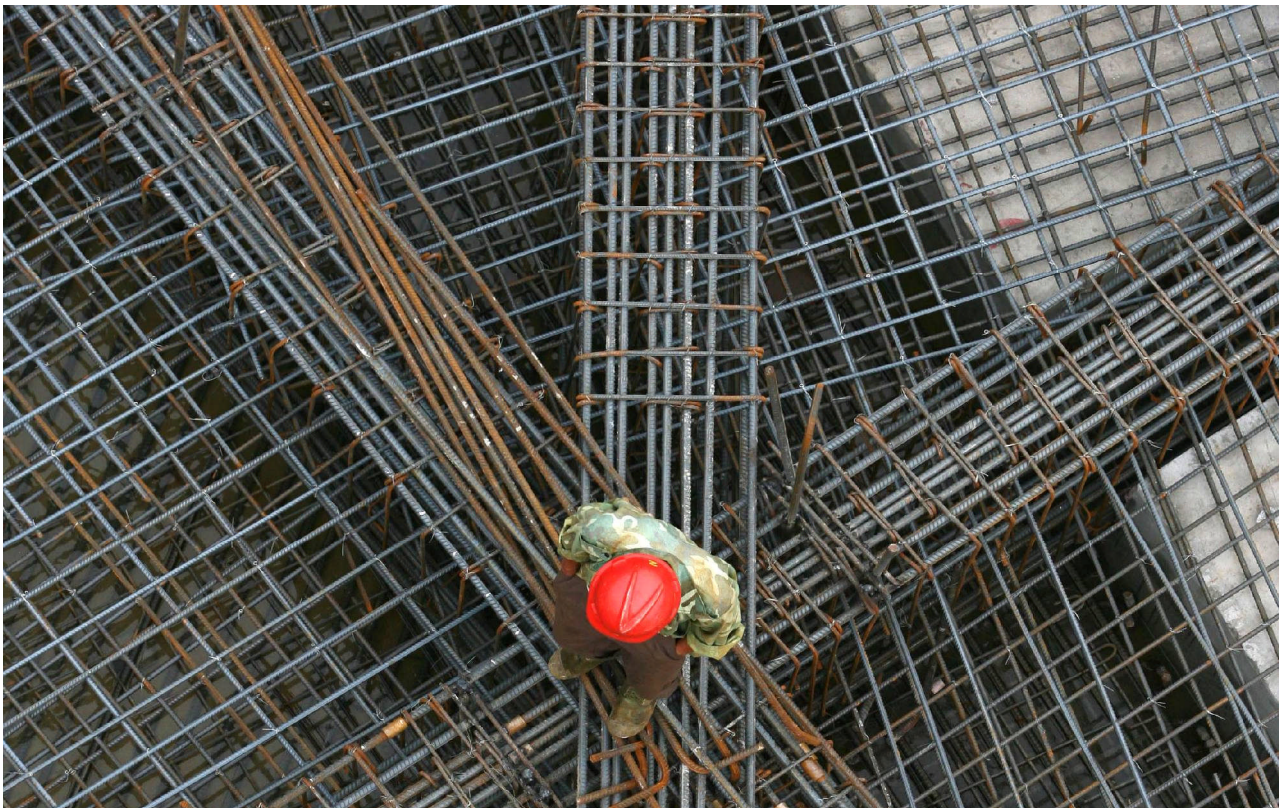


# Construction Sector Transparency Initiative

Design for Pilot Phase

July 2007



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# Acknowledgements

This Design for a **Construction Sector Transparency Initiative (CoST)** was prepared by a team of consultants under a contract between DFID and Oxford Policy Management in association with I.T. Transport Ltd. The CoST consulting team members were as follows:

- David Stafford, Oxford Policy Management (Project Manager);
- Aidan Davy, Fairfields Consulting (Team Leader);
- Adam Andreski, Rachel Flanary, and Gary Taylor, I.T. Transport Ltd;
- Catherine Stansbury, Transparency International UK;
- Steve Jones, Meta-Development LLP (Facilitation).

**The design has benefited greatly from the input of numerous interested stakeholders.**

An informal Steering Group convened by DFID provided overall guidance on the focus of the initiative, and constructive criticism on earlier drafts of the report. The Steering Group comprised representatives from construction and engineering companies, consulting engineering firms, professional engineering associations, UK Anti-Corruption Forum, EBRD, Overseas Development Institute, Imperial College, Transparency International UK, Engineers Against Poverty, Crown Agents, National Audit Office, DFID and FCO.

Guidance, direction and support were provided from the World Bank Group; the EC (both DG Development in Brussels and Head of Office in Ghana and Tanzania); and the World Economic Forum, drawing on its Partnering Against Corruption Initiative (PACI).

A Concept Outline of CoST was prepared for consultations in Ghana, Tanzania, Socialist Republic of Vietnam and United Kingdom. Numerous stakeholders were interviewed in these four countries, which assisted in the development of the Concept into a draft Outline Design.

The draft Outline Design was prepared for further consultation at an International Forum held in London on 20 June 2007, at which there were more than 80 participants from about 20 countries, representing: governments; the construction industry, engineering consultants, and professional bodies; civil society; academia; trades unions; and donor agencies. This amended Design takes account of these further consultations.

The key sources of published information used in preparing this design are given in Annex A.

Finally, it is important to acknowledge that stakeholder input should not be interpreted as endorsement. Invariably, it was not possible to reconcile the sometimes competing perspectives on what CoST should or should not embrace. This Design for the Pilot Phase reflects the opinion of the consulting team, and does not necessarily represent the views of DFID.



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# Executive summary

The construction sector plays a vital role in supporting social and economic development, yet it consistently ranks as one of the most corrupt sectors. Corruption on public sector projects has been known to increase contract prices and result in unnecessary, unsuitable, defective or dangerous projects, often subject to severe delays. The complexity of the causes and types of corruption are such that they can not be addressed by a single initiative.

This initial Design for piloting a Construction Sector Transparency Initiative (CoST) aims to enhance the transparency and accountability of publicly financed construction projects. The expectation is that improved transparency will be supportive of better management of public finances and reduced corruption. CoST will build on other country and international initiatives that exist already to increase transparency and reduce corruption.

This Design has been prepared for countries involved in piloting CoST, with the expectation that the Pilot Phase will identify and help resolve practical challenges to CoST implementation to be reflected in a final design.

## Core concept and scope

The core concept of CoST is '**Get What You Pay For**', by enhancing the transparency of material project information. The ultimate aim is to enhance the accountability of procuring entities and construction companies for the cost and quality of public sector construction projects, by improving transparency to a broad range of stakeholders.

Although the starting point is for countries to recognise the value of transparency at all stages of the construction project cycle, the initial focus of CoST is on the period from contract award through to final build, to allow questions to be raised about outcomes and how the overall procurement process is being managed.

CoST is designed to be applicable to any country and to any government department or agency with responsibility for public sector construction projects. This Design sets out some core requirements for CoST that pilot countries should attempt to adhere to, but which provide considerable latitude for flexibility in detailed implementation in-country.

## Outline of CoST for Pilot Phase

A set of Principles and Criteria have been developed for CoST. The CoST Principles reflect a shared commitment to transparency and accountability on the part of construction sector stakeholders, and outline a set of aspirational beliefs and values. The proposed Criteria have a more operational focus, and represent the concept that is to be piloted.

