

TRANSPARENCY INTERNATIONAL



**PREVENTING CORRUPTION ON
CONSTRUCTION PROJECTS**

**RISK ASSESSMENT AND PROPOSED ACTIONS
FOR BANKS, EXPORT CREDIT AGENCIES,
GUARANTORS AND INSURERS**

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EXECUTIVE SUMMARY

1. Corruption imposes significant risks on any organisation (“Funder”) which provides finance, guarantees or insurance in relation to a construction project, or to companies involved in the construction industry. A Funder may include an international financing institution, an export credit or credit insurance agency, a commercial bank, a surety company or other guarantor, or an insurance company. Although these organisations have different roles in relation to a project, they share the common factors of not being directly involved in the execution of the project, and yet bearing a financial risk which depends on the manner in which the project is executed.
2. Corrupt practices can occur at every phase of a construction project: during planning and design, pre-qualification and tender, project execution, and operation and maintenance. These practices can involve bribery or fraud, and often involve both.
3. The extent of bribes paid on construction projects depends on the country and the project. A bribe of 5% of the project cost would be considered quite low. Bribes can be in excess of 30% of the project cost. Further bribes paid during project execution, and fraudulent practices can also add considerably to the project cost. Many major cost overruns which are blamed on management inadequacies or changes in design may in fact be due to corruption.
4. Corruption may result in losses and reputational risk for the Funder. For example, the additional costs caused by corruption can make the project uneconomic which may result in non-payment to the Funder. Claims against the Funder may be fraudulent. Contracts which are procured through bribes may be invalid, or can be terminated, resulting in the collapse of the project or contractor, and resultant irrecoverable losses to the Funder. Failure to undertake adequate anti-corruption measures could expose the Funder and its employees to the accusation that they were aiding and abetting bribery.
5. Corrupt practices also have significant impact on other parties.
 - a) Corruption can disadvantage the developing world by resulting in projects which are unnecessary, unsuitable, defective or dangerous; which require overly complex components; which are over-priced or expensive to operate and maintain; or which are delayed.
 - b) Corruption can disadvantage construction and engineering companies by resulting in wasted tender expenses, tendering uncertainty, increased project costs, economic damage, blackmail, criminal prosecutions, fines, blacklisting, and reputational risk.
 - c) Corruption can disadvantage individual directors and managers by resulting in criminal prosecution, fines, imprisonment, loss of professional status, disqualification from office, and loss of employment.
6. A Funder needs to take urgent action to reduce the risk of corruption in relation to projects or companies which it is financing, guaranteeing or insuring. These actions should include the following:

Immediate Actions

- a) The Funder should only agree to provide finance, guarantees or insurance in relation to a project if each key participant has implemented an **internal anti-corruption code of conduct and management programme** which commits the participant to a strict anti-corruption policy.

- b) Contractual documentation should include adequate **anti-corruption warranties** given by the key participants in the project to the Funder. Breach of the warranties should entitle the Funder to deny payment under the funding contract, and to obtain compensation from the appropriate party.
- c) The Funder should undertake greater **due diligence** to try to ensure that there is no corruption in relation to the project. Particular attention should be paid to agents. Effective due diligence would be materially assisted by the appointment of an independent assessor (see paragraph f) below).
- d) The Owner should ensure that all pre-qualification, tendering and project management procedures are fair, reasonable, objective and **transparent**. Corruption is concealed. The greater the transparency, the more difficult it will be to conceal corruption.
- e) Funders should **report** allegations of corrupt practices to the authorities, and to any applicable trade or professional association. Corruption can only be prosecuted if it is reported. No anti-corruption mechanism can fully succeed unless there is the real likelihood of prosecution for offenders.

Medium term actions

- f) The Funder should 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. The assessor can be appointed under an integrity pact, or under alternative appointment arrangements.
 - g) The Funder should require the use of a project **integrity pact** during both tender and project execution phases. Each party undertakes to the other parties that it will act with absolute integrity in relation to the project. Compliance with the pact is monitored by an independent assessor. The pact contains enforceable sanctions and arbitration mechanisms.
 - h) The Funder should support the introduction of an **international externally audited ethical standard** which companies can only attain and keep if they implement an effective internal anti-corruption code of conduct and management programme. Once this accreditation has been introduced, the Funder should only agree to provide finance, guarantees or insurance in relation to a project if all key participants have achieved this standard.
 - i) The Funder should develop a fair, proportionate and transparent **blacklisting** 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.
7. This report concentrates on actions which can be taken by Funders. Funders are the key to the implementation of successful anti-corruption actions. However, corruption cannot be eliminated by Funders alone. Urgent action also needs to be taken to ensure that other participants in projects also undertake necessary measures. TI has therefore issued equivalent reports to this which recommend actions for project owners and construction and engineering companies (“Preventing Corruption on Construction Projects” - www.transparency.org).
8. The above concepts are examined in further detail in the following paragraphs.

