sup>11</sup> One SOC can result in multiple determinations as it may relate to multiple Respondents and the SO has to assess the evidence against each Respondent. Each Respondent has to be sanctioned individually, according to the merits of the case.

FIGURE 9: NUMBER OF SO DETERMINATIONS

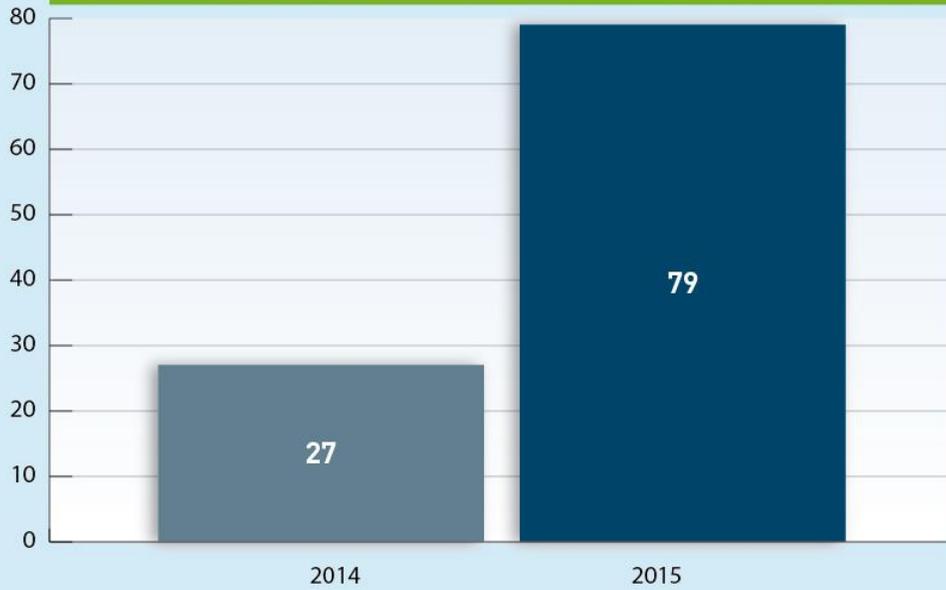


FIGURE 10: SO RECOMMENDED SANCTIONS

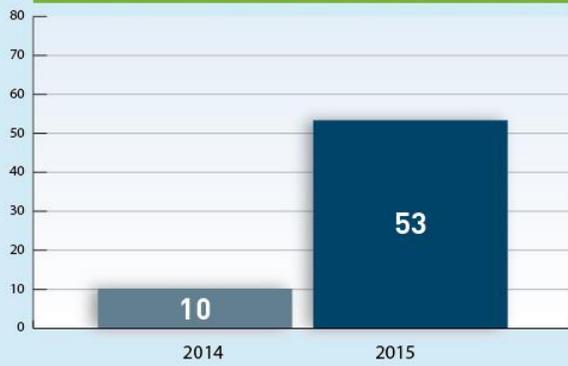


FIGURE 11: SO DELIVERED NOTICES



## NOTIFICATION PROCESS

When the SO issues a Notice, he notifies the Respondent regarding the initiation of the Sanctions Proceedings. After this notification, the respondent has 60 calendar days to submit a Response to the SO's Notice. If the Respondent fails to submit a Response within this period, the Respondent is considered to have admitted to the allegations set forth in the SOC and to have waived the opportunity to appeal the SO's Determination before the SNC.

According to the Sanctions Procedures, this Notice is to be made using certified mail or other courier services that can provide evidence of delivery. Frequently, however, the mail courier or carrier services are unable to deliver such Notice to Respondents due to varying degrees of postal service development in member countries.

In these cases, the SO's Office attempts to contact Respondents through various means, including phone, e-mail or paper correspondence to confirm receipt. In some cases the SO's Office has collaborated with the Bank's Representation in the country where the Respondent resides, in order to contact Respondents. Each of these notification efforts, referred to as "Notice Transactions", is recorded and documented.

