

# U4 Expert Answer



## Programmatic approaches to address corruption in the construction sector

### Query

***What programmatic approaches have been used to address or prevent corruption in the construction sector? What measures can be used to prevent the award of government contracts to individuals linked to criminal activities? What oversight is required to ensure transparency and accountability in this area?***

### Purpose

To inform design of an anti-corruption and governance programme in the construction sector.

### Content

1. Brief overview of corruption risks in the construction sector
2. Programmatic approaches to prevent corruption
3. The role of public accountability in preventing corruption
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### Summary

The construction sector plays a vital role in supporting social and economic development. Construction is a USD 1.7 trillion industry worldwide, much of which is linked to publicly financed projects. The nature of the projects and their organisation make the sector very vulnerable to corruption, a challenge that is also reflected in comparative analyses.

The 2008 Transparency International Bribe Payers' Survey, for example, ranked public works and

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**Date:** 04 August 2010 **Number:** 254

construction as the most corrupt sector (Transparency International 2008).

This expert answer briefly examines the various entry points in the construction project cycle when corruption is most likely to occur. It then describes some programmatic approaches to preventing corruption in construction / infrastructure projects. It is found that implementing codes of conduct, inclusion of contractual provisions that specifically guard against corruption, disclosure of contractual information, raising awareness of corruption issues among all stakeholders, ensuring compliance and effective reporting mechanisms are among the essential components for corruption prevention. Thorough due diligence measures are necessary in order to prevent contracts from being awarded to individuals linked to criminal activities.

An interesting approach to collectively raise the transparency standards across the sector is pursued by a new multi-stakeholder initiative which develops specific guidelines for information disclosure that can help to ensure better accountability and reduced corruption in public construction projects.

## 1 Brief overview of corruption risks in the construction sector

The complexity and breadth of public infrastructure projects and the multitude of actors involved make managing, overseeing and monitoring these projects particularly difficult and give rise to multiple entry points for different types of corruption from bribery to extortion, bid-rigging and fraud.

The characteristics of the construction sector that make these projects particularly vulnerable to corruption include: complexity of contractual structures with typically several levels of sub-contracting; the diversity of technical skills involved which make quality assurance and oversight difficult; multiple project phases which might involve multiple management teams; large scale of projects which make expenditure tracking more complicated and hiding inflated costs and bribes easier; preference for commercial confidentiality as the industry norm, rather than transparency which makes accountability difficult to accomplish and significant involvement of government officials which give rise to ample opportunities for bureaucratic rent-seeking (Global Infrastructure Anti-Corruption Centre, n.d. a)

Corruption is likely to enter construction projects at the following risk-points:

### Project identification

The parties involved in project identification may include the relevant government official responsible for approving the project and potential project owners, funders and contractors who may also play a part in the construction and operation processes. Corruption can occur where one or more of these individuals seek to choose a project primarily for their own illicit profit or benefit.

### Project financing

The parties to project financing transactions include the project owner who is seeking funding for the project, prospective funders, and consultants advising those parties in relation to, for example, the viability of the project. Corruption can occur where one or more of these individuals corruptly secures and/or manages a financing arrangement for the project, by way of bribery or fraud or both.

## Project planning, design and regulatory approval

The parties involved in the planning and design phases include the project owner, government departments responsible for issuing planning permissions and other approvals, the architect, and design consultants. An example of corrupt practices during the planning and design phases can be bribes by the project owner to a government or local official in order to obtain planning permission or approval for a design which does not meet the relevant criteria or regulations.

### Pre-qualification and tendering

There are many opportunities for corruption to enter during the project pre-qualification and tendering stage. The contractual structure of construction projects can be very complex and may involve many layers of delegation. For example, the project owner may contract directly with a main contractor and with consulting engineers; alternatively, the project owner may contract out the whole project to a managing contractor, or the project owner may contract with several different contractors for different packages. Corruption can occur in relation to any of these contracts.

