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OIG INVESTIGATION INTO THE NIGERIA SUPPLY CHAIN

On 9 March 2021, the Office of the Inspector General (OIG) published its report on the findings of its investigation into the Nigeria supply Chain which revealed that sub-contractor invoicing fraud had resulted in substantial overcharging.

Background

This report concerns the OIG's investigation into the systematic inflating of invoices for the distribution of health commodities to warehouses and health facilities throughout Nigeria between 2017 and 2019. The OIG found that Zenith Carex ('Zenith') – a sub-contractor of Chemonics International ('Chemonics') who managed an integrated supply chain for Global Fund Principal Recipients in Nigeria – defrauded Global Fund-supported programs of US$3 million.

In April 2019, the Global Fund Nigeria Country Team had alerted the OIG after Chemonics made a retroactive request for additional funds and forecast multi-million-dollar budget overruns on their fixed-price Global Fund contracts. The Country Team engaged the Local Fund Agent (LFA) to examine potential causes of the overspend, which led to the identification of numerous unsupported sub-contractor expenditures. As neither the outcome of the LFA inquiry nor statements from Chemonics fully explained the root cause or extent of the budget overruns, the OIG opened a proactive investigation into potential fraud in the supply chain.

Investigation Findings

The report lists four findings:

1. Zenith inflated distribution invoices up to ten-fold and misrepresented the services executed,

resulting in overcharging $3 million.
2. Chemonics' Field Office controls were poorly implemented and ineffective at preventing fraud.
3. Collusion could have contributed to the fraud remaining undetected.
4. Chemonics' financial monitoring and oversight were ineffective in detecting fraud.

Tin explaining these findings, this article quotes from the OIG report.

Zenith's inflated distribution invoices

Zenith was Chemonics' primary vendor for both Long-Haul distribution between warehouses in Abuja, Jos and Lagos and Last Mile Delivery ("LMD") of cold chain commodities – specialized, low volume items such as HIV testing reagents – to 400 health facilities across Nigeria. This investigation uncovered a systemic invoice fraud which drove up the cost of distributing specialist HIV cold chain commodities between and from warehouses in Abuja, Jos and Lagos to the 400 health facilities. The fraud was a significant factor in Chemonics' subsequent requests for additional funding from the Global Fund. The report notes that 'Unsustainable costs affected the financial viability of the supply chain in supporting the fight against the three diseases in Nigeria'.

The report provides a clear explanation and examples of the fraudulent overcharging: 'Zenith was paid US$766,223 for Global Fund-related Long-Haul cold chain services, which under the terms of the contract were valued at US$53,636. Zenith defrauded the Global Fund by US$712,588, or 93% of the total charges, by invoicing for truck tonnage (the gross weight of the trucks used to transport goods). This was contrary to the distribution contract, and Chemonics' Request for Proposal (RFP) to potential vendors, which stated that Long-Haul cold chain charges were to be based on commodity weight (the actual kilogram weight of the goods transported)'.

'This scheme started from the first invoice Zenith submitted to Chemonics in August 2017, which charged $33,953 for transporting 60,000 kilograms from Abuja to Jos. Zenith inflated the charges tenfold: supporting documentation revealed that only 6,009 kg of packaged commodities had been transported, which should have cost $3,400. Zenith continued invoicing in truck tonnage until June 2019, invoicing from 2 tons (2,000 kg) to 215 tons (215,000kg) on 113 routes.'

'In July 2018, Zenith charged the Program $159,972 for a 210-ton delivery from Abuja to Lagos Premier Medical Warehouse, the single highest charge invoiced for a Long-Haul route. OIG found the 210-ton charge, equivalent to multiple shipping containers, implausible based on the total volume of cold chain commodities in the supply chain: the largest single import of cold chain commodities into Nigeria was nine tons, also in July 2018. Supporting documentation (Proofs of Delivery, 'POD') showed only two vehicle movements on the route; OIG calculated the charge should have been $11,198 for an estimated 14,700 kilograms of packaged commodities.'

'Zenith confirmed invoicing Long Haul based on truck tonnage, saying this reflected the vehicle volumes required to transport the commodities. Zenith claimed that they had received verbal approval to charge by truck tonnage in a 2017 meeting with a former Chemonics procurement specialist, but could provide no records, or contract amendment, to support this.'

