

**TRANSPARENCY INTERNATIONAL**



**PREVENTING CORRUPTION  
ON CONSTRUCTION PROJECTS**

**RISK ASSESSMENT AND PROPOSED ACTIONS  
FOR FUNDERS**

July 2006

**PREVENTING CORRUPTION  
ON CONSTRUCTION PROJECTS**

**RISK ASSESSMENT AND PROPOSED ACTIONS  
FOR FUNDERS**

**INDEX**

<b>Section 1:</b>	<b>Purpose of Report</b>	3
<b>Section 2:</b>	<b>Executive Summary</b>	3
<b>Section 3:</b>	<b>Detailed Analysis</b>	9
	Definitions	9
	Sources of finance	9
	Types of corruption	10
	The concealment of corruption	11
	The nature of a construction project	12
	Corruption in the financing and execution of projects	13
	The costs of corruption	22
	The risks to funders as a result of corruption	22
	Anti-corruption actions for funders	26
	Disclaimer	34
	Acknowledgements	35
<b>Schedule:</b>	<b>Examples of corruption</b>	36

## **PREVENTING CORRUPTION ON CONSTRUCTION PROJECTS**

### **RISK ASSESSMENT AND PROPOSED ACTIONS FOR FUNDERS**

#### **SECTION 1: PURPOSE OF REPORT**

1. This report examines the following issues:
  - a) How corruption can take place in the financing and execution of domestic and international construction projects.
  - b) The risks this imposes on those providing various types of finance for projects (funders).
  - c) The actions which funders can take to mitigate these risks.
2. It is not an in-depth analysis of the issues. It is an overview designed to result in a better understanding of the issues, to help funders train their staff, to promote best practice by funders, and to provide the basis for a checklist for an anti-corruption control framework for funders. Although this report focuses on corruption in the financing and execution of construction projects, many of the comments and recommendations would also apply to project and trade finance in other sectors.
3. This report is designed principally for funders. Separate reports have been issued by Transparency International which contain risk assessments and proposed actions:
  - a) for project owners<sup>1</sup> and
  - b) for construction and engineering companies and consulting engineering firms<sup>2</sup>.

#### **SECTION 2: EXECUTIVE SUMMARY**

##### **Corruption in the construction sector**

4. Transparency International's Bribe Payers' Index<sup>3</sup> rates public works/construction as the most corrupt sector internationally. Without financing, construction projects could not be built. The combination of the high level of corruption in the sector, and the importance of financing to the project's success, imposes not only risks on funders, but also obligations on funders to both beneficiaries and stakeholders to take reasonable steps to ensure that the financing they provide is properly managed.

##### **Sources of finance**

5. The financing of a construction project can include any or all of a variety of sources and products.
  - a) Aid/grants/subsidies;
  - b) Equity investment;
  - c) Loans;
  - d) Lease finance;
  - e) Financial guarantees and insurance;
  - f) All risks and general insurance.

<sup>1</sup> See [www.transparency.org](http://www.transparency.org). Go to "how to fight corruption" then to "preventing corruption on construction projects" then to "risk assessment and proposed actions for project owners".

<sup>2</sup> See [www.transparency.org](http://www.transparency.org). Go to "how to fight corruption" then to "preventing corruption on construction projects" then to "risk assessment and proposed actions for construction and engineering companies and consulting engineering firms".

<sup>3</sup> See [www.transparency.org](http://www.transparency.org)

The providers of these types of finance are referred to in this report as "funders". The different sources of financing are often inter-related. Each of these sources may be at direct risk of corruption, and also at indirect risk as a result of corruption in any related source.

### **Types of corruption**

6. Corruption can include bribery, extortion, fraud and other equivalent criminal offences.

### **The concealment of corruption**

7. 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. Fraud is by its nature concealed, as it involves one party deceiving another. Bribery is often used to help conceal fraud. Conversely, fraud is often necessary in order to facilitate or conceal a bribe.

### **The nature of a construction project**

8. The nature of construction projects facilitates corruption. In particular, the complex contractual structure, the diversity of skills, different project phases, the large size, uniqueness and complexity of projects, the concealment of some items of work by other items, the lack of transparency in the industry, and the extent of government involvement all contribute to an environment in which bribery and fraud can be difficult to prevent and detect.

### **Corruption in the financing and execution of construction projects**

9. Corruption in relation to a construction project can occur in two areas:
  - a) In the provision and management of the financing for a project.
  - b) During project execution (planning, design, tendering, construction, operation and maintenance of a project).

#### **Corruption in the provision and management of the financing**

10. Corruption in the provision and management of the financing for a project can occur as follows:
  - a) Bribes can be paid or fraud perpetrated by the funder's representative for the benefit of the funder. For example, the investors in a private sector project may offer equity in the project to a relative of a government minister in return for approval of the project.
  - b) Bribes can be paid or fraud perpetrated by the funder's representative for the personal benefit of the funder's representative. For example, a representative of the funder may, as a result of inside information, secretly buy land which is needed for the project construction, and then sell or lease it to the project owner at a profit.
  - c) Bribes can be paid or fraud perpetrated by the project owner's representative for the benefit of the project owner. For example, the project owner, in order to obtain financing for a project, may pay a bribe to the funder's consulting engineer to issue an engineering report which conceals adverse site, social or environmental data in relation to the project.
  - d) Bribes can be paid or fraud perpetrated by the project owner's representative for the personal benefit of the project owner's representative. For example, the project owner's purchasing manager may secretly be part owner of a sub-contractor constructing the project, and make a fraudulent claim which benefits the sub-contractor under the project owner's insurance policy.

- e) Bribes can be extorted, or fraud can be perpetrated, by a government official. For example, a grant given to a government by a donor for a specific purpose may be misappropriated by a government official.

#### Corruption during project execution

11. Corruption during project execution can occur in numerous ways. For example:
- a) The project owner may bribe a government official in order to obtain planning permission for a project.
  - b) The project may, as a result of a bribe from a bidder, be designed by the project owner's engineer in a manner which improperly favours that bidder over the others.
  - c) A bidder may pay a bribe to the project owner's representative to win the contract.
  - d) Bidders may secretly collude with each other to agree who will win the contract and at what price.
  - e) A contractor may pay a bribe to the project owner's representative in return for the project owner approving defective or non-existent work.
  - f) The project owner may pay a bribe to the project engineer in return for the engineer refraining from issuing a payment certificate or an extension of time to the contractor.
  - g) The project 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.
  - h) If the parties are in dispute in relation to the construction of the project, one party may bribe a witness, expert, arbitrator or judge in order to give a favourable opinion or verdict.

#### The costs of corruption

12. Bribery or fraud in the provision and management of the financing for a project can result in:
- a) more expensive or inappropriate financing for the project owner;
  - b) lower return on investment or higher risk for the funder;
  - c) funding being provided for non-existent, unnecessary, unviable, dangerous, or environmentally or socially destructive projects;
  - d) misappropriation of funds.
13. Bribery or fraud during project execution can result in:
- a) unviable, defective, dangerous or environmentally or socially destructive projects;
  - b) an increase in the financing, capital, operating and maintenance costs of projects;
  - c) uneconomic projects;
  - d) misappropriation of funds.

#### The risks to funders as a result of corruption

14. In the event of corruption in relation to the financing or execution of the project, the funder may incur:
- a) contractual liability;
  - b) criminal liability;
  - c) financial loss;
  - d) reputational risk.

Contractual liability

15. The funder may incur contractual liability in the event of corrupt practices committed by or on behalf of the funder, or by a party for which the funder is legally or contractually responsible.
- a) **Termination:** The project owner or other aggrieved party may be entitled to terminate a contract which has been procured through bribery or fraud.
  - b) **Damages:** The funder may be required to pay damages to those affected by the bribery or fraud.
  - c) **Liability for acts committed by other parties:** The funder could be contractually liable for bribery or fraud committed by the funder's employee, associated or subsidiary company, agent, joint venture partner or sub-contractor.

Criminal liability

16. The funder may incur criminal liability in the event of corrupt practices committed by or on behalf of the funder, or by a party for which the funder is legally responsible.
- a) **Corruption by employees:** If an employee of the funder commits bribery or fraud in the course of his employment, then the funder may incur criminal liability for the employee's acts. In addition, employees may incur personal criminal liability even where they are committing bribery or fraud only for the purposes of their employer's business and not for their personal gain. Such risk of liability may apply not only to the individuals directly involved in the bribery or fraud, but also to those individuals who authorised, tacitly condoned or wilfully turned a blind eye to it and thereby permitted the action to go ahead. Such individuals may include directors, managers, lawyers and financial officers of the funder.
  - b) **Corruption by other parties:** The funder may incur criminal liability for the acts committed in relation to the financing contract by the funder's associated or subsidiary company, agent, joint venture partner or sub-contractor. This is likely to be the case where the funder approved, condoned or turned a blind eye to the commission of the offence.
  - c) **Aiding and abetting:** It is now widely acknowledged that, without proper anti-corruption systems, funds are often misappropriated or misused, both within the funding organisation and by the recipient of the funding. A funder could therefore be liable for aiding and abetting corruption if it deliberately or recklessly:
    - i) provides funding in such a way as to facilitate the perpetration of bribery or fraud;
    - ii) turns a blind eye to the possibility that bribery or fraud may be perpetrated;
    - iii) fails to take reasonable steps to prevent corruption.

Financial loss

17. Even if the funder is not contractually or criminally liable for corrupt acts in the circumstances referred to in paragraphs 15 and 16 above, it can incur substantial financial losses in the event of corrupt acts by others. In particular, it could lose the whole or part of its investment.

Reputational risk

18. The funder may suffer considerable reputational risk as a result of its involvement in a corrupt project. This will be regardless of whether or not it is responsible for the corruption.

### **Anti-corruption actions for funders**

19. The following are recommended actions which could be taken by a funder to reduce the risk of corruption in relation to:
  - a) the provision and management of the financing for a project; and
  - b) project execution.
20. It will obviously not be possible to make certain that there will be no corruption in relation to the provision of funding or project execution. Only reasonable preventive actions can be taken.
  - a) As far as contractual liability is concerned, the funder should try to ensure that no corrupt act is committed by it or on its behalf, as it may bear the financial consequences whether or not it had knowledge of the corruption, and whether or not it took preventive actions.
  - b) As far as criminal liability is concerned, the funder should take sufficient steps to ensure that it is not:
    - i) complicit in corruption;
    - ii) wilfully blind or reckless as to whether or not corruption occurs;
    - iii) aiding and abetting corruption.
21. **Corporate anti-corruption code of conduct and management programme:** The funder should ensure that it operates an effective anti-corruption code of conduct and management programme. The code prohibits all employees of the company from engaging in any form of corrupt conduct. The management programme puts into effect management, audit, reporting and training procedures to ensure that the code is complied with.
22. **Bonuses and incentives:** If the funder's employees are given bonuses or incentives which relate to their performance:
  - a) The funder should avoid or closely monitor such arrangements which could encourage the employees to engage in corrupt activities with a view to enhancing their bonus or incentive.
  - b) The funder should introduce a factor into such arrangements which rewards employees for identifying and avoiding a potentially corrupt activity, even if this means that the funder loses the funding contract.
23. **Due diligence:** The funder should undertake adequate due diligence on:
  - a) its key employees;
  - b) the financing transaction;
  - c) the key participants in the project;
  - d) agents and intermediaries;
  - e) the project.
24. **Conflicts of interest:** Conflicts of interest can often lead to corruption. Such conflicts need to be identified and, as far as possible, avoided. A register of interests should be maintained so that potential conflicts can be identified.
25. **Verification:** The provision of funding often depends on key calculations, assessments or projections. These could relate to matters such as the projected income of the project, or technical, safety, environmental or social issues. These reports are therefore particularly prone to corruption, as they may be critical to the success of the project, but rely often on opinion or expertise, and are difficult to verify. These key issues should be independently verified by parties of known reputation and integrity. Once the funding has been provided, the funder needs to verify whether the funding actually is being used for the purpose for which it was intended.
26. **Single sourcing:** Single sourcing is where a contract is negotiated with a single supplier rather than putting the contract out to competitive tender. Single sourcing is normally discouraged because it can lead to higher prices, as there is no competitive pressure on the supplier to keep his price low. In addition, single sourcing can be the result of corruption, in that the supplier may have paid a bribe in order to ensure that there is no competitive tendering. The higher price can then conceal the bribe. Single sourcing should be avoided unless there are very good reasons for it.