The challenge is to balance the widely accepted need for greater transparency with the necessity of designing a system that is practicable. CoST comprises two components: the **disclosure** of material project information on a selection of construction projects; and a **structure** to provide a framework within which all stakeholders (including civil society) can engage effectively.



**Disclosures:** the core disclosures relate to key project information at contract award through to final build, together with significant changes during project execution. Other disclosures should also be made relating to earlier stages in the project cycle, since difficulties that arise during contract execution may have their origins in these other stages. Disclosures are envisaged on a selection of projects to ensure that CoST is manageable and practicable.

**Structure:** at the heart of CoST is a multi-stakeholder group (MSG), a representative body comprising key stakeholders, including government, the construction industry, and civil society. The MSG oversees the implementation of CoST. At a technical level the MSG is supported by an independent Assurance Team that plays an interpretative role in helping to make raw data disclosures more intelligible to the MSG, and to enable appropriate conclusions to be drawn. Overall responsibility for ensuring that CoST is implemented is exercised by a senior level Government representative, or 'CoST champion'.

### Implementation of CoST

The process for implementing CoST comprises two phases. The first is an initial preparation phase to establish the structure and main processes to be followed. The second is the operation phase which is envisaged to take place in three stages: public disclosure of material information on selected projects by the procuring entities; analysis/interpretation of the disclosures by the Assurance Team and presentation of its findings to the MSG; and reporting of the main findings to the public.

### Next steps

The Pilot Phase will start after the launch of CoST. Pilot countries will be supported, as appropriate, by donors in the form of: practical guidance, capacity building, informal quality assurance, and initial facilitation of a lesson-learning forum to be carried on by the pilot countries. Capacity building will be an important ingredient of the Pilot Phase for many countries.

# 1. Introduction

## 1.1 Overview and background

This Design has been prepared for piloting a Construction Sector Transparency Initiative (CoST) in a number of countries. It is based on an earlier Outline Design, which was discussed and commented on at an International Forum in June 2007, attended by more than 80 participants from about 20 countries. The earlier design has been amended both to clarify specifically what is to be piloted, and to reflect comments made at the Forum such as the need for capacity building for many of the pilot countries.

CoST is built on the Extractive Industries Transparency Initiative (EITI)<sup>1</sup>, extending the EITI concept to the construction sector. The aim of CoST is to enhance the transparency of, and accountability for, publicly financed construction projects, with the expectation that this will be supportive of efforts to improve the management of public finances and to tackle corruption.

While the basic concept and framework of CoST are consonant with EITI, the two initiatives are necessarily different in substance and approach. For example, EITI places a strong emphasis on financial auditing of revenue transfers, whereas the focus of CoST is on public disclosure of information on construction projects.

## 1.2 Rationale for CoST: the challenge of construction corruption

The construction sector plays a vital role supporting social and economic development, yet is consistently ranked as one of the most corrupt areas of economic activity. The 2005 Global Corruption Report of Transparency International (TI) was devoted to *Corruption in Construction and Post-Conflict Reconstruction*, and portrayed a sobering picture of the extent of corruption in the construction sector, and the economic and social costs of corruption. A 2006 estimate by the American Society of Civil Engineers suggested that 10% of the \$4 trillion spent annually on construction worldwide is lost to corruption, or between \$390-400 billion.

In 2005 the OECD reported that corruption in public construction contracts was widespread, and that the costs can exceed 20% of the contract value<sup>2</sup>. TI suggests that these are sometimes likely to be conservative estimates.

The costs of corruption in public sector construction projects extend far beyond increasing contract prices. Corruption can result in unnecessary, unsuitable, defective or dangerous projects, which are often subject to severe delays. It adversely affects social and economic development by undermining the rule of law and hindering the development of strong and accountable institutions on which economic growth depends. The effects of corruption are especially severe on the poor, who are most reliant on the timely and cost-effective provision of public services, and are least able to pay the extra costs associated with bribery, fraud, extortion and other forms of corruption. But corruption is not the exclusive domain of developing or emerging economies. It is equally relevant to countries such as the UK, as indicated by a 2006 Chartered Institute of Building survey, which suggested that construction corruption is widespread<sup>3</sup>.

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<sup>1</sup> The EITI is a transparency initiative that supports improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil, gas, and mining.

<sup>2</sup> Organisation for Economic Co-operation and Development Assistance Committee (OECD-DAC) (2005). *Harmonising Donor Practices for Effective Aid Delivery*. Volume 3: *Strengthening Procurement Practices in Developing Countries*. OECD, Paris.

<sup>3</sup> CIOB (2006). *Corruption in the UK Construction Industry: Survey 2006*. Chartered Institute of Building, Ascot, UK.

While the severe costs of corruption and related effects are compelling, there is also evidence to suggest that enhanced anti-corruption measures are potentially powerful deterrents. For example, TI's 2005 Global Corruption Report observed that the introduction of a competitive bidding procurement process on federal projects in Nigeria resulted in a reported reduction in capital costs of 40-50%. Reducing corruption has also been shown to result in significant reductions in recurrent costs for utilities, with favourable consequences for investment in essential infrastructure such as water, electricity and telecoms (see TI Global Corruption Report, 2005).

### 1.3 Key differences between CoST and EITI

EITI has its origins in the civil society '**Publish What You Pay**' (PWYP) campaign<sup>4</sup>, directed at extractive companies. The core concept of EITI remains true to the original campaign, albeit extended for governments to '**Publish What You Receive**'. In the extractive sectors (i.e. oil, gas and mining), companies make a variety of payments to governments (e.g. signature bonuses, production streams, taxes, royalties, etc.), creating a revenue stream which is available to the government for development and other purposes. There is potential for corruption through discrepancies between reported revenues (by the Government) and payments (by the companies). EITI provides for separate disclosure by companies and government so that these figures can be independently reconciled.

In the construction sector, the flow of payments is reversed: governments make payments to contractors in exchange for provision of infrastructure or other constructed assets<sup>5</sup>. Whilst discrepancies between government payments and contractor receipts may be a source of corruption, other areas within the construction project cycle provide significantly greater opportunities for corruption (e.g. during project identification, the funding of the project, the procurement process, and during execution and maintenance). Such corruption, in the form of bribery and fraud, may result in inappropriate projects being commissioned, corrupt funding terms, over-design, the appointment of unsuitable contractors, re-award of contracts, inflated contract prices, delays and poor quality projects.

The absence of a revenue stream to reconcile with payments makes the task of CoST more difficult than EITI, as constructed assets are not readily quantifiable for auditable comparison. Because each construction project is to an extent unique, it is difficult to standardise and benchmark unit costs of construction. Furthermore, contractors generally have more information about the true costs of construction than procuring entities. This information asymmetry, combined with the reality that public sector construction projects are both commissioned and regulated by government, create a range of opportunities for corruption.

### 1.4 Core concept

The core concept of CoST can be described as '**Get What You Pay For**'. The 'You' applies equally to government, affected stakeholders, and to the wider public. One essential feature of CoST is the meaningful engagement of a range of stakeholders in the initiative, consistent with the approach adopted by EITI. The main groups of stakeholders in publicly financed construction projects are: the procuring entities, public financial management entities, construction companies and associations, civil society, external (non-governmental) providers of finance or loan guarantees, and other international partners. Further information on these stakeholders and their interests in construction projects are given in Annex B.

