

Red Flags project

(www.redflags.eu)

NEW WARNING SYSTEM FOR THE IDENTIFICATION OF RED FLAGS IN PUBLIC PROCUREMENTS

(Summary)

red
flags

Transparency International Hungary's goal as an independent professional organization is to contribute to mitigating corruption, promoting transparency and accountability in the public sphere of decision making processes as well as allocation of public funds, moreover to improving accessibility of public interest information.

K-Monitor is an anti-corruption grass root NGO founded in 2007. K-Monitor strives against corruption and promotes the transparency of public spending in Hungary. K-Monitor operates open data websites, conducts research and advocates for legal reform.

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1.

CORRUPTION RISKS IN PUBLIC PROCUREMENTS, THE MOST IMPORTANT ACHIEVEMENTS SO FAR IN THE FIGHT AGAINST PUBLIC PROCUREMENT CORRUPTION, AND THE CONCEPT OF THE NEW RED FLAG WARNING SYSTEM

1.1. BACKGROUND

Within the framework of the project “*Prevention and detection of corrupt procurements through analysis, red flags and follow up*”, the European Commission provided grant to Transparency International Hungary (TI), K-Monitor and PetaByte to create a warning system which accelerates the fight against corruption in the European Union (EU) by developing practical solutions that help the control of public procurement procedures and the identification of risks in the early stage of procedures. The project’s objective is to develop a risk-assessment methodology, which allows for the creation of a creative, innovative and interactive online monitoring tool that may be used in all member states of the EU.

1.2. INTRODUCTION

Several studies, analyses, best practice materials have been published in the recent years on the links between public procurement and corruption, and the contamination of public procurement procedures by corruption, along with tools for the identification, measurement and prevention of corruption. These days, the question is not whether such links exist, but rather how corruption effects could be prevented or averted. In addition to the description of the widest possible context and correlations, another important undertaking is the development of tools and solutions for practical use.

Within the framework of this project – building on the results from previous analyses and tools – a new automatic warning system has been developed that may be used to uncover risks preventively, and which is based on the standard form system of the European Union. The system gives warnings using the actual data of public procurement procedures that begin with the use and completion of the standard forms, and highlights individual risks and in a more general sense the overall risk category of public procurement procedures. The Red Flags warning system has been developed with the Hungarian legislative framework in mind: we defined indicators, tested the system and set the signal thresholds of the individual indicators based on the data and information in the standard forms of public procurement procedures announced in accordance with Hungarian public procurement regulations. By using this approach, the warning system may be adapted to the different regulations of individual member states for wider use while still based on the same standard forms, which also enables comparisons at European level where certain aspects are shared.

1.3. CORRUPTION RISKS IN PUBLIC PROCUREMENTS, THE MOST IMPORTANT ACHIEVEMENTS SO FAR IN THE FIGHT AGAINST PUBLIC PROCUREMENT CORRUPTION

EU regulations are focussed on meeting the goals of the internal market also in relation to public procurements. At the same time, the principles of equal treatment free of discrimination, fair competition, transparency and openness and the procedural framework of public procurements developed based on these may also reduce corruption risks. The majority of regulatory issues or legal constructs that are expressly aimed at the action against or the prevention of corruption in a broader sense (e.g. incompatibility) are however found at the core of the national regulations of countries on public procurement. However, the latest EU-level modernisation approach to public procurement and the new directives adopted in 2014 were amended with several regulatory elements that are expressly focussed on combating corruption, the fairness of procedures, and a more efficient use of public funds.

In addition to the development of regulations to combat corruption, one of the most sensitive issues in practice remains the prevention of procedures or contracting permeated by corruption. Several studies and analyses have shown that the preparation of public procurement procedures is one of the weaker points, if not the weakest point of the process of public procurements, and carries the highest risk in terms of corruption. The most frequent risks of the period before tendering begins include targeted invitations to tender, i.e. tailoring procurement terms and conditions; exaggerated ability conditions or disproportionate other conditions; discriminatory (technical) description of the object of public procurement; applying non-objective evaluation criteria; opting for a type of procedure intended to avoid transparency or wider competition; setting short deadlines for tendering; applying unnecessary administrative burdens and conditions.¹

As the compilation of the notices containing the invitation to tender that launches the procedure (and that of the related specifications) is a decisive part of the critical preparatory phase of public procurement procedures, the assessment of data and information contained in the notices helps identify risks that may be linked to certain corruption techniques in the early phase of public procurement procedures. (In the current project, we did not only generate potential indicators based on the launching contract notices and the data contained in these, but also based on the information notices closing the procedures, as the subsequent evaluation of certain information available at the end of the procedure may also prove useful for highlighting corruption risks, though only after the procedure.)

Several international organisations and research projects have dealt with the examination of corruption, or developing some form of supporting materials or tools. Below, we give a non-exhaustive list of the analyses that we took into consideration, and tools similar to, yet different from the development of this project.