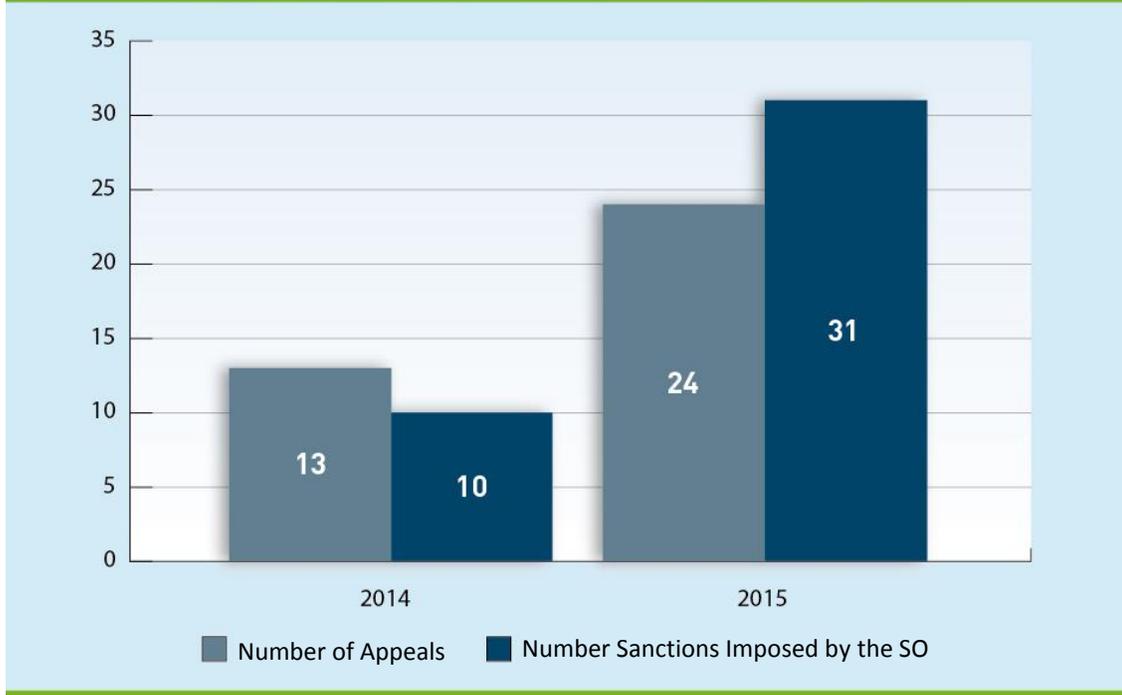
If the SO's Office cannot deliver a Notice to the address obtained by OII during the investigation, and its efforts to contact Respondents are not successful, the SO's Office applies the Protocol for the Delivery of Notices in Relation to the Inter-American Development Bank Group's Sanctions Procedures (Protocol). According to the Protocol, the SO is to issue a sealed letter to the Respondent informing that the Bank Group has initiated an administrative sanctions proceeding against the Respondent. The SO's sealed letter further indicates that if the Respondent does not contact the SO, the Bank Group will post a public notice (Constructive Notice) on the Bank Group's website for a period of no less than 30 calendar days. The Notice is considered delivered after the 30-day period has elapsed. The Protocol seeks to ensure that all Respondents effectively receive the Notices and have an opportunity to submit a Response.

- 4.17. **Notification Process.** The SO has the responsibility to notify Respondents of the commencing of administrative sanctions proceedings (Notice) by using certified mail or courier services. During 2015, the SO notified a total of 64 Respondents whereas, in 2014 the SO notified 23 Respondents. If the SO cannot deliver a Notice through these methods, the Respondent is notified through Constructive Notice. During 2015, the SO

published 20 Constructive Notices in the Banks Group's webpage, five of which led the Respondents to contact the SO's Office, whereas in 2014 the number of published Constructive Notices was six.

- 4.18. **Sanctions Recommended.** During 2015, the SO recommended 53 sanctions under the previous Sanctions Procedures. All recommended sanctions were debarments related to fraud, collusion and corruption. The recommended debarments ranged between one year and permanent debarment. The average recommended debarment, excluding permanent debarments, was six years.
- 4.19. **Sanctions Imposed.** Under the previous Sanctions Procedures, the SO's Determinations with recommended sanctions become final if a Respondent does not submit a Response to the Notice within 60 days. During 2015, 55 Respondents had the opportunity to appeal the SO's Determinations, an opportunity that was only exercised by 24 Respondents. The sanctions recommended against the 31 remaining Respondents became effective. Twenty nine of the 31 sanctions met the criteria for Cross-Debarment. Finally, during 2015 the SO did not impose sanctions under the current Sanctions Procedures, as all cases are still ongoing.
- 4.20. **Response Time.** During 2015, the SO issued his Determinations in 180 days, on average. In 2014, the SO issued his determination in 85 days, on average. However, while in 2014 the SO issued 27 Determinations, this number almost tripled to 79 Determinations in 2015. In addition, the complexity of cases required enhanced examination, as 32 Determinations were related to collusion. The SO issued Determinations in English, French, and Spanish in accordance with the Respondent's native language.

