

**TRANSPARENCY INTERNATIONAL**



**PREVENTING CORRUPTION ON  
CONSTRUCTION PROJECTS**

**INDEPENDENT ASSESSMENT**

**March 2005**

## **EXECUTIVE SUMMARY**

1. This report examines the use of independent assessment as a method of preventing and uncovering corruption on construction projects.
2. Corruption on a construction project increases project costs, and imposes business, economic and legal risks on both corporations and individuals. It also has an adverse effect on international development, resulting in increased poverty.
3. In TI's view, corruption could be materially reduced by the appointment of an independent assessor whose duty is to monitor the project for evidence of corrupt practices.
4. The assessor would have full access to the relevant books, records and staff of the parties for the duration of the project, and would report periodically to all parties on any evidence of corrupt practice. On major or complex projects, more than one assessor may be appointed.
5. The key aim of the appointment of the assessor is prevention. Parties are less likely to undertake corrupt practices if there is a reasonable chance that these practices may be discovered by the assessor. However, if the assessor does uncover corrupt practice, he will report these to the parties and to the appropriate criminal authorities so that enforcement action can be taken.
6. TI believes that the cost of the assessor will be more than fully repaid by the savings which result from his corruption prevention activities.
7. The following paragraphs examine this concept in more detail.

## **ANALYSIS**

### **THE NEED FOR INDEPENDENT ASSESSMENT**

8. Corrupt practices include bribery and fraud, and can take place during all the different phases of a construction project. They can take place at all links of the contractual chain, from the smallest sub-contract or supply contract at the bottom of the contractual chain, right the way up to main contract level.
9. Corrupt practices are normally concealed. It is very difficult for anyone who does not have the appropriate skills, who does not have access to the relevant documents and people, and who does not have an in-depth involvement in the project, to be able to prevent or uncover these practices.
10. However, a skilled assessor, or team of assessors, given appropriate access to documents and individuals for the duration of the project, could play a material role in preventing and uncovering corruption.
11. The following are a few examples of corrupt practices on a construction project which the assessor will be looking out for, and could, as a result, prevent or uncover.

12. **Planning and Design Phase**

- a) The project owner may pay a bribe to a government official in return for planning permission, or a waiver of 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.

13. **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 the owner or engineer by another bidder.
- b) A bidder may pay a bribe in return for being awarded a contract.
- c) The bidders may secretly collude with each other to share the market.
- d) A group of suppliers of materials may collude to fix the minimum price of the materials they supply.

14. **Project Execution Phase**

- a) 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 during project execution.
- b) 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.
- c) A contractor may pay a bribe to the owner's works inspector in return for him approving defective or non-existent work.
- d) 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.
- e) A contractor may submit falsified records to support a claim (e.g. false programmes, invoices, timesheets etc.).
- f) 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.
- g) 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.
- h) A scaffolding sub-contractor may exaggerate the amount of scaffolding on site, or the number of men used to put it in place.

### **Operation and Maintenance Phase**

15. 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.

### **Detailed Examples**

16. More extensive and detailed examples and analysis of corrupt practices are contained in TI's report "Preventing Corruption on Construction Projects – Examples of Corruption" ([www.transparency.org](http://www.transparency.org)).

## **THE ROLE OF THE INDEPENDENT ASSESSOR**

### **Purpose**

17. The purpose of the assessor is to:
- a) prevent corrupt practices;
  - b) uncover and report corrupt practices.

### **Experience**

18. 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.

### **Scope of Work**

19. 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. The following are suggestions as to his scope of work:

### **Pre-qualification**

20. The possible scope of work of the assessor in relation to a pre-qualification is as follows. He familiarises himself with the technical and financial project requirements. He ensures that the requirements for submission of pre-qualification in terms of time, date and location are fair and are complied with. He reads all submitted pre-qualifications, and any assessments of the pre-qualifications undertaken by the owner. He attends all meetings during which the owner discusses the pre-qualification candidates. He reads the owner's final pre-qualification decision. He decides whether the decision appears to have been made on fair, objective and arms-length criteria. If a bidder is rejected for reasons which appear not to meet these criteria, he makes enquiries of the owner and relevant bidder to ascertain whether these reasons are fair. He issues his report in which he lists his actions, and gives his full views on the process.