OECD

Of the materials and research of the Organisation for Economic Cooperation and Development (OECD), the principles, checklist and good practices (2009, 2008, 2007) developed to provide integrity in public procurements deserve special mention.²

¹ See for example:

– TI research <http://merjtenni.hu/hol-tapasztalt-korrupciot-2/kozbeszerzesek/>
– Enhancing Integrity in Public Procurement: A Checklist, OECD 2008. <http://www.oecd.org/gov/41760991.pdf>
– OECD Principles for Integrity in Public Procurement, OECD 2009. <http://www.oecd.org/ethics/48994520.pdf>
– The Public Procurement Code of Ethics of the Public Procurement Authority http://kozbeszerzes.hu/data/attachments/2013/02/26/Eln%C3%B6k_T%C3%A1j%C3%A9koztat%C3%B3_-_K%C3%B6zbeszerz%C3%A9si_Etikai_K%C3%B3dex_v%C3%A9gleges.pdf

² OECD Principles for Integrity in Public Procurement, OECD 2009. <http://www.oecd.org/gov/ethics/48994520.pdf>

Enhancing Integrity in Public Procurement: A Checklist, OECD 2008. <http://www.oecd.org/gov/41760991.pdf>

Integrity in Public Procurement, Good Practice from A to Z, OECD 2007.

http://www.keepeek.com/Digital-Asset-Management/oecd/governance/integrity-in-public-procurement_9789264027510-en#page1

The OECD has developed international supporting materials and practical tools to aid good governance in order to introduce a culture of integrity throughout the whole public procurement process, that may be used in different legislative or public administration environments, and also developed further. These represent guidelines for legislators for the design of a suitable regulatory framework on the one hand, and also helps with the implementation of such on the other in all phases from needs assessment to contract performance.³

The related public procurement toolbox⁴ is an online resource that collects the best solutions for the prevention of corruption, which strengthen suitable management techniques in public procurement procedures in member countries of the OECD and others.

These tools are in that sense mainly aimed at finding methods for good procurement, which includes a suitable set of goals and management from the preparatory phase to implementation. The tools may be a response to needs arising on the part of the contracting authorities in their efforts to make public procurement activities in the public sector professional.

EBRD

The regional survey of the European Bank for Reconstruction and Development (EBRD) on public procurement regulations and legal practice and their benchmark material aimed at efficient public procurements (2010-2011)⁵ also highlight internationally accepted good practices while taking an overall view of the public procurement process.

Public procurement „Due Diligence Tool“

The public procurement Due Diligence Tool⁶ published on the Business Anti-Corruption Portal is a tool developed for the assessment and prevention of corruption risks in public procurement, which consists of three documents and one interactive tool. Using the questions provided by the Due Diligence Tool, the different phases of the public procurement procedure have to be analysed, and based on the answers given, an evaluation matrix identifies the degree of the risk for transparency and fair procedure.

World Bank

One of the red flag corruption analyses (2010)⁷ of the World Bank uses an approach that proved particularly useful from the point of view of this project, while there is still a significant difference between the underlying data contents, as the World Bank's analysis is based on the contracts and public procurement documents of construction projects.

4 types of red flags have been identified:⁸

- Unobservable red flags (e.g. identification of pressures on Bid Evaluation Committee members)
- Uncollectible red flags (e.g. errors due to a failure to provide secure storage of bids received)
- Potentially irrelevant red flags (e.g. failure to include the names of the Bid Evaluation Committee in the bid evaluation report)
- Observable, collectible and relevant red flags.

³ <http://www.oecd.org/corruption/ethics/procurement-principles.htm>

⁴ OECD Procurement Toolbox <http://www.oecd.org/governance/procurement/toolbox/>

⁵ EBRD 2010 Regional Assessment of Public Procurement Legal Frameworks, Astana, May 19th 2011
http://www.kozbeszerzes.hu/static/uploaded/document/EBRD_Annual_Meeting_Publication_print.pdf

⁶ Public Procurement Due Diligence Tool
<http://www.business-anti-corruption.com/tools/due-diligence-tools/public-procurement-tool.aspx>

⁷ Charles Kenny and Maria Musatova: 'Red Flags of Corruption' in World Bank Projects. An Analysis of Infrastructure Contracts. The World Bank, March 2010. <https://openknowledge.worldbank.org/bitstream/handle/10986/3731/WPS5243.pdf?sequence=1>

⁸ Charles Kenny and Maria Musatova (2010), 6-7.

Here we wish to deal in particular with the last type, i.e. with less soft, easily defined factors and existing correlations.

The analyses of the World Bank chooses 13 red flags from the expressly alarming signs.

The process of public procurement was divided into a pre-evaluation and post-evaluation phase for the categorisation of red flags. The former phase for example includes factors like the length of the tendering period, and the number of tenders received, while the latter includes factors like the length of the period between evaluation and contracting, the exclusion of the tenderer offering the lowest price, the difference between the estimated value and the winning bid, and the difference between the winning bid and the contractual price.⁹ Thresholds were defined based on experience also in this case.