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<sup>4</sup> The Publish What You Pay (PWYP) campaign was initiated by Global Witness and a number of other founding NGOs as a result of Global Witness's 1999 report on Angola (A Crude Awakening), and officially launched by George Soros of the Open Society Institute in June 2002.

<sup>5</sup> For ease of reference, this Design uses the terms 'constructed assets' or 'infrastructure' as shorthand for all public sector construction projects including: transportation and export facilities (roads, rail, airports, ports and harbours); utilities (water and wastewater, power generation and supply, telecoms); and other built assets such as hospitals, universities, government offices, etc.



The ultimate aim of CoST is to enhance the accountability of procuring entities and contractors for the cost and quality of public sector construction projects, by improving transparency to a broad range of stakeholders. While CoST is a transparency initiative and not an anti-corruption initiative per se, the implicit assumption which underpins CoST is that enhanced transparency of the construction sector will be supportive of, and complementary to, existing initiatives to improve public sector financial management and to tackle corruption.

CoST provides for the **disclosure of material project information** on a selection of construction projects. 'Material' in this context is intended to indicate that sufficient information be provided to enable stakeholders to make informed judgements about the cost and the quality of the infrastructure constructed. The disclosures include, for example, a description of the project; its purpose and location; and, at the implementation stage, summary details of the original and final: project specification, project cost, contractor, and completion dates. The disclosures also include justification for any significant differences between this original and final information, as well as project evaluation and completion reports.

Disclosure of raw information on its own is unlikely to be sufficient to achieve greater accountability due to its complexity. The disclosures need to be reviewed and analysed to ensure that they are comprehensible to all stakeholders (including civil society), and to enable appropriate conclusions to be drawn. CoST introduces a **structure** to meet this need.

## 1.5 Scope, outline and status of the initiative

One of the key lessons from EITI is the importance of retaining a clear and narrow focus. From the early phases in the development of CoST, which included consultations with a Steering Group<sup>6</sup> convened by DFID, consensus emerged that the initial focus of CoST should be the period between award of contract and final build – the implementation stage. The reasons for this choice were that, first, the project identification and tendering phases are already fairly extensively covered by existing procurement initiatives<sup>7</sup>, while there are relatively few initiatives aimed at the period starting at contract award through to final build; second, the implementation stage is often where the damage from corruption arises that is actually felt by ordinary people, for example through inadequate, non-existent, or sometimes dangerous construction; and third, focus on implementation could help prevent bribes occurring in the first place by making them more difficult to afford (eg bribe payers sometimes plan to make up the cost of the bribe by skimping on quality and inputs in implementation).

Although the main focus is on contract award through to final build, the starting point for CoST is for countries to recognise the value of transparency at all stages of the construction project cycle. This could be supported by the additional disclosure of details and/or documents to provide transparency of the process from project identification through to main contract award. During preliminary consultations on CoST in-country, a number of stakeholders expressed strong interest in linking CoST to existing initiatives aimed at enhancing the transparency of public procurement practices.

The challenge for CoST is to balance the widely accepted need for greater transparency<sup>8</sup>, with the necessity of designing a system that is practicable. If disclosure is too limited it will serve no

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<sup>6</sup> In addition to a 3-person DFID/World Bank Working Group overseeing the initial design of CoST, there is a Steering Group which has its origins in an initial brainstorming meeting in April 2006. Participants were asked if they would like to join a focus group and those who put their names forward were included. There are currently around 25 representatives from government, the industry and civil society.

<sup>7</sup> These include initiatives: at the international level such as the joint OECD/DAC - World Bank's Round Table Initiative on Strengthening Procurement Capacities in Developing Countries; with a regional focus such as the ADB/OECD Anti-Corruption Initiative for Asia Pacific; promoted by bilateral agencies such as DFID's framework agreement with Crown Agents on procurement with a particular emphasis on anti-corruption; and numerous country-level initiatives to strengthen public procurement procedures, examples of which were evident during country consultations in Ghana, Tanzania and Vietnam.

<sup>8</sup> As evidenced by the growing number of international organisations with anti-corruption programmes (e.g. EU, European Bank for Reconstruction and Development, Inter-American Development Bank, World Bank) and approximately 200 private companies from the construction sector internationally that are participants in the Global Compact (which includes the principle that "businesses should work against corruption in all its forms, including extortion and bribery"). The importance of transparency was also affirmed in a declaration issued following an International Anti-Corruption Conference (IACC) in Guatemala in November 2006, attended by over 1,000 international delegates from government, business and

purpose and enable corrupt officials and contractors to resist demands for greater transparency. It will therefore be ineffective and counter-productive. Too great a requirement for disclosure would be onerous and discourage participation.

The main sources of corruption from the point of contract award are corruption in the original contract terms (in particular, price relative to the original specification), and corruption during execution resulting in price increases, delays, re-award of contracts, and poor quality. CoST proposes simple indicators that capture these elements.

CoST is designed to be applicable to any country and to any government department or agency with responsibility for public sector construction projects - the procuring entities. For all projects above an agreed threshold (which may vary between countries or sectors), CoST provides for regular publication of material project information. While broad disclosures are encouraged, this Design proposes specific disclosures of material project information to ensure that CoST achieves its ultimate aim.

This Design has been prepared specifically for the Pilot Phase. The expectation is that the Pilot Phase will identify and help resolve practical challenges to CoST implementation, which will be reflected in a final design document. The Design sets out some core requirements for CoST that pilot countries should attempt to adhere to, but these requirements provide considerable latitude for flexibility in detailed implementation in-country.

## **1.6 Added Value of CoST**

The complexity of the causes and types of corruption in the construction sector are such that they cannot be addressed by a single initiative. CoST will build on, and not duplicate, country and international initiatives that exist already to increase transparency and reduce corruption. Many of these initiatives target broad-based procurement reform across sectors, and, as noted above, the earlier stages of procurement such as tendering. Relatively few focus specifically on the construction sector; and on outputs and implementation.

The fully multi-stakeholder nature of CoST should also add value to existing initiatives. CoST aims to bring together government, the industry, and civil society to build on their common interests to improve transparency. Experience from the EITI indicates that this approach can enhance trust amongst the different parties, improve credibility and lead to innovative ways of working. CoST is not just a technical exercise, but includes civil society groups in the process, improving their ability to hold governments and companies accountable. CoST adds value by matching the disclosure of project information with accountability.

CoST has potential benefits for all stakeholders. For governments, the management of public finances should be strengthened, and the governance of public sector construction projects improved. As CoST gains international recognition, the hope is that it will provide a seal of approval that will open the door to increased flows of funding for construction projects. This is already beginning to happen in the case of EITI.

For companies involved in the sector (including engineering consultants and construction companies), CoST has the potential to level the playing field by making material project information public. Through their participation in the multi-stakeholder group (MSG) that lies at the heart of CoST, the companies will also participate in identifying the scope of 'material project information', and have a clear understanding of the implications of CoST (in terms of disclosure requirements

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civil society, which called on the "parties to major infrastructure projects to implement effective anti-corruption systems. They must include full transparency and expert independent monitoring involving civil society throughout the project cycle."

and related benefits). CoST can also help to illustrate the broader social and economic development contribution made by companies within the construction sector. One potentially important indirect benefit of CoST is in improving professional standards within the sector – a factor that was emphasised during consultations at the international and country level.