27. **Transparency:** Corruption is concealed. The greater the transparency, the more difficult it will be to conceal corruption. The funder should try to ensure that all material elements relevant to the funding and project are published on the internet, and are available on request. This increases the chance that an interested third party may discover and report any suspicious circumstances, and therefore reduces the chance of a party participating in a corrupt activity.
28. **Decision making:** The decision to enter into a financing contract should be taken by at least two people, or by a committee constituted for that purpose. The decision, and the reasons for the decision, should be recorded, and be available for inspection by other senior management of the funder and the auditors.
29. **Anti-corruption warranties:** Contractual documentation should include adequate anti-corruption warranties given by the relevant 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.
30. **Independent assessor:** 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.
31. **Reporting:** The funder should put into effect internal and external reporting procedures:
- a) It should publicly disclose that it is the funder for a particular project and any employee or third party should be able to report matters of concern in a confidential manner to an appropriate senior manager of the funder.
  - b) It 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 a real likelihood of prosecution for offenders.
32. **Recourse:** The funder should ensure that it has the right of full recourse against employees, the project owner, government, contractor and other relevant parties in the event of a corrupt act. The funder should exercise this right if corruption occurs. The knowledge that recourse will be sought is an effective deterrent.
33. **Guarantee:** The funder should ensure that there are no circumstances in which it is contractually obliged to make payments under guarantees or insurance policies in the event that there has been a corrupt act relevant to the claim.
34. **Debarment:** The funder should develop 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.
35. **Co-operative action:** Anti-corruption actions would be far more effective if all funders and other parties who are involved in a project commit to anti-corruption measures, and co-operate together to ensure their implementation. Co-operation would
- a) reduce the likelihood that a government or project owner will ignore the funder's requirement;
  - b) result in shared due diligence activities and shared knowledge;
  - c) spread the cost of anti-corruption mechanisms between more participants.

### **Detailed Analysis**

36. The contents of the Executive Summary are analysed in more detail in Section 3: Detailed Analysis.

## SECTION 3: DETAILED ANALYSIS

### DEFINITIONS

37. In this report, the following terms are used:
- a) "Corruption" includes bribery, extortion, fraud or equivalent criminal offence.
  - b) "Financing" means any form of financial support provided for a construction project, including aid, loans, equity, insurance or guarantees;
  - c) "Funder" means an organisation which provides financing for a construction project;
  - d) "Project owner" means the organisation which owns or develops a construction project.
  - e) "Contractor" means the company bidding for, or constructing, the whole or part of the project.

### SOURCES OF FINANCE

38. The financing of a construction project can include any or all of a variety of sources and products.
- a) **Aid/grants/subsidies:** International or national donors may:
    - i) give non-repayable aid or grants for the construction of a project;
    - ii) subsidise the financial costs (e.g. interest rates);
    - iii) subsidise the cost of construction, operation or maintenance;
    - iv) subsidise the cost of the product produced by the project.
  - b) **Equity investment:** Projects may be paid for using equity invested by shareholders in the project owner. Equity investment could come from:
    - i) existing shareholders in the project owner;
    - ii) private sector equity investors brought in specifically to help finance the project;
    - iii) the contractors who are building the project;
    - iv) the operators who are maintaining the project.
  - c) **Loans:** Money may be lent for the construction of the project. The money lent will be repayable with interest over the life of the loan. Loans may come from:
    - i) governments;
    - ii) multi-lateral banks;
    - iii) public or private sector commercial banks;
    - iv) the shareholders in the project owner;
    - v) a company associated with the project owner.
  - d) **Lease Finance:** Money may be provided for the purchase of capital assets by means of lease finance. Under these arrangements, the funder purchases a capital asset which is required by the project owner, and then leases the asset for an agreed period to the project owner in return for periodic lease payments by the project owner. At the end of the agreed period, the lease is either extended, or the funder re-possesses and sells the asset.
  - e) **Financial guarantees and insurance:** In high risk sectors or territories, and in most emerging markets, banks are unlikely to lend money unless repayment is guaranteed or insured by a party other than the project owner. Financial guarantees or insurance can be provided by:
    - i) Governments (normally through government owned or controlled corporations, central banks, ministries, or other government departments);
    - ii) National, multi-national or multi-lateral export credit agencies;
    - iii) private sector guarantors or insurers.
  - f) **All risks and general insurance:** Commercial banks would not normally lend to a project, and equity investors would not normally invest share capital, unless the project had adequate insurance against material risks which could damage the viability of the project or project owner. This insurance would normally cover:
    - i) losses to the works while being constructed due to fire, storm, earthquake etc.
    - ii) consequential losses;

- iii) public liability;
- iv) equipment or design failure;
- v) injury to workers or third parties.

39. Financing can also be provided from the national budget of the country in which the project is being built. Corruption in government funding is not examined in this report, although many of the principles will be similar to those which apply to the other sources of financing examined in this report.
40. The different sources of financing are often inter-related. Each of these sources may be at direct risk of corruption, and also at indirect risk as a result of corruption in any related source.
41. Many funders will be providing their finance as part of a consortium of funders. A lead funder may be appointed to represent the other funders in negotiating and obtaining the finance contract. The other funders will be relying on the integrity and due diligence of the lead funder in this regard.
42. Many of these sources of finance are traded on the secondary market. A funder which has negotiated and obtained the financing may sell the whole or part of the funding contract to another funder or group of funders. The funder which is buying the financing contract will to some extent be relying on the integrity and due diligence of the primary funder in this regard.

### **TYPES OF CORRUPTION**

43. Corruption can include bribery, extortion, fraud and other equivalent criminal offences.

#### **Bribery**

44. Bribery can be defined as the demanding, receiving, offering or giving of an undue reward by or to any person in order to influence his behaviour.
45. The perpetrators of bribery will include both those who demand or receive the bribe (demand-side bribery) and those who offer or give it (supply-side bribery).
46. A bribe may be a cash payment, or a non-cash advantage (such as the promise of a future contract, or a holiday). It may be paid directly or indirectly (e.g. through an agent, joint venture partner or a subsidiary). It may be received directly or indirectly (e.g. by a friend, relative or spouse).
47. A bribe may be paid or received with the full approval of the organisation (institutional bribery). On the other hand, it may be paid or received by a representative of an organisation without the approval of the organisation (personal bribery). Normally, 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, if a funder pays a bribe to a representative of a project owner in exchange for the award of a contract to provide financing, the funder 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 funder will normally directly benefit. The funder will benefit as an organisation if it wins the contract. However, the recipient of the bribe will normally be receiving the bribe for personal benefit. The project owner whom he represents will not normally benefit, as the cost of financing will usually be higher to reflect the cost of the bribe. However, in some circumstances, it is possible for both the payment and receipt to be personal acts. This would be the case where the representative of the funder is paying a bribe in a personal capacity and without the approval of the board or senior manager with a view, for example, to enhancing his personal bonus as a result of the award.
48. Bribery sometimes involves a wide conspiracy. It is possible to have arrangements where a bribe benefits a whole group of individuals on the demand side and/or where the receivers secretly kick back a portion of the bribe to one or more individuals on the supply side.
49. "Facilitation payment" is the term used to describe relatively minor payments extorted by junior officials to expedite services which should be provided without payment of a bribe. In most legal jurisdictions,

facilitation payments will be regarded as bribes. Therefore, the payer of the facilitation payment, in addition to the person demanding it, is normally guilty of bribery.

### **Extortion**

50. Extortion is a form of blackmail. It is the term applied to the process of demanding a bribe where the demander uses some form of physical or financial pressure, and where the person from which the payment is demanded may feel that he has little choice but to comply. Funders could be directly involved in extortion, for example, where a payment officer of the funder refuses to make due payments to a project owner without receipt of a bribe, or where the project owner refuses to make a loan repayment to the funder without receipt of a bribe. Alternatively, extortion may affect a project for which finance is provided. For example, there may be extortion by policemen at road blocks, or by gangs on a construction site. Sometimes the coercion is the threat of inaction (e.g. non payment or a service not provided). Sometimes the threat is of action (e.g. physical or other harm to a party, or disconnecting a telephone). Although the extortion may constitute blackmail, or equivalent criminal offence, giving in to the coercion may make the coerced party liable for the offence of bribery. Some jurisdictions allow the coerced party to avoid liability for bribery in circumstances where there is a real threat of imminent personal injury.

### **Fraud**

51. 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 payment or advantage from another party, or to deny another party a due payment or advantage. For example, the project owner may deceive the funder by providing over-optimistic projections about the project's future income stream.

### **Bribery and Fraud**

52. Bribery normally involves a degree of fraud. A bribe paid to win a financing contract will normally be fraudulently concealed with the aim that the award appears to have been won on a genuine arms-length basis.
53. Fraud does not necessarily involve bribery. However, many acts of deception (fraud) may need an act of bribery in order to complete the deception. For example, provision by a project owner of over-optimistic projections may require the project owner to bribe the funder's engineer to overlook flaws in the projections.
54. Although bribery normally receives a higher public profile, the financial wastage in a project due to fraudulent practices is often higher than that attributable to bribery.

### **THE CONCEALMENT OF CORRUPTION**

55. 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 funder may be genuinely unaware that these practices are occurring. However, in many cases, the funder will at the very least have been wilfully blind to the circumstances. The following are methods by which a funder may conceal a bribe by the use of intermediaries. The same principles of concealment would apply to a contractor who is bidding for the construction contract.
- a) **Agents.** The most common form of intermediary is the agent. The funder appoints an agent who has contacts with a representative of the project owner or with the government of the country concerned. The funder pays the agent a percentage of the funding amount on being awarded the financing contract. The agent passes the whole or part of the payment to the representative of the project owner or government in return for the funder winning the contract. The payment is usually made in foreign currency into an offshore bank account. Funders 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 project owners and investigation by prosecution authorities is lower in some countries than in others. When a funder bids as part of an international joint venture from several countries, the joint venture may arrange for an agency agreement to be executed in, and the commission paid from, the country least likely to discover the commission. Similarly, where the funder is part of a multinational group, the commission may be paid by a subsidiary or other group company in a country where the commission is less likely to be detected. The subsidiary or other group company will then be repaid by the funder through inter-company charges for false services, or services of inflated value.

