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**THE GOVERNANCE,
THE LEBANESE WAY
CASE STUDY: A&M CONTRACT**

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Preface

Lebanon is undergoing a stifling economic crisis that has had repercussions on all aspects of life amid a faltering political recession, going from presidential, to parliamentary and governmental vacuums, to political settlements and quota governments, the last of which was the formation of a government that was soon obstructed from within, which exposed its political structure that was based on partisan and sectarian divisions. The political recession left a devastating impact on the economic and the financial levels. The Lebanese lira went through an unprecedented collapse against the dollar, which has had repercussions on livelihoods amongst all social classes in Lebanon. Since the October 17 revolution in 2019, the Lebanese people have been standing against the political class that has been ruling the country over the past years. In addition to this stifling scene, the deterioration of the relations with the Gulf states – that is unusual within Lebanon’s diplomatic relations – has transformed the nation of openness and pluralism to an isolated zone in its surroundings.

Facing this grim reality, “Maison du Futur” organized a conference in partnership with Konrad-Adenauer-Stiftung, in which elites from the civil society and its cadres participated, some of whom have worked in state administrations and been

in decision-making positions, specifically on the financial level. This gave the conference enriching dual scientific and practical dimensions. If the scientific dimension of the forums is the result of a higher academic education and specialized competencies, their practical dimension comes from personal experiences and significant expertise they gained in the field of financial policies. This allows them to demonstrate the true reality of the public affairs in light of political, economic and financial challenges as well as the performance of former mandates and successive governments, and Central Bank policies over the past years, which made the state of Lebanon a non-friendly environment for a good governance (first part). Throughout the three discussion sessions, speakers broke down the contract signed between the Lebanese state and the global firm Alvarez and Marsal (A&M) for the purpose of a forensic audit of the Central Bank of Lebanon's accounts, which was merely a facade to display that the Lebanese state is serious about putting an end to the waste and corruption within its institutions and defining responsibilities (second part).

First Part: The Non-Governance-Friendly Environment

First, it must be made clear that this conference is not dedicated to addressing the concept of lost sovereignty whether it be as a result of Hezbollah's practices, that has managed to infiltrate state institutions and administrations through its military influence, or as a result of "high-risk zones" that undermine the concept of a state's sovereignty over its territory, as is the case within Palestinian camps. Therefore, the discussions within this

conference were limited to the reasons behind poor governance (first) and showcasing its results (second).



FIRST: THE REASONS BEHIND POOR GOVERNANCE

It must be recognized that Lebanon suffers from poor governance, and this is an understatement about the reality of this country that refrains from implementing the law, from enforcing accountability and from incriminating the perpetrators, especially those who have committed financial crimes, with obvious apathy from the judiciary and the supervisory bodies' end. In the process of building a state, Lebanon went from being a promising country in the 60s, as a state with good governance and a promising economy, to the most indebted and corrupt country, with corruption being a semi-legitimate benefit in the exercise of governance. Citizens unwittingly bear some of the responsibility and complicity in the establishment of this oligarchy, due to their silence about this abnormal situation that imposed its control over Lebanon for decades, given that street movement took until October 17, 2019 to occur.

Amongst the reasons behind poor governance and the rampant waste of public money on all levels are internal reasons related to governance practices (1) and external reasons related to Lebanon's relation with the region (2).

1- The Internal Reasons

It has been proven that political practices in Lebanon do not hold back on violating the Constitution, take as an example the



presidential and governmental vacuums, and running the country for years without approving any budgets that control the public spending. Thus, the reasons behind poor governance would be as follows:

A- The absence of sovereignty and with it the behavior of some country leaders in Lebanon, which led to the establishment of a state, or rather a ministate within the state, with its own weapons, army, financial and banking system, and its own foreign relations. That is a main cause for the collapse that shook Lebanon to its core.