Tender

21. The possible scope of work of the assessor in relation to a tender is as follows. He familiarises himself with the technical and financial project requirements. He ensures that the requirements for submission of tender in terms of time, date and location are fair and are complied with. In particular, he ensures that there is a public tender opening exercise and price read out, and that he attends such exercise. He reads all submitted tenders, and any assessments of the tenders undertaken by the owner. He attends all meetings during which the owner discusses the tenders. He reads the owner's final tender decision. He decides whether the decision appears to have been made on fair, objective and arms-length criteria. If a bidder is rejected for reasons which appear not to meet these criteria, he makes enquiries of the owner and relevant bidder to ascertain whether these reasons are fair. He visits the office of the selected bidder. He examines the contractor's price schedule and list of sub-contractors and suppliers to see whether any proposed appointments are on the face of it unusual, either in terms of identity, scope of work or price. He makes enquiries in relation to any items he believes are unusual. He questions the senior management of the selected bidder as to whether any agents have been appointed. If an agent has been appointed, he assesses the scope of work and fee of the agent, the legitimacy of the scope of work, and the capability of the agent to undertake this scope of work. He visits the agent and questions him on the scope of work to ensure that he can carry it out, and is not merely a front for a bribe. He investigates any report as to impropriety he receives from a whistleblower, an NGO or the press. He issues his report in which he lists his actions, and gives his full views on the process.

Project Execution

22. The possible scope of work of the assessor in relation to project execution is as follows. He familiarises himself with the technical and financial project requirements. He visits the office of the contractor. He examines the contractor's price schedule and list of sub-contractors and suppliers to see whether any appointments are on the face of it unusual, either in terms of identity, scope of work or price. He makes enquiries in relation to any items he believes are unusual. He questions the senior management of the contractor as to whether any agents have been appointed. If an agent has been appointed, he assesses the scope of work and fee of the agent, the legitimacy of the scope of work, and the capability of the agent to undertake this scope of work. He visits the agent and questions him on the scope of work to ensure that he can carry it out, and is not merely a front for a bribe. He checks at a later stage that the agent actually has carried out the required scope of work. He takes similar actions in relation to joint venture or consortium partners, parent, subsidiary or associated companies, and major sub-contractors. He attends project meetings between the parties at which critical matters are discussed. He meets the senior management of the owner and certifier, and examines their accounts to see whether there are any unusual payments or receipts. In relation to contract claims, variations, extensions of time etc., he looks at the supporting records of the parties to such claims, attends key meetings between the parties at which these issues are discussed, and questions key staff as to the reasonableness and accuracy of their submissions and decisions. He investigates any report as to impropriety he receives from a whistleblower, an NGO or the press. He issues his reports in which he will list his actions, and gives his full views on the process.

Appointment and Removal

23. The assessor could be appointed full time or part time according to the requirements of the parties and the size of the project.
24. It may in some situations be felt that a panel of assessors (for example three) is 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.
25. An alternative to a panel in the situations referred to above would be to appoint an appropriate international organisation as the assessor. The organisation would have responsibility for appointing appropriate international or local assessors, and for co-coordinating their activities and reports.
26. There are many alternative methods by which an assessor can be selected by the parties. If only one assessor is to be appointed, then the parties either could agree on his identity, or request an appropriate independent third party to appoint the assessor. If a panel of three assessors is to be appointed, the same method of appointment could be adopted as for a single assessor. Alternatively, the parties could agree on two assessors, or each appoint an assessor, and require the two assessors to appoint the third assessor.
27. The assessor should not be able to be removed from his appointment unless:
- a) all of the parties agree in writing to remove him; or
  - b) he resigns; or
  - c) he is removed from his office by order of a court having appropriate jurisdiction.
- In the case of his removal, he should be immediately replaced.