56. Fraud is by its nature concealed, as it involves one party deceiving another. Bribery is often used to help conceal fraud. Conversely, fraud is often necessary in order to facilitate or conceal a bribe.

### **THE NATURE OF A CONSTRUCTION PROJECT**

57. The nature of construction projects facilitates corruption, and makes bribery and fraud difficult to prevent and detect.
58. **Contractual structure:** Construction projects normally have a large number of participants linked together in a complex contractual structure. Each link has its own contractual documentation, and unique risks and difficulties. The project owner may contract with the main contractor to construct the whole project. The main contractor may then sub-contract key parts of the project to major sub-contractors. Those sub-contractors may in turn sub-sub-contract parts of their work to sub-sub-contractors. These sub-sub-contractors will purchase equipment and materials from suppliers, and may further sub-contract parts of their work. The resultant contractual cascade could easily have in excess of 1,000 contractual links, each of which depends to some extent on other contractual links in the chain. Every contractual link provides the opportunity for someone to pay a bribe in return for an award of the relevant contract. In relation to every contractual link, work and services are exchanged for payment. Every item of work and every payment provides an opportunity for a bribe to be paid in return for certifying too much work, certifying defective work, certifying extensions of time, or paying more expeditiously. Every contractual link also provides an opportunity for fraud (for example collusion, price fixing, or inflated claims).
59. **Diversity of skills:** The construction industry is a very diverse industry, both in the number of different professions and trades which work in the industry, and in the number of different specialist contractors. This leads to varied standards of qualification, integrity and oversight.
60. **Project phases:** Projects normally have several different phases, each involving different management teams, and each requiring handovers of the completed phase to the contractors undertaking the next phase. For example, a power station project may have the following phases: feasibility study, design, civil works, building works, mechanical and electrical works (including manufacture, supply and erection of equipment), power station commissioning, and operation. Even if one main contractor undertakes all the phases, it will normally sub-contract the different phases to different sub-contractors. This leads to difficulties in control and oversight.
61. **Size of projects:** Some projects can be very large in scale. Major dams, power plants, industrial plants and motorways cost significant amounts of money. It is easier to hide large bribes and inflated claims in large projects than in small projects.
62. **Uniqueness of projects:** Projects vary tremendously in content and size, and rates for labour, equipment and materials vary according to market demand. Many projects are unique. As a result costs are often difficult to compare. This makes it easier to inflate costs and hide bribes.
63. **Complexity of projects:** Projects can be complex. The inter-relationship between the various parties to the contract and events is often uncertain. In many cases, people working on a project appear not to

know, or to disagree on, the reason why something has gone wrong, or why costs have overrun. This makes it easier to blame other participants for problems, and to claim payment for these problems, even if such claims are unjustified. It also creates a reason to pay a bribe, as decisions on cause and effect and their cost consequences can have enormous impact. Bribes and inflated claims can also as a result be more easily hidden, and be blamed on other factors, such as poor design or mismanagement.

64. **Concealed work:** Most components in a construction project end up being concealed by other components. For example, structural steel may be concealed by concrete, brickwork may be concealed by plaster, engineering components may be concealed in casings, and roof structures may be concealed by cladding. As a result, enormous dependence is placed by the industry on individuals certifying the correctness of the work before it is concealed. This provides opportunities for fraudulent claims, and the payment of bribes to these individuals to certify too much work, or to approve defective or non-existent work.
65. **Lack of transparency:** There is little transparency in the construction industry. Costs are as far as possible kept secret, even when public money is spent. Commercial confidentiality currently seems to take precedence over public interest. Therefore, publication of financial information, and routine inspection of books and records (both of which could prevent or uncover malpractice) does not normally take place.
66. **The extent of government involvement:** The extent of government involvement in construction projects is significant. Many major international construction projects are government owned. Even private sector projects normally require government approvals, such as planning permission, or agreements to pay for the use of the end product of the development. The power wielded by government officials in this regard, when combined with the structural and financial complexity of the industry referred to above, makes it relatively easy for uncontrolled government officials to extract large bribes from construction projects.

### **CORRUPTION IN THE FINANCING AND EXECUTION OF CONSTRUCTION PROJECTS**

67. Corruption in relation to a construction project can take place in two areas:
  - a) in the provision and management of the financing for a project;
  - b) during project execution (planning, design, tendering, construction, operation and maintenance of a project).
68. Paragraphs 69 to 89 below examine the different categories of corruption in these two areas, and give examples. This is done in order to enhance understanding of the types of corruption. The categories and examples are not exhaustive, and there is inevitably overlap between the areas. In addition some examples in one category could also be used, in mirror image, as an example in a different category (for example, a bribe offered or given by a funder to a government official is also a bribe requested or received by the official).

#### **Corruption in relation to the provision and management of the financing for the project**

69. This section looks at 5 types of corruption in the provision and management of financing for the project:
  - a) Bribes paid or fraud perpetrated by the funder's representative for the benefit of the funder;
  - b) Bribes paid or fraud perpetrated by the funder's representative for his own personal benefit;
  - c) Bribes paid or fraud perpetrated by the project owner's representative for the benefit of the project owner;
  - d) Bribes paid or fraud perpetrated by the project owner's representative for his own personal benefit;
  - e) Bribes extorted or fraud perpetrated by a government official for the benefit of the official.

#### **Bribes paid or fraud perpetrated by the funder's representative for the benefit of the funder**

70. A representative of the funder may, with the intention of benefiting the funder, pay a bribe or make fraudulent representations to a representative of the project owner, or to an official in the country in which a

project is located, in order to secure the financing contract or to obtain unduly favourable financing terms. For example:

- a) The investors in a private sector project may give free equity to a relative of a government minister in return for project approval.
- b) A bank may pay a bribe to a senior official through an agent in return for the bank being awarded the contract to finance the construction of a project at enhanced interest rates.
- c) An insurance company may pay for a holiday for the insurance manager of the project owner in return for him placing the insurance contract with the insurer.
- d) An exporting government may threaten to suspend subsidised military supplies unless a contractor from that country is awarded a major contract.

71. A representative of the funder may defraud other funders. For example, a company which is both an investor in the project owner and undertaking construction work in relation to the project, may inflate the cost of its construction contract to include the cost of its equity investment. The other funders will then wrongly believe that the contractor is using its own funds to purchase equity, and that its contract price is a fair market price.

72. In addition to contract award, the bribe or fraud could be intended to result in the following benefits for each category of funder listed below.

a) **Donor:**

- i) Political influence;
- ii) Tying donations to inappropriate, overpriced or harmful equipment or services from that country;
- iii) Tying donations to national commercial interest.

b) **Equity investor:**

- i) Lower amount invested in return for higher percentage of shareholding;
- ii) Changes to the law to allow the investment;
- iii) Changes in the law to disallow any similar future investment from any other party in order to guarantee better returns and less competitive pricing owing to a monopolistic position;
- iv) Guarantees or favourable treatment for the project company which lead to a higher return on investment.

c) **Lender:**

- i) Higher loan amount;
- ii) Higher interest rate;
- iii) Higher fees;
- iv) Longer loan term;
- v) Increased security.

d) **Lessor:**

- i) Higher lease amount;
- ii) Higher lease payments;
- iii) Higher fees;
- iv) Longer lease term;
- v) Increased guaranteed residual value of asset.

e) **Guarantor:**

- i) Higher premium or fee;
- ii) Lower amount guaranteed;
- iii) Fewer circumstances in which guarantee will operate;
- iv) Higher levels of recourse (the ability to claim compensation in the event of default).

- f) **Insurer:**
  - i) Higher premium or fee;
  - ii) Lower amount insured;
  - iii) Fewer circumstances in which insurance will operate;
  - iv) Higher levels of recourse.

Bribes paid or fraud perpetrated by the funder's representative for his own personal benefit

73. A representative of the funder may, with the intention of benefiting himself, pay a bribe or make fraudulent representations in order to secure a financing contract. The bribe could result in the same benefits for each category of funder specified in paragraph 72 above. However, it is likely that the prime motive of the representative in paying the bribe would be to enhance a bonus or other benefit which he would receive if the transaction were successfully completed. His primary concern may therefore be to ensure that the project goes ahead, or to maximise the quantity of funding, regardless of the quality of the funding and of the underlying projects. Consequently, the terms may not be as favourable to the funder as those under paragraph 72 above, and may even be prejudicial to the funder. For example:
- a) A representative of the funder may receive a performance bonus in the event that the transaction is completed. In order to ensure that he receives the bonus, he may:
    - i) agree with a representative of the project owner to share the bonus with him in the event that the contract is awarded to the funder; or
    - ii) conceal adverse project data from the funder which would have prevented the funder's board from approving the contract.
  - b) A representative of the funder may, as a result of inside information in relation to a project:
    - i) secretly buy land which is needed for the project construction, and then sell or lease it to the project owner at a profit; or
    - ii) secretly buy shares in the project owner, or in a company which will benefit from the project.
  - c) A representative of the funder may conspire with an auctioneer to declare that assets were sold at the end of a lease period for a lower amount than the actual sale price, and then share the additional proceeds.
74. The bribe or fraud could result in the following detriment to each category of funder listed below:
- a) **Donor:**
    - i) A donation being made for non-existent, corrupt or unviable projects;
    - ii) Higher amount donated;
    - iii) Lower levels of control on use of money.
  - b) **Equity investor:**
    - i) Equity being invested for non-existent, corrupt or unviable projects;
    - ii) Higher amount invested in return for lower percentage of shareholding;
    - iii) Lower return on investment;
    - iv) Insider trading.
  - c) **Lender:**
    - i) A loan being made for non-existent, corrupt or unviable projects;
    - ii) Higher amount lent;
    - iii) Lower interest rate;
    - iv) Lower fees;
    - v) A longer loan term;
    - v) Reduced security.
  - d) **Lessor:**
    - i) A lease being granted for non-existent or unviable assets;
    - ii) Lower lease amount;

- iii) Lower lease payments;
  - iv) Lower fees;
  - v) Shorter lease term;
  - vi) Reduced guaranteed residual value of asset.
- e) **Guarantor:**
- i) A guarantee being given for non-existent, corrupt or unviable projects;
  - ii) Lower premium or fee;
  - iii) Higher amount guaranteed;
  - iv) Increased circumstances in which guarantee will operate;
  - v) Lower levels of recourse.
- f) **Insurance:**
- i) Insurance being provided for non-existent, corrupt or unviable projects;
  - ii) Lower premium or fee;
  - iii) Higher amount insured;
  - iv) Increased circumstances in which insurance will operate;
  - v) Lower levels of recourse.