B- The absence of a parliamentary oversight on the government and the abolishment of the principle calling for the separation of powers, since the government is the result of sectarian and party quotas represented in the parliament. This makes the government a smaller version of the parliament and the cabinet, intertwined in a way that violates all of the principles and rules of democracy, and completely disrupts the parliament's observatory role.

C- The absence of judicial oversight of the holders of legislative and executive positions, especially when it comes to prosecuting politically exposed people such as presidents, ministers and deputies who are hiding behind their immunity, preventing the Central Inspection, the Court of Audit and the public prosecutors from going after them. The best proof being the case of the Beirut Port explosion, with all the attempts of dismantling the blood that unites the families of the victims, distorting the investigation and obstructing it by getting the first investigating Judge dismissed,

and trying to get the second one removed from the case. Otherwise, they will aim to divide the investigation between a regular judicial investigation and a political one led by the Supreme Council for the trial of Presidents and Ministers, in addition to following the trend in Lebanon by hiding the identity of the perpetrators who have committed political and major crimes. Even if we assume, for the sake of argument, the lawful jurisdiction of the Supreme Council, the political considerations that have a great influence within the Council would still undermine justice and assert that getting away without punishment will continue to happen. The political class relies on politicizing the judiciary by offering rewards that lavish the judges, either through promoting them to highly sensitive judicial positions, or by appointing them as ministers when the political time is right. That or by intimidating them and threatening to transfer them to a marginal position. All this calls for the adoption of the Independence of the Judicial system, as a constitutional power and according to the Constitution.

D- The political hierarchy that opposes and prevents the institutionalization of administrations, on the grounds that institutionalization leads to political authorities losing their influence over the public and their public services, and the state going from one built on clientelism to one built on the culture of citizenship.

E- The correlation between the banking system and politicians on one hand, and oligarchy, money embezzlement, and Hezbollah's weapons on the other hand, which allowed non-governmental

groups to have capacities that exceeded those of the state.

F- The absence of budgets and closing accounts, and the regulation of the spending on the basis of the “Provisional Twelfth”.

G- The banking secrecy system that constitutes a protection to those versed in corruption, and an excuse institutions use to withhold required information, such as the Central Bank withholding details from the Minister of Finance regarding treasury bonds and Eurobonds, same goes for certificates of deposit and remittance. In addition to that, the implementation of the banking secrecy system is randomly run and is covered with unconstructive ambiguity, which led to hiding the true financial numbers, the actual losses and the size of the Central Bank’s reserve. This made it difficult to make the right choices when it came to subsidizing food, medicine and hospitalization security, and also formed an obstacle to the negotiations with the International Monetary fund (IMF).

2- The External Reasons

Lebanon’s location, size and internal composition have undoubtedly made it vulnerable in a zone rampant with danger. The external reasons that reinforced internal poor governance can be listed as follows:

A- For a long period of time, Lebanon was subject to numerous guardianship authorities, the last of which being the Syrian scene that ruled through the military High Commissioner that controlled the political system in Lebanon.

B- Going from a direct external guardianship to an internal one that works for foreign countries, serves their regional plan, and is represented by Hezbollah's violation of Lebanon's sovereignty with continuous Iranian support. Whatever is happening with Iran at this stage used to occur through the influence of Palestinians then Syrians over some Lebanese groups in the past.

C- The international exploitation of the present sectarianism and confessionalism, which allowed foreign countries to have tools and agents on the inside. This amplified the culture of impunity, and was used to abate loyalty while fueling clientelism at the sake of citizenship.

D- Foreign countries exploiting the Lebanese media and exercising the carrot and stick approach as a way of taming them and keeping them from deviating from the "legitimacy" of guardianship powers. This caused the media to fall short on fully playing its role in uncovering the truths and exposing the perpetrators, as a result of which righteous people fear the media, while criminals trust in it.

E- Wrongly betting on the success of the Oslo Accords for peace that gave false hope to those who were betting on it to achieve comprehensive peace, which led Lebanon to greedily take out loans in order to guarantee its structural readiness in the period of lost Peace.