ANALYSIS

CORRUPTION IN RELATION TO A CONSTRUCTION PROJECT

Bribery

9. A representative of one party may pay a bribe to a representative of another party. The bribe may be a cash payment, or it may be a non-cash advantage (such as the promise of a future contract, or a holiday). The bribe may be paid directly or indirectly (e.g. through an agent, joint venture partner or a subsidiary). The bribe may be received directly or indirectly (e.g. by a friend or spouse). The bribe may be paid or received with the full approval of the organisation (institutional bribery). On the other hand, the bribe may be paid or received by a representative of an organisation without the approval of the organisation (personal bribery). It is normally, but not always, the case that the payment of a bribe in relation to a construction project is an institutional act, and the receipt of the bribe is a personal act. For example, when a contractor pays a bribe to a representative of the project developer or owner (“owner”), in exchange for the award of a contract, the contractor will normally be paying the bribe with the knowledge of its board or senior management for the sole purpose of winning the contract. No individual of the contractor will normally be directly benefiting. The contractor will gain the benefit as an organisation as it will have won the contract. However, the recipient of the bribe will normally be receiving the bribe for his personal benefit. The owner whom he represents will not normally benefit, as the contract price will usually be higher to reflect the cost of the bribe.

Fraud

10. A representative of one party may try to deceive a representative of another party. The party using the deception will normally be attempting wrongfully to extract additional payment or advantage from the other party, or to deny the other party a due payment or advantage. For example, contractors may secretly collude during bidding so as to increase the contract price, or an owner may wrongly accuse the contractor of project delays or defects in order to withhold the final payment due to the contractor. These practices can be included under the heading “fraud”, but can also be referred to by various different names, such as deception, anti-competitive practices or claims inflation.

Bribery and Fraud

11. Bribery normally inevitably involves a degree of fraud. A bribe paid to win a project will normally be concealed with the aim that the project appears from the outside to have been won on a genuine arms-length basis.
12. Fraud (such as collusion during bids and false claims) does not necessarily involve bribery. However, many of these acts of deception may need an act of bribery in order to complete the deception. For example, submission of a false claim by a contractor (which is fraud) may go to arbitration, and the contractor may then be compelled to bribe a witness or expert to give false evidence in order to obtain a satisfactory judgement.
13. Although bribery normally receives a higher public profile, the financial wastage in a project due to fraudulent practices such as claims inflation is often higher than that attributable to bribery.

Voluntary or Coerced?

14. In some cases, the corrupt practice may be a voluntary act undertaken by the relevant party with the deliberate intention of gaining a competitive advantage or obtaining additional unjustified compensation.
15. However, in other cases, the practice may be undertaken so as to “level the playing field”. For example, a contractor may feel compelled to offer a bribe during tendering if it believes that its competitors will all be offering a bribe. A contractor may feel that it is necessary to inflate a claim artificially if it believes that the owner will automatically and unjustifiably reduce the contractor’s claim, or raise artificial counter-claims against the contractor.
16. In some circumstances, a bribe may be extorted from the payer. The contractor may be informed that if it does not pay a bribe, it will not receive a payment or an extension of time to which it is entitled, or will not be able to clear its equipment through customs.

The Concealment of Bribes

17. The payment of a bribe may be made direct to a recipient. However, it is common for a bribe to be paid through intermediaries so as to obscure its identity and purpose. The contractors or Funders may be genuinely unaware that these practices are occurring. However, in many cases, they will at the very least have been wilfully blind to the circumstances. The following are common methods of concealing a bribe by the use of intermediaries.
 - a) **Agents.** The most common form of intermediary is the agent. The contractor appoints an agent who has contacts with a representative of the owner or with the government of the country concerned. The contractor pays the agent a percentage of the contract price on being awarded the contract. The agent passes the whole or part of the payment to the representative of the owner or government in return for the contractor winning the contract. The payment is usually made in foreign currency into an offshore bank account. Contractors may hide the bribes in formal agreements that state the scope of the agent’s work. The scope of work will often be false or exaggerated, however, and the size of the payment significantly in excess of the value of any legitimate services the agent carries out.
 - b) **Joint ventures and subsidiaries.** The level of due diligence by Funders and prosecution authorities is lower in some countries than in others. When a contractor bids as part of an international joint venture from several countries, the joint venture may arrange for the agency agreement to be executed in, and the commission paid from, the country least likely to discover the commission. Similarly, where the contractor is part of a multinational group, the commission may be paid by a subsidiary in a country where the commission is less likely to be detected. The subsidiary will then be repaid by the contractor through inter-company charges for false services, or services of inflated value.
 - c) **Sub-contractors.** A contractor may also channel a bribe through a disguised sub-contract arrangement. For example, a sub-contractor might agree to provide services to a contractor in return for a certain payment, but in reality it will not provide these services, or will provide services of a vastly lower value than the price agreed. The balance of the payment can then be passed on by the sub-contractor to the relevant party as a bribe.