Bribes paid or fraud perpetrated by the project owner's representative for the benefit of the project owner

75. The project owner's representative may, with the intention of benefiting the project owner, pay a bribe or make fraudulent representations to a representative of the funder, in order to obtain funding for the project which is more favourable to the project owner than it should be, or which allows funding to be obtained which would not normally be obtained. In the case of a bribe, the representative of the funder would be acting in his own interests, and not in the interests of the funder. For example:
- a) The project owner's representative may pay a bribe to a representative of the funder to ensure that the funder approves the financing, or awards it on unduly favourable terms to the project owner.
  - b) The project owner's representative may pay a bribe to the funder's consulting engineer to issue an engineering report which conceals adverse site, social or environmental data in relation to the project. The funder then may make a decision on the viability of the project on falsely optimistic parameters.
  - c) The project owner's representative may defraud the funder. The fraud may be designed to achieve the following aims.
    - i) To raise financing for a project which does not exist, so that the financing can be misappropriated. For example, the project owner may provide falsified documentation which shows that it owns an asset, when it does not.
    - ii) To ensure funding for a project that is not otherwise a priority to a donor or lender.
    - iii) To raise funds for a specified purpose, but to use the funds for another purpose.
    - iv) To make the project seem more attractive to the funder than it actually is by:
      - diminishing the likely costs of the project;
      - exaggerating the likely income or impact of the project;
      - exaggerating the values of the project assets;
      - concealing adverse site conditions, or environmental or safety data;
      - falsifying documents which are required to prove the likely income or costs;
      - falsely leading the funder to believe that it has good payment security.
    - v) To misappropriate money directly from the funder by:
      - submitting false invoices claiming payment for work which has not been done;
      - submitting false or inflated claims under guarantees or insurance policies.

- vi) To misappropriate money provided by the funder to the project by:
  - submitting false invoices claiming payment for work which has not been done;
  - submitting false invoices claiming inflated payment for work which has been done;
  - receiving and spending the money, but not undertaking the work for which the funds were intended.
- vii) To ensure continued fund flows from the funder by:
  - submitting false certificates claiming the fulfilment of agreed conditions that have not been achieved;
  - procuring that the funder agrees to a relaxation of rules where the funder's conditions prove difficult to implement.

Bribes paid or fraud perpetrated by the project owner's representative for his own personal benefit

76. A representative of the project owner may, with the intention of benefiting himself, pay a bribe or make fraudulent representations in relation to a financing contract. The representative would be acting in his own interests, and not in the interests of the project owner. His primary motivation would be to make personal financial gain. For example:
- a) The project owner's representative may receive a performance bonus in the event that the transaction is completed. In order to ensure that he receives the bonus, he may:
    - i) agree with a representative of a funder to share the bonus with him in the event that the funder provides the financing necessary to enable the project to go ahead; or
    - ii) conceal adverse project data from the project owner which would have prevented the project owner's board from approving the contract.
  - b) The project owner's representative may, as a result of inside information in relation to a project:
    - i) secretly buy land which is needed for the project construction, and then sell or lease it to the project owner at a profit; or
    - ii) secretly buy shares in the project owner, or in a company which will benefit from the project.
  - c) The project owner's representative may secretly be part owner of a contractor working on the project, and may make a fraudulent claim which benefits the contractor under the project owner's insurance policy.
  - d) The project owner's representative may misappropriate some of the financing through false accounting or non-existent or fraudulent contracts.

Bribes extorted or fraud perpetrated by a government official for the benefit of the official

77. A government official may extort bribes as a condition of his approval of the project. For example, he may require:
- a) shares in the project owner;
  - b) a share in the proceeds of sales by the project owner;
  - c) a share in the profits of construction from the contractor;
  - d) the use of his own companies to provide construction services or supplies to the project owner.
78. A government official may defraud the funder. For example, he may:
- a) Misappropriate the whole or part of the financing by:
    - i) using the financing for fictitious projects or contracts; or
    - ii) diverting funds intended for genuine projects.
  - b) Use the whole or part of the funding for a corrupt purpose (for example, building a road to his constituency prior to an election).

Actions of other participants

79. The actions referred to above may be taken by or on behalf of the funder or the project owner. Alternatively, they could be taken by or on behalf of group companies, agents, consultants, joint venture partners, or sub-contractors of the funder or project owner.

Detailed examples

80. Detailed examples of the above categories of corruption in relation to the provision and management of the financing for the project are contained in Schedule 1 to this Report.

**Corruption in relation to project execution**

81. Corruption during project execution (planning, design, tendering, construction, operation and maintenance of a project) can have a fundamental impact on the funder's profitability and risk. Although funders do not normally exercise direct control over project execution, they can indirectly assert control by imposing and monitoring anti-corruption procedures during these phases.
82. The following paragraphs assess some of the more common corrupt practices which can take place during the different phases in the execution of a construction project.

Corruption during planning and design phase

83. The following corrupt practices could occur during the planning and design phase.
- a) The project 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 project owner or engineer in a manner which improperly favours one bidder over the others. For example, a certain technology which is possessed by only 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 project owner would knowingly have caused the design to be undertaken in this manner. In other cases, the project owner may not be aware that the design has been undertaken in this manner (for example where the project owner has appointed an architect or engineering consultant to undertake the design, or where the decision is taken corruptly by a representative of the project owner).

Corruption during pre-qualification and tender phase

84. The following are some examples of the circumstances in which bribes could be paid during the pre-qualification and tender 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 project 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 project 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 project 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 project owner and not be opened at a public opening exercise. In this case, no-one except the project owner will be aware of the bidders' prices and other critical tender components. This secrecy will enable a representative of the project 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 tenders may be opened at a public opening exercise. In return for a bribe, the project owner's representative may disqualify all lower priced contractors on the basis of spurious technical infringements. The bribing contractor will as a result be the lowest of the technically compliant contractors, and be awarded the contract.
- e) 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 other cases, it is remarkably overt.

85. The following are some examples of fraudulent practices during the pre-qualification and tender 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.
- d) A representative of the project owner or government may directly or indirectly own one of the bidders, and may use his official status to ensure that his own bidder is awarded the contract.
- e) Funders can be defrauded by the agencies that they contract to manage their investments, projects and field operations. For example, a senior manager of the agency may have direct or indirect links with the contractor or consultant, and could manipulate tender assessments and project reports so as to favour these parties in the due diligence, award or construction process. This manipulation can be the result of a bribe paid to the manager, or his part ownership of one of the companies.

#### Corruption during project construction phase

86. The following are some examples of the circumstances in which bribes could be paid during project construction phase.

- a) A contractor may pay a bribe to the project owner's representative in return for the project 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 project 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 project 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 project owner's works inspector in return for him approving defective or non-existent work.
- f) The project 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.

87. 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 project 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 project owner for an extension of time based on an alleged cause for which the project 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 project 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 project 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 project owner based on an allegation that the project owner is responsible for a particular event, while concealing from the project 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 project 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 project 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 project owner not to grant it, or in the hope of gaining future work from the owner.
- i) The project 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 project 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 project owner may falsely claim that its share of the 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.

#### Corruption during operation and maintenance phase

88. 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.

Detailed examples

89. For detailed examples and analysis of corrupt practices in relation to project execution, see Section 4 of TI's report "Preventing Corruption on Construction Projects – Examples of Corruption"<sup>4</sup>.

**THE COSTS OF CORRUPTION**

90. Bribery or fraud by the funder in the provision and management of the financing for a project can be detrimental to the project owner in that it can result in more expensive or inappropriate financing.
91. Bribery or fraud by the project owner in relation to the provision and management of the financing for a project can be detrimental to the funder in that it can result in:
- a) funding being provided for non-existent, unnecessary, unviable, dangerous, or environmentally or socially destructive projects
  - b) misappropriation of funds;
  - c) lower return on investment or higher risk for the funder.
92. Bribery or fraud during project execution can result in the following detriment to the funder and project owner:
- a) unviable, defective, dangerous or environmentally or socially destructive projects;
  - b) an increase in the financing, capital, operating and maintenance costs of projects;
  - c) uneconomic projects;
  - d) misappropriation of funds.
93. The above circumstances can all adversely impact on consumers and citizens

**THE RISKS TO FUNDERS AS A RESULT OF CORRUPTION**

94. In the event of corruption in relation to the financing or execution of the project, the funder may incur:
- a) contractual liability;
  - b) criminal liability;
  - c) financial loss;
  - d) reputational risk.
- These aspects are examined below. The principles set out below may apply in a number of jurisdictions. There will, however, inevitably be differences in law between jurisdictions and local legal advice should always be sought.

**Contractual liability**

95. The funder may incur contractual liability in the event of corrupt practices committed by or on behalf of the funder, or by a party for which the funder is legally or contractually responsible. The contractual liability of the funder will normally be determined by the terms of the financing contract and the governing law of that contract. The potential liability is analysed below.
96. Termination
- a) The governing law of the contract may provide that a contract which has been procured through an illegal act (which would normally include bribery or fraud) is void, or may be terminated by the aggrieved party.

---

<sup>4</sup> See [www.transparency.org](http://www.transparency.org). Go to "how to fight corruption" then to "preventing corruption on construction projects" then to "examples of corruption".

- b) Many financing contracts contain an express clause entitling termination of the contract in the event of bribery or fraud.

### Damages

97. If bribery or fraud is committed by or on behalf of a funder, or by a party for which the funder is legally or contractually responsible, the funder may be required to pay damages to the parties prejudiced by the corruption. These damages could be extensive and could include the following:
- repayment of the cost of any bribe;
  - repayment of unduly high interest payments, commissions or fees;
  - payment of losses suffered by the relevant parties as a result of delay to or collapse of the project, or termination of the contract (where these are a consequence of the corruption);
  - compensation to the party who would have won the contract but for the bribe;
  - other losses resulting from the corruption.

### Funder's contractual liability for acts committed by other parties

98. The funder could be contractually liable for bribery or fraud committed by the following:
- an officer or employee of the funder;
  - a subsidiary or associated company of the funder;
  - a joint venture/consortium/syndicate partner of the funder;
  - a sub-contractor of the funder;
  - an adviser of the funder;
  - an agent of the funder.
99. The reason for this liability is that:
- the action may be construed as having been taken on behalf of the funder (for example, if the action was committed by an employee, subsidiary, adviser or agent of the funder);
  - the action may be one for which the funder is jointly and severally liable (for example, if the action was committed by a joint venture partner);
  - the action may be one for which the funder is contractually liable (for example, an action of a sub-contractor).
100. The funder may incur contractual liability for bribery or fraud committed by those parties listed in paragraph 98 above even where the funder:
- did not benefit from the corruption; and/or
  - had not authorised the corruption; and/or
  - had no knowledge of the corruption; and/or
  - had taken all reasonable steps to prevent corruption.

### Funder's right of recourse

101. Where the funder incurs losses as a result of the actions of any of the parties listed in paragraph 98 above, the funder may seek to recover its losses by commencing legal proceedings against such parties. However, in many cases, it would be unlikely that the funder could recover all its losses as:
- the party responsible for the corrupt act may not have assets sufficient to cover the funder's losses;
  - the individual recipient of any bribe may be hard to locate;
  - legal proceedings may be difficult in the country in question.

### Criminal liability

102. The funder may incur criminal liability in the event of corrupt practices committed by or on behalf of the funder, or by a party for which the funder is legally responsible. The nature of any criminal liability will depend on the law of the country in which the crime was committed and on the law of the home countries of the parties involved in the crime. The potential criminal liability of the funder is analysed below.

Funder's criminal liability for bribery or fraud committed by its employees

103. If an employee of the funder commits bribery or fraud in the course of his employment, then the funder may incur criminal liability for the employee's acts in the following circumstances:
- a) the funder required the corrupt act to be committed;
  - b) the funder expressly or tacitly condoned the act;
  - c) the funder wilfully turned a blind eye to the act; or
  - d) the employee was aware of the act, but the funder was unaware of the act.
104. In the case of sub-paragraph 103 d), the liability of the funder may be mitigated (but not necessarily avoided) to the extent that it can be shown that the funder took reasonable steps to prevent corruption in the operation of its business.