### **Appointment document**

28. The assessor will need a formal appointment document which specifies his terms of appointment (such as scope of work, duration of services, fees, access to documents and staff, and reporting obligations).
29. It is preferable that all major parties to the project are signatories to the appointment document, as the parties need to be contractually obliged to give the assessor access to their documents and staff, and to permit the assessor to be present in meetings. If, however, all relevant parties are not a signatory to the assessor's appointment, then the rights of the assessor in this regard need to be contractually provided for (for example in the project contract and financing documents).
30. An **integrity pact** provides the ideal appointment mechanism. This is a type of agreement developed by TI, and used in over 14 countries ([www.transparency.org](http://www.transparency.org)). The participants in a specific project agree to act with integrity in relation to that project. A construction integrity pact can have the following two components in relation to a specific project:
- 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 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, banks and export credit agencies would also join in the pact. A third type of integrity pact (sector integrity pact) has been designed to be used by companies which routinely compete against each other for the award of construction projects. See TI's report "Preventing Corruption on Construction Projects – Construction Integrity Pacts" for a detailed analysis on construction integrity pacts ([www.transparency.org](http://www.transparency.org)).

**Fees**

31. The fees of the assessor could be borne by the project owner as a project cost. However, it is preferable that the assessor is not in the pay of any one party, as he is required to be independent. It is probably best, therefore, for the cost to be shared between the parties in an agreed proportion. In relation to projects which are being supported by international aid, the cost of the assessor could be funded out of the aid budget. Cost allocation could be varied in certain circumstances, for example by providing for the costs to be borne by the defaulting party in the event that the assessor identifies a breach of an integrity obligation.

**Transparency**

32. A key to the success of the assessor's appointment is that the project is undertaken, as far as the assessor's role is concerned, with total transparency. This has two aspects:
- a) the open access which the assessor has to the books, records and staff of all parties;
  - b) the requirement of the assessor to report his findings simultaneously to all project participants, and also, in certain cases, on the internet.
33. It is important that the assessor has open access to the relevant books, records and staff of the parties. Many companies may wish to resist this open access. However, it should be borne in mind that an assessor is unlikely to be effective without this access. Bribes and deceptive actions are hidden. Therefore, a company which refuses access to its project accounts can keep a bribe concealed. The assessor should also have open access to the relevant books, records and staff of consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers. This is important, as otherwise bribes could be hidden in the books of these organisations. In addition, the corrupt actions of these organisations can materially impact on the company, and it is imperative that a company which is operating an anti-bribery policy takes all reasonable steps to ensure that these related organisations also operate an effective anti-bribery policy.
34. The assessor should issue his reports simultaneously to all parties, and to other relevant parties such as the financing banks and export credit agencies. This ensures that all parties are equally aware of any issues. In addition, the assessor should publish reports on publicly funded projects on the internet. The issuing of this information into the public domain will be a powerful deterrent, and will also ensure access of information to the electorate and to NGO's who may ensure that appropriate follow up action is taken.

**Due Diligence**

35. The assessor also carries out a valuable role in relation to due diligence. Bodies providing finance, guarantees or insurance in relation to a project carry out, or should carry out, due diligence in relation to the project and project participants so as to ensure, as far as reasonably possible, that no corruption takes place in relation to the project. This due diligence should not only be carried out prior to contract award, but also during project execution when much of the bribery and fraud can take place. The assessor can perform a significant part of this function on behalf of these parties. In the case of a project which has several parties involved providing finance, guarantees and insurance, the assessor can be extremely cost effective, as he can provide this service to all of these parties, which avoids duplication of cost.