EXAMPLES OF CORRUPT PRACTICES

18. The following paragraphs assess some of the more common corrupt practices which can take place during the different phases of a construction project.

Corrupt Practices during Planning and Design Phase

19. The following corrupt practices could occur during the planning and design phase.
- a) An owner may bribe a government or local authority official in order to obtain planning permission for a project, or to obtain approval for a design which does not meet relevant building regulations.
 - b) The project may, as a result of a bribe, be designed or specified by the owner or engineer in a manner which improperly favours one bidder over the others. For example, a certain technology which is only possessed by one of the bidders may be specified, even though other technologies may be preferable or cheaper. This would normally result in the contractors who do not possess the specified technology being kept off the pre-qualification list, or being rejected as non-compliant at tender stage. In some cases, the owner would knowingly have caused the design to be undertaken in this manner. In other cases, the owner may not be aware that the design has been undertaken in this manner (for example where the owner has appointed an architect or engineering consultant to undertake the design, or where the decision is taken corruptly by a representative of the owner).

Corrupt Practices during Pre-Qualification and Tendering Phase

20. The following are some examples of the circumstances in which bribes could be paid during the pre-qualification and tendering phase.
- a) A bidder which is properly qualified may find itself being rejected at pre-qualification stage as a result of a bribe paid to a representative of the owner or engineer by another bidder. The reasons given for rejection would be artificial. Alternatively, no reasons may be given. The rejection of several potential winners could result in the favoured bidder being given an unfair advantage at tender stage.
 - b) There may be, in relation to a project at tender stage, confidential details such as the owner's minimum and maximum acceptable prices, or tender assessment system. Possession of this information may assist a contractor in its bid. The leaking of this information by a representative of the owner or engineer to the favoured bidder in return for a bribe may therefore give it an unfair advantage.
 - c) The tenders may be received by the owner and not be opened at a public opening exercise. In this case, no-one except the owner will be aware of the bidders' prices and other critical tender components. This secrecy will enable a representative of the owner to provide confidential information to the favoured bidder in return for a bribe. This bidder can then amend its tender (for example by dropping its price) so as to secure a winning position. The tenders can then be publicised, and the favoured bidder announced as the winner, and no-one will be aware that the winning bidder was given the secret opportunity to amend its tender.
 - d) The tender process may be corrupted by international pressure. For example, during an allegedly competitive tender process, the government of a developed country may influence the government

of a developing country to make sure that a company from the developed country is awarded a project, even if it is not the cheapest or best option. Such pressure can take many forms, including the offer of aid, arms deals or agreements to support a government's application to join an international organisation. Great lengths are taken to conceal this pressure in some cases. In others, it is remarkably overt.

21. The following are some examples of fraudulent practices during the pre-qualification and tendering phase.
- a) The bidders may secretly collude with each other to share the market. This normally entails the bidders agreeing that each one of them will win a certain number of projects, or a certain amount of turnover, in a particular sector. In respect of each project, a winning bidder will be pre-selected secretly by all the bidders, and the other bidders will put in tenders at a price which is higher than that of the pre-selected bidder.
 - b) The bidders may agree with each other on a "losers' fee" arrangement. This normally entails the bidders agreeing that they will bid in full competition with each other (i.e. no price fixing agreement, or pre-selection of the winner). However, they agree that they will each include in their price a fixed sum representing the estimated aggregate bid costs of all the bidders. The winner will then divide this fixed sum equally between the losers. The primary reason for this arrangement is compensation for the irrecoverable bidding costs of the losing bidders.
 - c) A group of suppliers of materials may collude to fix the minimum price of the materials they supply. Even when there is competitive tendering, prices will be kept higher than would be the case with genuine competition.

Corrupt Practices during Project Execution Phase

22. The following are some examples of the circumstances in which bribes could be paid during the project execution phase.
- a) A contractor may pay a bribe to the owner's representative in return for the owner issuing a variation which materially increases the contractor's scope of work.
 - b) A contractor may win a contract tender as the lowest priced bidder without including a bribe in the contract price, but agree secretly with the owner's representative that a large variation including a bribe will be agreed at a later stage. Deferring a bribe until after the appointment of the contractor can be an effective means of concealment since there is normally no competitive tender for variations, and post-contract variations attract much less publicity than competitive tenders.
 - c) A contractor may pay a bribe to the architect/engineer in return for the architect/engineer issuing a payment certificate or an extension of time to the contractor.
 - d) A contractor may pay a bribe to the owner's quantity surveyor in return for the quantity surveyor approving the contractor's work schedules and time sheets.
 - e) A contractor may pay a bribe to the owner's works inspector in return for him approving defective or non-existent work.
 - f) An owner may pay a bribe to the architect/engineer in return for the architect/engineer refraining from issuing a payment certificate or an extension of time to the contractor, or for issuing a certificate entitling the deduction of liquidated damages from the contractor.