Funder's criminal liability for bribery or fraud committed by other parties

105. The funder may incur criminal liability for bribery or fraud in relation to the funder's contract committed by the following parties:
- a) a subsidiary or associated company of the funder;
  - b) a joint venture/consortium/syndicate partner of the funder;
  - c) a sub-contractor of the funder;
  - d) an adviser of the funder;
  - e) an agent of the funder.
106. Such liability may be incurred in the following circumstances:
- a) the funder required the corrupt act to be committed;
  - b) the funder expressly or tacitly condoned such act;
  - c) the funder wilfully turned a blind eye to the act.

Criminal liability of the funder's employees

107. Employees of the funder may incur personal criminal liability even where they are committing bribery or fraud only for the purposes of their employer's business and not for their personal gain. Such risk of liability may apply not only to the individuals directly involved in the bribery or fraud, but also to those individuals who authorised, tacitly condoned or wilfully turned a blind eye to it and thereby permitted the action to go ahead. Such individuals may include directors, managers, lawyers and financial officers of the funder.

Aiding and abetting corruption

108. The aiding and abetting of corruption is a criminal offence in many jurisdictions. In general terms, it occurs where a party aids, abets, counsels, procures or assists in the commission of an offence. The maximum penalty for aiding and abetting will often be the same as for the principal offence.
109. It is now widely acknowledged that, without proper anti-corruption systems, funds are often misappropriated or misused both within the funding organisation and by the recipient of the funding. Funders are normally able to set anti-corruption conditions under which the funding is to be provided and used. Therefore, a funder which deliberately or recklessly takes insufficient care in the manner in which funding is provided or monitored could be said to be aiding and abetting corruption. The following failures, where deliberate or reckless, could constitute aiding and abetting:
- a) Providing funding in such a way as to facilitate the perpetration of bribery or fraud.
  - b) Turning a blind eye when bribery or fraud is being perpetrated.
  - c) Providing funding in circumstances where it would be difficult to establish whether the funds had been used for the intended purpose.

- d) Providing funding to a government or governmental department reputed to be corrupt without taking reasonable precautions to guard against further corruption.
- e) Providing funding when there are suspicious circumstances; for example, where the comparative cost of the project to be funded is, without good reason, significantly above the cost of other similar projects.
- f) Providing funding without suitable verification that the project to be funded exists.
- g) Providing funding without carrying out cost-benefit and feasibility studies in order to establish to a reasonable degree that the project to be funded is not corrupt and is viable.
- h) Providing funding without requiring the adoption of reasonable anti-corruption measures in the underlying project.
- i) Providing guarantees (for example, export credit guarantees) which ensure recovery and/or prevent recourse in the case of corruption.
- j) Providing the financing through a special purpose investment vehicle, while failing to take reasonable steps to ensure that the investment vehicle implements reasonable anti-corruption mechanisms.
- k) Paying out under a guarantee or insurance policy in circumstances where there has been corruption.
- l) Failing to take reasonable steps to assess how funds have been used.
- m) Failing to take reasonable steps to assess whether the project for which funds have been provided is of proper quality.
- n) Failing to take reasonable steps to follow-up and investigate allegations of corruption in the use of funds.
- o) Failing to take reasonable steps when employees or other parties are suspected of corruption.

#### Corporate and individual liability

- 110. In many countries, companies can be liable for criminal offences. In these countries, both the responsible company and the responsible individuals can be prosecuted.
- 111. In countries where companies cannot be liable for criminal offences, only the responsible individuals can be prosecuted.

#### Extra-territorial jurisdiction

- 112. Many countries (including all OECD countries) now have extra-territorial jurisdiction to prosecute bribery. Consequently, it is possible that a bribe may constitute a crime in one or more of:
  - a) the country in which the crime was committed;
  - b) the home countries of the individuals involved in the crime;
  - c) the countries of incorporation or registration of the companies involved in the crime.
 A funder and its employees are not, therefore, safe from prosecution in relation to a bribe paid in a country which is lax in prosecution of corruption, as both the funder and its employees may be prosecuted in their home countries. In addition, a funder and its employees may be prosecuted for corruption in a country which has far more severe penalties for corruption (for example, execution of individuals) than in their home country.

#### Consequences of criminal liability for funder and its employees

- 113. The criminal penalties for bribery and fraud are serious and could include the following:
  - a) Companies: Companies convicted of bribery or fraud may be fined. They may also be debarred from tendering for public sector contracts, and may be removed from private sector tender lists.
  - b) Individuals: Individuals convicted of bribery or fraud may be fined, imprisoned and, in some jurisdictions, executed. Criminal conviction could also result in loss of employment, prohibition from acting as a director, and loss of professional qualification or accreditation.

**Financial loss**

114. Even if the funder is not contractually or criminally liable for corrupt acts in the circumstances referred to in paragraphs 95 to 113 above, it can incur substantial financial losses in the event of corrupt acts by others. In particular, it could lose the whole or part of its investment. For example:
- a) Bribes paid by the contractor to win the construction contract may make the project financially unviable. The project owner may as a result be unable to repay the funder.
  - b) The project owner may terminate the contract of a contractor who has paid a bribe. This may result in the collapse of the contractor. If the funder has lent money to the contractor, the funder may be unable to recover its funds.
  - c) An equity investor in a project owner may lose the whole or part of its investment if the project collapses or becomes unviable as a result of corruption.
  - d) An equity investor in a contractor may lose the whole or part of its investment if the contractor loses business as a result of it being debarred from tendering due to a conviction for corruption.

**Reputational risk**

115. The funder may suffer considerable reputational risk as a result of its involvement in a corrupt project. This will be regardless of whether or not it also suffers financial losses, or whether it, or any of its employees are convicted of corruption. Trust and reputation can take a considerable amount of time to re-establish.

**ANTI-CORRUPTION ACTIONS FOR FUNDERS**

116. The following are recommended actions which could be taken by the funder to reduce the risk of corruption in relation to:
- a) the provision and management of the financing for a project; and
  - b) project execution.
117. Anti-corruption actions should deal with all types of corruption referred to in paragraphs 69 to 89 above, both by implementing appropriate anti-corruption systems within the funder's organisation, and by ensuring, as a condition of funding, that suitable anti-corruption controls are imposed at project level.
118. Anti-corruption actions may be modified according to the extent of the commercial risk and the type of financing being provided by the funder. The provision of aid, or a material amount of equity or lending will inevitably give a funder greater control over the implementation of project anti-corruption mechanisms than, for example, the provision of insurance. Small or low risk contracts or projects would require a lower level of preventive action than large or high risk contracts or projects. However, it should be remembered that while commercial risk may be reduced according to the size of the contract or project, the criminal risk will remain the same.
119. It will obviously not be possible to make certain that there will be no corruption in relation to the provision of funding or project execution. Only reasonable preventive actions can be undertaken.
- a) As far as contractual liability is concerned, the funder should try to ensure that no corrupt act is committed by it or on its behalf, as it may bear the financial consequences whether or not it had knowledge of the corruption, and whether or not it took preventive actions.
  - b) As far as criminal liability is concerned, the funder should take sufficient steps to ensure that it is not:
    - i) complicit in corruption;
    - ii) wilfully blind or reckless as to whether or not corruption occurs;
    - iii) aiding and abetting corruption.

### **Internal anti-corruption code of conduct and management programme**

120. The funder should have in place an effective internal anti-corruption code of conduct and management programme. Several organisations have developed systems and guidance to assist this purpose:
- a) Transparency International has developed the “Business Principles for Countering Bribery” and accompanying guidelines, implementation plan and verification module<sup>5</sup>.
  - b) The International Chamber of Commerce has developed "Combating Extortion and Bribery: ICC Rules of Conduct and Recommendations"<sup>6</sup>.
  - c) The International Federation of Consulting Engineers (FIDIC) has developed "Guidelines for Business Integrity Management in the Consulting Industry"<sup>7</sup>.
121. The **code of conduct** should:
- a) Prohibit all employees of the funder from engaging in any form of corrupt conduct.
  - b) 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. This policy should either prohibit these items, or should specify clearly the circumstances in which they are payable, and the maximum amounts, and approval requirements. All payments should be recorded in a register which can be accessed by the funder’s management and auditors.
  - c) Specify the funder’s policy on facilitation payments. These are small payments which are in some countries frequently extorted by government officials in return for permits and approvals. The ultimate aim of the funder should be a ban of these payments.
  - d) Require all employees to comply with the funder’s policies on provision of funding so as to limit the risk of corruption. Non-compliance should be a disciplinary offence which can lead in serious cases to dismissal.
  - e) 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, sub-contractors and suppliers. Such steps could include, for example, requiring those parties to put into effect anti-corruption codes of conduct and management programmes.
122. The purpose of the funder’s **anti-corruption management programme** is to ensure that the anti-corruption code of conduct is complied with. The programme should contain the following components:
- a) A senior officer of the funder should have responsibility for management of the programme.
  - b) All relevant employees of the funder should receive adequate training in implementation of the programme. One of the most powerful anti-corruption tools a company can have is well-trained employees who are alert to the dangers of corruption, and who can identify warning signs at an early stage. Training can be provided by workshops, and be supplemented by videos and written material. Training should cover the following ground:
    - i) an explanation of the applicable laws and the penalty for breaching the laws (for example, imprisonment);
    - ii) an explanation of the funder’s code of conduct, and the penalty for breaching the code (for example, various levels of warning or dismissal);
    - iii) detailed examples of what type of conduct would constitute a breach of the law and/or the funder’s code of conduct;
    - iv) guidance on “red flags” which would warn the employee about likely corrupt conduct;

<sup>5</sup> See [www.transparency.org](http://www.transparency.org) (Business Principles for Countering Bribery)

<sup>6</sup> See [www.iccwbo.org](http://www.iccwbo.org)

<sup>7</sup> See [www.fidic.org](http://www.fidic.org)

v) an explanation of the funder's investigatory procedures.

A member of staff should be appointed who can advise employees on possible corruption issues which arise during the course of the company's business.

- c) The code of conduct should be applied in relation to all dealings by the funder with parties with which it has business relationships.
- d) The funder should develop and implement effective internal whistle-blowing and investigatory procedures. These procedures should be properly documented, and be notified to all employees. Upon receipt of a complaint, the complaint should be investigated, and if found to be justified, appropriate action should be taken. This could include disciplining the relevant employee, reporting to the authorities, and/or withdrawing from the relevant commercial arrangements.
- e) Internal controls should be put into place in order to try to avoid any breach of the procedures.
- f) Internal audit should monitor compliance with the procedures.
- g) The code of conduct and management programme should be reviewed at least annually so as to ensure that they are up to date and accord with international good practice.

123. An effective anti-corruption code and management programme will not guarantee that corrupt behaviour will not take place. However, they could materially assist in the prevention of corrupt behaviour, and provide important evidence that the organisation had taken reasonable steps to prevent corruption in the event of prosecution.