The added value for civil society comes from improved access to information on construction projects, increased participation in the governance of the construction sector, improved prospects for better quality and value-for-money for beneficiaries, and reduced corruption within the sector.

For providers of finance to, investors in, or insurers of the construction sector, the potential added value of CoST is the mitigation of political and reputational risks, which in turn can have an impact on credit risks.

## 2. Overview of CoST

### 2.1 CoST Principles and Criteria

In the initial stages of EITI, a diverse group of countries, companies and civil society organisations agreed a Statement of Principles that became known as the EITI Principles, and provided the cornerstone for the initiative. Following the pilot stage of EITI, participants in EITI recognised the need to adopt a mutually agreed set of EITI Criteria for all countries wishing to implement EITI.

The CoST Principles reflect a shared commitment to transparency and accountability on the part of construction sector stakeholders, and outline a set of aspirational beliefs and values. The proposed Criteria have a more operational focus and reflect the proposed entry point for, and implementation requirements of, CoST.

**The Principles and Criteria for this Pilot Phase of CoST are as follows:**

#### **The CoST Principles**

1. We share a belief that public sector infrastructure projects should support sustainable economic growth that contributes to sustainable development and poverty reduction, but that mismanagement during construction can undermine their potential social and economic benefits and value for money.
2. We believe in accountability by government to all citizens for public expenditure on construction projects, and are committed to encouraging high standards of transparency and accountability in all parts of the construction sector, both public and private.
3. We consider that disclosure of basic project information throughout the project cycle could be an effective and efficient way to improve value for money of construction projects over time, and that greater transparency during project implementation should be supported by open and transparent tendering processes.
4. We recognise the enhanced environment for domestic and foreign direct investment that transparency may bring.
5. In seeking solutions, we believe that a collaborative multi-stakeholder group\* can play an important oversight and interpretative role in ensuring greater transparency and public understanding of information disclosed on projects.

## The CoST Criteria

1. For public sector construction projects above an agreed threshold, regular disclosure of material project information\* to a wide audience in a publicly accessible, comprehensive and comprehensible manner.
2. Procuring entities are subject to a credible audit process and, as far as practicable, projects are subject to credible, independent financial and technical audits.
3. The adequacy of material project disclosures and audits are assessed by an independent, objective and technically competent Assurance Team\*\*, with publication of reports including any causes for concern in the information disclosed.
4. The application of this approach is extended to the main procuring entities assigned responsibility for public sector procurement, and related contractors.
5. A Multi-Stakeholder Group \*\* has oversight of the CoST process.
6. Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate.
6. A public, financially sustainable work plan for all the above is developed by the host government, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.

**The CoST Criteria represent the core requirements that are to be piloted.**

The Criteria will be reviewed during the Pilot Phase, and amended if necessary before the design of CoST is finalised.

## 2.2 Support for piloting and national implementation

The institutional structures and longer term funding arrangements in support of EITI at the international level (including the EITI Board, EITI Secretariat and Multi-Donor Trust Fund) were established through iterative discussions between key stakeholders over a number of years. While it would be premature to attempt to map out equivalent institutional structures in support of CoST at this stage, most pilot countries are likely to need assurances that they have access to adequate support for implementation during the Pilot Phase (including capacity building).

One of the purposes of the Pilot Phase is to provide information on the costs of implementing CoST, and on its efficacy. While the expectation is that CoST should lead to significant reductions in losses during the implementation phase of construction projects, a cost-benefit analysis for CoST has not been undertaken. It is important therefore, that implementing countries are provided, where appropriate, with technical and financial resources in support of the Pilot Phase to enable the participation of emerging and transition economies. There is a role for donors<sup>9</sup> to:

- Provide capacity building and other forms of support as required;
- Provide practical guidance to countries during the pilot implementation of CoST;

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<sup>9</sup> DFID has already made a commitment to support the Pilot Phase and further commitments from other donors are expected.



- Exercise a convening and enabling role for key stakeholders in the pilot countries to share experience;
- Secure a broader base of support for CoST – political, institutional and financial – and initiate discussions about the longer-term institutional structures and funding arrangements for CoST at the international level; and
- Provide informal quality assurance oversight to pilot countries, prior to the establishment of a more formal quality assurance mechanism.

Shared experiences and lesson-learning should be an integral part of the Pilot Phase. It is expected that the participating countries will make their own arrangements for this purpose (eg a core group or forum), although donors could provide an initial convening and enabling role for representatives from pilot countries. Any group or forum should include multi-stakeholder representation to maximise the benefits, and donors would expect to attend (probably with observer status).

## 2.3 Initial CoST Concept to be piloted

The outline in Section 1.4 of the core concept of CoST described two components:

- The **disclosure** of material project information on a selection of construction projects;
- A **CoST structure** to enable all stakeholders (including civil society) to engage effectively in the process and to draw appropriate conclusions.

**This section sets out an initial concept to form the basis for testing during the Pilot Phase. Section 2.4 then outlines how CoST might be implemented in practice.**

### 2.3.1 Disclosures

The initial disclosures to be piloted are given in Table 2.1. For the reasons given in Section 1.5, the main focus of CoST is on the period between award of contract and final build. Table 2.1 lists the key disclosures that should be made at award of contract and at post contract completion, together with the disclosure of significant changes to price, programme or re-award of the contract during contract execution. These are the core disclosures in CoST, and are aimed at comparing commitments and outcomes during the implementation stage.

Since difficulties that arise during contract execution may have their origins in deficiencies at earlier stages in the project cycle, Table 2.1 also lists other key disclosures for the stages before award of contract. These disclosures are in support of the main focus of CoST.

**Table 2.1 Initial Disclosures for Pilot Phase**

Stage in Project Cycle		Disclosures
Prior disclosures in support of CoST	<b>Project identification</b>	<ul style="list-style-type: none"> <li>• Project specification</li> <li>• Purpose</li> <li>• Location</li> <li>• Intended beneficiaries</li> <li>• Feasibility study</li> </ul>
	<b>Project funding</b>	<ul style="list-style-type: none"> <li>• Financing agreement</li> </ul>
	<b>Tender process</b> (Main contracts for works and/or services <sup>10</sup> )	<ul style="list-style-type: none"> <li>• List of tenderers</li> <li>• Tender evaluation report</li> </ul>
Core disclosures in support of CoST	<b>Contract award</b> (Main contract for works)	<ul style="list-style-type: none"> <li>• Contractor name</li> <li>• Contract price</li> <li>• Contract scope of work</li> <li>• Contract programme</li> </ul>
	<b>Contract execution</b> (Main contract for works)	<ul style="list-style-type: none"> <li>• Individual significant changes to the contract which affect the price (the threshold to be determined by the MSG), and reasons for those changes</li> <li>• Individual significant changes to the contract which affect the programme and duration (the threshold to be determined by the MSG), and reasons for those changes</li> <li>• Details of any re-award of main contract</li> </ul>
	<b>Post contract completion</b> (Main contract for works)	<ul style="list-style-type: none"> <li>• Contractor name</li> <li>• Actual contract price</li> <li>• Final contract payment</li> <li>• Actual contract scope of work</li> <li>• Actual contract programme</li> <li>• Project evaluation report (upon completion and on-going)</li> </ul>

**Note:**

*The intent of the above disclosures is that information should be disclosed regarding the major contracts for financing, design, project management, construction, operation and maintenance (where appropriate) of the project. In traditional contractual arrangements, the main contracts for works and/or services will generally be between the procuring entity and each relevant contractor. However, increasingly, procuring entities are contracting out, to one or more parties, responsibility for design, construction, financing, operation and maintenance. In such cases, the above information should be disclosed in relation to the first tier contract between the procuring entity and the prime contractor(s), and in relation to the second tier contracts between the prime contractor and those providing finance, design, project management, construction and operation.*

All the disclosures in Table 2.1 are viewed as integral to the CoST concept, but there may be some refinements during the Pilot Phase, and piloting countries may wish to add further disclosures to the list for their own purposes.