### Project execution

Example of corruption during project execution include lowest price bidders fraudulently introducing costly variations and extensions after the project has been awarded or secretly using substandard materials or processes to raise individual profit margins (For more examples see: Global Infrastructure Anti-Corruption Centre 2008 and Kenny 2007).

### Operation and maintenance

Corruption can also enter in the project operation and maintenance stage, again in relation to overcharging, rigged service contracts or corrupted inspections. In many projects, the cost of operation and maintenance will exceed the actual capital cost of construction and offer significant opportunities for bribery and fraud (Global Infrastructure Anti-Corruption Centre, n.d. a).

## 2 Programmatic approaches to prevent corruption

Programmatic approaches to counter corruption build on the involvement of all stakeholders of private infrastructure projects in order to put in place and ensure proper enforcement of robust anti-corruption mechanisms. Experts have stressed the need for specific project controls which can mitigate corruption risks. These include: cost management, schedule management, quality control, contract management and robust monitoring and investigative measures that help detect corruption and amplify warning signs (KPMG 2009).

Different programmatic approaches for tackling corruption in the sector exist. One approach by the World Bank takes a sector-wide view (Kenny 2007) Other approaches provide solutions for specific parts of the construction project cycle, for example, procurement.

Four of these approaches are described below. The first one offers a broad framework for corruption prevention at the project level that can be applied by a multitude of stakeholders; the second approach, integrity pacts, deals with corruption risks specific to the procurement process; the third approach outlines efforts that can be undertaken by project funders and the fourth approach outlines some measures that help prevent public construction awards to be given to individuals linked with criminal activities.

### Comprehensive programmatic approach to prevent corruption at the project level – Project Anti-Corruption System (PACS)

The Global Anti-Corruption Infrastructure Centre (GIACC), an independent, non-profit organisation, has developed the Project Anti-Corruption System (PACS), which is widely regarded as a leading edge system designed to assist in the prevention and detection of corruption on construction projects. It provides a comprehensive overview of anti-corruption measures which can be integrated into project management. These measures cover all project phases, major participants, and different contractual levels (Global Infrastructure Anti-Corruption Centre, n.d. b).

The main elements of the PACS Standards include:

- **Independent assessment:** It's recommended that an independent assessor be appointed whose duty is, for the duration of the project, to monitor and assess the project for corruption and make appropriate reports.
- **Transparency:** It's recommended that the project owner discloses project information to the public on a website on a regular basis and in an easily accessible and comprehensible form (more on this in section 3).
- **Pre-contract disclosure:** It's recommended that at the tendering stage, the project owner and each applicant provide each other with relevant information which could reveal a risk of corruption (for example in relation to their principal shareholders, officers, financial status, agents, joint venture partners, major sub-contractors, criminal convictions and debarment). Each major contractor should do the same with each applicant for its major sub-contracts.
- **Project anti-corruption commitments:** It's recommended that project owner and each major project participant provide anti-corruption contractual commitments which expressly cover the main types of corruption, and which oblige them to implement anti-corruption measures. Remedies should be specified in the event of breach of these commitments.
- **Funder (non-government) anti-corruption commitments:** It's recommended that project owner and each project funder provide anti-corruption contractual commitments to each other which expressly cover the main types of corruption, and which oblige them to implement anti-corruption measures. Remedies should be specified in the event of breach of these commitments.
- **Government anti-corruption commitments:** It's recommended that relevant government departments take steps to minimise extortion by their officers in the issuing of permits, licences and approvals. They should appoint a senior officer to whom complaints of bribery and extortion can be made, and should publicise a list of fees and time-scales which apply to government procedures.
- **Raising awareness:** It's recommended that project participants raise awareness among

their staff of the damage and risks of corruption.