The interpretation environment is similar as we see, and despite the differences in data content, part of the methodology, the simplification and testing are exemplary for our project as well.

In a more user-friendly and also simplified model of the World Bank based on the above, there are further red flags introduced.¹⁰ The following are particularly worth mentioning:

- any complaint from tenderers
- suspicious tenderers
- repeat awards to same contractor
- changes in contract terms and value
- poor quality works/services.

In our case, it is rather the more detailed interpretation environment that is exemplary for us. At the same time, these red flags also include more critical warnings (e.g. repeat awards to same contractor, more severe cases of contract modification), even though from a risk point of view, it is difficult to distinguish between these, just as the World Bank's material does not actually do such when grouping the red flags in 10 points.

Corruption Risk Index

The corruption risk index (CRI) developed by the Corruption Research Center Budapest (CRCB) is a composite index based on micro data that evaluates public procurement procedures using data of public procurement databases with the help of a complex indicator system. Part of the applied indicators is similar to the ones developed by us, however, the aim of the tool is different. While the primary aim of the red flags tool developed by us is prediction and prevention, the CRI is intended to give an ex-post evaluation, which, at the end, provides a posterior picture on the public procurement system as a whole, and its actors. The results of the system are available on the website www.kozpenzkereso.eu.

Study prepared for the European Commission (PwC–Ecorys)

The study commissioned by the European Commission (OLAF), prepared by PwC and Ecorys (2013)¹¹ and aimed at identifying and reducing public procurement corruption in the European Union also contains findings useful for our project. The main goal of the study is to provide information, a methodology and suitable tools to the European Commission and the authorities of the member states for the implementation of the EU's anti-corruption policies. It is centred on the survey of public procurement corruption and its direct costs, and also the development of a

⁹ Charles Kenny and Maria Musatova (2010), 8.

¹⁰ Most Common Red Flags of IN BANK-FINANCED PROJECTS Fraud and Corruption in Procurement. The World Bank Group – Integrity Vice Presidency http://siteresources.worldbank.org/INTDOI/Resourses/Red_flags_reader_friendly.pdf

¹¹ Identifying and Reducing Corruption in Public Procurement in the EU. Development of a methodology to estimate the direct costs of corruption and other elements for an EU-evaluation mechanism in the area of anti-corruption. Study prepared for the European Commission by PwC and Ecorys, with support of Utrecht University. 30 June 2013. http://ec.europa.eu/anti_fraud/documents/anti-fraud-policy/research-and-studies/identifying_reducing_corruption_in_public_procurement_en.pdf

new and innovative methodology that is capable of estimating the direct costs of public procurement corruption in the different sectors developed using EU funds.

The study and the methodology builds on earlier cases of corruption risks and their measurement. It is worth highlighting that 27 red flags were identified for the survey and methodology that were the aim of the study, of which only 8 red flags proved to work in practice also based on data from the TED database¹², with respect to the availability of data. (These were: length of the tendering period; type of procedure; value of the public procurement contract; number of bids; ratio of the estimated value and the contractual price; EU financing issues; certain missing pieces of information.)¹³

In the interpretation of the study, a stronger correlation could be observed between red flag warnings and corruption in the following cases: negative media coverage; amount of missing information; preferred supplier indications; conflict of interest amongst members of the evaluation team; substantial changes in project scope/ costs after award.¹⁴

The study also mentions the controversial link between red flag risk signals and corruption,¹⁵ and the fact that it is essential for stronger corruption risk warnings, and in general for the identification of red flags to have suitable data resources available, and to perform analyses in addition to these.¹⁶

ARACHNE tool

The risk scoring, preventive tool developed as part of anti-fraud measures by the European Commission (2013)¹⁷ may primarily help the authorities of member states by helping to identify EU-funded projects where the risks of fraud, incompatibility, or irregularity can be observed. Its database consists of data from EU member states and other databases, so that this tool relies at once on internal and external data. Several different searches and controls are possible through the database among others by projects, beneficiaries, contracts or winning companies. The tool automatically gives a fraud warning based on data from the database. One group of risk indicators is connected to the public procurement process. A weakness of the tool is that a part of the data entries depends on data provided by the member states, moreover the participation of member states in the programme is not compulsory.

1.4. THE CONCEPT OF THE NEW RED FLAG WARNING SYSTEM

The tool developed in this project is fundamentally intended to identify and highlight corruption threats and risk factors in public procurement contract notices possible to detect with IT tools,. In the meantime, it is open for further development of the tool (creating index, link with other data etc.).

The automatic warning system's operation is based on publicly available data. Its system of indicators is intended to highlight risks related to corruption in a wider sense and corruption risks, which can also have a preventive function.

¹² Tender Electronic Daily (TED) data base

¹³ Identifying and Reducing Corruption in Public Procurement in the EU (2013), 147-152., 187-196.

¹⁴ Identifying and Reducing Corruption in Public Procurement in the EU (2013), 156.