<sup>10</sup> This would include, for example, consultant contracts for design and supervision.

Especially during the Pilot Phase, project thresholds are envisaged to restrict the number of projects to be included in CoST, to ensure that the process is manageable and practicable. In some pilot countries, many thousands of separate public construction projects may be let annually. The challenge is to ensure that CoST embraces a sufficiently large number (and value) of projects to ensure that the intended benefits in terms of improved transparency and reduced corruption are realised. A combination of thresholds and random sampling of projects below the threshold might help to extend the potential benefits to smaller projects, and projects procured at devolved levels of government.

### 2.3.2 CoST structure

Without pre-empting the final design of CoST, it is important to test the practicality of the concept by developing an outline structure for the Pilot Phase<sup>11</sup>. To the extent possible, those implementing CoST should draw upon and extend the reach of existing institutional arrangements, and should avoid creating new institutional structures. Nevertheless, donors fully recognise the need to provide capacity building support to many countries to enable CoST to be implemented effectively.

The proposed structure is illustrated in Figure 2.1. The main entities are:

- **Multi-Stakeholder Group (MSG):** The MSG is a representative body comprising key stakeholders that plays the central role in the oversight of CoST. The composition, appointment, remuneration, responsibility and accountability of the MSG may vary between countries, but in all cases it should be governed by clear terms of reference (TOR). Its membership and TOR should be publicly disclosed. In addition, the civil society representation on the MSG should be, and be perceived to be, independent of both government and the construction industry. Some of the MSG's members will have detailed or substantial experience of the construction sector, but others (eg civil society representatives) may not.

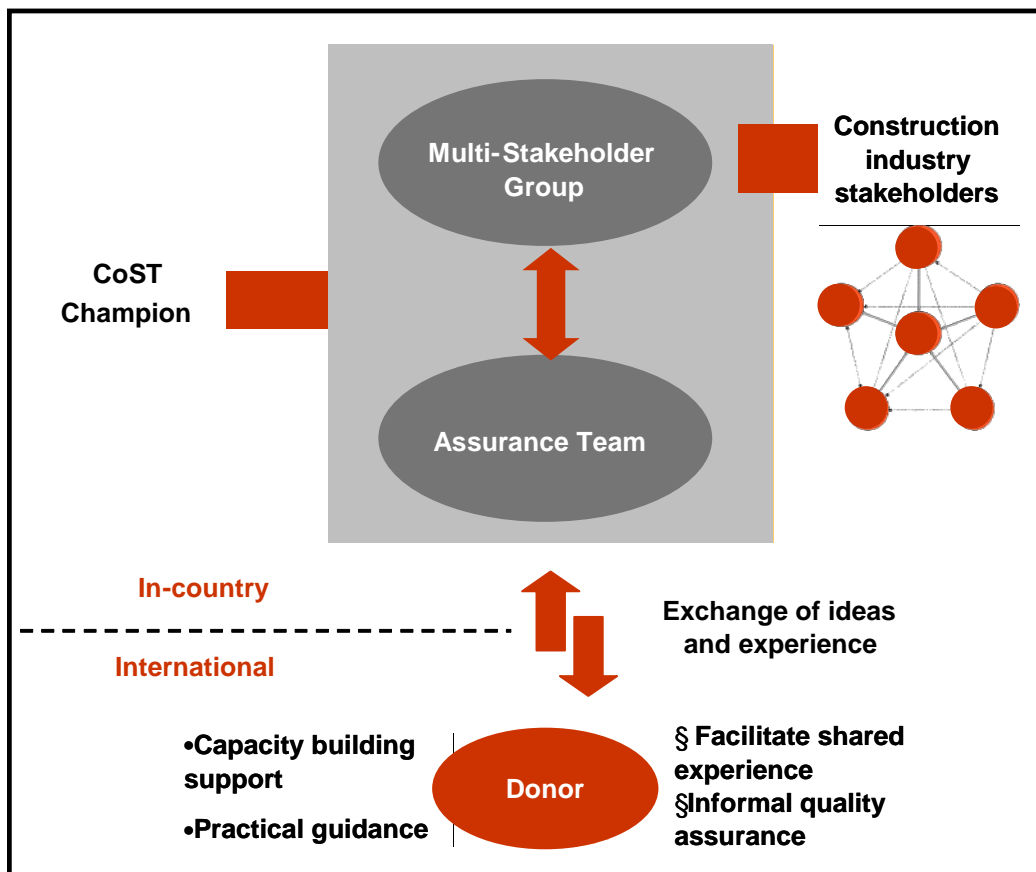
The TOR for the MSG should specify its responsibilities in the implementation of CoST. The MSG should also provide an interface between those with specialist and detailed knowledge of the structure and workings of the construction sector, and a wider set of interested and affected stakeholders. In general, the MSG should identify and build upon existing structures, procedures and initiatives relating to the provision of transparency.

- **Assurance Team:** The Assurance Team is responsible for assessing the adequacy and reliability of material project information disclosures, identifying causes for concern in such disclosures, and reporting its findings to the MSG. Its function is technical, operating in accordance with its TOR and instructions from the MSG. Through its reporting, the Assurance Team plays an interpretative role in helping to make raw data disclosures more intelligible to the MSG and, through the MSG, to a wider range of affected stakeholders. It is vital that the Assurance Team is, and is perceived by stakeholders to be, independent, trustworthy, objective and technically competent. The membership and TOR of the Assurance Team should be publicly disclosed.
- **CoST champion:** The 'CoST champion' is a senior official appointed by government with overall responsibility for ensuring that CoST is implemented in-country, but is not necessarily involved substantially in implementation.

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<sup>11</sup> This Design has been simplified from the earlier Outline Design to remove entities that are not relevant to the early stages of the Pilot Phase, such as the Validator and International Secretariat.