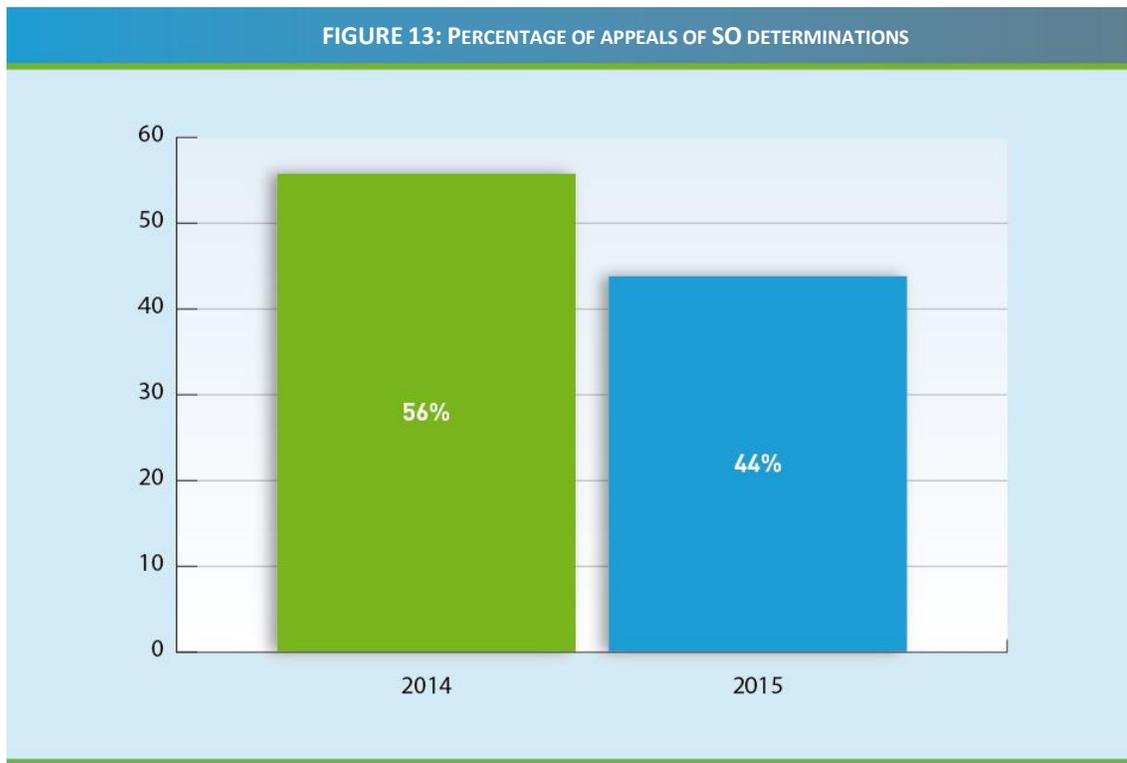
FIGURE 12: SO DETERMINATIONS



### Outputs of the SNC and its Executive Secretariat

- 4.21. **Transitioning SNC Membership.** In 2015, the President of the IDB appointed two new external members and reappointed Mr. Andrés Rigo, current SNC Chairperson, and Ms. Josefa Sicard-Mirabal for a second term as external members.
- 4.22. **Key Milestones.** The Executive Secretariat processed Appeals in French, English, and Spanish. The SNC imposed a variety of sanctions, including conditional non-debarments, which require Respondents to set compliance programs and to reimburse mismanaged funds. The cases reviewed by the SNC were also generally more complex and included more documentation than in prior years.
- 4.23. **Appeals Processed.** The Executive Secretariat processed 30 Appeals from Respondents in 2015; all of them related to fraud. Six of these were filed in 2014, while the remaining 24 were presented in 2015. The SNC decided 16 of these cases in 2015.