Chemonics had awarded the 2017 tender to the lowest 'drop' price, technically qualified bidder. However, Zenith consistently charged for numerous 'direct' routes, when the same vehicle delivered to multiple health facilities on the same day, exploiting their own Local Government Area (LGA)-based interpretation of routes, which lacked a contractual basis and did not provide value for money for donors. Zenith charged separate direct fees from the warehouse to each health facility visited on a route by the same delivery vehicle. The OIG report cites two examples: (1) In April 2019, a Zenith truck delivered to six facilities in four neighbouring LGAs in Ibadan, in the space of three hours. Zenith charged the program for four separate Lagos-Ibadan direct deliveries; and (2) in January 2019, one Zenith vehicle dropped supplies at 11 facilities in Adamawa, including four facilities in Yola North LGA. Zenith invoiced nine direct routes, including two for the Yola North deliveries, failing to invoice drops in line with even the broadest possible interpretation of routes. By contrast, another vendor completing non-cold chain LMD in Adamawa in September 2018 completed 12 direct routes, seven of which delivered to facilities in different LGAs.

In 2019, Zenith told Chemonics that their 2017 'drop' rates, on which they had won the tender, were below cost. The OIG found Zenith's 2017 bid pricing – with very low drop and very high direct rates – was suspicious, and likely undercut competitors with an artificially low drop cost as part of a 'bait and switch' scheme, where Zenith intended to incorrectly charge for the more expensive 'direct' rates. Zenith increased the proportion of more expensive direct routes over time. In May 2017, 78% of the routes invoiced by Zenith were 'drops'. The number of drop routes then steadily decreased to 2% in January 2019, resulting in significantly higher costs per cycle.

Zenith responded that they had prepared routes and invoices per LGA. They rejected the OIG's findings as a 'total falsehood' but did not provide any evidence that altered the OIG's conclusions.

Chemonics' ineffective controls

The OIG report explains the elements that led to concluding that Chemonics' Field Office controls were poorly implemented and ineffective at preventing fraud:

1. Chemonics' Nigeria Field Office was responsible for all aspects of managing third-party logistics providers, including selecting vendors, drafting contracts, and reviewing and approving invoices;
2. Chemonics staff were negligent in their implementation of controls. Staff reviewed and approved vendor invoices without fully understanding the contract terms, and inadequately reviewed supporting documentation;
3. The design of the invoice payment process appeared robust: six internal documents were needed to be signed off by up to six people from different departments, including Warehousing and Distribution and Finance, as well as one senior manager with a delegation of authority (DOA), the authorization to spend money on behalf of Chemonics. However, OIG investigation revealed that Zenith's first Long-Haul invoice, in August 2017, was approved by staff throughout the hierarchy ? including the Country Director, Deputy Country Director, and Warehousing and Distribution Director ? but none of them checked whether it was in line with the contract signed three months previously. Both the Deputy Country Director, who held a DOA, and Warehousing and Distribution Director had been closely involved with the vendor selection and contracting process, and would have, or ought to have, known the correct contract terms;
4. On multiple occasions, Zenith's LMD invoices, containing over 1,000 pages of accompanying PODs, were approved by both the Logistics Advisor and Warehousing and Distribution Director on the same day Chemonics received them, indicating there was no proper review. Chemonics' Logistics Advisor told the OIG they did not look at PODs when reviewing invoices as this was 'too time consuming'. In not doing so, Chemonics staff could not ensure invoiced charges were accurate and supported;
5. The Warehousing and Distribution Director, who directly oversaw the invoice approval process, did not undertake adequate checks. The Director signed off every fraudulent invoice identified during the investigation, thereby confirming that deliveries were completed as per order requirements and invoices were reviewed and cleared for payment. When confronted with the fraudulent invoices, the Director stated the team had "reviewed the wrong thing", without explaining his own failure to ensure the accuracy of invoices or to ensure staff were adequately trained and supervised;
6. Extraordinarily high invoices went unchallenged, including $330,000 for just eight Long-Haul routes in a July 2018 invoice, representing 10% of the entire Zenith annual contract ceiling for Long-Haul and Last-Mile Delivery combined. By comparison, even at the inflated rates, the July 2018 Last-Mile

Delivery to around 400 facilities cost $412,000; and

7. Chemonics staff missed red flags in Zenith's 2017 tender submission. Zenith submitted unaudited 2016 financial statements with altered entries from the corresponding 2015 audited statements, which misrepresented its financial position by inflating its 2016 turnover by NGN 102 million (67%) compared to the official records held by the Nigerian Corporate Affairs Commission. The statements also showed an unexplained NGN 131.6 million (600%) increase in year-end net assets and lowered liabilities, thereby improving their balance sheet. Despite Zenith's admission that its management statements were 'erroneous', Chemonics did not request any subsequent supporting documentation to corroborate the significant financial turnaround from Zenith's 2015 audited statements, which reported year-end liabilities of NGN97 million and cash of only NGN458,000 (approximately $2,300). Zenith responded that Chemonics did not request updated 2016 audited financial documents and referred to the due diligence process being the responsibility of Chemonics. Zenith was invited, but declined, to provide the OIG with 2016-2019 audited financials and project ledgers; their response did not clarify or refute the inconsistencies identified.