- **Compliance:** It's recommended that major project participants appoint a compliance manager who will take all reasonable steps to ensure compliance by its management and staff with their anti-corruption commitments.
- **Audit:** Financial audits are recommended to be carried out to ensure that all payments by the project owner have been properly made to legitimate organisations for legitimate services. Technical audits should be carried out to ensure that the project design, specification and construction are in accordance with good technical practice and provide value for money. Auditors should be aware of the risk that any deficiencies they identify may be caused by corruption, and should compile appropriate reports.
- **Reporting:** Safe and effective systems, including whistle blowing systems, should be established by which corruption on the project can be reported by the public, by project staff, and by the independent assessor.
- **Enforcement:** It's recommended that enforcement measures for breach of anti-corruption commitments include civil enforcement (e.g. disqualification from tender, termination of contracts, damages and dismissal from employment). The risk of criminal enforcement (e.g. fines and imprisonment) should be highlighted.

The PACS system also includes a set of templates which parties can use to assist them in implementing anti-corruption measures on projects. These are available online at:

[http://www.giaccentre.org/project\\_anti\\_corruption\\_system\\_home.php](http://www.giaccentre.org/project_anti_corruption_system_home.php)

The GIACC also provides a set of tools that can be helpful in formulating claims' codes, contract terms, due diligence measures, as well as gift and hospitality policies. More information can be found at: <http://www.giaccentre.org/>

## Preventing corruption in the procurement process – integrity pacts

Developed by Transparency International, the Integrity Pact (IP) is a tool aimed at preventing corruption in

public contracting. It consists of a process that includes an agreement between a government or a government department (at the federal, national or local level) and all bidders for a public contract, including construction and infrastructure projects.

The IP sets out rights and obligations to the effect that neither side will pay, offer, demand or accept bribes, or collude with competitors in the process of obtaining the contract or while carrying it out. In addition, bidders are required to disclose all commissions and similar expenses paid by them to anybody in connection with the contract.

The IP also introduces a monitoring system that provides for independent oversight and accountability. If violations occur then sanctions will apply, which range from loss or denial of contract, forfeiture of the bid or performance bond and liability for damages, to blacklisting for future contracts on the side of the bidders, and criminal or disciplinary action against employees of the government.

Companies and governments alike stand to benefit from IPs. Companies can refrain from bribing with the knowledge that their competitors are bound by the same rules, while governments can reduce the high cost of corruption on procurement, privatisation and licensing.

The IP has proven to be adaptable to many legal settings and flexible in its application. Since its conception, the IP has been used in more than 15 countries worldwide and has benefited from feedback from a variety of individuals and organisations.

For more information, please see:

[http://www.transparency.org/global\\_priorities/public\\_contracting/integrity\\_pacts](http://www.transparency.org/global_priorities/public_contracting/integrity_pacts)

## Anti-corruption measures targeted towards funders

Funders such as aid agencies, multi-lateral development banks, commercial banks, export credit agencies, guarantors and insurers play a central role in infrastructure development, whether by way of providing general budget support, or by providing funding, insurance or guarantees for individual projects. Therefore, they are in a powerful position to mitigate corruption risks in projects. The following are some anti-corruption measures that are recommended for project funders to reduce the risk of corruption in the provision

and management of the financing for a project and project execution. These measures are excerpted from a set of recommendations developed by Transparency International to aid funders in mitigating corruption risks in construction projects (Transparency International 2006).

### *Internal anti-corruption codes of conduct and management programmes*

Project funders should have in place an effective internal anti-corruption code of conduct, published on the funder's website and an appropriate management programme.

The code of conduct should:

- Prohibit all employees from engaging in any form of corrupt conduct.
- Specify clearly the funder's policy on political and charitable contributions, gifts, hospitality and expenses to ensure that they could not be used as a subterfuge for bribery.
- Specify the funder's policy on facilitation payments.
- Require all employees to comply with the funder's policies on provision of funding so as to limit the risk of corruption.
- Commit the funder to take all reasonable steps to prevent corruption by the company's subsidiary and associated companies, agents, consultants, joint venture and consortium partners, subcontractors and suppliers. Such steps could include, for example, requiring those parties to put into effect anti-corruption codes of conduct and management programmes.