#### **Non-executive directors**

124. The appointment of appropriate non-executive directors by the funder can help ensure that the funder is taking adequate steps to prevent corruption. To ensure independence, a non-executive director should preferably:
- a) be appointed after a competitive selection process;
  - b) be replaced by a newly appointed director after serving a specified period.

#### **Bonuses and incentives**

125. If the funder's employees are entitled to bonuses or incentives which relate to their performance:
- a) The funder should avoid or closely monitor bonus and incentive arrangements for employees which could encourage the employees to engage in corrupt activities with a view to enhancing their bonus or receiving an incentive. For example, a bonus arrangement related to the amount of the loan, the interest rate achieved, or the gross return to the funder could encourage the employee to try to push through the deal in corrupt circumstances. He could, for example, pay a bribe which facilitates contract award, or encourage or accept project studies which fraudulently manipulate data to make the project seem more attractive. Even if the employee is not deliberately manipulating data, a bonus or incentive can adversely affect his judgement and result in him turning a blind eye to the true circumstances.
  - b) The funder should introduce a factor into the bonus or incentive arrangements which rewards employees for ethical activity. For example, for identifying and avoiding a potentially corrupt activity, even if this means that the funder loses the funding contract.

## **Due diligence**

126. Adequate due diligence is a vital preventive mechanism. It can identify a potentially corrupt situation before it occurs, and will enable the funder either to take appropriate preventive measures, or to avoid the project altogether. Termination and recourse provisions in the event of default are important, but are too late, as, if they need to be used, the corruption will already have occurred.
127. Due diligence needs to be tailored to the size of the contract and the extent of the risk. Application of effective due diligence is largely a matter of good training and common sense. Due diligence cannot be so thorough that it results in the project not being cost effective. All risk cannot be avoided. The aim of due diligence is a proportionate assessment of the risk to enable a reasoned decision to be made as to whether to proceed with the project.
128. 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.
129. **Due diligence on its key employees:** The funder should undertake adequate due diligence on its key employees with a view to ensuring that there is no corruption in relation to the funding or project. In particular:
- a) Where possible, the funder should, prior to employment, obtain a certificate from the relevant criminal authorities that the employee has not been convicted of a criminal offence.
  - b) Employees of a funder who are in a position in which they may receive bribes should declare annually to the funder:
    - i) their assets, and the assets of their close family;
    - ii) their directorships and consultancies, and those of their close family.
  - c) Employees of a funder who are involved in the project should be prohibited from directly or indirectly purchasing shares in the project participants.
  - d) Additional attention should be paid to employees who are operating in corrupt environments, and who may therefore be exposed to corrupt pressures.
130. **Due diligence on the financing transaction:** The funder should undertake adequate due diligence on the financing transaction with a view to ensuring that there is no corruption. In particular:
- a) Corruption is more prevalent in some countries than in others. Operating in high risk countries will inevitably require greater precautions. Transparency International publishes a "Corruption Perceptions Index"<sup>8</sup> which assesses the perceived corruption risk in most countries.
  - b) The funder should adopt greater due diligence where the terms of the transaction seem to be overly generous to the funder. Either a member of the bank staff, or a representative of the project owner, may be acting corruptly.
  - c) The funder should adopt greater due diligence where the funder is negotiating the funding in a non-competitive situation. Either a member of the bank staff, or a representative of the project owner, may be acting corruptly.
131. **Due diligence on key participants in the project:** The funder should undertake adequate due diligence on the key participants in the project with a view to ensuring that there is no corruption in relation to the funding or project. In particular:

<sup>8</sup> See [www.transparency.org](http://www.transparency.org) (Corruption Perceptions Index)

- a) The funder needs to establish whether the key participants in the project are taking adequate steps within their own organisations to prevent corruption. It should therefore ask key participants to supply details of their internal codes of conduct and management programmes (see paragraphs 120 to 123 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 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.
  - c) The funder needs to establish that the project owner is established and managed in a way which will reduce the opportunities for corruption. In particular:
    - i) The project owner should have an effective management team which is committed to prevent corruption.
    - ii) The project owner's staff should be properly qualified, and be paid at a level sufficient to avoid them needing to require bribes to increase their income to a living wage.
132. **Due diligence on agents and intermediaries:** The funder should undertake adequate due diligence on agents and intermediaries with a view to ensuring that there is no corruption in relation to the funding or project. In particular:
- a) The funder should ensure that all payments to its agents or intermediaries are reasonable payments in return for legitimate services provided.
  - b) The funder should avoid paying agents or intermediaries in tax havens unless there are genuine and legitimate reasons to do so.
  - c) The funder should establish 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. The funder then needs to try to establish as far as possible whether or not these agents could be used as conduits for the payment of a bribe.
133. **Due diligence on the project:** The funder should undertake adequate due diligence on the project with a view to ensuring that there is no corruption. In particular:
- a) The funder should establish 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.
  - b) The funder should establish whether an effective anti-corruption management system will be implemented in relation to the project.
  - c) The funder should undertake independent checking of the estimated project costs and income. Additional due diligence should be undertaken if the costs or income seem too high or too low.
134. **Red flags:** The funder should develop a set of "red flags" which are appropriate to its business. These are warning signs which alert the funder's employees to potentially corrupt activities.

### **Conflicts of interest**

135. Conflicts of interest can often lead to corruption. Such conflicts need to be identified and, as far as possible, avoided. A register of interests should be maintained so that potential conflicts can be identified. Examples of possible conflicts are as follows:

- a) The situation where a party which is constructing a project, or supplying goods or services to a project, is also an equity investor should as far as possible be avoided. The result is a conflict of interest which can lead to fraudulent consequences. The aim of the project owner is to obtain the most competitive price as possible from its contractors and suppliers. The contractor's and supplier's aim is to obtain the most profitable price. Similar conflicts will arise during construction, where the project owner's interests are to minimise paying additional sums to the contractor for delay and disruption, and the contractor's interests are to maximise its claims for delay and disruption. If the contractor has a 100% share in the construction of the project, and only a 33% share in the ownership of the project, the contractor may obtain more benefit from enhancing its contract price than by enhancing the project's profitability.
- b) The situation where an engineer designs a project, and subsequently acts as project certifier can lead to serious conflicts of interest. If the design is incorrect, the engineer may avoid issuing a variation during project execution which corrects this error, as issuing this variation may expose the engineer to claims for compensation from the project owner and/or contractor. There are circumstances where the benefits of having the same engineer involved as both designer and certifier may outweigh the disadvantages, but careful attention needs to be paid to the potential conflict of interest.

### **Verification**

- 136. The provision of funding often depends on key calculations, assessments or projections. These could relate to:
  - a) the projected income of the project;
  - b) legal or political risk;
  - c) safety, environmental or social issues;
  - d) construction and/or operation costs;
  - e) cost/benefit for a community;
  - f) Impact on communities that will not benefit from the project (such as displacement of populations for roads or dams).
- 137. If these reports state that certain key parameters are not satisfactory, funding for a project may not be made available. On the other hand, if the reports state incorrectly that the parameters are satisfactory, funding may be provided, but the funders may as a result incur losses.
- 138. These reports are therefore particularly prone to corruption, as they may be critical to the success of the project, but rely often on opinion or expertise, and are difficult to verify. Precautionary steps in this regard could include the following:
  - a) Reports should be obtained only from independent parties of known expertise and integrity who can provide proof of implementation of internal anti-corruption codes of conduct and management systems (as outlined in paragraphs 120 to 123 above).
  - b) If the issues involve a significant amount of money, the reports should be verified by a second party who is independent from the party who wrote the report.
  - c) A senior manager of the funder should review the reports in detail and question the authors of the reports so as to determine as far as possible that they are based on sound principles.
  - d) The reports should be published with other relevant project data on the internet. This increases the chances that any incorrect assumption or statement in the reports could be identified by interested third parties who review the reports on the internet. Such public exposure also reduces the likelihood that the facts and assumptions in the reports will be manipulated by the author.
- 139. 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.

**Single sourcing**

140. Single sourcing is where a contract is negotiated with a single supplier rather than putting the contract out to competitive tender. Single sourcing is normally discouraged because it can lead to higher prices, as there is no competitive pressure on the supplier to keep his price low. In addition, single sourcing can be the result of corruption, in that the supplier may have paid a bribe in order to ensure that there is no competitive tendering. The higher price can then conceal the bribe. Single sourcing should be avoided unless there are very good reasons for it.

**Transparency**

141. Corruption is concealed. The greater the transparency, the more difficult it will be to conceal corruption.
- a) The funder should try to 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, and therefore reduces the chance of a party participating in a corrupt activity.
  - b) The funder should disclose to the project owner, in respect of all agents and intermediaries appointed by the funder in relation to the funding:
    - i) their identity;
    - ii) the nature of the services provided by them;
    - iii) the amount of payments made to them;
    - iv) the location of the payment.

**Decision making**

142. The decision to enter into a financing contract should be taken by at least two people, or by a committee constituted for that purpose. It is significantly more difficult for two people to be bribed than one.
143. The decision, and the reasons for the decision, should be recorded, and be available for inspection by other senior management of the funder and the auditors.

**Anti-corruption warranties**

144. Contractual documentation should include adequate anti-corruption warranties given by the relevant 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 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.
145. Breach of the warranties should entitle the funder to deny payment under the funding contract, and to obtain compensation from the appropriate party.

**Independent Assessors**

146. 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.

147. 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.
148. 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.
149. 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.
150. The fees of the assessor could be borne by the owner as a project cost, or be shared equally between the parties.
151. 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.
152. 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.
153. 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 require the appointment of 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.
154. The requirement by a funder that the project owner appoint an independent assessor cannot be regarded as unnecessary "interference" by the funder. Just as the funder is entitled to require that the project has effective safety, quality and environmental management systems, so it is entitled to require effective anti-corruption systems.
155. For a detailed analysis of independent assessment see TI's report "Preventing Corruption on Construction Projects – Independent Assessment"<sup>9</sup>.

---

<sup>9</sup> See [www.transparency.org](http://www.transparency.org). Go to "how to fight corruption" then to "preventing corruption on construction projects" then to "independent assessment".

**Reporting**

156. The funder should put into effect whistle-blowing procedures. It should publicly disclose that it is the funder for a particular project and any employee or third party should be able to report matters of concern in a confidential manner to an appropriate senior manager of the funder. The name and contact details of the funder's manager to whom reports may be made, and the reporting procedures, should be published on the funder's web-site, and (if there is one), on the project web-site. This manager should deal with the matter in accordance with the funder's investigatory procedures.
157. The funder 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.

**Recourse**

158. The funder should ensure that it has the right of full recourse against employees, the project owner, government, contractor and other relevant parties in the event of a corrupt act. The funder should exercise this right if corruption occurs. The knowledge that recourse will be sought is an effective deterrent.

**Guarantee**

159. The funder should ensure that there are no circumstances in which it is obliged to make payments under guarantees or insurance policies in the event that there has been a corrupt act relevant to the claim.

**Debarment**

160. The funder should develop 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.

**Co-operative action**

161. Anti-corruption actions would be far more effective if all funders who are involved in a project co-operate together to ensure their implementation. Co-operation will:
- a) reduce the likelihood that a government or project owner will ignore the funder's requirement;
  - b) result in shared due diligence activities and shared knowledge;
  - c) spread the cost of anti-corruption mechanisms over more participants.

