

Executive Summary

Public procurement: A major risk area

Governments and state-owned enterprises purchase a wide variety of goods, services and public works from the private sector, from basic computer equipment to the construction of roads. Public procurement is a key economic activity of governments that represents a significant percentage of the Gross Domestic Product (GDP) generating huge financial flows, estimated on average at 10-15% of GDP across the world.¹ An effective procurement system plays a strategic role in governments for avoiding mismanagement and waste of public funds.

Of all government activities, public procurement is also one of the most vulnerable to fraud and corruption. Bribery by international firms in OECD countries is more frequent in public procurement than in utilities, taxation, and judicial system, according to a survey of the World Economic Forum.² Bribery in government procurement is estimated to be adding 10-20% to total contract costs. Due to the fact that governments around the world spend about USD 4 trillion each year on the procurement of goods and services, a minimum of USD 400 billion per year is lost due to bribery (Peter Eigen, Transparency International, 2002).

Weak governance in public procurement hinders market competition and raises the price paid by the administration for goods and services, directly impacting public expenditures and therefore taxpayers' resources. The financial interests at stake, and the close interaction between the public and private sectors, make public procurement a major risk area.

Beyond the "tip of the iceberg": Addressing the entire procurement cycle

Although it is widely agreed that public procurement reforms should adhere to good governance principles, reform efforts at the international level have focused largely on the formation of contracts in the last decade, when tenders from suppliers are solicited and evaluated. These reforms were made in order to promote competitive tendering for the selection of suppliers, even

though rules also allow, in certain circumstances, less formal selection procedures.

So far, the formation of contracts – starting with the definition of requirements to the contract award – is the most regulated and transparent phase of the procurement cycle, the “tip of the iceberg”. However, discussions at the 2004 OECD Global Forum on Governance highlighted the need for governments to take additional measures to prevent risks of corruption in the entire procurement cycle, in particular:

- At the stage of **needs assessment**, which is particularly vulnerable to political interference, and in **contract management and payment**. These stages are less subject to transparency as they are usually not covered by procurement regulations.
- When using exceptions to competitive procedures, for instance in **national security and emergency procurement**.

A commitment from OECD countries

Could countries do more to prevent mismanagement, fraud and corruption in public procurement? OECD countries demonstrated their commitment to take action in this area in October 2008. Following the proposal of the Public Governance Committee, they approved the OECD *Principles for Enhancing Integrity in Public Procurement* in the form of an OECD Recommendation. The Principles are primarily directed at policy makers in governments at the national level, but may also offer general guidance for sub-national government and state-owned enterprises.

The Principles provide a policy instrument for enhancing integrity in the entire public procurement cycle. They take a holistic view by addressing various risks to integrity, from needs assessment, through the award stage, contract management and up to final payment.

Procedures that enhance transparency, good management, prevention of misconduct, accountability and control contribute to preventing the waste of public resources as well as corrupt practices. Efforts to enhance good governance and integrity in public procurement are fully part of an efficient and effective management of public resources.

How to keep the public procurement process transparent?

Corruption thrives on secrecy. A key challenge across countries is to ensure transparency in the entire public procurement cycle, no matter what the stage of the process is or the procurement method used.

The first Principle for Enhancing Integrity in Public Procurement calls on governments to **provide an adequate degree of transparency in the entire procurement cycle in order to promote fair and equitable treatment for potential suppliers**. There are several things governments can do to ensure this. For example, if key decisions on procurement are well-documented and easily accessible, inspectors are able to check whether specifications are unbiased or award decisions are based on fair grounds. The degree of transparency also needs to be adapted according to the recipient of information and the stage of the cycle. In particular, governments should protect confidential information, such as trade secrets of tenderers, to ensure a level playing field.

The second Principle stresses that governments should **maximise transparency in competitive tendering and take precautionary measures to enhance integrity, in particular for exceptions to competitive tendering**, such as extreme urgency or national security. To ensure sound competitive processes, governments should provide clear rules, and possibly guidance, on the choice of the procurement method. No matter what the procedure used, maximising transparency is key, for example through the publication of notices on-line for low-value purchases. Governments could also set up procedures to mitigate possible risks to integrity. In the case of a hurricane or a flood, a risk mitigation board could be set up to bring together key stakeholders to allow for clear policy directions and increased communication during the emergency.