Figure 2.1 Structure of CoST Pilot Phase

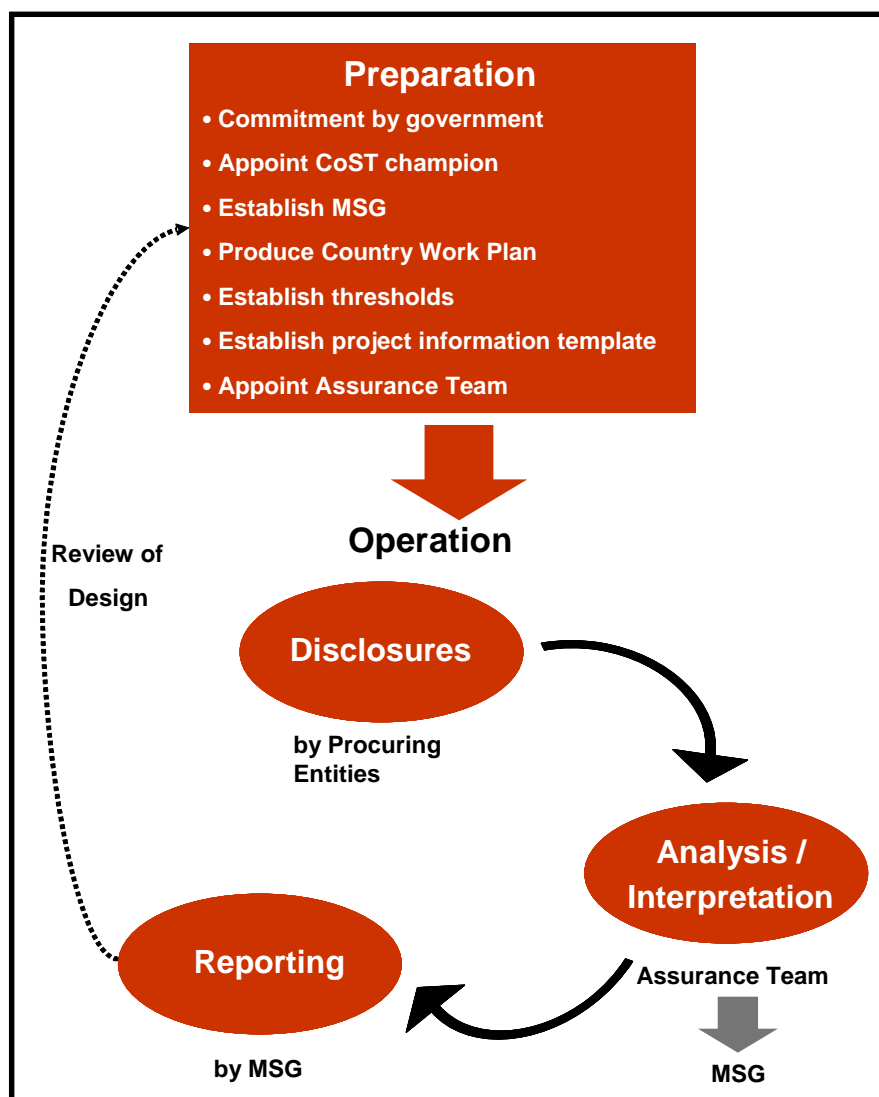


The nomenclature used for these entities should be taken as indicative only, and final decisions should be determined in-country. The titles or institutional terms are not as important as their responsibilities. The MSG and Assurance Team are at the heart of the implementation of CoST, with the 'CoST champion' being ultimately responsible for ensuring that implementation takes place in accordance with the Principles and Criteria.

## 2.4 Implementation of CoST

An illustrative sequence for implementing CoST is summarised in Figure 2.2. A more detailed example of a possible implementation process is given in Annex C.

Figure 2.2 Illustrative CoST Process



The sequence in Figure 2.2 is divided into two phases: **preparation** and **operation**.

#### 2.4.1 Preparation

The following main steps are envisaged before the operation phase of CoST can start:

- A public statement by the government that it intends to pilot CoST;
- Appointment of the 'CoST champion';
- The constitution of an MSG to oversee CoST implementation, ensuring adequate representation of key stakeholders;
- The production of a costed Country Work Plan for implementing CoST, with a timetable and an assessment of capacity constraints (government, private sector and civil society), and taking account of existing structures, procedures and initiatives which may be relevant to the provision of transparency;
- The establishment of project thresholds to ensure that the process is manageable and practicable;



- The establishment of project information templates to define the nature and extent of information to be disclosed by procuring entities on all projects included in CoST;
- Appointment of an Assurance Team.

The steps that follow the constitution of the MSG (ie the actions on the County Work Plan, project thresholds, project information templates, and Assurance Team) are expected to be approved by the MSG. In some cases the actions might be led by the MSG.

#### 2.4.2 Operation of CoST

The operation of CoST in Figure 2.2 is divided into three stages: disclosure, analysis/interpretation, and reporting.

**Disclosure:** The operation phase CoST starts with the public disclosure of material information on the individual projects included in CoST. The disclosures are made by procuring entities in accordance with the project information templates, and in cooperation with contractors, on an ongoing basis and within an agreed timeframe. In support of the CoST process, procuring entities might be encouraged to provide further disclosure of material project information (beyond the template requirements).

**Analysis/interpretation:** This stage is envisaged to have two parts. First, the Assurance Team assesses the adequacy and reliability of the project information disclosed by the procuring agencies, and identifies causes for concern in such disclosures. For example, it could assess whether the project information disclosed complies with the project information templates, whether it is consistent with relevant project documentation and records, whether audits have been conducted of the procuring entity and of the project, and the scope of such audits<sup>12</sup>. Where appropriate, the Assurance Team might seek further information in relation to any concerns it may have.

Second, the Assurance Team reports to the MSG on its findings, providing an interpretation of the disclosures and the main conclusions that can be drawn. The MSG could be empowered to request additional information, and potentially to commission further investigations or evaluations, in order to address concerns or discrepancies raised by the Assurance Team.

**Reporting:** In the third stage, the MSG publishes reports at regular intervals to disclose to the public the main findings of the Assurance Team. The expectation is that these reports will ultimately discuss progress on CoST implementation and emerging trends, based on information from across a range of projects and procuring entities. They could also identify individual projects where the Assurance Team has identified unresolved discrepancies or causes for concern, or systemic problems with the systems for information collection and disclosure. The MSG might also develop a website on which reports and other information are posted.

The question of investigative powers, punitive measures or remedies being available through CoST with respect to apparent discrepancies was raised during the consultation process. The Design focuses on enhanced transparency rather than ensuring that corrupt parties are investigated and punished. While this does not preclude provision for such measures within CoST during implementation in-country, the expectation is that suspected incidences of corruption should be passed on to the appropriate authorities for consideration. These might include the national audit agency, existing regulatory agencies or inspectorates, or the judiciary.

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<sup>12</sup> It is not envisaged, however, that the Assurance Team will conduct any audits.

## **2.5 CoST participants: incentives and obstacles**

Since CoST is a voluntary initiative, it is important to consider the incentives for, and obstacles to, stakeholder participation. This is particularly important given that some influential observers of, and participants in, existing voluntary initiatives have recently begun to publicly question their efficacy and future. CoST will only gain support among key stakeholder groups if they are persuaded that the incentives for participating in CoST outweigh any potential costs or obstacles.

These incentives may not be immediately apparent to stakeholders. Each group may have distinct incentives, some of which may be shared with other stakeholders and some that may be unique. A preliminary outline of incentives and obstacles is given in Annex D. These will need to be more fully developed and enriched by the opinions of stakeholders in-country during the Pilot Phase of CoST.

## 3. Next steps in development of CoST

### 3.1 Next steps for governments

This Design has been prepared for the Pilot Phase. A government that intends to pilot CoST should first:

- Confirm its agreement to the Principles in Section 2.1 of this Design;
- Nominate a ‘CoST champion’;
- Identify relevant stakeholders.