**DISCLAIMER**

162. 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 of the circumstances that can lead to corruption and its 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 UK Anti-Corruption Forum, nor DFID, nor the authors, nor the many organisations and individuals who have contributed to this report, can accept responsibility for the consequences of any action claimed to be taken in reliance on the contents of this report.

## **ACKNOWLEDGEMENTS**

163. This report has been prepared by Transparency International (UK) on commission for the UK Government's Department for International Development (DFID). It has been endorsed by the UK Anti-Corruption Forum which is an alliance between UK business associations, professional institutions and organisations with interests in the domestic and international infrastructure, construction and engineering sectors.

### **Report Authors:**

164. **Neill Stansbury** and **Catherine Stansbury** - Transparency International (UK)  
([neill.stansbury@transparency.org.uk](mailto:neill.stansbury@transparency.org.uk)) ([catherine.stansbury@transparency.org.uk](mailto:catherine.stansbury@transparency.org.uk))

### **Contributors:**

165. 20 people from 5 countries with experience of the financing and/or execution of international construction projects have contributed to this report, by commenting on the report, and/or by providing examples of corrupt practices, and suggestions for corruption prevention. They include bankers, engineers, lawyers and accountants. Some consented to their names being listed below as contributors. Other preferred to remain anonymous. The fact that contributors are named below does not mean that they endorse all aspects of the report.

### **Contributors: (in alphabetical order)**

Björn Blüml; Owen Bolt; Christopher Boyd; Peter Boyd; John Drysdale; Henrik Gaarde-Nielsen; Rob Goddard; Hamish Goldie-Scot; John Howell; Mott MacDonald Limited; Wendy Ormond; Tom Osorio; Quintiliano Valenti; Michael Wiehen.

## SCHEDULE

### EXAMPLES OF CORRUPTION IN THE PROVISION AND MANAGEMENT OF FINANCING FOR CONSTRUCTION PROJECTS

- A. Examples of corruption in the provision and management of financing for construction projects are given below. The range of possible corrupt actions is extremely wide. These examples are illustrative only, and are not intended to cover all possibilities. There is inevitably overlap between the areas. In addition some examples in one category could also be used, in mirror image, as an example in a different category (for example, a bribe offered or given by a funder to a government official is also a bribe requested or received by the official).
- B. All these examples are based on real incidents which have been observed by or related to the authors of, or contributors to, this report. In order to protect confidentiality, the facts have been changed. For the purposes of brevity, the facts have been simplified.
- C. The purpose of giving these examples is to assist funders in training their staff to identify potentially corrupt circumstances before they occur.

#### **Bribes paid or fraud perpetrated by the funder's representative for the benefit of the funder**

**Example 1:** An industrial plant is planned to be built by the project owner. It requires loan financing. A representative of an international bank indicates to the finance director of the project owner that if the project owner enters into a loan agreement with the bank without going out to competitive tender, the bank will pay the finance director a bribe. The finance director agrees. The bank's interest rate, as a result of the bribe, is higher than the market rate for a project of that nature in that territory. The project owner therefore pays the bank additional interest charges over the term of the loan. The bribe is paid by the bank to the finance director through an off-shore shell company set up for the purpose, and which is owned by the finance director's family. It is recorded in the bank's books as a consultancy fee in relation to the loan.

**Example 2:** A consortium wishes to build a private sector power station in a developing country. The consortium members include the operator of the power station and some investment funds. They will invest equity into a company which will be the project owner. They are informed that approval for the construction of the power station will not be granted by the government unless the son of the president is given a shareholding in the project owner at no cost or risk to the son. In return for the shareholding being granted, the consortium is offered approval for the construction of the power station, and a guarantee from the government utility that it will purchase power from the power station at a rate significantly above market rate. The consortium members are aware that granting a free shareholding to the president's son in return for these approvals is a bribe. The son is providing no legitimate services of value to the project. They therefore attempt to disguise the bribe by arranging for a bank to lend the amount of the equity investment to the president's son. The son then invests the loan proceeds into the project owner as equity. The son is not obliged to repay the loan until the plant is generating (at which time he will receive dividends from the project owner which enable him both to repay the loan and make a profit). The loan is guaranteed by the other consortium members.

**Example 3:** A private sector project owner intends to build an industrial plant in a developing country. The design of the plant would result in higher than permitted toxic emissions. In order to gain the local government's agreement to overlook the environmental requirements, the equity investors in the project owner promise to donate a substantial sum for the construction of schools in the area.

**Example 4:** The investment licence for a private sector mining project requires the consent of four ministers. Three give their approval. The fourth only gives his approval after one of the equity investors in the project owner agrees to provide free schooling overseas for the minister's children.

**Example 5:** A steel foundry is planned to be built by a private sector project owner. The capital cost is US\$ 200 million. The project requires equity investment and loan financing. The ratio of equity to debt is 30:70 (US\$ 60 million equity and US\$ 140 million debt). The project owner is a consortium of companies, including the contractor who is building the steel foundry, the operator of the foundry and a private equity investment fund. Each member of the consortium is required to invest US\$ 20 million equity. The contractor warrants to the other consortium members and to the funders that its price for the construction of the foundry is competitive. However, it secretly includes in its price an additional US\$ 20 million to cover its equity investment. It invests the equity out of its own funds, but is repaid its equity out of the construction price as the works proceed. The price of the foundry is therefore US\$ 20 million higher than it should be which has adverse implications on the profitability of the foundry and on the risk of default to the funders. The contractor makes a fraudulent secret profit of US\$ 20 million.

**Example 6:** A public sector utility places a contract to build a power station after an international competitive tender. One of the losing companies is from a country which provides subsidised defence equipment to the host country in which the power station is being constructed. The government of the country which provides the defence equipment informs the host country government that unless it awards the power station contract to the company from the defence supplier's country, it would suspend supplies of defence equipment. The host country does so, and as a result is compelled to purchase a more expensive power station. The contractor which had won the competitive tender is wrongfully deprived of a contract.

**Example 7:** A project owner is constructing a bridge. It requests a local insurance broker to obtain construction all risks insurance at the best available price. Due to the size of the project and the funder's requirements, the insurance is required to be placed with an international underwriter. The broker obtains a quote from various international underwriters. It selects the best quote and marks it up by 100%. It submits the inflated quotation to the project owner, representing that it is the best quote available. It does not disclose to the project owner the underwriter's quote or the extent of the broker's mark-up. The project owner instructs the broker to place the insurance. The project owner pays the broker the inflated price. The broker pays the underwriter the actual price, and retains the 100% mark-up. The insurance underwriter issues an insurance certificate for the project, but, at the request of the broker, this does not show the underwriter's premium. The project owner is therefore unaware that the insurance has been marked up by 100%.

**Example 8:** The commercial manager of the project owner is required to obtain construction all risks, third party and employee liability insurance for the construction of a project. An insurance company offers him an all expenses paid luxury holiday if he places the insurance with them. The manager does so, even though the premium is higher, and the coverage less favourable, than that offered by other insurance companies. He receives the holiday.

**Bribes paid or fraud perpetrated by the funder's representative for his own personal benefit**

**Example 9:** An aid donor's representative is negotiating with government officials in relation to a project which the aid donor is to finance. The donor's representative will be promoted more rapidly if his section achieves disbursement targets. He offers the government officials an overseas "fact-finding" tour if they increase the size of the project. The government officials provide a false justification for the enlarged project, which the donor's representative verifies. The project is approved for funding and the donor's representative recommends the overseas tour which is paid for by the donor. The donor's representative is promoted.

**Example 10:** A bank is seeking business in a developing country. The manager of the bank responsible for that territory will receive a bonus dependent upon the amount of business he procures. He offers to share the bonus with the manager of a project owner in the event that the project owner obtains finance from the bank for a project. The manager of the bank does not carry out sufficient due diligence on the project and as a result the funds are provided for an unviable project.

**Example 11:** A private sector power plant is planned for a site. It will need to be connected to the grid. Before taking the investment decision for his company, a representative of one of the shareholders in the project owner acquires, through a friend, the land over which the connection to the grid will run. The friend leases the land to the project owner, and shares the lease payments with the representative of the project owner.

**Example 12:** A project cannot be built without a guarantee issued by a national export credit agency. A high ranking official in the export credit agency is offered a future board position in the project owner in return for his services in securing the guarantee from the export credit agency.

**Example 13:** A project has assets which are lease financed. At the end of the lease period, the assets are sent to auctioneers for sale. The proceeds of sale will belong to the lease finance company. The auctioneers and the manager of the lease finance company who is responsible for the sale of the assets conspire. The asset is sold. The auctioneer declares a far lower sale price than was actually achieved. The auctioneer and manager of the lease finance company share the surplus.

**Bribes paid or fraud perpetrated by the project owner's representative for the benefit of the project owner**

**Example 14:** A project owner raises equity investment on a stock market for the construction of a major manufacturing plant in a developing country. The stated purpose of the plant is to manufacture equipment which has allegedly been ordered under a long-term contract with the government of that country. The investors visit the plant upon completion, and witness the equipment being manufactured, and see the company's name on the factory. However, it later turns out that the government contract is a fraud, and that the plant is owned by another company. The owners of the plant, in exchange for a fee, have agreed to change the sign on the factory premises, and to show the investors around the plant as if it belonged to the former company. The whole transaction is a fraud, and 100% of the equity investment is misappropriated.

**Example 15:** A commercial building is planned to be built by the project owner. It requires loan financing. The funder's procedures require that, in this sector and territory, at least 30% of the commercial building must be pre-let to high quality tenants before it advances the funding. The project owner is unable to identify any tenants who are willing to sign pre-letting agreements, but believes that it will be able to let the building once built. However, it cannot build it without funding. The project owner therefore signs fraudulent pre-letting agreements for 35% of the building with companies related to the project owner. The project owner pays a bribe to the bank employee assigned to undertake due diligence on these pre-letting agreements. The bank employee falsely certifies the pre-letting agreements as valid, and of good security. The funder lends the money to the project owner. The building is built. Sufficient tenants cannot be found. The project owner becomes insolvent, and the pre-letting agreements are exposed as frauds. The bank has to appoint receivers, and suffers irrecoverable losses.

**Example 16:** A power plant is planned to be built by a private sector project owner. It requires equity investment from funders. The funders require a feasibility study in relation to the project, which includes a requirement to provide estimates of the plant's generation costs. The profitability of the power station (and therefore the dividend income for the funders) is dependent on the generation costs. The project owner pays a bribe to the engineer appointed by the funders to undertake the feasibility study. As a result of the bribe, the engineer deliberately understates the anticipated generation costs of the power station. As a result, the project seems more attractive to the funders than it actually is, and the funders, on the basis of this report, provide equity investment. Once the project is complete, the generation costs turn out to be higher than indicated in the feasibility study. The dividend income for the funders is therefore less than projected.

**Example 17:** The project owner developing a block of luxury flats undertakes a ground survey before the construction contract is placed. The survey shows that part of the site is firm material, and part is alluvial clay. The project owner suppresses the part of the survey showing alluvial clay, and releases only the part showing firm material. The contractor as a result tenders on the basis of a substantially quicker and cheaper method of piling works than it would have done had the extent of alluvial clay been known to the contractor. The project owner raises a bank loan for the project on the basis of the contractor's price and programme. Once the contractor commences works, it encounters the alluvial clay, and has to change its piling method. The contract is as a result substantially delayed, and there are major contract claims by the contractor against the owner. The delay in completion results in a delay in selling the apartments, and a consequent delay by the project owner in repaying the bank loans. Had the funder known in advance the true cost and programme of the project, its terms would have been different.