¹⁵ Identifying and Reducing Corruption in Public Procurement in the EU (2013), 147.

¹⁶ Identifying and Reducing Corruption in Public Procurement in the EU (2013), 38-39.

¹⁷ Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures. European Structural and Investment Funds, Guidance for Member States and Programme Authorities. European Commission Directorate-General. EGESIF_14-0021-00 16/06/2014, June 2014. https://ec.europa.eu/sfc/sites/sfc2014/files/sfc-files/guidance_fraud_risk_assessment.pdf ARACHNE PROJECT Risk scoring tool. Presentation by Jörg Schreckenberger (Auditor – DG Regio) and Luc Molemans (Project Manager Arachne – DG EMPL), 16 Mai 2013. <http://admin.interact-eu.net/downloads/7857/Presentation>

In our case therefore, the goal is not the identification and evaluation of good practices or in contrast, solutions to be avoided with a more traditional approach, based on a more in-depth analysis of public procurement regulations and practice, and applicable to the whole process of public procurement. However, during the development of the tools and the identification of risk indicators, we did take such research experience in consideration. Indicators were listed and the expressly negative risk warnings, the red flags were developed based on the above and the contract notice data in TED.

Contract notices are the purest sources of public procurement processes, as they include the actual and public data provided by the contracting authorities. This resource is definitely an advantage in that the basis for the operation of the system is a reliable, relevant and relatively well-structured body of data that shows up true correlations. The weakness of the tool can also be traced back to this same aspect: on the one hand, the data is not complete as far as showing the most characteristic symptoms and conditions of public procurement corruption is concerned (as the primary goal of publishing this data is different); on the other, in contrast to the whole of public procurement a process, the public announcements launching the procedure and informing about its outcome limit the scope of data and the publication of these to these two steps in the process. The evaluation of the history of projects before and after tendering and contracting, and warnings based on these would require involving further internal and external data resources. For this reason, we wish to stress that further data that can be linked to the database and the involvement of human resources and analyses (see also Section 4) can generate further added value for the operation of the tool.

With an automatic warning tool like this, the system, scope and quality of data is essential. From this point of view, the unified system of standard forms under EU regulations is a favourable starting point, just as the fact that the other pillar of development, Hungary's legislative environment requires contracting authorities to provide a more than averagely large scope of data, with greater precision. (At the same time, the data content and systematic structure of EU contract notices could be further improved, which would also help the useful operation of risk warning systems.)

While creating the tool, we took a wide interpretation as our basis and included elements in our warning system that do not obviously manifest in all corruption cases, or do not inevitably lead to corruption.

The signals therefore raise awareness, and multiple signals may point to a more severe risk or even corruption. However, not all flagged public procurement procedures can be automatically considered corrupt.

Overall, red flags mark potential threats and risks, but are not in themselves evidence for corruption¹⁸ In our case too, the new warning system capable of predicting risks and negative effects is not a tool for measuring corruption.

This warning however may be ominous signs for contracting authorities in public procurement procedures as to what is worth avoiding in the interest of fair competition.

¹⁸ Kari K. Heggstad, Mona Frøystad: The basics of integrity in procurement (2011), 18.

2.

LIST, DESCRIPTION AND ANALYSIS OF INDICATORS

2.1. INTRODUCTION

Within the framework of this project, the definition and development of indicators could be realised in a somewhat restricted scope. (More on the details and consequences of this under Section 3 and 4.) Above all, this means that we relied on EU standard forms in our examination of higher-value public procurements that reach or exceed EU thresholds, and within those concentrated on ones that are related to the general procedural rules on the public procurements of so called classic contracting authorities.¹⁹

We will first give a review of the indicators developed on the basis of the notices used in Hungary's legislative environment²⁰ in accordance with the standard form for the contracting authority's notices, or more precisely the contract notice related to the classical directive. After that, we will present the indicators developed on the basis of notices used in Hungary's legislative environment in accordance with the standard form for contract award notices. We have defined the possible indicators for linking data contained in the public procurement notices published at the launch and at the end of the procedures, however, the comprehensive implementation of these indicators will be achieved at a later stage of the project.

We will return to the issue of distinction between indicators (red flags vs. pink flags) under Section 3.

The listing and brief description of indicators relies on (compulsory and possible) data content in line with EU standard forms, and we also kept the sequence of data and information as they are structured in the standard forms.

2.2. EU STANDARD FORMS, HUNGARIAN LEGISLATIVE ENVIRONMENT

2.2.1. Contract notice

1. Contracting authority has been convicted by final judgement, or has bad reputation

This indicator is not a red flag, but an indicator signalling other risks ("pink flag"). The reason for this is that we do not arrive at a risk factor based on the data from one specific public procurement procedure, but it is possible to conclude that there is a risk based on the earlier activities and practices of the contracting authority, that may potentially affect the specific procedure. The risk lies in the fact that the contracting authority (repeatedly) infringed on legislation in the course of its earlier public procurement activities (by final judgement), or its past activities have failed to establish its good reputation in the market, the press had reported a questionable activity of the organisation in the past. The system, at the moment, uses the database of K-Monitor²¹ for this purpose. (It is a prerequisite for the further development of this indicator that a list of contracting authorities convicted by final judgement should be available, and updated).