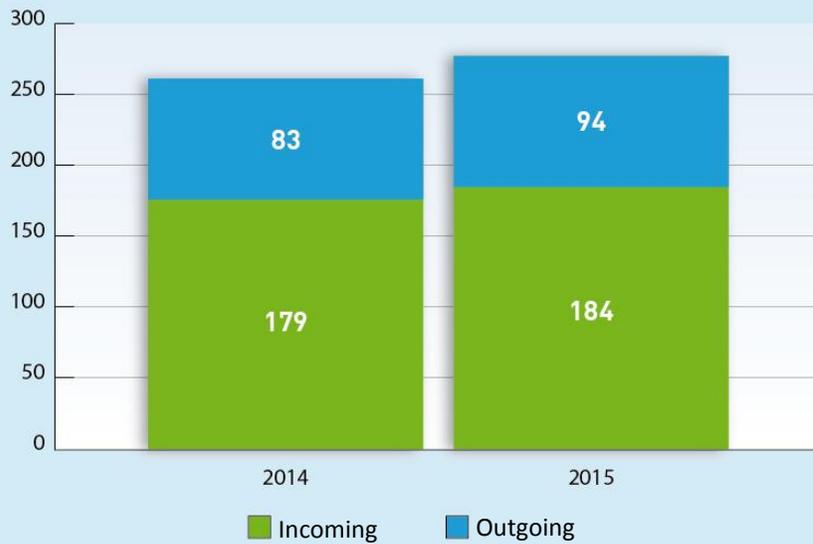
The remaining 14 cases had party submissions pending at the end of 2015, and will mature in 2016.<sup>12</sup>



4.24. **SNC Executive Secretariat’s Outputs.** During 2015, the Executive Secretariat received approximately 184 submissions, not including consultations from external and internal stakeholders, such as the Legal Department and other MDBs, as well as ad hoc submissions by parties. In addition, the Executive Secretariat drafted 94 communications and referred them to OII and Respondents.

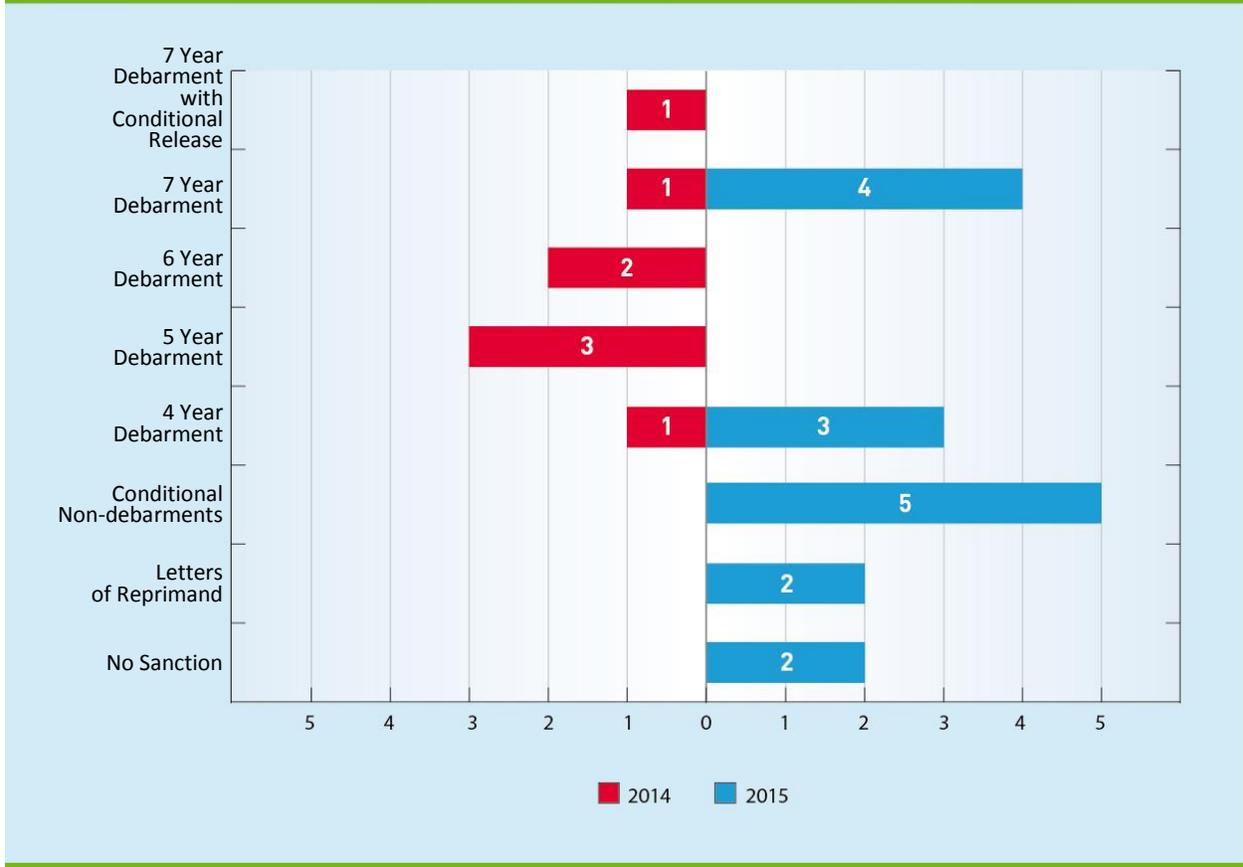
<sup>12</sup> An appeal reaches maturity when all submissions have been presented by the parties and the case is ready to be decided by the SNC.