- g) A contractor may require an import permit to bring equipment into the country in which the project is being constructed, and may have to pay the import clerk a bribe in order to obtain the necessary paperwork.

23. The following are some examples of fraudulent practices during the project execution phase.

- a) A contractor may submit a claim for payment for a variation to the owner, when the contractor knows that, or is reckless as to whether, the amount claimed is greater than the amount allowed to the contractor under the contract or by law.
- b) A contractor may make a claim against the owner for an extension of time based on an alleged cause for which the owner is responsible, when the contractor knows that, or is reckless as to whether, the actual delay was due to a cause for which the contractor is responsible
- c) A contractor may make a claim against the owner for an extension of time, when the contractor knows that, or is reckless as to whether, the claim is for a period greater than the actual delay caused to the contractor by the event on which the claim is based.
- d) A contractor may submit a loss and expense claim to the owner which is based on an extension of time claim, when the contractor knows that, or is reckless as to whether, the extension of time claim is false or exaggerated.
- e) A contractor may submit falsified records to support a claim (e.g. false programmes, invoices, timesheets etc.) whether or not the claim itself is genuine.
- f) A contractor may submit a loss and expense claim to the owner based on an allegation that the owner is responsible for a particular event, while concealing from the owner records which would prejudice the contractor's claim (e.g. letters from the contractor to a sub-contractor which attribute blame for the claimed event to the sub-contractor rather than to the owner).
- g) An architect/engineer may know that a variation should properly be issued to a contractor, yet refuse to issue the variation, as it fears that issuing the variation could expose the architect/engineer to a claim for breach of contract (e.g. design error) by the owner.
- h) An architect/engineer may know that an extension of time should properly be granted to a contractor, yet refuse the extension of time as a result of pressure from the owner not to grant it, or in the hope of gaining future work from the owner.
- i) An owner may submit false or exaggerated claims against the contractor alleging that the contractor has delayed the project, or that the contractor's works are defective. In many cases, the owner will use these false or exaggerated claims as a pretext to draw down on the contractor's performance bond, deduct liquidated damages, or withhold the retention.
- j) A joint venture partner of the owner may falsely claim that its project expenses are higher than they actually are.
- k) A scaffolding sub-contractor may exaggerate the amount of scaffolding on site, or the number of men used to put it in place.
- l) An earth-works sub-contractor may falsify the amount of earth removed.

- m) A claimant may add a significant amount of false extra cost to a contract claim as a ‘negotiation margin’. The claimant’s logic in including this margin is that it believes that the opponent will attempt to reduce the claim, and so a sufficient margin must be added to enable negotiations to arrive at the ‘correct’ figure.
- n) Employees, consultants or independent experts may give evidence in a court or arbitration hearing which they do not believe to be true in order to support their employer’s false claim.
- o) Lawyers and other professional advisors working on a contract dispute may dishonestly allocate too many staff to work on a claim, charge for too many hours of work, or give their client over-optimistic advice as to the likelihood of a claim’s success.

Corrupt Practices during Operation and Maintenance Phase

24. The following are some of the corrupt practices which could occur during the operation and maintenance phase.
- a) Bribes can be paid to win operation and maintenance contracts, and fraudulent practices can lead to inflated operation and maintenance costs, in just the same way as during the tender and project execution phases referred to above. In many projects, the cost of operation and maintenance will exceed the actual capital cost of constructing the project. As a result, the opportunities for bribery and fraud may be greater.
 - b) Sometimes the same contractors that built the project will also operate and maintain it, and so the bribe paid to win the construction contract may also cover operation and maintenance. In other cases, a separate bribe may be paid to cover operation and maintenance phase.
 - c) Public/private projects, where a private consortium builds, owns and operates a project and then supplies the government or local utility with the end product (e.g. electricity), provide substantial opportunities for bribery in relation to agreeing the price that will be paid for the end product.
 - d) In high technology projects, the contractor that built the project may be the only company capable of maintaining it. As a result, it will have a monopoly of supply during the operation and maintenance period. This monopoly makes it difficult to compare costs and increases the opportunities for concealing bribes and inflating claims.
25. For more detailed examples and analysis of corrupt practices, see Section 4 of TI’s report “Preventing Corruption on Construction Projects – Examples of Corruption” (www.transparency.org).