Second: The Results of Poor Governance

Poor governance has resulted in a series of repercussions that

struck all Lebanese facilities and left serious consequences notably on the political level (1) and on the financial level (2).

1- The Political Impact

Lebanon's consecutive policies have prevented the formation of a capable state and Lebanese citizenship through various means, among which:

A- Internal sectarianism and the conflict of Powers in the region, which put Lebanon in an unstable position; one that will last as long as sects are looking for protection from foreign countries.

B- The sectarian cover went beyond religious boundaries to become mundane. Violating any figure in the state is considered a violation of a sect or a confession, which protects the state of corruption and causes it to exacerbate.

C- The forced or voluntary withdrawal of the state in favor of a ministate which works for a foreign country that undertakes its financing and arming has forcibly turned Lebanon into a favorable environment for illegal weapons, on the pretext of fighting the Israeli occupation. Today, Hezbollah is no longer only a parallel force, but rather a political, military, security, financial, and banking infrastructure that has guaranteed the party an optimized sustainability amid the collapse of the state and its institutions.

If we take all these risks into account, Lebanon is in dire need for a new regional arrangement under international auspices that can restore its stability, pick it up from the collapse, help it in its inability to pay its external debts, and free it from the compulsion to

approve of international settlements when it comes to Palestinian refugees and displaced Syrians.

2- The Financial Impact

Several factors and causes accumulated because of the absence of a good governance. This led to a financial collapse and forced Hassan Diab's government to take the decision to refrain from paying the sovereign debts. The most important reasons being:

A- The absence of an economic policy supported by financial and monetary policies, as well as the absence of development in the productive sectors based on a political and economic feasibility study taking into account Lebanon's location, its distinctive features and competitiveness.

It is worth recalling that McKinsey's reform and development plan drew an economic policy for Lebanon by determining its distinctive sectors and investing in them. Among these sectors is the nature of the Bekaa region and the quality of its soil that could be suited to the cultivation of cannabis and medicinal herbs, that would later be sold by multinational companies that work in the pharmaceutical sector, thus generating a high revenue to Lebanon.

B- The Central Bank's financial engineering that dissipated the large surplus in liquidity (32 billion dollars) that was caused by two factors: the Syrian army withdrawing from Lebanon and the Lebanese people returning their money to Lebanese banks.

C- The Central Bank has gone beyond its monetary role to ensuring

investments in Venture Capital, as well as investing in start-ups, which is the role of the government, not the Central Bank.

D- The adoption of a strange and unnatural triad that constitutes a financial and monetary heresy. This triad, adopted as the golden rule since 1997, was based on: (1) a free movement of capital, (2) an independent monetary policy, (3) a fixed exchange rate of the national currency against the dollar. (It is possible to adopt two out of three factors, and not the three together).

After concluding the observation of the general framework of the state which led to the collapse, it is essential to ask a number of questions, the main ones being:

1- Who decided to shut down the banking sector in October 2019, and why?

2- Why ignore the fact that banks have been rationing dollar exchange and liquidation since April of 2018, meaning before the revolution broke out? This means that the dollar bills have been missing from the markets since before the revolution due to the Central Bank's policies, and the losses it suffered which hid the real numbers. That, in addition to covering up its engineering policies and refusing the proposition of suspending payments even though the required reserve in dollars was starting to run out.

3- Why the delay in restructuring the banking situation, while only maintaining solvent banks?

4 - Why was the company Kroll, specialized in forensic audit



SECOND PART: THE CONTRACT THAT IS THE FORENSIC AUDIT

excluded and replaced by the firm Alvarez & Marsal (A&M) that specializes in restructuring commercial companies, and that has limited expertise in the forensic audit field? Why insist that the contract be signed with Alvarez & Marsal Middle East Limited, which is registered in Dubai- the UAE, and is an Emirati sister company to the original American one? Why wasn't the contract signed with the parent company registered in the United States of America?