¹⁹ During the term of the project, this means standard forms as defined by Directive 2004/18/EC and Annexes II and III of Commission implementing regulation 842/2011/EU.

²⁰ During the term of the project: Act CVIII on Public Procurement of 2011 (Public Procurement Act, PPA), and the related enforcement regulations.

²¹ <http://k-monitor.hu>

2. Framework agreement with a tenderer

This indicator is a red flag. Even though it is legally permissible to conclude a framework agreement with a tenderer, it still means that if the volume of goods or services to be procured is large, it will exclude competition for a longer period. Due to such situations potentially limiting competition, we are signalling a risk with the indicator. This indicator is only relevant in public procurement procedures aimed at awarding a framework agreement.

3. Framework agreement with several tenderers (with less than 3 tenderers participating)

This red flag indicator signals when in a public procurement procedure aimed at awarding a framework agreement to several tenderers the contracting authority defined the minimum and/or maximum number of tenderers in less than the range of the number of tenderers including at least three tenderers under the Public Procurement Act, and thereby unlawfully restricted competition. Evidently, this indicator is only relevant in relation to awarding framework agreements, and only those to be concluded with several tenderers. (Based on the requirements²² of the Public Procurement Act, the number of participants should depend on the specific characteristics of the procedure, and real competition must be ensured under any circumstances.)

4. Term of the framework agreement (long)

This red flag indicator assesses two conditions in relation to the term of framework agreements. On the one hand, it signals a risk any time when the contracting authority announces an intention to conclude a framework agreement for longer than four years. Even though the Public Procurement Act happens to allow for this, a framework agreement concluded for a longer term may result in a disproportionate restriction of competition. On the other hand – exactly with respect to this exceptional case that requires some consideration –, the contracting authority has to state his reasons in the contract notice for setting a term longer than four years. The indicator also signals the breach of this safeguard, i.e. an omission of the justification. Evidently, this indicator is only relevant in public procurement procedures aimed at awarding a framework agreement.

5. Estimated total value of framework agreement (high)

This indicator is a red flag. The reason for this is that framework agreements of a more significant estimated value (typically in centralised public procurements) may carry potential risks simply due to their magnitude and the stakes of contract award (or staying in competition). The system signals above 1,5 billion HUF for works, and above 1 billion HUF in case of goods and services. As it is not compulsory to provide the estimated value in the contract notice, relevant data are not always available for this indicator.

6. Object of public procurement (cartel risk)

This indicator signals other risks, and is not a red flag. The reason for this is that there are objects of public procurement where there may be a significant cartel risk based on experience and procedures in Hungary so far. This potential risk, however, can not be concluded from the data of the specific procedure, but rather from the activities of the given market actors, tenderers in the past. After a review of the procedures and final decisions of Hungary's Competition Authority (Hungarian abbreviation: GVH) we used the public procurements with objects specified in the *Appendix* to compile our list. The objects were previously narrowed down depending on whether they could be assigned a CPV-code²³ (road construction, railway construction, bridge construction; see this too in the *Appendix*).

²² Paragraph (3) of Section 109 of the Public Procurement Act

²³ CPV: Common Procurement Vocabulary (nomenclature); see Regulation (EC) No 2195/2002 of the European Parliament and of the Council amended several times

7. High estimated value (contract of outstanding value)

This indicator is a red flag. The reason for this is that contracts of a more significant estimated value may carry potential risks simply due to their magnitude and the stakes of contract award. As it is not compulsory to provide the estimated value in the contract notice, relevant data are not always available for this indicator. This indicator differs from the one under Section 5 above in that the above indicator refers to the estimated value of the framework agreement, while this one involves the estimated value of public procurement contracts. This is 1,5 billion HUF for works, and 1 billion HUF in case of goods and services.

8. Amounts excessively uncertain (great difference allowed)

This red flag indicator signals a risk when the contractual amount is defined in an overly uncertain manner in the contract notice by the contracting authority, e.g. defines the amount to be procured in a way that allows for a (positive or negative) difference of 50% or more. Procurements by contracting authorities that leave such a great margin carry the risk of making suitable, realistic tendering impossible, which makes comparability also impossible. (The level of risk may depend on the object of the procurement, but the indicator is not triggered by this factor in this project.)

9. Contract can be renewed (several times, or for a longer time)

This red flag indicator is based on information on the renewability of contracts and signals situations as risky when the number of possible renewals may be considered high (3 or more), or result in a contract of a longer term (longer than 4 years). This means that the indicator does not signal an optional renewal of the contract in itself as a risk, only in qualified cases. This approach is also in line with efforts to have contracts with longer terms or factors and contractual conditions involving a more significant level of insecurity classed as risky. (The indicator is not capable of “reviewing”, signalling the lawfulness of an optional renewal set out in the contract notice.)