FIGURE 14: SUBMISSIONS HANDLED BY THE EXECUTIVE SECRETARIAT



- 4.25. **Sanctions.** The SNC issued Decisions on 16 Appeals, imposing a sanction in 14 of them. The nature of the sanctions imposed is summarized in Figure 15 below. Seven of the sanctions issued met the requirements for recognition under the Cross-Debarment Agreement.
- 4.26. As the administrator of the list of Sanctioned Firms and Individuals, the Executive Secretariat published the 38 sanctions (31 issued by the SO and seven issued by the SNC) imposed by the Sanctions System, and 92 sanctions that were imposed by other MDBs and recognized under the Cross-Debarment Agreement.

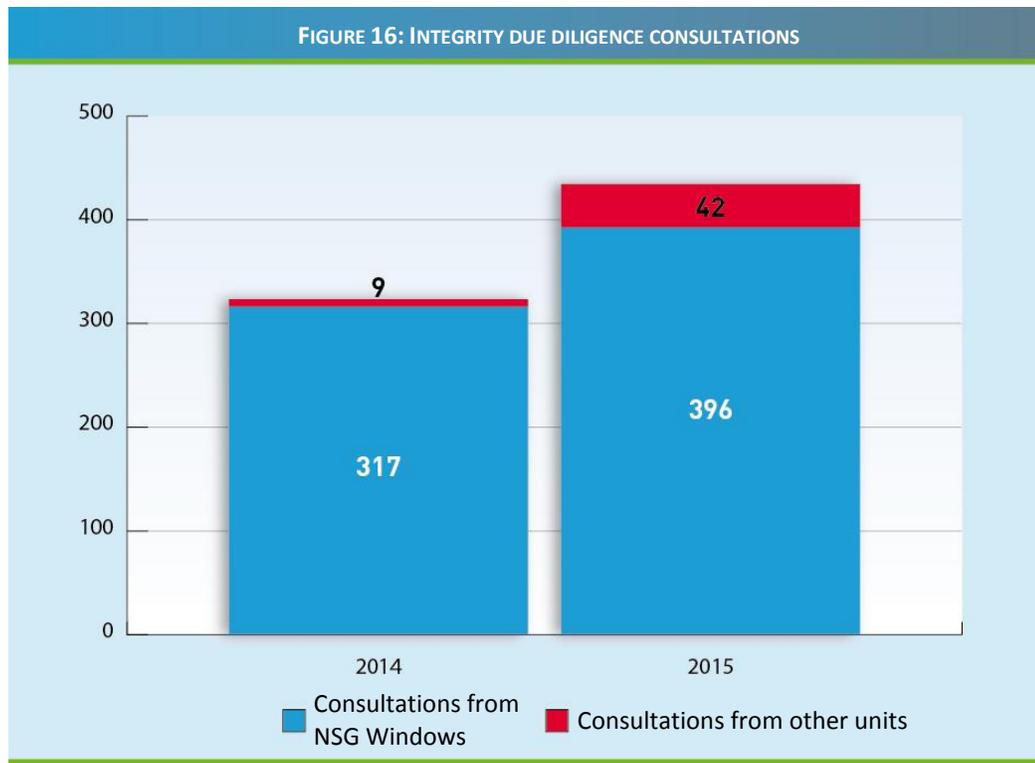
FIGURE 15: SANCTIONS IMPOSED BY THE SNC



**B. Prevention Function Outputs**

4.27. OII devotes a significant part of its resources to pursue preventive activities. These relate mostly to the IDB Group financed operations, but increasingly have also covered corporate activities. This subsection summarizes the outputs of the prevention function, by the different lines of activities.