Collusion could have contributed to the fraud

The extent of Zenith's fraudulent billing and the scale of control lapses at Chemonics indicate the possibility of collusion between Chemonics staff and Zenith.

First, the contract award was very lucrative for Zenith. The first-year distribution contract value (May 2017 – May 2018), over NGN 1 billion per year, was over six times Zenith's previous annual turnover. In 2018, Zenith derived NGN1.5 billion ($4 million) in revenue from Chemonics alone – ten times their 2016 turnover. In the RFP, Zenith undertook to significantly expand their vehicle fleet if awarded the contract.

Second, a Chemonics Director who was in a position to be aware of the fraud was living substantially beyond his Chemonics salary. The individual was on the Committee which evaluated third-party logistics provider bids and set contract terms, including the commodity weight charging for Long-Haul cold chain, and the definitions of 'direct' and 'drop' for Last Mile Delivery. This individual signed off on all Warehousing and Distribution invoices and oversaw the invoice review process. Despite not declaring any secondary employment or income, the Chemonics Director made a housing project investment in excess of his entire salary between October 2017 and January 2019. Between March and November 2019, the individual deposited additional cash equivalent to 25% of his annual salary (which was separately credited into his account) into various bank accounts in his name. Other major expenses and luxury purchases further indicated a lifestyle that far exceeded his Chemonics salary.

Third, Zenith's revised LMD cold chain pricing, submitted on 26 August, mirrored and undercut by a fraction of one percent that of the lowest bidder (Competitor A) for most direct rates. This strongly indicates Zenith's bid benefited from unfairly obtaining competitors' pricing during the bidding process.

Some Chemonics staff justified retaining Zenith during the renegotiation on the basis that they were the only competent LMD cold chain provider. The evaluation metric for the 2019 renegotiation changed after prices were received. Chemonics initially evaluated prices on 1 August 2019 based on 100% 'drop' rates.

The OIG, via Chemonics, sought comment from the former employee implicated by the collusion indicators, but he did not respond. Chemonics terminated their dealings with Zenith and took decisive disciplinary action related to associated staff.

Zenith responded to the OIG that "Zenith Carex did not have any personal or official relationship with any staff of Chemonics before winning the sub-contract, and maintained professional relationships with the staff of Chemonics until we discontinued working for them

.” Zenith made no substantive comment refuting the finding of submitting suspicious pricing during the renegotiation.

Chemonics’ ineffective financial monitoring and oversight

Chemonics’ Headquarters oversight focused on strategic and programmatic issues; they did not monitor individual third-party logistics provider sub-contracts, or complete secondary checks on invoices. These responsibilities remained with Field Offices, who oversaw individual sub-contracts, including monitoring contract ceilings, an annual maximum contract value. Headquarters prepared donor financial reporting based on aggregated logistics costs, from which Global Fund invoices were prepared approximately every two months.

On 1 May 2019, with just 16 days remaining in the contract period, Chemonics signed a ceiling increase modification for Zenith of over $2 million, representing a 75% increase of the annual ceiling. The request, prepared by the Field Office, was signed off by Headquarters because the value surpassed local delegation of authority.

In December 2018, Chemonics asked the Global Fund for a $1.7 million retroactive extension for the contract period ending August 2018. As the initial overrun was not identified until after the contract period closed, Chemonics and the Global Fund Secretariat were unable to mitigate the causes of budget pressures on the subsequent contract. On 25 April 2019, Chemonics requested a further $3 million extension for the fixed-price contract period ending August 2019. Chemonics’ extension requests to the Global Fund cited increased logistics expenses as a root cause but did not identify fraud as a driver of cost overruns.

Headquarters-led Annual Finance Compliance Reviews found examples of invoices unsupported by Proofs of Delivery and retrospective third-party logistics providers ceiling extensions. However, the fact that the OIG identified subsequent instances of the same issues indicates these reviews did not take adequate measures to improve Field Office controls.