10. Term of the contract (long or indefinite)

This red flag indicator assesses two conditions in relation to the term of public procurement contracts. On the one hand, it signals a risk when the contracting authority intends to award a contract for an indefinite term. On the other, it will identify it as a risk, if the contracting authority announces an intention to conclude a contract for a definite term longer than four years. The Public Procurement Act only allows contracts of indefinite or longer terms in especially justified cases, as it is contrary to the goal of maintaining competition and the efficient spending of public funds.

11. Omission of the definition of compulsory grounds of exclusion

This red flag signals when the compulsory grounds for exclusion defined in the Public Procurement Act or a reference to these is missing from the contract notice. In addition to the fact that this situation is unlawful, it is also problematic, because specifying the basic conditions for the participation in the public procurement procedure (tendering) is a significant safeguard, which is omitted in such a case.

12. Economic and financial ability – no minimum requirements

This indicator is a red flag. It signals when the minimum economic and financial ability requirements compulsory to specify under the Public Procurement Act are missing from the contract notice. In addition to the fact that this situation is unlawful, it is also problematic, because specifying the minimum ability requirements for the performance of the contract is a significant safeguard, which is omitted in such a case. Non-compliance with ability requirements may have the legal consequence of an invalid bid (application to participate).

13. Economic and financial ability – criteria for capital (levels)

This red flag indicator signals if the contract notice contains the precise amount or at least the required magnitude of the (subscribed) capital as part of the economic and financial ability requirements. This criterion is namely no evidence of actual financial-economic capacities, and is usually unnecessary, restrictive and therefore carries a risk.

14. Economic and financial ability – required sales revenues > estimated value

This red flag indicator signals if the contracting authority requires tenderers to provide proof of a higher level of (relevant) sales revenues than the estimated value for economic and financial ability. Such a criterion would be on the boundary between infringement and risk, as it exceeds the reasonable requirements arising from the necessity-proportionality test – as dictated by jurisdiction – defined under Paragraph (3) of Section 55 of the Public Procurement Act. The higher the requirement for sales revenues, the more potential competitors, tenderers may be excluded from the given public procurement procedure. This expectation for ability also limits other forms of ability. As it is not compulsory to provide the estimated value in the contract notice, relevant data are not always available for this indicator.

15. Economic and financial ability – statement of sales revenues (period)

This red flag indicator signals if the contracting authority defines a retrospective period for the assessment of sales revenues in breach of legislation. An implementing regulation of the Public Procurement Act²⁴ namely sets a range for the period where sales revenues can be retrospectively assessed by stipulating that a statement of sales revenues may only be requested for the previous three business years.

16. Technical capacity – no minimum requirement defined

This indicator is a red flag. It signals when the minimum technical capacity requirements compulsory to specify under the Public Procurement Act are missing from the contract notice. In addition to the fact that this situation is unlawful, it is also problematic, because specifying the minimum ability requirements for the performance of the contract is a significant safeguard, which is omitted in such a case. Non-compliance with ability/capacity requirements may have the legal consequence of an invalid tender (application to participate).

17. Technical capacity – reference value > estimated value

This red flag indicator signals if the contracting authority requires tenderers to provide proof of a higher value reference (past performance relevant for the subject) than the estimated value of the procurement for technical capacity. Such a criterion would be on the boundary between infringement and risk, as it exceeds the reasonable requirements arising from the necessity-proportionality test – as dictated by jurisdiction – defined under Paragraph (3) of Section 55 of the Public Procurement Act. The higher the requirement for the value of reference, the more potential competitors, tenderers may be excluded from the given public procurement procedure. As it is not compulsory to provide the estimated value in the contract notice, relevant data are not always available for this indicator.

18. Technical capacity – period of reference requirement

This red flag indicator signals if the contracting authority defines a retrospective period for the assessment of the reference for technical capacity in breach of legislation. An enforcement decree of the Public Procurement Act²⁵ namely sets a range for the period that can be retroactively assessed for reference (the possible requirement for goods and services procurements is a minimum of 3 years and maximum of 6 years, and for construction developments a minimum of 5 years and a maximum of 8 years).

²⁴ Sub-paragraph c) of Paragraph (1) of Section 14 of Government Decree 310/2011. (XII. 23.)

²⁵ Section 15 of Government Decree 310/2011. (XII. 23.)

19. Technical capacity – requirement of a reference performance under a contract

This red flag indicator is linked to technical capacity, and within requirements for references, it specifically checks whether the contracting authority unjustifiably limits acceptance of past performances by requiring references of a given value or amount that were performed “under a contract”. Even though the indicator does not (and cannot) analyse the relation of this criterion to other criteria (e.g. object of the procurement, contractual conditions), it signals its occurrence as a risk, as it usually means a disproportionate, unwarranted restriction.