Governments can decide when they wish to start piloting CoST, but it is intended that some countries will start soon after the launch, and that the Pilot Phase will initially extend for 24 months.

Governments of pilot countries will also be encouraged and supported to form a core group or forum at which experience and ideas about CoST can be exchanged (see Section 2.2).

### 3.2 Support from donors

The areas of support from donors are set out in Section 2.2. An important area is capacity building to enable stakeholders to perform their role in implementing CoST. The Country Work Plans should identify each country’s specific needs for capacity building as a basis for discussion with donors.

The Pilot Phase will include provision for a more detailed exploration of the costs and benefits of CoST. This should assess the broad order of costs for implementing CoST, including an analysis of where the burden of implementation falls (in terms of allocation of costs between stakeholders). It should also identify the likely financial savings resulting from CoST implementation, and establish which stakeholders these savings would accrue to. This analysis is considered important, firstly to assess the potential value of CoST more empirically, and secondly, to identify any significant discrepancies between the institutions that bear the cost of implementation and those that are the primary beneficiaries of resultant savings.

Throughout, and especially towards the end of, the Pilot Phase, donors will be responsible for compiling lessons based on experience with in-country application of this Design, and proposing a final design for CoST. The final design proposal will be subject to broad consultation with international stakeholders.

In parallel, donors will need to actively pursue a broader base of support for CoST – politically, institutionally and financially – and to develop proposals for the longer-term institutional structures and funding arrangements for CoST at an international level.

# Annex A

## Key sources of additional information

- EITI (2005). Extractive Industries Transparency Initiative Source book. EITI Secretariat, DFID
- EITI (2006). Final Report International Advisory Group. EITI Secretariat, DFID
- Kaufmann, D., Kraay, A. and Mastruzzi, M. (2006). Measuring corruption: Myths and Realities. World Bank, Washington, D.C.
- Transparency International (2005). Global Corruption Report: Corruption in Construction and Post-Conflict Reconstruction. Berlin, Germany.
- Transparency International (2007). PACS: Project Anti-Corruption System (Construction Projects). [In particular Modules 1, 12 and 13]
- Transparency International (2005). Preventing Corruption on Construction Projects: Risk assessment and proposed actions for funders

# Annex B

## Stakeholders in CoST

The potential stakeholders in CoST comprise a number of groups:

- **Procuring entities:** The main government ministries, departments or agencies with responsibility for public sector construction projects. These will differ from country to country, but could include ministries of public works, energy, water, roads and other forms of transport infrastructure, health, education etc.
- **Public financial management entities:** The main ministry or government department with oversight of public financial management, auditor generals' office, and perhaps legislative committees with oversight of public funds.
- **Construction companies and associations:** Domestic and international construction and engineering companies, consulting engineering firms, and professional institutions and business associations which serve the industry.
- **Civil society:** Community-based, national and international non-governmental organisations (NGOs) with an interest in transparency and accountability of public sector construction projects; media; and academic and research institutions. This group would also include representatives of the intended beneficiaries (or user groups) of construction projects.
- **External (non-governmental) providers of finance or loan guarantees:** Multilateral or bilateral lenders or donors, providers of private sector finance (e.g. domestic banks, international banks, including 'Equator Banks'<sup>13</sup>), international financial institutions (e.g. International Finance Corporation (IFC) or European Bank for Reconstruction and Development (EBRD)), providers of loan guarantees (e.g. export credit agencies or the Multilateral Investment Guarantee Agency (MIGA)).
- **Other international partners:** International institutions with an interest in enhanced sectoral transparency and accountability (such as the IMF, World Bank, United Nations, or European Investment Bank).

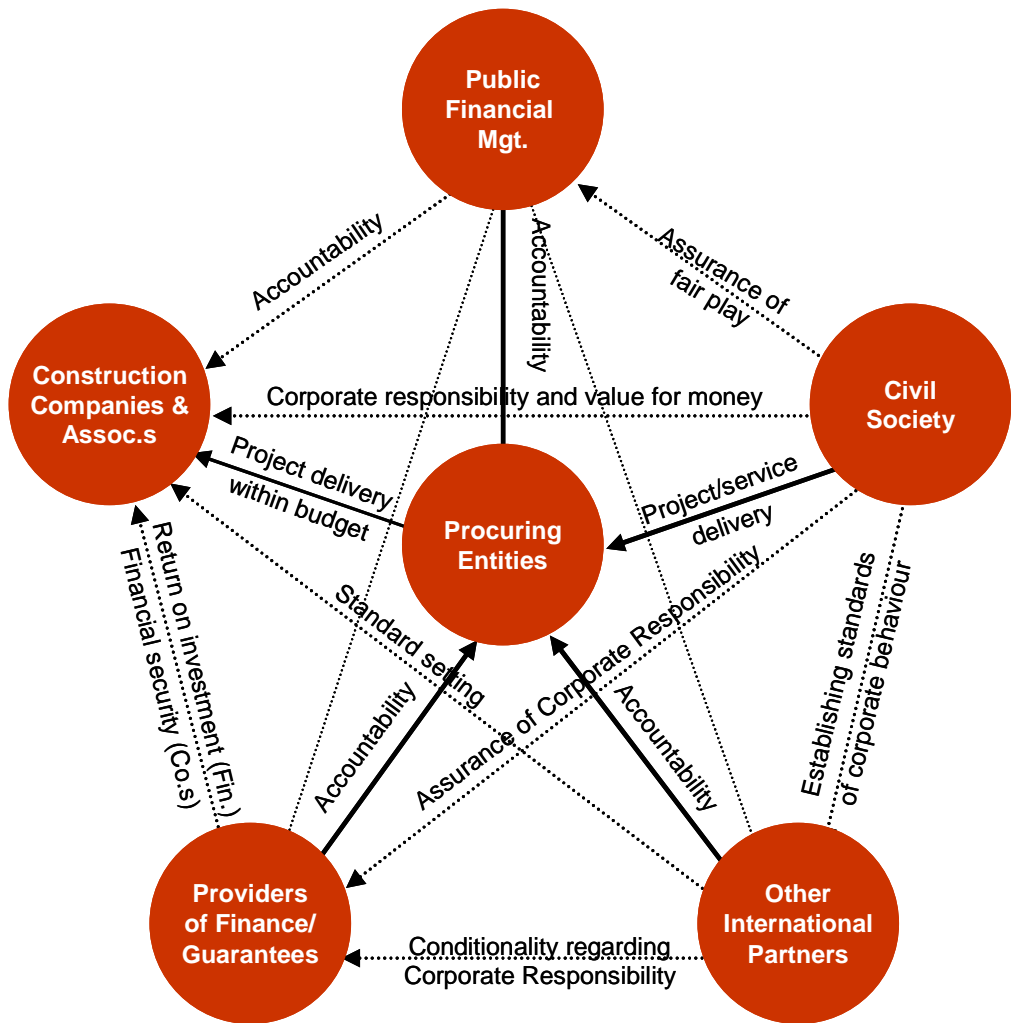
Some of the interests of these stakeholder groups in construction projects are illustrated in Figure B.1.

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<sup>13</sup> In June 2003, a group of major financial institutions adopted a set of voluntary guidelines known as the 'Equator Principles (EPs)' for managing environmental and social issues in the project finance sector. The EPs are based on the policies and guidelines of the International Finance Corporation (IFC), part of the World Bank Group. Currently over 40 financial institutions (known as Equator Banks) have signed up to the EPs, and collectively represent over 90 percent of global project finance.