THE EFFECT OF CORRUPTION ON PROJECT COSTS

26. Although the examples of corruption referred to in paragraphs 17 to 24 above relate mainly to main contracts, the same principles apply all the way down the contractual chain. A major construction project may have thousands of contractual links between the main contractor, sub-contractors, sub-sub-contractors and suppliers. At the top of the chain, the main contractor may pay US \$30 million to the representative of a government in return for the award of a major infrastructure project. At the bottom of the chain, a sub-sub-contractor or supplier may make a payment of US \$500 to the procurement manager of a company in exchange for a minor sub-contract or supply contract. Fraud (such as false or inflated claims) can also have an enormous impact on the overall contract price. It can occur at every contractual link. The cost of the bribes and false claims will often form part of the final contract price, and have a cumulative effect. A bribe or false claim at the bottom end of the chain may be passed all the way up the

chain, with an overhead cost added at every level, magnifying the cost of the initial bribe or fraudulent act.

27. Similar principles to those summarised above in relation to construction contracts can apply to the award and execution of engineering and consulting contracts.
28. While the costs and effects would vary tremendously from project to project, the following hypothetical scenario illustrates the cumulative effect of bribery and fraud on a construction project.

Cumulative cost effect:

Assume that a power station would cost \$100 million if properly engineered, if awarded after a genuine arms-length open-market tender, and if managed in an environment free from bribery and fraud. The following example analyses what could happen to the \$100 million price if the environment was not free from bribery and fraud. The calculations and methodology are deliberately simplistic.

- a) A utility in a developing country requires a power station, and calls for international tenders to build the power station.
- b) The power station which should cost \$100 million is over-designed and over-specified by 20% so as to maximise the opportunities for bribery amongst the Government Ministers and utility staff. Additional cost: \$20 million. Power station cost now \$120 million.
- c) The contract calls for a 10% retention. The contractor assumes that it will never be paid the retention, as it is aware that the utility will probably create false claims against the contractor to set off against the retention. The contractor therefore adds the value of the retention into the contract price twice. Additional cost: \$12 million. Power station cost now \$132 million.
- d) A bribe of 10% of the contract price is required. The contractor includes the cost of the bribe in the contract price. Additional cost: \$13.2 million. Power station cost now \$145.2 million.
- e) The power station cost is to be covered by an export credit guarantee in the form of a buyer credit. 15% of the project cost will be paid by the utility in cash direct to the contractor. 85% of the project cost (\$123.4 million) will be financed by a loan from an international bank secured by the export credit. The utility is based in a high risk country for which the export credit agency charges a premium of 8%. The premium on the uninflated cost of \$100 million is already included as part of the \$100 million cost. The additional unnecessary cost of the power station is \$45.2 million. The additional premium on this amount is \$3.6 million (8% x \$45.2 million). Power station cost now \$148.8 million.
- f) The construction period is 3 years. The loan on 85% of the project cost charges interest at 6% per annum over 15 years. Interest during the 3 year construction period is to be capitalised. The utility would in any event be paying interest during construction on the uninflated cost of \$100 million. The additional unnecessary capitalised interest during construction is \$8.8 million (8% x \$48.8 million x 3 years). Power station cost now \$157.6 million.
- g) The project is completed late, and there are some defects and performance deficiencies in the power station. The contractor and the utility blame each other. The contractor makes claims against the utility for variations and loss and expense. The utility has no intention of paying the contractor's claims. It also wishes to keep the retention of 10%. It therefore counterclaims against the contractor for liquidated damages, defective work and performance deficiencies. The counterclaim of the utility is equivalent to 10% of the contract price plus the value of the contractor's claims. The contractor increases its claim to a figure which matches the utility's

claim. The claims and counterclaims therefore effectively neutralise each other. A large proportion of both the contractor's claims and the utility's counterclaims are false or exaggerated. After each incurring legal and expert fees of \$0.4 million, the contractor and the utility settle on a walk away basis. The contractor is compelled to absorb costs which it should have been able to recover from the utility had the utility not falsified counterclaims. Power station cost to the utility now \$158 million.

- h) The capital cost of the power station is therefore, at the date of completion of the project, \$58 million higher than it should have been. The cost will further increase during the lifetime of the 15 year loan, as interest of 6% per annum will be paid by the utility on the additional unnecessary cost of \$58 million. This results in the utility paying additional unnecessary finance charges of \$3.5 million per annum.
- i) As a result, the utility has a capital overspend of \$58 million which needs to be repaid, and an additional annual finance charge of \$3.5 million.
- j) The consumers who use the electricity produced by the power station would not be able to afford the electricity if the true cost of producing the electricity were taken into account. The utility therefore charges a subsidised amount for the power, and its income as a result is too low for the utility to be able to repay the capital and pay the interest on the loan for the power station. The utility defaults on the loan.
- k) The power station breaks down. Because of the default on the loan, the utility is unable to borrow further sums to purchase spare parts. The contractor is aware of the utility's financial difficulties, and therefore refuses to supply spare parts and to repair the power station unless it is paid in advance in cash. The utility cannot do so. The power station is not repaired. The consumers receive insufficient electricity.
- l) The bank is paid its annual interest under the export credit guarantee.
- m) Eventually, part of the outstanding capital and interest in relation to the loan for the power station is written off as a result of an international debt relief package. The bank is re-paid its capital under the export credit guarantee.