How to achieve value for money?

Common shortfalls in the planning and management of procurement include needs that are not well estimated, unrealistic budgets or officials who are under skilled. Governments realise that procurement should be integrated into a more strategic view of government actions to improve value for money.

The third Principle states that governments need to **ensure that public funds are used in procurement according to the purposes intended**. Procurement plans generally include the related budget planning, formulated on an annual or multi-annual basis, with a detailed and realistic description of the financial and human resource management requirements. The management of public funds should be monitored by internal control and internal audit bodies, supreme audit institutions and/or parliamentary committees. When a bridge is to be built, for example, a court of audit may verify not only the legality of the spending decision but also whether the planned bridge responds to a real need.

The fourth Principle calls on governments to **ensure that procurement officials meet high professional standards of knowledge, skills and integrity**. Recognising working in public procurement as a profession is critical to reducing mismanagement, waste and corruption. Just like the medical or legal professions, public procurement officials could benefit from well-defined curricula, specialised knowledge, professional certifications and integrity guidelines. For example, if a public official sitting on a tendering commission finds that one of the tenderers is someone with whom he or she has a personal relationship, the official should be able to identify the potential conflict of interest and take action.

How to improve resistance to fraud and corruption?

There is increasing recognition that specific measures are needed in the public and private sectors to identify and address risks of fraud and corruption in public procurement.

The fifth Principle requests governments to **put mechanisms in place to prevent risks to integrity in public procurement**. Risks to integrity can pertain to potentially vulnerable positions, activities, or projects. For instance, an anti-corruption agency could draw a “risk map” that identifies the positions of officials who are vulnerable, activities in the procurement where risks arose in the past, and the particular projects at risk due to their value or complexity. These risks can be addressed through mechanisms that foster a culture of integrity in the public service such as integrity training, financial disclosure, or the management of conflict of interest.

The sixth Principle **encourages close co-operation between government and the private sector to maintain high standards of integrity, particularly in contract management**. Governments should set clear integrity standards for the private sector and ensure they are followed. For example, officials who systematically record feedback on experience with individual suppliers are in a better position to evaluate future tenders. Potential suppliers should also be encouraged to take voluntary steps to reinforce integrity in their relationship with the government. These include codes of conduct, integrity training programmes for employees, corporate procedures to report fraud and corruption, internal controls, certification and audits by a third independent party.

The seventh Principle calls on governments to **provide specific mechanisms for the monitoring of public procurement and the detection and sanctioning of misconduct**. For example, a public procurement agency could have “blinking” indicators that track decisions and identify potential irregularities by drawing attention to transactions departing from established norms for a project. Procedures for reporting misconduct could also be established, such as an internal complaint desk, a hotline, an external

ombudsman or an electronic reporting system that protects the anonymity of the individual. Governments should not only define sanctions by law but also provide the means for them to be applied in an effective, proportional and timely manner.

How to ensure that rules are followed?

A key condition for a public procurement system to operate with integrity is the availability and effectiveness of accountability and control mechanisms.

The eighth Principle highlights the importance for governments to **establish a clear chain of responsibility together with effective control mechanisms**. A clear chain of responsibility is key for defining the authority for approval and based on an appropriate segregation of duties, as well as the obligations for internal reporting. In addition, the regularity and thoroughness of controls should be proportionate to the risks involved. For example, probity advisors could be called upon for purchases that are high value/volume, complex or sensitive in order to advise the procuring authority at key stages of the process and provide a level of independent assistance about the fairness of the procurement.

The ninth Principle stresses that governments should **handle complaints from potential suppliers in a fair and timely manner**. To ensure an impartial review, an independent body with the power to enforce its decisions should rule on procurement decisions and provide adequate remedies. In particular, potential suppliers should be able to refer to an appeal body. In addition, establishing alternative dispute settlement mechanisms can also be a way to avoid formal litigation and reduce the time for solving complaints. For example, the government could set up an advisory complaint board or a contact point for advice to companies facing problems in cross-border cases.