Chemonics applied a percentage-based ‘General and Administrative Expense’ and ‘Fixed Fee’ on all contract costs, including staff salaries and logistics, to Global Fund invoices. The OIG considers the expenses and fees levied on payments related to Zenith’s fraudulent charges to be recoverable. Prior to this investigation, Chemonics committed to waiving these charges on amounts over the contract ceiling; the final recoverable fees would be offset against this waiver.

Chemonics acknowledged this investigation’s findings, stating they recognized the need to strengthen oversight and compliance of Nigerian warehousing and distribution services. Chemonics assert they have already implemented key changes, including changing Field Office leadership, appointing a dedicated expatriate Contracts and Compliance Director, and from Spring 2019 establishing the ‘Situation Room’ to enhance third-party logistics monitoring.

Agreed Management Actions

Five Global Fund management actions have been agreed with the Secretariat:

1. Based on the findings of this report, the Secretariat will finalize and pursue from Chemonics an appropriate recoverable amount from the non-compliant expenditures identified in this report. This amount will be determined by the Secretariat in accordance with its evaluation of applicable legal rights and obligations and associated determination of recoverability.
2. The Secretariat, in consultation with the OIG, will report findings of Zenith’s supplier misconduct for potential referral to the Sanctions Panel.
3. Supply Operations and Risk will establish an interim framework which provides guidance on

assurances and necessary oversight of identified strategic 4PL & 3PL suppliers and/or prime contractors used by the Global Fund.

4. The Secretariat will ensure the Nigeria invoice format from Chemonics provides sufficient data to facilitate detailed analysis by Global Fund of contract performance against signed budgets, including on an activity / line-item basis.

Observations and Analysis

This report shows that a lot of investigative work has been undertaken. However, it is not an easy read, especially for a non-accountant. The difficulty in understanding the report starts early on: In the Genesis and Scope, the report states that ‘The OIG reviewed over $20 million in third-party logistics provider charges to the Global Fund from 2017 to 2019, reviewing documentation for six key logistics providers and analyzing invoices and proofs of delivery’. It is unclear whether the charges related only to Nigeria programs; but, more interestingly, it does not name the ‘key logistics providers’. Were these Chemonics and five other providers? And what were the findings of the review of charges of the non-Chemonics providers? Somewhat out of context, the second paragraph under Context ends with the sentence ‘Of $27 million in total Global Fund expenses from 2016–2019, third-party logistic costs accounted for $18.7 million, of which $11 million was for Long-Haul and Last Mile Distribution’. OIG has since clarified that the ‘third-party logistic costs’ refers to the total charges from Chemonics, inclusive of direct 3PL/sub-contractor expenses. Even so, the statement raises several questions: (1) Does this apply to four full calendar years? (2) What proportion – in terms of volume and contractual value was – and are – Chemonics managing for the Global Fund supported programmes in Nigeria? (3) Did anyone in the Nigeria Global Fund Country Team not notice anything unusual in the annual levels of these expenses?

The Impact of the Investigation (Section 1.5) puts the blame for the fraud on Zenith: “The fraud was a significant factor in Chemonics’ subsequent requests for additional funding from the Global Fund”. Note that the report subtitle is: “Sub-contractor invoice fraud resulted in substantial overcharging”; so Chemonics gets off lightly. It goes on to explain that “Chemonics has now ceased working with Zenith” and “the Secretariat has ensured Zenith is no longer providing any service to Global Fund supported programs in Nigeria”. But here – and in the later analyses – the report fails to highlight the root cause of the fraud: Chemonics’ wholly deficient, if not fraudulent, tender process that led to Zenith – a clearly inappropriate candidate – being awarded a contract to provide delivery services. The second agreed management action is therefore unclear: not only does the action not say to whom the Secretariat will report to but surely it is Chemonics, not just Zenith, who should be referred to the Sanctions Panel?

The third management action only makes sense if the reader understands the meaning of “4PL and 3PL suppliers”.

This serious case of overcharging only came to light because Chemonics had made a retroactive request for additional funds. That indicates that both Chemonics and the Global Fund did not – and perhaps still do not – have a management accounting system in place that reports monthly on budgeted/projected and actual costs. Such routine reporting would have highlighted the problem a lot earlier.

Given the evidence of collusion between certain Chemonics staff and Zenith and Chemonics’ inadequate financial monitoring in the local office and Headquarters, surely the Global Fund should also seek to recover from Chemonics the cost of the OIG investigation?

The OIG investigation has clearly been thorough and worthwhile; but it might have been more accurate to have titled it as ‘Supply Distribution Costs in Nigeria’ since ‘Nigeria Supply Chain’ is a much broader subject.

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