Figure B.1 Stakeholder interests in Public Construction Projects



# Annex C

## Illustrative implementation process

This annex provides an illustrative process for implementing CoST. It is not intended to be prescriptive but to serve as one possible way in which CoST might be implemented. It is expected that pilot countries will develop different processes, which will help to inform the finalisation of the design of CoST for rolling out beyond the Pilot Phase. This illustrative process is shown graphically in Figure C.1 and is elaborated below:

- **Appointment of a 'CoST champion':** After committing to piloting CoST, the government appoints a 'CoST champion' with responsibility for ensuring that CoST is implemented.
- **Constitution of an MSG:** The 'CoST champion' convenes an MSG through an open and transparent process.
- **Development of a Country Work Plan:** The 'CoST champion', in consultation with the MSG, develops a costed Country Work Plan which is made publicly available. The Work Plan could include, but not be limited to: the stages for implementation; funding arrangements for CoST; provisions for meaningful involvement of the MSG; an assessment of the capacity constraints of CoST participants to engage in the initiative; measurable targets; and a timetable for implementation.
- **Agreement on project thresholds:** The MSG establishes project thresholds according to which CoST projects will be selected.
- **Agreement on project information templates:** The project information templates might be developed either by the 'CoST champion' in consultation with the MSG, or by the MSG, but the final templates should be approved by the MSG. One important aspect of developing these templates (and subsequent information disclosure) will be the interface between procuring entities and contractors, in support of an effective and efficient disclosure process. For example, procuring entities should clearly identify the extent of project-level disclosures to prospective tenderers, and could specify contractual obligations in support of such disclosures. The MSG will need to ensure that the disclosed project information will enable the Assurance Team to consider issues including price increases, delays, re-award of contracts, and poor project quality.
- **Appointment of an Assurance Team:** The Assurance Team should be selected through a transparent process, and both the Assurance Team and its TOR should be approved by the MSG. The Assurance Team should have the attributes highlighted in Section 2.3.2, but the selection process might be led by the 'CoST champion' in consultation with the MSG, or by the MSG.
- **Public disclosure in accordance with project information templates:** Public disclosure of material information on the individual projects is undertaken by procuring entities in accordance with the project information templates, and in cooperation with contractors (e.g. on a project website or information centre). This should provide an effective means for the MSG to engage with interested and affected parties throughout the lifetime of a project.

- **Assessments by the Assurance Team:** The Assurance Team assesses the adequacy and reliability of the project information disclosed by the procuring agencies, and identifies causes for concern in such disclosures. Where appropriate, the Assurance Team might seek further information in relation to any concerns it may have.
- **Reporting to the MSG:** The Assurance Team reports to the MSG on its findings.
- **Public disclosure of CoST reports:** The MSG publishes reports at regular intervals to disclose to the public the main findings of the Assurance Team.

### Figure C.1 – Illustrative implementation process

# Annex D

## Preliminary Outline of Incentives for and Obstacles to Stakeholder Groups Engaging in CoST

Stakeholder Group	Incentives	Obstacles
<b>Procuring entities</b>	Improved efficiency and transparency of contract management process, and improved public confidence in the procuring entities.	Concerns that introduction of CoST will impose an administrative burden, in light of required procedural changes.
	Increased likelihood of competent contractors being awarded (e.g. as a result of improved perception of level playing field) and related benefits of improved construction quality and reduced delays.	Increased transparency of process can represent a threat to potentially corrupt elements by decreasing their ability to exert influence over the allocation of projects or payments.
	Reduced corruption and wastage enabling more projects to contribute to social and economic development.	Concerns that anticipated benefits of CoST might not be realised.
<b>Public financial management entities</b>	Enhanced management of public finances, improved public confidence in government, and reduced opportunities for corruption.	Increased transparency of process can represent a threat to potentially corrupt elements by decreasing their ability to exert influence over the allocation of projects or payments.
	Improved governance likely to improve business confidence and trust, and increase prospects for investment.	Concerns that increased costs associated with CoST might offset potential gains resulting in no net benefit to the public purse.
	Potential for improvements to be recognised by ratings agencies and/or financial institutions providing better access to private capital.	Concerns that introduction of CoST will impose an administrative burden, in light of required procedural changes.
<b>Construction companies and associations</b>	Increased confidence that 'level playing field' prevails and improved prospects that contract award, implementation and payment schedules will be characterised by fairness.	Concern that unless all companies are equally affected by CoST, a level playing field will never materialise and there will be no positive effect on payments, reputational risks, etc.
	Reduced likelihood of reputational risk through association with projects that are perceived as corrupt or fail to meet their objectives.	Increased transparency of process can represent a threat to potentially corrupt companies by decreasing their ability to exert influence over the allocation of projects or payments.
	Improved financial risk management leading to better access to private capital and/or more favourable lending terms.	Concerns that compliance with CoST will impose an administrative burden, and that increased costs might not be offset by the benefits.

Stakeholder Group	Incentives	Obstacles
<b>Civil society</b>	Enhanced prospects for better outcomes from public sector investment in infrastructure, in terms of value for money and responsiveness to interests and concerns of intended beneficiaries or affected communities.	Concerns that CoST process might fail to improve project outcomes, yet legitimise what remains a corrupt sector by creating the illusion of enhanced transparency and accountability.
	Enhanced opportunities for public participation in governance and accountability for public sector projects, and greater assurances that opportunities for corruption are reduced.	Concerns that engagement may not result in decreased corruption and/or that engagement in CoST will result in reputational damage as a result of perceived 'guilt by association' with a flawed process.
	Engagement process should lead to improved relationships and greater influence with companies and governments.	Concerns that engagement may not result in decreased corruption and be a distraction from the core objectives of the civil society organisations.
<b>Providers of finance or loan guarantees</b>	Reduced credit risks and improved prospects for a return on investment as a result of greater financial transparency and accountability. For donor organisations, additional benefit that funds provided are likely to achieve development objectives.	Concerns that credit risks may be unaffected by CoST and that returns on investment will not improve. For donor organisations, concerns that development objectives will not be enhanced.
	Decreased risk of a claim in the event of project failure as a result of improved management of the financial and other implementation risks.	Concerns that CoST may convey a false sense of risk mitigation and that the prospects for claim reduction will not be improved.
	Reduced likelihood of reputational risk through association with projects that are perceived as corrupt or fail to meet their objectives.	Concerns that introduction of CoST will impose administrative costs and that there will be no positive effect on reputational risks of association with 'bad' projects.
<b>International partners</b>	Improved potential for support to, and extending the reach of, current initiatives by international partners to enhance governance	Concerns that introduction of CoST will absorb a considerable amount of donor funds and that governance will not be enhanced.
	Enhanced prospects that funds directed to construction projects achieve stated development impacts.	Concerns that development outcomes will not be enhanced by the introduction of CoST.
	Enhanced profile for the potential for voluntary cross-sectoral initiatives (public, private, civil society, donors) to result in positive development outcomes.	Concerns that emerging backlash against/cynicism with voluntary cross-sectoral initiatives will be exacerbated if CoST fails to deliver.



For more information on the CoST initiative and the pilot programme, please contact the CoST secretariat:

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