5- Why work on distributing the losses instead of finding a way to make up for them? In the first case, we are talking about a political accounting process through which the losses are distributed between the state, the Central Bank, banks and depositors whereas in the second case, every person proven to be responsible in the waste of public funds and corruption is prosecuted.

6- Is the Lebanese judiciary ready and capable of looking into the cases resulting from the forensic audit and imposing sanctions on powerful people within the state, at the forefront the politically exposed people, in case the audit manages to identify those who were involved in the waste and corruption? What is happening in the trial related to the August 4 explosion, and the shameless intervention of the political authority is the perfect proof of its attempt to tame the judiciary.

In any case, these questions, among others, must be highlighted

when standing up against the forensic audit agreement mentioned in the second part below.

For a proper analysis of the forensic audit agreement concluded between the state and the A&M firm, a differentiation must be made between that contract and the financial audit (first), to then discuss the nature and content of the contract (second).

First: The Distinction between a Financial Audit and a Forensic Audit

A forensic audit is a detailed financial examination that goes beyond simply verifying if the numbers add up between assets and liabilities. It rather digs deeply into the numbers and the transactions to make sure they're legit and accurate. Due to the mechanisms and methodologies it follows, a forensic audit is far more extensive than a financial audit and lasts for a long period of time that could extend up to years in order to uncover fraud, forgery, waste of public money, public fund embezzlement, illegal transactions to foreign countries, and all kind of corruption. As a general rule, a financial audit must be done prior to the forensic audit. Then, based on the results of the forensic audit, and in case it confirms suspicions, a penal case file is formed and becomes a public right.

1 - The Negotiations Around the Audit

In fact, the signing of the contract between the state and A&M came after negotiations that took place with Kroll, a company that

is classified as number one globally when it comes to forensic audit. The negotiations ended with the exclusion of Kroll for refusing to comply with the conditions set by the Lebanese state, that made sure since the beginning to prevent the audit from reaching certain sectors and parties. The state worked hard on drafting the contract in a way that prevents the investigation from condemning powerful sides within the state, by including certain vocabulary, and pre-emptive and protective clauses. The golden rule in force in Lebanon imposes that no political, economic or financial official allows that a forensic audit or even an accounting one targets or convicts them, or else it would cause a domino effect where officials in lower positions would drag down officials in higher positions, which would make it quite impossible to conclude the forensic audit.

2 - The Pretext Behind the Decision Made

In light of the refusal of Kroll to comply with the Lebanese state's conditions, A&M was chosen since it was more flexible and lenient and accepted what Kroll had refused, knowing that A&M is essentially specialized in restructuring commercial companies, and its experience with forensic audit only dates back to not more than two and a half years, therefore forensic audit is not its specialization. The Lebanese state was well aware of that, ever since it chose this compliant company. It must be pointed out that the cost of contracting Kroll, the specialized company, was lower than that allocated to Alvarez & Marsal. The official excuse used by the state to justify excluding Kroll was based

on a security report that, in a state like Lebanon, does the trick. This report indicated the presence of a representative of the firm in Israel, and therefore, signing a contract with the A&M was inadmissible. This was merely a reproduction of the conspiracy theory Lebanese people got used to, and a false pretence under the pretext of fighting Israel. This excuse was exposed through the structure of Deloitte, which has been auditing the accounts of the Central Bank for years, since it turned out that the company had a representative office in Israel.

In fact, it is not in the political class' best interest that the Central Bank opens a Pandora's Box that will backfire on major people working in it as well as government officials that are profiting off the waste that is taking place. The many loopholes found in the contract signed with A&M Middle East, seem as if they were purposely inserted to prevent the forensic audit from leading anywhere.

Second: The Nature of the Contract Concluded between the Lebanese state and A&M Firm

The ambiguity revolving around the contract signed between the Lebanese state and A&M revealed its real nature: it is not a forensic audit contract as promoted but rather a preliminary forensic audit report added to the classic audit in the Central Bank's accounts done by KPMG and Oliver Wyman.