**Example 18:** A project owner is constructing a private sector power station. Once the station is complete, it will sell electricity to the public utility. The successful financing of the power station depends on the tariff per kWh to be paid by the utility to the project owner. A bribe of 30% of the total project cost needs to be paid by the project owner to the minister of energy of the national government in order to obtain approval for the construction of the power station. The project owner needs to recover the cost of the bribe. The contractor building the power station is also an investor in the project owner. It is therefore agreed between the project owner and contractor that the contractor will include the cost of the bribe in its price for the construction of the power station. The contractor pays the bribe to the minister through an agent. The amount which has to be obtained from funders therefore is increased by 30%. This increase in the price, once capitalisation of interest during construction and associated charges are taken into account, requires an increase in the power purchase tariff of 40%. The minister of energy, as a result of the bribe, compels the public sector utility to agree to this high tariff. A consortium of banks finances the power station, using the power purchase agreement as the basis of their security. The government of the country in which the power station is being constructed changes shortly after completion of the power station. The new government investigates the project, uncovers the corruption, and terminates the power purchase agreement on the basis of corruption in its award. The project owner becomes insolvent, and fails to repay the banks.

**Example 19:** A public sector highways agency obtains finance from an international donor to establish an inventory of roads. After three years, the donation has been consumed, but no progress has been made in undertaking the inventory.

**Example 20:** A project to fund the construction of provincial roads is agreed between a multi-lateral development bank as funder and a government department as project owner. The bank imposes, and the government agrees to, comprehensive social and environmental safeguards. When the project gets underway, it is apparent that these safeguards cannot be met. The project is monitored on behalf of the funder by a young local employee. The much older representative of the project owner has political influence, and threatens the funder's representative with difficulties for family members in obtaining qualifications and documents if he does not certify compliance. As a result, the funder's representative falsely certifies that the project complies with the social and environmental safeguards, and the funding is released.

**Example 21:** A project owner requests financing for a project from a bank. The project owner produces to the bank, as part of its project documentation, a letter from a potential customer which guarantees that it would buy an agreed amount of product from the project once completed at an agreed price. During its due diligence on the project prior to financing, the bank discovers that the project owner has agreed to pay a "fee" to the customer of 10% of the project cost in return for it issuing the letter. The bank suspects that this fee is in fact a bribe, and declines to finance the project.

**Example 22:** Approval for the construction of a cement plant is only given by the relevant government minister after the project owner agrees to purchase the raw materials from a company which is indirectly owned by the minister.

### **Bribes paid or fraud perpetrated by the project owner's representative for his own personal benefit**

**Example 23:** In a project involving the construction of bridges, the representatives of the project owner agree with an aid donor that all contracts will be based on agreed schedules of rates. These schedules have been fraudulently prepared by the project owner's representatives to show rates which are twice the anticipated rates of the contractor. The project owner's representatives secretly make clear to contractors bidding for packages under the project that their bids might be disqualified on technicalities if they do not agree to bid at the fraudulently high rates, and share an appropriate amount of the surplus with the representatives of the project owner. The winning contractor undertakes the work, and claims payment based on the excessive rates. The project owner's representative certifies the work as complete and the rates as correct. The requests for payments from the funder are therefore fully substantiated, and are acceptable to auditors. The contractor receives payment of an amount which is twice his actual cost. He shares the surplus with the project owner's representatives.

**Example 24:** A public sector water utility wishes to seek funding for the repair of its pipes. It has already previously received aid for this purpose from an aid organisation, but this aid has been misappropriated by an officer of the utility. In order to conceal this misappropriation from the first aid organisation, the officer wishes to obtain aid from the second organisation, and use this aid to carry out the works. The officer pays a bribe to a senior manager of the second aid agency to ensure that the grant is awarded. The manager of the aid agency authorises the aid even though he is aware that aid previously provided for the same purpose has been misappropriated.

**Example 25:** The project owner is building a factory. A fire destroys part of the factory during construction. The commercial manager of the project owner is also secretly the owner of one of the suppliers which is supplying material to the project. The commercial manager agrees with the claims assessor of the insurer that the assessor will approve an inflated claim submitted by the supplier, and that the commercial manager and assessor will share the profit from the claim.

**Example 26:** The project owner's representative deliberately specifies 10% more structural steel than is actually needed for the project. The representative then arranges for this 10% excess to be secretly removed from site by parties connected to the project owner's representative. The steel is then sold, and the representative and his partners share the proceeds. As sufficient steel was left on the project to complete its construction, the missing materials are not noticed.

**Example 27:** The project owner's representative deliberately routes an access road through land owned by his family. The family sells the land to the project owner at a price higher than its market value prior to the re-routing.

**Example 28:** The project owner's representative nominates a particular brand of air conditioning plant for use in the project owner's new commercial building. The representative has a financial interest in the local distributor of that make of air conditioner.

**Example 29:** The project owner's representative requires a transaction for a private sector plant to be structured as follows: the contractor will build the plant, and will then sell the plant on to a company specifically set up for that purpose for a fixed price. The company will then immediately sell the plant to the project owner for a 10% mark up (without adding any value). The interposition of the intermediary company is a device to enable an artificial mark-up to be added. The 10% mark up is a bribe which will be shared by the project owner's representative and various officials.

**Example 30:** A donor is funding road maintenance. Maintenance reports for gravel roads in a region show that 85% of the network has been subject to both heavy and light grading each year. From the state of the roads, it is obvious that this level of maintenance has not been undertaken on most of the network. The responsible officials in the highways authority have set up false contracts which show that the work has been undertaken, and have diverted the funds.

### **Bribes extorted, or fraud perpetrated, by a government official for the benefit of the official**

**Example 31:** An overseas bank is applying for a banking licence. The Minister responsible for banking licences agrees that he will grant a licence, but, at the same time requests that the bank lend money to a company which the Minister owns to build a block of flats. The bank agrees. The licence is granted to the bank. The bank lends the money to the Minister's company and takes security over the development. The Minister's company defaults. When the bank threatens to take re-possession proceedings, the Minister threatens to revoke the bank's licence. The bank writes off the debt in order to save its licence.

**Example 32:** A senior official in the ministry of transport fraudulently represents that US\$ 20 million is required for road repair in a particular province. A donor provides the requested amount of funding. The money is paid to the ministry of transport. No audit controls are placed over the money by the donor. No independent inspection agency is appointed by the donor to certify that the works have been completed, or to assess the value of the works completed. The citizens of that region are not informed about the proposed road programme, or of the amount of money which has been donated for the purpose of road repairs. No public whistle-blowing mechanisms are established. The minister and other senior officials use US\$ 5 million to repair the roads, and misappropriate the balance of US\$ 15 million. They misappropriate the US\$15 million by establishing a string of shell companies, and awarding contracts to these companies for services which they never perform.

**Example 33:** A project owner wishes to construct a manufacturing plant. The minister responsible for giving approval refuses to do so unless he is given a 70% interest in the plant. The project owner is unwilling to do so and is forced to abandon the project.

**Example 34:** A bank lends money to a project owner to build a highway to the president's home town. The specification of the road is unnecessarily high, and the majority of the rest of the road network in that country is in chronic disrepair. Although these concerns are obvious from the independent engineer's report, and from civil society complaints, the bank lends the money.

**Example 35:** A donor wishes to fund a project that will bring rural electrification to villages that are demonstrably poor. The minister of power sees that, unless he intervenes, the benefits will accrue to areas that support his rival's power base. He therefore instructs his technical staff to issue preparatory survey contracts to an NGO controlled by his supporters. The NGO conducts sample socio-economic surveys in the field, and falsifies the results to demonstrate a greater need in the areas of the minister's interest. As a result, the project takes place in the minister's power base.

**Example 36:** A minister of transport wants to ensure popularity in his constituency by bringing more roads into the area. He threatens corruptible officials in the public works department with appointments that will ruin their careers if they do not comply with his demand for the construction of new roads in this area. The officials add the roads into the scope of a project planned for a forthcoming loan from a multi-lateral development bank.

**Example 37:** A regional government subsidises the development of a residential property complex. A state owned construction company is awarded the contract for the development and construction. The state owned company enters into a joint venture with a company owned by a relative of the city's mayor to sell the properties. The joint venture is paid a fraudulently large success fee on the sale of the properties. Therefore a large part of the subsidy flows into the hands of the family of the city's mayor.

**Example 38:** A government official responsible for planning incorporates a company, and grants that company permission to develop a prime site. When developers approach the government to develop that site, they are compelled to buy the company from the government official.

**Example 39:** A government official will only give approval for a project if a company which he has an interest in is given the exclusive fuel supply contract for the life of the project.

**Example 40:** A senior government official requires both a share in the profits of the land sale from the project owner, and a share in the profits of construction from the contractor, as a condition of his approving the project.

**Example 41:** There is a landslide on a donor-funded road project. The international team managing the work has no expertise in slope stabilisation and seeks the advice of their local government counterpart. He has been bribed by a renowned local geotechnical engineer to recommend the engineer's services. The engineer is a major shareholder in a company that owns the only equipment in the country for deep piling works. The project owner appoints the engineer. Although a low cost solution would have been appropriate, the engineer produces a report that requires deep pile foundations, and provides specifications that his piling company can fulfil without the need for international assistance. The project management team does not carry out adequate diligence checks. The works are duly tendered. The engineer's company is the only company which can bid for the work, and it therefore does so at an inflated price. The resulting contract costs the donor far more than it should have done.

**Example 42:** A donor agrees to finance the rehabilitation of 100 km of secondary roads. The highways agency establishes a technical committee to review the 8 bids. One government member of the technical committee favours the bid of a company owned by his son. This company is not technically competent. The technical committee (which also contains independent members) eliminates this company's bid. The government, at the instigation of the government member of the committee, instructs the committee to re-instate the eliminated bid. The committee refuses. The government therefore declares the whole bid process void, and calls for a re-bid. This process results in delays to the project, and wasted expenditure by the donor.

**Example 43:** A finance contract is executed. The majority of the finance is transferred to the project owner in one tranche, and the remainder in a second tranche. A government official cancels the finance contract on the basis that all the money should have been transferred in one tranche (even though that had not been a contractual requirement), and declares that the funding would be forfeit. This is an attempt by the government official to extract a bribe in return for re-instating the contract.

**Example 44:** The financial viability of a project depends not on the economics of the underlying project, but on the government's willingness to provide a subsidy on the foreign currency element of the project equipment cost. One minister is responsible for approving this subsidy at each stage of equipment purchase. This leaves the project vulnerable to continued requests for bribes from this minister prior to each foreign currency approval.

**Example 45:** It is a condition of the construction of a project that the construction all risks insurance is to be placed through the state controlled insurance company. The premium is significantly above market rate and the insurance company has a reputation for not paying claims. The project owner has no choice but to pay the premium. Government officials divert most of the premium out of the state controlled insurance company into their personal accounts. As the insurance company is unlikely to pay claims, the project owner has to place a back up cover with an international insurance company at additional cost.