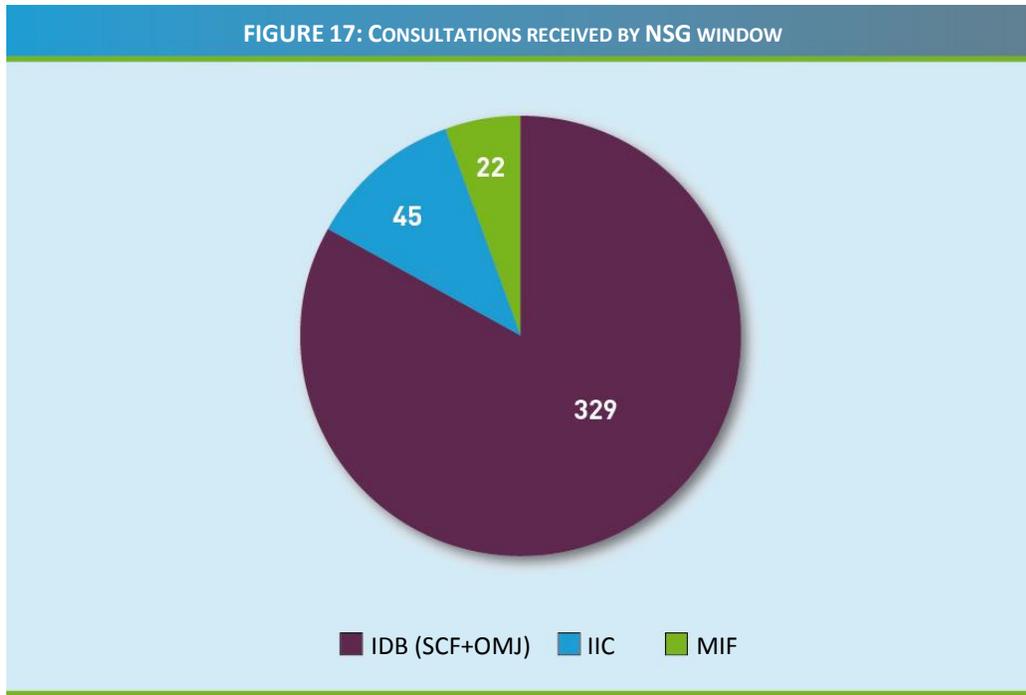
4.28. **Advice on NSG Operations.** OII’s preventive work in support of NSG operations is generally performed in response to consultations received from NSG Windows. These consultations relate to operations being prepared as well as operations already in portfolio. As shown in Figure 16, the overall number of NSG consultations in 2015 increased significantly compared to prior years.



4.29. **Consultations unrelated to SGO or NSG Operations.** For several years, OII has responded to consultations unrelated to SGO or NSG operations, when different units at the Bank request advice regarding the identification, assessment and mitigation of risks identified through integrity due diligence. In 2015, the number of such consultations was substantial, as shown in Figure 16 above. A significant number (28) of those consultations came from ORP, in connection with the potential for reputational impact arising from partnerships with private sector entities. Corporate Procurement and the Finance Department also consulted with OII, as did the MIF in relation to technical cooperation operations. Consultations from these units seem likely to continue to increase in future years.

4.30. **Consultations Received by NSG Window.** Of the total 438 consultations, 396 were from NSG windows. Figure 17 shows the number of consultations received from the different NSG Windows. The predominant source of consultations came from the IDB – i.e., SCF and OMJ. This is largely a result of OII’s participation in the approval process for all SCF and OMJ operations. In contrast, OII’s interaction with IIC and MIF has been to respond to consultations in connections with specific situations identified by the