Looking at the course of the negotiations, it turns out that the first contract was signed on August 31, 2020, then was followed by the signing of a second contract on August 24, 2021. The fees went

up unexplainably; perhaps it was because of certain additional required services. The second contract in force has no title, and it is a type of unnamed contracts outside of any legal concept and any specific classification stated in the contracts category, commonly known as sui generis contracts. Therefore, this contract is like a preliminary sounding based on its definition, being a contract that mentions an audit postponed to a later stage, which requires the signing of a new contract in light of the issuance of the first one. This calls for both parties – being the Lebanese state and the audit firm – to be willing to meet once again; that in addition to agreeing on new services and new fees. This also means that the present contract is but a “limited service provider” agreement, i.e. those mentioned in the body of the contract. Therefore, the contract was untitled, and the state officials were great at inserting loopholes that will obstruct the audit from being successful, which made the contract a premediated fictitious one, as it will be demonstrated when studying the Object of the Contract (1), and identifying the responsibility of each party (2).

1- The Object of the Contract

The object of a forensic audit contract is to determine cases of extortion, fraud and maladministration, whereas the object of the contract signed between the Lebanese state and A&M stipulates that the firm provides “Consulting and Advisory Services” to the state, while the latter claims otherwise, and calls the contract a “Forensic Audit”.

Furthermore, in the annexes of the contract, the cause of the

outcome, which is the forensic audit, isn't mentioned, bearing in mind that in the law, the word "forensic" should not be used without proven evidence or probable causes. When studying the contract in light of the comparative law, all the requirements and clauses that should be present in a forensic audit agreement are not present in the contract with A&M, starting with the choice of the firm, as it was done without any call for tenders, and with a total absence of terms of references that can protect the rights of the contracting party and ensure the authenticity of the results. When referring to the website of the original company based in the United States of America, and to the Emirati subsidiary's website, it turns out that among the companies' specializations, neither a forensic audit nor a regular audit are mentioned in the list. In fact, the two companies are specialized in restructuring commercial companies, managing risks and financial portfolios, and improving corporate performance, among others.

These facts left the Lebanese state with an inadequate and fictitious contract that it deliberately contributed in elaborating, as the state was already aware that it was neither ready to present the books of its institutions for auditing, starting with the Central Bank, nor to determine the number of losses, as these numbers and their calculations are debated between the Ministry of Finance, the Central Bank and the Association of Banks.

In reality, it was mentioned in the body of the contract that the Client, i.e., the Republic of Lebanon, acknowledges that A&M's mission does not constitute an audit and the firm as per the

contract is not subject to any commitment, not even minimum standards of behavioral and professional ethics that the American Institute of Certified Public Accountants and the supervisory bodies abide by. It is for that reason that the firm insisted that the report it would be issuing shall not be used against any third party. In fact, it was mentioned in the contract that the Lebanese state can neither use the report or share it with anyone including the judiciary, nor declare the report to be A&M's without prior authorization and clear approval of A&M knowing that the latter preserves an exclusive right to modifying the report or providing a version that protects the professional secrecy. This makes it a "foundling" report, with an unknown source, that cannot be relied on when determining the responsibilities:

..."the client is required to disclose the Preliminary Forensic Audit Report in court proceedings against any individual or party implicated by the Preliminary Forensic Audit Report, ... it shall ... first seek A&M's approval... provided that in such event A&M may, in its sole discretion, (i) provide a revised or redacted report for the purposes of such proceedings or (ii) provide the Preliminary Forensic Audit Report not marked as A&M's work product and without any further references to A&M as part of the Preliminary Forensic Audit Report."...

In light of these facts, the following question arises: Is this a case of intersected interests – a financial one for the firm, and a political one for the Lebanese state – where the company is ashamed of

the quality of its work and the state fears the results of a serious and transparent report?