Result:

- n) The consumers in the developing country do not receive a continuous supply of electricity due to the late completion, breakdown and non-repair of the power station. This damages industry in the developing country.
- o) Aid to the developing country is cut back due to the loan default and rumoured corruption in relation to the project.
- p) The \$58 million overspend means that this sum is not available for use on other projects.
- q) Part of the ultimate cost of the bribe and project overspend is paid by taxpayers in the developing country, who cannot afford such a burden. The balance is paid by taxpayers in the developed country owing to the debt write-off.
- r) No further orders for major capital projects are placed by the developing country due to lack of aid. The consumers in the developing country lose the opportunity to improve their lives. Contractors in the developed world lose potential business.

- s) In the short term, the contractor and the bank gain, as the contractor is paid the contract price, and the bank is paid the capital and interest on the loan. However, in the long-term, they lose potential business in the country due to lack of further development.
- t) The contractor and its relevant employees face the long-term risk that the bribe will be discovered, and that they will be prosecuted for bribery. The bank and export credit agency and their employees face the risk of being prosecuted for aiding and abetting if they knew of the circumstances of the bribe, or were wilfully blind.
- u) Ultimately, only the recipients of the bribe gain. They may move country to avoid prosecution. The bribe money is normally retained in offshore bank accounts for the use of the recipients of the bribe and their families.

THE RISK TO FUNDERS AS A RESULT OF CORRUPTION

- 29. Corruption can increase the capital, operating and maintenance costs of projects, or result in unnecessary, wrongly specified, or defective projects. Any of these factors can make the project uneconomic. The owner could as a result fail to repay the Funder, resulting in losses for the Funder.
- 30. Corruption can result in dangerous or environmentally destructive projects. This could involve the Funder in losses, litigation or reputational risk.
- 31. A contract which has been procured by an illegal act (which would normally include a bribe) is in many jurisdictions either invalid from commencement, or can be terminated by the aggrieved party, who would then be entitled to claim damages. If a project contract were to be terminated by the owner as a result of the contractor paying a bribe, the contractor and/or the project may collapse financially, leading to possible irrecoverable losses being borne by the Funder.
- 32. Fraudulent practices perpetrated against a contractor by the owner or sub-contractors (for example false claims, or wrongful withholding of payments) can result in collapse of the contractor, leading to possible irrecoverable losses being borne by a Funder who has lent money to, or guaranteed, the contractor or the project.
- 33. If a Funder has provided a guarantee or insurance in respect of a project, and has to make payment under that guarantee or insurance, the amount it is required to pay may be inflated by bribes, false claims or other fraudulent practices.
- 34. Participation in a corrupt project will inevitably involve the Funder in reputational risk.
- 35. There is possible criminal liability for Funders and their employees. The extent of corruption in relation to infrastructure projects in some countries is so widely known that Funders are on notice of this situation. Some projects would not go ahead were it not for the presence of both a bribe and international finance, guarantees and insurance. Failure to undertake adequate anti-corruption measures could expose Funders and their employees to the accusation that they were aiding and abetting bribery.
- 36. The above risks do not only result from a corrupt act by the contractor. The contractor can in some circumstances be liable for the corrupt acts of its agents, associated and subsidiary companies, joint venture and consortium partners, sub-contractors and suppliers.

ACTIONS FOR FUNDERS

37. The following are recommended actions which could be taken by a Funder to reduce the risk of bribery and fraud on construction projects which it is financing, guaranteeing or insuring. The actions are divided into immediate actions, and medium term actions.
- a) Immediate actions are those which the Funder should immediately take steps to implement. If the Funder has already implemented actions of this nature, the Funder should review the adequacy of its procedures in this regard.
 - b) Medium term actions are those which it is desirable for the Funder to implement, but which may take more time to develop and implement. The Funder can therefore initiate the development of these actions, and implement them as soon as possible.
38. Anti-corruption actions should be modified according to the extent of the risk. Small or low risk contracts or projects would require a lower level of preventive action than large or high risk contracts or projects.