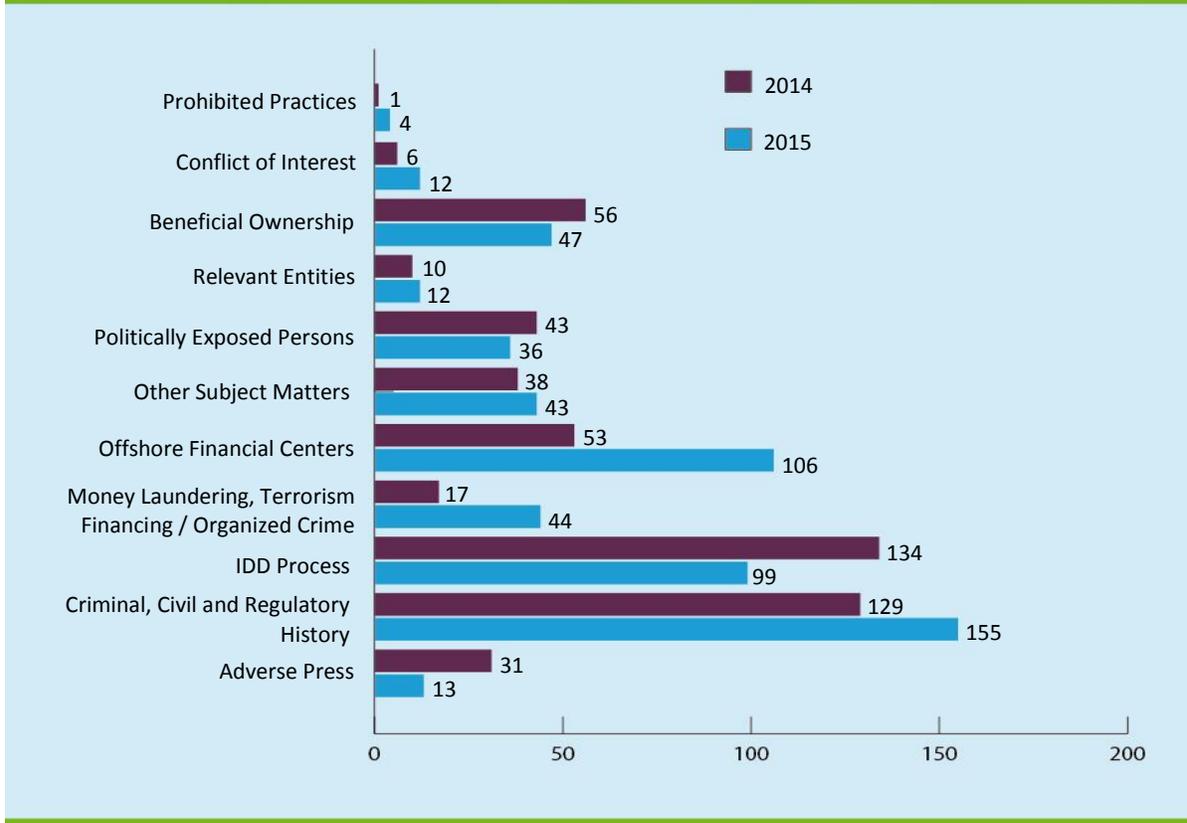
investment officers when conducting integrity due diligence. The new operational procedures for the IIC build on the experience with SCF and OMJ and provide for OII's participation in all projects.



4.31. **Subject Matter of NSG Consultations.** Figure 18 shows the changes in subject matter of NSG consultations from 2014 to 2015<sup>13</sup>. The decrease in process-related consultations continues a trend identified last year, which OII attributes to the expertise developed by the loan support unit established within SCF's Portfolio Management Unit, which conducted much of the information-gathering for IDD in connection with SCF and OMJ operations. The creation of this unit, which coordinates closely with OII and investment officers, has significantly improved the quality and efficiency of integrity due diligence reviews. This office will continue to operate under the IIC structure with the same functions. Separately, the increase in consultations regarding OFC reflects the enhanced due diligence practice described in Section III above.

<sup>13</sup> One consultation can relate to multiple subject matters.

FIGURE 18: SUBJECT MATTERS OF CONSULTATIONS



4.32. **Reports of Investigation.** As noted above, OII shares lessons learned with operational staff through ROIs. During 2015 OII shared 10 ROIs with Country Managers, Sector Managers and relevant Division Chiefs and Country Representatives.

4.33. **Training Activities.** In 2015 OII conducted a total of 29 knowledge-sharing and training activities. OII provided general integrity training for staff in the Country Offices of Argentina, Bahamas, Guyana, Honduras, Nicaragua, Paraguay and Surinam. It also offered such training to new IDB employees and members of the Board of Directors and held one-on-one sessions with new staff in the Operations Financial Management and Procurement Services Office. As part of the training, OII shared examples of integrity red flags and mitigation measures, and discussed how OII and country teams can collaborate to manage integrity risks.

4.34. Similarly, OII delivered a more focused training for staff of the AUG, discussing lessons learned from investigations and opportunities for cooperation. OII also presented

preventive tools to the Vice-President for Sectors (VPS) and Sector Managers and to Division Chiefs of the Energy and Infrastructure Sector to raise awareness of the advisory services OII offers.