2- The Obligations of Both Contracting Parties

The obligation imposed on the Lebanese state that A&M agreed to, while Kroll rejected, is an obligation that is neither firm nor productive to, say the least, since it only requires the state to commit to handing over the information and strive to achieve this goal. This intentional loophole allowed the Central Bank not to hand over the required documents and information, or to stall in handing them over. Any party asked for documents can claim it did its best to comply and looked through the archive but failed to find said documents, or perhaps said party saw that the documents should not be handed over, which gives the state the option to hand over documents that are not important while hiding the actual documents that provide information on the waste and deals made. It is the art of deception and political oligarchy that state institutions have perfected. The Lebanese state also approved of expensive obligations that it will have to abide by, such as occupational and health insurance, and physical safety insurance against murder and abduction attempts, in addition to any other dangers that the contracting party's staff may encounter.

As for the obligation of A&M, the firm's job is to generalize and throw off simply by stating that it "provides consulting and advisory services" without mentioning a forensic audit, but rather

providing a preliminary report.

In addition to that, the agreement gave the Emirati auditing company A&M Middle East Limited the prior and ultimate right to drop any joint responsibility off the American parent company and absolve it and its shareholders of any responsibility. The contract mentions conditioned tax exemptions, which breaks the law, and violates Article 137 of the Public Accounting Law, which forbids the payment of the value of the transaction until after the deal is completed. However, it allows the Minister of Finance to give out advances, on condition that it does not surpass 25% of the value of the transaction in exchange for guarantees, unless the government decides otherwise, which has not happened. Both contracting parties also evaded provisions number 28/2018 of the Lebanese law stipulating that any contract or agreement with a value that exceeds 5 million Lebanese pounds must be published on the website of the relevant ministry.

Conclusion

The slogan of fighting corruption remains a theoretical title for the successive governments, and nothing more than political propaganda, especially during two stages: the first one being that after the October 17, 2019 movement, and the second one being that before the parliamentary elections in the spring of 2022. The authority has previously tried to contain the revolution by requesting a fictitious forensic audit, and falsely clearing its own

name in front of the public opinion. Going forward, it will try to promote itself as an institution that is determined to put an end to corruption and waste of public money through this supposed forensic audit.

Ultimately, regardless of the tragic reality taking over the country, there is a dire need to accomplish the following:

*The need for an actual, non-fictitious audit; a forensic audit that goes beyond the central bank's accounts to include ministries, administrations, councils, funds and public contracts; one that can expose those who were benefitting off the public money, all of which have been met with a blocking banking secrecy. However, it is known that the accounts of public administrations are not subject to the banking secrecy law for they are considered public money. Hence why they need to go through an actual forensic audit, not a preliminary report that was not presented for what it truly was.

*The need for a civil state, and the formulation of a new social contract and economic system, rather than patching up the ridges and restoring the cracks present in the structure of the institutions. This will ensure an undiminished sovereignty, complete justice and an equitable social development.

*The restoration of the trust in the banking system.

*The elaboration of a recovery plan and restructuring the public debt following the decision to suspend payments, which should have instantly followed the decision to stop paying. The decision that was taken without any recovery plan was like a bankruptcy announcement for the state.

*The restructuring of the banking sector which – had the Central Bank and the Banking Control Commission implemented earlier – would have saved the deposits of small accounts from the possibility of them being subject to a haircut.

*The launch of a judicial revolution in Lebanon with the need for a constitutional amendment that puts an end to exceptional and special courts, including the military, spiritual and Sharia courts, as well as the judicial Council, and the Supreme Council for the trial of Presidents and Ministers, in addition to making everyone subject to the authority of the civil judiciary and setting clear boundaries between the three powers, by applying the principle of the separation of powers.

*Unifying opposing forces (the revolution) and consolidating them with endogenous capabilities that would protect them from being tamed.

*Putting an end to impunity whether it be for financial crimes or political assassination, which allowed corruption to spread and a series of political assassinations to take place starting with the