### **The likelihood of the assessor uncovering corrupt activities**

36. There is no guarantee that the assessor will uncover all corrupt activities. Some bribes or activities may be too well hidden. Some assessors may not be sufficiently experienced, alert or diligent, or may not have adequate time under their appointment to examine certain aspects. However, it is considered that they will make a material impact, for the following reasons:
- a) Most employees in companies do not want to be involved in corrupt activities, either on their own behalf, or on behalf of their employer. In many cases they will participate reluctantly if they believe that it is for the benefit of their employer. If they are aware that they may be questioned by an assessor, and that the books and records of the company may be investigated, and that breaches will be reported to the prosecuting authorities, then it is likely that most of these employees will refuse to participate. Most corrupt activities are known to certain key employees. Bribes have to be paid, either in cash or by transfers to off-shore bank accounts. Senior managers have to approve these payments, and accounts staff have to process them. Contractors are extremely careful to ensure that the sub-contractors and suppliers are capable of carrying out the specified scope of work, and that the price is reasonable. As such, the contractor will normally be aware if it appoints an agent through which a bribe will be paid that the agent is not carrying out the scope of work specified in the agency agreement. Therefore, questions asked by the assessor to the contractor's project and sales staff, legal department and accounts department, and a follow up visit to the agent, could establish whether the agent has been appointed as a conduit for the payment of a bribe. When claims are submitted, the assessor could ask questions of the contractor's project manager, programmer and quantity surveyor to establish the extent to which the claim is accurate and supported by genuine records. The assessor could also establish, by inspecting the contractor's records, whether the contractor has suppressed contrary evidence (e.g. where the contractor claims from the owner in relation to a particular event, but has also, in other correspondence, blamed a sub-contractor for this event). The manner in which corrupt activities are undertaken in relation to construction projects are well known. An experienced assessor could find evidence of most major corrupt activities with relative ease given proper access to the records and staff of all the parties.
  - b) The assessor may receive tip offs. Whistle blowing is likely to become more common if people realise that there is a person to whom they can send a tip-off, and that that person has the power to investigate.
37. Therefore, the very presence of the assessor is likely to result in a material reduction in corrupt activities. There is also a significant chance that the assessor will uncover corrupt activities which take place. The contractual obligation of the assessor to report any suspicious activities he uncovers to the appropriate criminal authorities and professional associations, and to publicise his findings, gives him considerable power, and therefore makes him a significant deterrent.

### **Will the assessor be cost effective?**

38. It is impossible to calculate whether or not an assessor will necessarily be cost effective. Will he save more money in preventing corrupt practices than the cost of his fees? As corruption is by definition hidden, the actual cost of corruption cannot be calculated. Nor would it be possible to calculate the actual cost of completing a project with an assessor as opposed to without an assessor. The cost assessment therefore must be undertaken on assumptions.
39. Many observers assume the cost of corruption at a minimum of 5% of project value. This would certainly not be an unnaturally high figure for a bribe paid in relation to a construction project. Bribes as high as 30% of the project value are not unknown. In addition to the actual bribe paid to procure the

project, “project leakage” during project execution also adds to the cost. This could comprise matters such as inflated claims (procured by deception and/or bribery), and large variations to the contract scope procured by a bribe. Some people estimate the total wastage on a project, including the bribe and “project leakage” at 20-50% of the contract value.

40. The World Bank in December 2003 estimated the total cost of corruption at US\$1.5 trillion a year (based on 5% of the World economy). The European Commission, in its “Communication on a Comprehensive EU Policy against Corruption” issued on 28.05.03 also estimated the global cost of corruption at 5% of the world economy.
41. In addition to the above attempts to quantify the costs of corruption in financial terms, there are the unquantifiable costs, such as the construction of over-designed or unnecessary projects, the retarding effect of corruption on international development, and the uncertainties and inefficiencies which it introduces into business.
42. Based on the above analysis, it is reasonable to assume that the appointment of a competent assessor with a carefully controlled scope of work and fee structure is likely to be a highly cost effective investment.

#### **The integrity and safety of the assessor**

43. It is an obvious risk that if the assessor uncovers a bribe, he could be bribed or threatened by the defaulting party not to reveal the bribe. This risk can be minimised, but not entirely avoided.
  - a) The bribery risk to the assessor can be minimised by ensuring that the assessor is a member of a professional association which maintains the highest ethical standards, and which has strict disciplinary procedures. The association could require its members to disclose annually and publicly their income and assets. The formation of a specific international professional association of assessors should be considered.
  - b) The risk of personal danger to the assessor can be minimised by rapid and routine disclosure by the assessor of his findings to all related parties. Threats are normally designed to prevent information from being published. Once the information has been published, the threats become less effective. The assessor’s safety must be taken very seriously, and protection for the assessor may need to be provided in some countries.

#### **CONCLUSION**

44. TI believes that a suitably qualified and diligent independent assessor, given open access to the records and staff of the participants, can make a major contribution to reducing bribery and deceptive practices in relation to construction projects. As such, this appointment is in the interests of all project participants. There is no reason why independent assessment should not become a routine part of the contractual structure of construction projects.

#### **DISCLAIMER**

45. The comments in this report on the law 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**

46. 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**

47. 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 website at *www.transparency.org*

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