IMMEDIATE ACTIONS

Internal anti-corruption code of conduct and management programme

39. The Funder should only agree to provide finance, guarantees or insurance in relation to a construction project if each key participant has implemented an internal anti-corruption code of conduct and management programme which commits the participant to a strict anti-corruption policy. TI has developed the “Business Principles for Countering Bribery” and accompanying guidelines and implementation plan to assist this purpose (*www.transparency.org*).
40. The code of conduct should:
- a) Prohibit all officers and employees of the company from engaging in any form of corrupt conduct.
 - b) Specify the company’s policy on political and charitable contributions, gifts, hospitality and expenses to ensure that they could not be used as a subterfuge for bribery.
 - c) Specify the company’s policy on facilitation payments.
 - d) Commit the company to take all reasonable steps to prevent corruption by the company’s subsidiary and associated companies, agents, joint venture and consortium partners, sub-contractors and suppliers.
41. The purpose of the company’s anti-corruption management programme is to ensure that the code is complied with. As such, the programme should:
- a) Require a senior officer of the company to have responsibility for management of the programme.
 - b) Ensure that all employees receive adequate training in implementation of the programme.
 - c) Ensure that the code is applied in relation to all dealings by the company with parties with which it has business relationships.
 - d) Put into effect proper whistle-blowing procedures.
 - e) Be subject to adequate internal controls and audit.
 - f) Be periodically monitored and reviewed.
42. An effective anti-corruption code and management programme will not guarantee that no corrupt behaviour will take place. However, they could materially assist in the prevention of corrupt behaviour.

Anti-corruption warranties

43. Contractual documentation should include adequate anti-corruption warranties given by the key participants in the project to the Funder. Under these warranties, participants should undertake to the Funder:
- a) that they will not participate in any corrupt practices in relation to the project;
 - b) that they will ensure that their officers and employees, and subsidiary and associated companies, do not participate in any corrupt practices;
 - c) that they will take reasonable steps to ensure that their agents, joint venture and consortium partners, sub-contractors, suppliers and consultants do not participate in any corrupt practices.
44. Breach of the warranties should entitle the Funder to deny payment under the funding contract, and to obtain compensation from the appropriate party.

Due diligence

45. The Funder should undertake adequate due diligence with a view to ensuring that there is no corruption in relation to the project. Particular areas of risk in this regard which due diligence would try to prevent are the following:
- a) The Funder needs to establish whether the participants in the project are taking adequate steps within their own organisations to prevent corruption. It should therefore ask participants to supply details of their internal codes of conduct and management programmes (see paragraphs 39 to 42 above).
 - b) The Funder needs to establish whether any of the key participants in the project are being investigated or prosecuted, or have been convicted or blacklisted, for corruption.
 - c) The Funder needs to establish whether agents 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. The Funder then needs to try to establish whether or not these agents could be used as conduits for the payment of a bribe.
 - d) Some countries and project owners are more corrupt than others. Operating in high risk countries, or contracting with high risk owners, will inevitably require greater precautions. TI publishes a "Corruption Perceptions Index" which assesses the perceived corruption risk in most countries (www.transparency.org).
46. Effective due diligence would be materially assisted by the appointment of an independent assessor (see paragraphs 50 to 57 below). The assessor plays a valuable role in ascertaining whether bribes could be, or have been, paid. As such, the assessor has both a preventative and investigative role.
47. It will obviously not be possible to make certain that there will be no corruption in relation to the project. Only reasonable enquiries and preventive actions can be undertaken. However, as far as civil liability is concerned, the Funder should try to ensure that no bribes are paid, as it may be liable for the consequences whether or not it had knowledge of the bribe, and whether or not it took preventive actions. As far as criminal liability is concerned, the Funder should take sufficient steps to ensure that it cannot be accused of being wilfully blind or reckless as to whether or not a bribe was paid.

Transparency

48. The Funder should require that all pre-qualification, tendering and project management procedures are fair, reasonable, objective and transparent. Corruption is concealed. The greater the transparency, the more difficult it will be to conceal corruption.

Reporting

49. The Funder should report allegations of corrupt practices to the authorities, and to any applicable trade or professional association. Reporting would be enhanced by the establishment of effective “whistle-blowing” procedures. Corruption can only be prosecuted if it is reported. No anti-corruption mechanism can fully succeed unless there is the real likelihood of prosecution for offenders.