20. Technical capacity – requirement of references co-financed by the EU

This red flag indicator is linked to technical capacity, and within requirements for references, it specifically checks whether the contracting authority also requires references that were “financed with EU funds” (or uses similar phrases, like “co-financed”) Even though the indicator does not (and cannot) analyse the relation of this criterion to other criteria (e.g. object of the procurement, contractual conditions), it signals its occurrence as a risk, as it usually means a disproportionate, unwarranted restriction. Although jurisdiction has been more permissive as regards project management (managerial) services, the indicator also signals a risk here. The requirement concerned – however understandable – could namely be achieved with less restricting means (e.g. setting a requirement for the suitable know-how or experience of the experts to be involved).

21. Technical capacity – setting geographical requirements

This red flag indicator is related (but not restricted) to technical capacity, and checks whether the contracting authority unjustifiably limits compliance with ability/capacity requirements by setting so called geographical requirements, e.g. the availability of capacities, equipment or site within a specific physical distance. Even though the indicator does not (and cannot) analyse the relation of this criterion to other criteria (e.g. object of the procurement, contractual conditions), it signals its occurrence as a risk, as it usually means a disproportionate, unwarranted restriction limiting equal opportunities.

22. Technical capacity – experience of experts involved (number of years)

This red flag indicator signals if the contracting authority sets the technical capacity requirement of five years or more of experience for the experts involved. Even though the indicator does not (and cannot) analyse the relation of this criterion to other criteria (e.g. object of the procurement, contractual conditions), it signals such requirements as risk, as it usually means an exaggerated, disproportionate restriction.

23. The use of accelerated procedure

This red flag indicator checks two conditions related to types of public procurement procedures that can be accelerated. On the one hand, it signals a risk when the contracting authority opts for an accelerated procedure. The Public Procurement Act does make acceleration possible in certain cases, but whether the prerequisite of an “exceptionally justified and urgent” case truly exists is mostly trusted to the discretion of the contracting authority, and deadlines are usually quite short for candidates and tenderers. Consequently, the use of such a procedure carries a risk in itself. On the other hand – exactly with respect to this exceptional case that requires some consideration –, the contracting authority has to state his reasons in the contract notice for opting for an accelerated restricted procedure or competitive procedure.

24. Negotiated procedure as legal grounds

This red flag indicator signals if the contract notice does not or falsely include the grounds for the use of a negotiated procedure launched by publishing a notice. This is an infringement. Based on the Public Procurement Act (and EU regulations), so called classical public procurement contracting authorities are not free to use negotiated procedures launched by a contract notice in accordance with general procedural rules, only when the specific conditions for these are met. The rule that the grounds for the competitive procedure have to be stated in the invitation to tender is therefore a safeguard.

25. The actual or predefined number of candidates is low

This red flag indicator signals when in certain types of procedures (restricted, negotiated, competitive dialogue) the contracting authority defines the minimum or maximum number of tenderers in less than the range of the number of tenderers (incl. the minimum number) stipulated by the Public Procurement Act, and thereby unlawfully restricts competition. This minimum number is no less than five in restricted procedures and no less than three tenderers in negotiated procedures and competitive dialogue. It is not compulsory for the contracting authority to use a range, it is only a possibility. (Under the provisions of the Public Procurement Act²⁶ true competition has to be guaranteed even if there is a range of the number of tenderers.)

26. No criteria specified for the limitation of candidate numbers

This red flag indicator checks whether the contracting authority defined the method of ranking (the objective criteria for limiting the number of participants) in the contract notice if they set a range to the number of candidates as described above, as they would have to narrow down the group of eligible candidates and publish an invitation to tender based on that, if the number of candidates eligible for participation exceeds the pre-defined upper limit. Defining the method of ranking is a safeguard, and omitting it is an infringement.

27. Award criterion – definition is incomplete (no constituent factor or at least 2 constituent factors; basically no method defined)

This indicator is a red flag. It signals if – when selecting the overall most favourable tender – the contracting authority gives an incomplete and therefore unlawful definition of the constituent elements necessary for using the given award criterion. The indicator currently only signals three fundamental types of incompleteness: if the constituent factors are not defined in the notice, if no more than two are defined, and if the definition of the evaluation method is basically missing. The appropriate definition of the tenders' evaluation criteria in the contract notice is an essential prerequisite of the transparent and fair realisation of the public procurement procedure.

28. Award criterion – payment deadline

This red flag indicator signals if – when selecting the overall most favourable tender – the sub-criteria specified by the contracting authority also include a constituent factor for the (length of the) payment deadline. It is not an infringement to use such, but it would mean that longer service/performance deadlines would be more favourable for the contracting authority, which may however be disadvantageous for wider competition and ensuring equal opportunities. This is why this indicator signals a risk.

