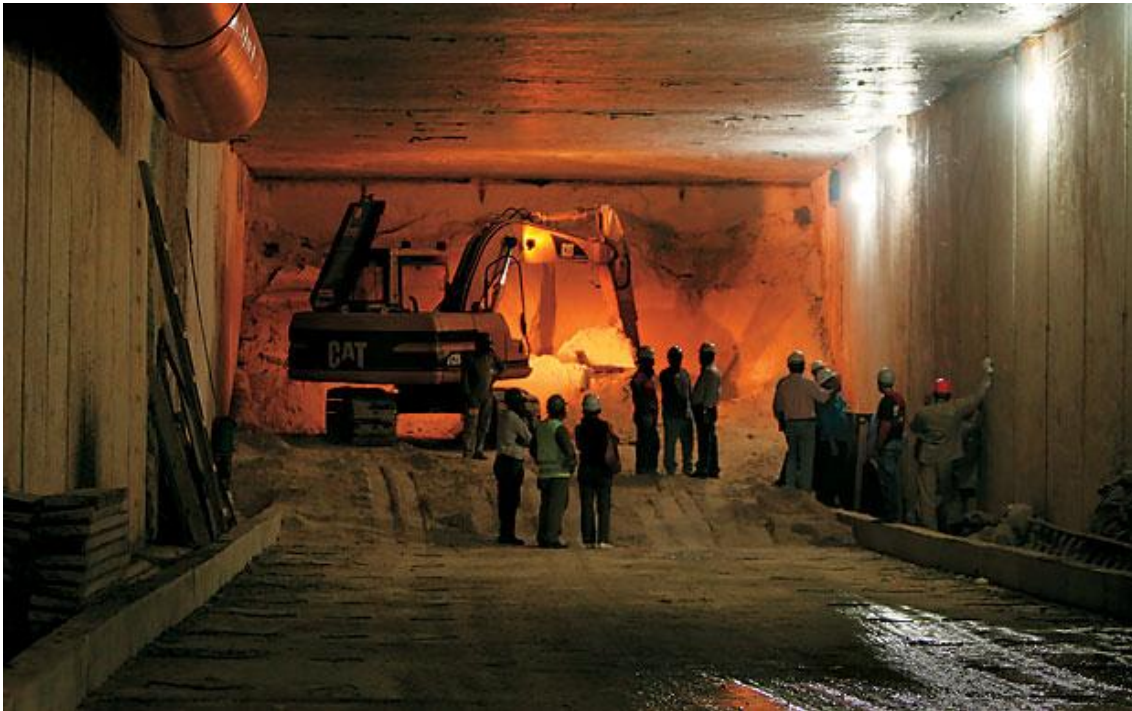


Unearthing Fraud

(Translation of an article from *Veja Magazine*, Edition 2145 from 6-jan-2010. For the full text, with pictures and notes on eleven public works projects and the irregularities detected, please see the original in Portuguese at <http://veja.abril.com.br/060110/desvios-subterraneos-p-042.shtml>)

There are innumerable construction sites in Brazil where taxpayer money seems to simply vanish. Thanks to the Brazilian Court of Audit, however, it is possible to pinpoint the escape routes for these misappropriated funds.



Exponential rise in costs

The contract to build Fortaleza's metro, in the state of Ceará, was awarded for 357 million *reais*. In the end, it may cost four times that amount. The TCU is fighting to restore 133 million to public coffers.

Upon close examination, the construction of the tunnel that will house Fortaleza's future metro system raises questions that Ceará's state government would prefer remain buried deep underground—in particular, suspicions concerning the project's astounding cost increases over the years. When work began in 1999, the tunnel was expected to be ready in 2002 at a cost of 357 million *reais* (roughly 200 million US dollars). In 2007, when the federal government took over the project, its cost was recalculated to 681 million *reais*. A single track has yet to be laid, but the Ceará government now says that it will need 1.4 billion *reais* to get the trains running. What could justify a quadrupling of the original cost of a public works project? In the case of Fortaleza's metro, two factors explain why the cost soared to over a billion *reais*: first, the state government authorized a series of changes to the project's original design. These changes, which were not subject to a competitive bidding process, were extremely expensive. In addition, a large portion of the services

performed by the contractors *Queiroz Galvão* and *Camargo Corrêa* were remunerated at rates significantly above market price.

These astounding price increases were brought to light thanks to the work of the Brazilian Court of Audit (*Tribunal de Contas da União* – TCU). After analyzing each phase of the Ceará project, the auditors made a conservative estimate that at least 133 million *reais* of my, your, our hard-earned money were buried there unjustifiably. The signs of irregularities are so clear that the Court requested that the project be temporarily suspended until the contractors could explain themselves. Since their answers were unconvincing, the TCU is now doing battle with the Ceará government, demanding that the money be returned to federal coffers.