- 4.35. OII provided capacity-building training specific to NSG Operations and to Partnerships. Training on how to identify, assess and mitigate integrity risks and reputational impact through IDD was provided to SCF and to ORP.
- 4.36. For External Stakeholders, OII offered training to Executing Agencies in the Bahamas and Haiti. During these trainings, OII explained the IDB Sanctions System, shared insights from investigations, and discussed measures that could be adopted to reduce the likelihood of Prohibited Practices in projects they implement. Among the risk mitigation measures discussed were: (i) enhancement of record management systems; (ii) segregation of duties; (iii) avoidance of conflicts of interest; and (iv) verification of information submitted by bidders.
- 4.37. The Chief of OII participated in the summer program of the International Anti-Corruption Academy, where she lectured on anti-corruption efforts of MDBs. She also presented the Integrity Framework of the IDB as part of a course of Ethics and Social Responsibility of the Public Policy and Management Master of the Universidad Católica Boliviana. OII staff also presented at the Consejo Profesional de Ingeniería Civil of Argentina.

## **C. Other Outputs and Activities**

### **Commemoration of International Anti-Corruption Day**

- 4.38. To commemorate International Anti-Corruption Day 2015, the Sanctions System, the Institutional Capacity of the State Division, and the Office of External Relations, organized a cartoon contest called “For a region with greater integrity and transparency: the image against corruption.” The contest was an innovative way to demonstrate IDB Group’s commitment to the anticorruption agenda and remind the public of the role that both individuals and society play in combating corruption and promoting transparency

and integrity. It was an invitation to the region's cartoonists to reflect on the many faces of corruption and their impact on institutions, vulnerable populations and sustainable development, not just in the public sphere but also in private life.

- 4.39. The contest drew more than 200 nominations from 18 countries in Latin America and the Caribbean. The jury composed of renowned anticorruption experts and cartoonist selected the cartoon of Mauricio Parra as the winner. Meanwhile, the general public, with more than 2,000 votes, selected Alberto Montt's drawing "Vote" as the winner of the Public's Favorite category.
  
- 4.40. During the awards ceremony President Moreno reminded the audience that although there is no unique recipe to fight corruption and other Prohibited Practices, the Bank acknowledges that transparency, institutional strengthening and integrity are the cornerstones of an effective anticorruption strategy.

FIGURE 19: WINNING CARTOON BY MAURICIO PARRA



#### Collaboration with Multilateral Development Banks and Other Stakeholders

- 4.41. **Multilateral Development Banks.** OII, the SO and the SNC all have a mandate to reach out to comparator institutions and other stakeholders. Through these efforts, they seek to collaborate with external parties, communicate about their work and generally increase the impact of their efforts. In 2015, these outreach efforts included collaboration with other MDBs, IFIs and other parallel organizations and offices. They also communicated with the private sector, academia, and the legal community.
- 4.42. As in previous years, OII participated at the **Private Sector Conference on Integrity** hosted by the International Finance Corporation (IFC), and met with the **Heads of Integrity** of the ADB, AfDB, EBRD, European Investment Bank (EIB) and WB to discuss issues of common interest. OII also participated in a meeting of MDB Sanctions Committees, and several OII investigators attended the **Conference of International Investigators** hosted by the Global Fund, which gathered over 100

investigators from international organization and included training on investigative techniques as well as many discussion panels on relevant topics.

- 4.43. The SNC attended the third “Meeting of the MDBs’ Sanctions Appeals Bodies,” organized by the Global Fund in Geneva, Switzerland. The Working Session was attended by members of Sanctions Appeals Bodies of the AfDB, the ADB, the EBRD, the WB Group, as well as their Secretariats. During the meeting, the participants discussed the challenges and opportunities they face, as well as strategies for further collaboration.
- 4.44. The SO participated in the First Tier Sanctions Officers' "Summit" organized by the Bank Group and the WB in Washington D.C. This meeting serves as a forum to share experiences and best practices among the different MDBs’ First Tier Officers.
- 4.45. **Compliance professionals and legal community.** The SO and the Executive Secretary of the SNC actively participated in a number of conferences and events targeting compliance professionals and the legal community that practices in the area of international bribery.
- 4.46. **Academia.** Staff from OII, the SO, and the SNC also participated in conferences, symposia and lectures at different universities, including the International Anticorruption Academy.