Several organisations have developed systems and guidance to assist in formulating codes of conduct for this purpose. These systems include:

- "Business Principles for Countering Bribery" and accompanying guidelines, implementation plan and verification module as developed by a multi-stakeholder initiative led by TI.
- The International Chamber of Commerce's "Combating Extortion and Bribery: ICC Rules of Conduct and Recommendations".
- The International Federation of Consulting Engineers (FIDIC)'s "Guidelines for Business Integrity Management in the Consulting Industry".

The funder's anti-corruption management programme should ensure that the anticorruption code of conduct is effectively complied with. It is recommended that such a programme should include a clear assignment of responsibility for management of the programme, adequate training for employees on the code of conduct, uniform application of the code in all business dealings, development of internal whistle-blowing and investigatory procedures, internal audit to monitor compliance, etc. For more detailed recommendations, please see:

[http://www.transparency.org/news\\_room/in\\_focus/2006/construction](http://www.transparency.org/news_room/in_focus/2006/construction)

### *Due diligence mechanisms*

Adequate due diligence is a vital preventive mechanism. It can identify a potentially corrupt situation before it occurs, and can enable the funder either to take appropriate preventive measures, or to avoid the project altogether. Due diligence should not be a one-off exercise prior to deciding whether or not to enter into a contract. Due diligence needs to be an ongoing exercise, with the relevant parties being constantly alert to changing circumstances.

Recommendations for due diligence measures include:

- **Due diligence on key employees:** The funder should undertake adequate due diligence on its key employees.
- **Due diligence on the financing transaction:** This is particularly important when the funder is negotiating the funding in a non-competitive situation.
- **Due diligence on key participants in the project:** This should include inquiring whether the key participants in the project are taking adequate steps within their own organisations to prevent corruption. It is recommended that the funder therefore ask key participants to supply details of their internal codes of conduct and management programmes. It should also include establishing whether any of the key participants in the project are being investigated or prosecuted, or have been convicted or debarred, for corruption. If so, the funder should ascertain as far as possible the facts of the case, and decide whether the relevant participant should be excluded from the project, or whether the funder should withdraw.

- **Due diligence on agents and intermediaries:** Recommendations in this regard include ensuring that all payments to agents or intermediaries are reasonable payments in return for legitimate services provided; establishing whether agents or intermediaries are being appointed by the key participants in the project, or by the participants' parent, subsidiary or associated companies, consortium or joint venture partners, or major sub-contractors.
- **Due diligence on the project:** This should include, establishing whether the project is a genuine project, or whether it has been wholly or partly contrived for the purposes of creating or concealing a bribe; whether an effective anti-corruption management system will be implemented in the project.

### *Managing conflicts of interest*

Conflicts of interest can often lead to corruption, therefore, such conflicts need to be identified and, as far as possible, avoided. It is recommended that a register of interests be maintained so that potential conflicts can be identified and appropriately managed.

### *Verification of project parameters*

Project parameters such as legal or political risk, safety, environmental or social issues, construction and/or operation costs and cost/benefit for a community are crucial for funding decisions. However, their assessment can often rely on opinions or expertise that is difficult to verify. Precautionary measures can include obtaining reports from independent parties of known expertise and integrity, verification by a second party, etc. Once the funding has been provided, the funder needs to take reasonable steps to verify whether the funding actually is being used for the purpose for which it was intended.

### *Independent Assessors*

It is recommended that the funder require the appointment of an independent assessor who monitors the pre-qualification, tender and execution of a project to ensure, as far as possible, that it is operated in an environment free from corruption. This is particularly important since bribery and fraud can take place in a variety of ways throughout the duration of the project and it is difficult for the funder to detect them since the funder plays no active role in the project activities and has no detailed knowledge of the technical and financial

aspects of the project. The assessor will therefore undertake the necessary monitoring role on behalf of the funder.