Keeping public funds from slipping down the drain is the *raison d'être* of the TCU, an advisory agency linked to Congress. The Court is the main agency responsible for overseeing the use of federal funds and informing Congress—and the nation—about whether they are being spent appropriately. This mission is crucial to democracy, since a layperson (your average taxpayer) cannot possibly gauge whether a politician's or government agency's balance sheets add up or not. The hodgepodge of contracts, spreadsheets, and amendment agreements that constitute each project form a web of numbers that is incomprehensible to nonspecialists. To perform its work, the TCU relies on 2,500 technical staff, trained to discover everything that the authorities swear does not exist in Brazil: misappropriation of funds, bidding fraud, overbilling, payment for services that were never rendered... The audits are then examined by nine ministers: three nominated by the Senate, three by the Chamber of Deputies, and three by the Office of the President. Of the latter three, one must come from the Court's Public Prosecution Office and another from its technical staff.

Notwithstanding the importance of its work, the TCU became the target of attack in 2009. Not a few politicians were upset about having their pet contracts scrutinized. Those who complained the most were from the Worker's Party, including the President of the Republic, Luiz Inácio Lula da Silva. "It's not fair to stop a construction project, even when there's something wrong, because it becomes more costly for the country and for the people," he said in August. After this statement, the administration's allies began to bombard the TCU with accusations. The Court was frequently accused of working for opposition parties, since it exposed corruption in the federal government's constructions projects, or of trying to stall the country's growth by unearthing irregularities in projects that are part of the Growth Acceleration Program (*Programa de Aceleração do Crescimento* – PAC). The bombardment was so intense that the Minister of Planning, Paulo Bernardo, convened a study group to craft an oversight agency that would be "more agile" (what he really meant was "more docile") than the TCU.

An agency whose mission it is to safeguard public funds cannot operate under constant suspicion, especially during an election year—when the results of its audits will inevitably influence the political process. VEJA decided, therefore, to assess whether the TCU fulfills its duties evenhandedly or if, in fact, it is simply trying to get in the way of the Lula administration. We focused on a list of fifteen construction projects—all of which had budgets in the millions of *reais*—at which the Court found signs of very serious violations. We pored over the extensive audit reports line by line. We visited the projects, located in eleven states and the Federal District, and interviewed their managers. At the end of this four-month process, we can affirm that the TCU's analyses comply with technical criteria and are grounded in solid evidence, since they are based on figures and cross-referenced information that leave no doubt as to the irregularities. "The TCU fulfills its role and will not

bow to political pressures that seek to interfere in its activities,” says Aroldo Cedraz, one of the Court’s ministers.

While the effectiveness of the auditors’ work is heartening, the portrait that emerges of how politicians spend our money, based on our analysis of the fifteen projects, is alarming. The contracts add up to a value of 7.65 billion *reais*. According to the TCU, the overpricing—expenditures above average market prices—amounts to 1.35 billion *reais*, or 17.6% of the total. In other words, of every 100 *reais* invested by the federal government in these projects, 17 were misspent. Where did all this money go? There are only two places to look: in the pockets (or perhaps in the underwear) of the politicians responsible for approving the funds, and in the contractors’ bank accounts. When the overpricing is discovered before construction begins, as was the case for the Angra 3 nuclear power plant, it is still possible to renegotiate the agreements and avoid the misappropriation. In other cases, such as Federal Highway BR-163, which was supposed to have been paved nearly twenty years ago but is still covered in mud, it is very difficult to recoup the expenditures, since they have already been approved and invoiced—thus the term “overbilling.”

In addition to overpricing, pure and simple, various other tactics are employed to inflate the budgets of public works projects. At VEJA’s request, TCU’s auditors detailed the six most common ploys, which played a part in almost all the projects that we analyzed:

- Poor preliminary engineering design – The first step in any construction project is to assess the terrain on which it will be built. If this requirement is not rigorously attended to, unforeseen circumstances arise that drive costs above the bid amount. For this reason, contractors love poorly drafted engineering plans.
- Improper amendment agreements – By law, the final price tag on any construction project in Brazil can be 25% higher than foreseen by the initial budget, in order to avoid work stoppages. However, what was intended as an exception has become the rule. Seldom does one encounter a project, large or small, whose budget does not grow by that percentage. This law needs to be reviewed.
- Bidding fraud – The classic ploy: contractors bribe politicians in order to win a bid. Later, they use gaps in the agreements to charge whatever they want for their services, with the certainty that the requested funds will be approved.
- Tinkering with spreadsheets - The company presents an unrealistic budget to beat the competition. After signing the construction agreement, it alleges that the listed materials cannot be used “for technical reasons” and opts for more expensive alternatives.
- Measurements “at a distance” – The government can only pay contractors for the portions of the construction projects that have been completed. Often, however, the government inspector does not even go to the work site, or just passes by quickly, but nonetheless approves the payments even when little or nothing has actually been built.
- Budget difference income (BDI) ploy – This is a percentage that should be applied to a project’s total budget solely to cover costs arising from taxes and the contractors’ central administration costs. The index, however, is often calculated imprecisely and is always higher than it should be.

With so many drains on public resources, the TCU is unable to cover all the bases. Its team is too small to oversee the thousands of contracts signed by the government. Since it is impracticable to scrutinize all the projects, the auditors focus on those of higher value. They follow the Pareto principle, a mathematical postulate stating that 20% of the causes are responsible for 80% of the effects. In other words, of all the public contracts, TCU audits the 20% that are most costly, because they account for 80% of the resources. It is a formidable job, which needs to be maintained and expanded. After all, as the case of Fortaleza's metro tunnel illustrates, a close look at public works in Brazil reveals that just about everything is covered in mud.

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