MEDIUM TERM ACTIONS**Independent Assessors**

50. The Funder should 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. The assessor can be appointed under an integrity pact (see paragraph 58 below), or under alternative appointment arrangements. For a detailed analysis of independent assessment see “Preventing Corruption on Construction Projects – Independent Assessment”- www.transparency.org.
51. As explained in paragraphs 9 to 28 above, bribery and fraud can take place in a variety of ways throughout the duration of the project. Bribery and fraud is concealed, and it is therefore extremely difficult for a Funder, who plays no active role in on-site activities, and who has no detailed knowledge of the technical and financial aspects of the project, to prevent or detect it. The assessor will therefore be undertaking the necessary monitoring role on behalf of the Funder.
52. The assessor will be appointed at pre-qualification stage, and will remain in place until completion of the project. The assessor should be a skilled individual, or an organisation of skilled individuals, who is independent from all parties involved with the project. He should have experience of the construction industry, and have a reasonable working knowledge of accounting and law. He should be a member of a recognised professional association which subjects its members to an enforceable ethical code.
53. The assessor could be appointed full time or part time according to the requirements of the parties and the size of the project. In some situations a panel of assessors (for example three) may be preferable to one assessor. This could be appropriate in the following situations:
- a) where the level of work or diversity of skills required from the assessor is so high or so great that one person would not be sufficient;
 - b) where there is a danger of one assessor being unduly influenced by some of the parties;
 - c) where because of language or accounting differences between the parties, a panel of assessors from different countries needs to be selected to ensure that, between them, they have the necessary skills.
54. The fees of the assessor could be borne by the owner as a project cost, or be shared equally between the parties.

55. The assessor will have open access to the relevant books, records and staff of the parties. He will attend pre-qualification and tender selection meetings, tender opening, and important project progress and claims meetings. He will issue reports simultaneously to all relevant parties, including Governments, the owner, the contractor, and the Funders. Where the project involves public funds, his report should also be made public. Reports will be issued at critical junctures, for example at completion of pre-qualification, at completion of tender, and periodically during project execution. A party who suspects corruption can report his suspicion to the assessor who can then investigate. Where the assessor finds evidence of corruption, he will be obliged to report his suspicions to the appropriate authorities.
56. It will be expensive and impossible for the assessor to examine every possible aspect of a tender or a project, and to verify all payments made by the parties. His scope of work will depend to a large extent on the amount that the project participants are willing to pay him. However his very presence and the possibility that he may examine certain aspects of the project will act as a powerful deterrent.
57. Significant amounts of money can be lost on construction projects due to bribery and fraud. It is highly likely that the presence of the assessor will greatly reduce this financial wastage, and that the savings which result from the presence of the assessor will more than off-set the cost of the assessor. The duty of the assessor is owed to all parties. Therefore, all Funders can appoint one assessor for a project, which will avoid duplication of cost and effort, and will save Funders the cost of alternative monitoring and due diligence procedures.

Integrity Pacts

58. The Funder should require the use of a project integrity pact during both tender and project execution phases for all projects which are financed, guaranteed or insured by the Funder. A project integrity pact is an agreement between the participants in a specific project to act with integrity in relation to that project. A project integrity pact can have the following two components:
- a) The pre-qualification and tender integrity pact is between the owner, designer and all bidding contractors.
 - b) The project execution integrity pact is between the owner, designer, certifier and the appointed contractor.

Each party undertakes to the other parties that it will act with absolute integrity in relation to the project. Specific integrity risks are expressly identified in the agreement. The parties agree to appoint a suitably qualified and experienced independent assessor (see paragraphs 50 to 57 above) whose duty is to assess on an independent and objective basis the extent to which the parties comply with their obligations under the integrity pact. The pacts contain enforceable sanctions. Disputes under the pact are referred to arbitration. In appropriate cases, relevant government departments and Funders would also join in the pact. TI has produced an analysis of integrity pacts in public contracting, and details of their use in 14 countries (www.transparency.org). TI(UK) has also produced, specifically for the construction and engineering industry, a report on integrity pacts, and draft pre-qualification and tender, and project execution integrity pacts (“Preventing Corruption on Construction Projects” - www.transparency.org).

International externally audited ethical standard

59. While many companies will properly implement an internal anti-corruption code of conduct and management programme of the kind referred to in paragraphs 39 to 42 above, some companies will pretend to implement it, but in reality continue with corrupt practices. This kind of abuse can be reduced by the introduction of an international externally audited ethical standard (e.g. ISO or equivalent) which

companies can only attain and keep if they implement an effective internal anti-corruption code of conduct and management programme. Once this accreditation has been introduced, the Funder should only agree to provide finance, guarantees or insurance in relation to a project if all key participants have achieved this standard.

Blacklisting

60. The Funder should develop a fair, proportionate and transparent blacklisting 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.

DISCLAIMER

61. The comments in this report on corruption and its consequences are neither comprehensive nor complete, and should not be relied on. They are intended merely to give indicators as to possible consequences. Independent legal advice should always be obtained. The proposed actions referred to in this report are suggestions only, and will need to be adapted to the specific circumstances of each case. Neither TI nor the author can accept responsibility for the consequences of any action claimed to be taken in reliance on the contents of this report.

COMMENTS

62. This report is issued as a discussion document. TI welcomes comments which would lead to its improvement. These should be sent to *neill.stansbury@transparency.org.uk*

FURTHER INFORMATION

63. TI has published a series of reports and business tools under the title “**Preventing Corruption on Construction Projects**”. These reports and business tools can be freely downloaded from TI’s web-site at *www.transparency.org*.

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