Last, but not least, the tenth Principle calls on governments to **empower civil society organisations, media and the wider public to scrutinise public procurement**. Civil society organisations, media and the wider public should have access to public information on the key terms of major contracts. The reports of supreme audit institutions should also be made widely available to enhance public scrutiny. Reviews of procurement activities could also be undertaken. For example, an *ad hoc* parliamentary committee may investigate large infrastructure projects. Direct control by citizens can complement these traditional accountability mechanisms, for example through the monitoring of high-value or complex procurements by a representative from a civil society organisation.

Implementing the Principles

The OECD Principles provide a policy framework for enhancing integrity in the entire public procurement cycle. However, following such principles in real-life situations is the true test.

From simple mistake to deliberate act: Adapting the response

Government contracts can give rise to mistakes, anomalies, fraud, and misappropriation of public funds or instances of corruption. Some of these problems can be avoided through adequate guidance for public procurement officials. Accordingly, the OECD developed a Checklist to help procurement officials implement the *Principles for Enhancing Integrity in Public Procurement*.

The Principles and Checklist are based on acknowledged good practices from governments in various legal and administrative systems. They are intended to be used in conjunction with identified good practices, which provide concrete options for reform for policy makers together with their underlying context (see *Integrity in Public Procurement: Good Practice from A to Z*, OECD (2007), available at www.oecd.org/gov/ethics).

For cases when fraud, misappropriation and corruption are the result of an official's deliberate act to circumvent the rules for illicit gain, the government's response needs to be adapted accordingly. A comprehensive map of risks to integrity can help auditors detect misappropriation of public funds, in particular fraud or corruption.

A practical Checklist for procurement officials

The *Checklist for Enhancing Integrity in Public Procurement* provides a practical tool for the implementation of the Principles. The Checklist provides guidance to practitioners at every stage of the public procurement cycle, from needs assessment to contract management and payment. The procurement cycle is defined as three main phases:

- pre-tendering, including needs assessment, planning and budgeting, definition of requirements and choice of procedures;
- tendering, including the invitation to tender, evaluation and award; and
- post-tendering, including contract management, order and payment.

Risk mapping

Gaining a better understanding of risks can help auditors detect fraud and corruption. The report provides insights into risks to integrity at key points of the public procurement process, that is:

- During the needs assessment, this could take the form of studies that are repeated, never delivered, or useless.
- During the planning, the estimate for the project is for instance over or undervalued, unnecessary documents are billed or project specifications are prepared in a way to allow for future gains.
- In relation to the selection method, this may take the form of reduced publicity, abuse of emergency procedures, or a misrepresented operation to split up contracts. For instance, during the contract management, discounts are provided to an “association” registered under the same address of a company, services are modified, invoices are overvalued or work unrelated to the contract is added.

A benchmark for OECD and non-member countries

The Principles are a point of reference with which policy makers can review, assess and further develop existing policies both in OECD and non-member countries.

Promoting policy dialogue

The Principles are used for conducting Joint Learning Studies and formulating capacity development plans in various regions of the world such as the Middle East and North Africa, South East Europe and Asia Pacific. A pilot application of the Principles was carried out in Morocco in 2007 that helped the government strengthen its public procurement procedures in the wider context of the fight against corruption. Highlights of the study on Morocco are presented in the report, in particular key findings and policy recommendations to improve the procurement system.

Acceding to OECD membership

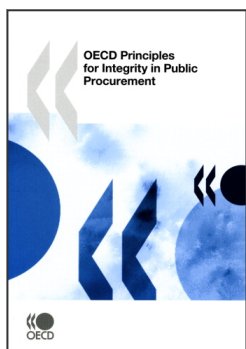
The Principles are also used for countries in the accession process to OECD membership, in particular Chile, Estonia, Israel, Russia and Slovenia, in order to benchmark with OECD standards.

Reporting on progress in 2011

With regard to OECD countries, they will report on progress made in implementing the Recommendation in 2011.

Notes

1. Quantifying the size of public procurement is a difficult task because of the absence of detailed and consistent measurements of government procurement markets for a large number of countries. It is estimated to be the equivalent of 10 to 15% of GDP in OECD countries, depending on whether the compensation for employees is included.
2. Kaufmann, World Bank (2006), based on Executive Opinion Survey 2005 of the World Economic Forum covering 117 countries.



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