### *Debarment for corruption*

It is recommended that the funder develops a fair, proportionate and transparent debarment procedure. Under this procedure, the funder would, for a specified period of time after the offence, deny project finance, guarantees or insurance to a company which is found to have been involved in corruption.

### *Recourse*

The knowledge that recourse will be sought is an effective deterrent. Therefore, it is recommended that the funder ensure that it has the right of full recourse against employees, government, contractor and other relevant parties in the event of a corrupt act.

### *Transparency*

Transparency reduces the possibility to conceal corruption. Therefore, it is recommended that the funder ensure that:

- All material elements relevant to the funding and project are published on the internet. This increases the chance that an interested third party may discover and report any suspicious circumstances.
- The funder should also disclose to the project owner, in respect of all agents and intermediaries appointed by the funder in relation to the funding: their identity; the nature of the services provided by them; the amount of payments made to them.

## **Prevention of contract awards to individuals linked to criminal activities**

Experts have pointed out the urgent need to develop mechanisms to prevent awarding construction contracts to individuals or organisations linked to criminal activities. The Council of Europe undertook a study in 2003 to identify best practices in this area. Their analysis on 3 member states – Sweden, Estonia and the Netherlands – identifies some best practices to prevent involvement of organised crime in public procurement. These include:

- Utilising available registers and databases of individuals with criminal records (e.g. criminal

records databases in EU member states) to perform background checks on potential suppliers and contractors.

- Rejecting exceptionally low tenders for which the applicant cannot give a reasonable explanation.
- Requiring suppliers to produce tax assessment certificates.
- Exclusion of legal persons from a tender procedure if their directors etc. have been convicted of any offence in the exercise of their profession.
- Requiring prospective contractors to give particulars of the subcontractors engaged by them.

(Council of Europe 2003)

### 3 The role of public accountability in preventing corruption

Evidence can be found that transparency, combined with oversight can play a significant role in reducing corruption in the construction sector. Data from World Bank financed roads contracts in 28 countries suggest that those countries where the citizen are more able to exercise their voice and accountability mechanisms experience lower costs in public infrastructure projects, such as rehabilitation of roads.

In order to ensure public accountability, transparency is needed in the entire project cycle – from project financing and design to implementation and maintenance. In fact, it has been argued that monitoring outcomes is the most important tool against lowest bidders skimping on delivery and bribing to cover up substandard work.

Project-level experience provides evidence in support of the impact of transparency and oversight in construction projects. For example, the Kecamatan Development project in Indonesia involved close local oversight which produced savings of between 25 to 56 percent over conventional infrastructure projects. Similarly, in Bangladesh a study of community oversight of infrastructure projects found that costs and completion times of projects were more than 25 percent lower while the longevity of assets were four times longer with community involvement. (Kenny 2010)

The recent Construction Sector Transparency Initiative (CoST), a multi-stakeholder initiative that includes procuring bodies, public financial management bodies, construction companies, civil society, external (i.e. non-governmental) providers of finance or loan guarantees and international partners, aims to ensure greater disclosure of information relating to public construction projects. CoST is designed to standardise and enable publication of the following contract details in public infrastructure projects:

- Identification details related to the contract, including project specification, purpose, location, intended beneficiaries and feasibility study.
- Project funding related to the contract, including financing agreement.
- Tender process details, including list of applicants and tender evaluation report.
- Award details, including contractor name, price, contract scope of work and contract program.
- Contract execution details including individual significant changes to the contract that affect the price and reasons for those changes, significant changes to the contract that affect the duration and reasons for those changes and details of any re-award of main contract.
- Post-completion details including contractor name, actual contract price, final contract payment, actual contract scope of work, actual contract program and project evaluation report.

More details on CoST, including a list of pilot countries and project reports can be found on their website at: <http://www.constructiontransparency.org/>

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