29. Time limit for tendering/participation (short)

This red flag indicator signals – an infringement –, if the time limit for tendering or participation is shorter than the minimum time limit stipulated in the Public Procurement Act (in accordance with EU regulations). In open procedures, the invitation to tender launching the procedure includes the time limit for tendering, while in two-stage procedures and competitive dialogue procedures the time limit for participation has to be defined in the invitation to participate launching the first stage. (The time limit for tendering relevant in the later stages of procedures of two or more stages however does not necessarily have to be specified in the notice.) The time frame for tendering and/or participation starts on the day of the dispatch of the notices concerned. (This means electronic dispatch by the Public Procurement Authority in the interest of EU-wide publicity.) Legal regulations define minimum deadlines for procedures to ensure that equal opportunities and fair competition are observed.

²⁶ Paragraph (4) of Section 84, Paragraph (3) of Section 90, Paragraph (2) of Section 102 of the Public Procurement Act.

30. Opening date of tenders (differs from the time limit for tendering/participation)

This red flag indicator signals if the opening date of the tenders or requests for participation is not identical with the expiry of the time frame for tendering or participation. This situation is unlawful, as the Public Procurement Act stipulates that the two dates must be the same with respect to the risks involved in opening tenders/requests for participation.

31. Tender guarantee (amount)

This red flag indicator checks the amount of the tender guarantee, and signals a risk if this amount exceeds a certain magnitude in ratio of the estimated value of the public procurement (2%). Although the Public Procurement Act²⁷ applies a different approach to the appropriate, acceptable amount of the tender guarantee intended to ensure that the tender is binding on the tenderer in public procurement procedures, in practice, the comparison to the estimated value still often plays a role. As it is not compulsory to provide the estimated value in the contract notice, relevant data are not always available for this indicator. On the other hand, the requirement for a tender guarantee too is trusted to the discretion of the contracting authority. The indicator is intended to signal excessive tender securities: such securities influence opportunity to participate in a procedure, compromise equal opportunities and may restrict competition.

2.2.2. Contract award notice

1. Procedures without prior publication

This red flag indicator signals a risk if the contracting authority opts for a procedure without prior publication. Based on the Public Procurement Act, this is a negotiated procedure without prior publication. The Public Procurement Act (in accordance with EU regulations) only makes the use of this type of procedure without prior publication possible if certain conditions (legal grounds) exist. As this type of procedure may not be used freely, and starts with the involvement of one or more tenderers called upon by the contracting authority, and its transparency is mostly ensured in retrospect on the basis of the data in the contract award notice, conducting such a procedure in itself involves risks. (Despite the fact that the contracting authority has to inform the Public Procurement Arbitration Committee by forwarding the data and documents required for the launch of each procedure.)

2. Number of tenders received (low)

This red flag indicator is linked to the number of tenders received in the procedure, and signals a risk, if competition is at a low level in the procedure, or completely missing. Such a situation namely fundamentally defeats the reason why competitive public procurement procedures exist at all. As indicators (for now) do not signal degrees of risks depending on their severity, this indicator signals less than three tenders received in a procedure (or a part thereof) as a risk, but also shows whether one or two tenders had been submitted. As in negotiated procedures without prior publication (see the description of the previous indicator), or in certain cases of these it may lawfully happen that negotiations are only entered with one tenderer, and the system automatically highlights such procedures as risky, these procedures are removed from the indicator's scope of assessment.

²⁷ Paragraph (3) of Section 59 of the Public Procurement Act: The amount of the tender guarantee shall be established in a way that ensures equal opportunity to all tenderers and set so as to cover any potential cost to be incurred, as foreseeable, by the contracting authority in the event of infringement of the validity period of the tender as described in Paragraph 4, in the event of the tenderer withdrawing his tender within the validity period or if the contracting fails due to reasons within the tenderer's sphere of interest. Where the contracting authority allows the division of the public procurement into lots, the tender guarantee and the amount thereof shall be stipulated separately for each lot.

3. Winning economic actor(s) – related information

This indicator is not a red flag, but an indicator signalling other risks. The reason for this is that we do not arrive at a risk factor based on the data from one specific public procurement procedure, but it is possible to conclude that there is a certain potential risk based on the earlier activities and practices, and corporate data of the tenderer(s), that may potentially affect the specific procedure. (Barred tenderers (Public Procurement Authority); tenderers sentenced for involvement in a cartel (Hungarian Competition Authority); “companies with close ties to the party”; “regularly winning companies”; newly established companies; certain corporate data, information, etc.)

4. Ratio of the total final value and the estimated value

This red flag indicator assesses two groups of cases in relation to the ratio of the total final value of contracts and their estimated value. On the one hand, it signals a risk, if the final value is higher than the estimated value. On the other, the indicator rates it as a risk, if the final value is lower than the estimated value by a magnitude (50%). The previously mentioned case may namely mean that the estimated value was calculated erroneously, or that competition was not suitable in the public procurement process. The second situation may also raise the question of a disproportionately low price or whether appropriate measures were taken based on that. As it is not compulsory to provide the estimated value in the contract notice, relevant data are not always available for this indicator.

5. Unsuccessful procedure for risky reasons

This red flag indicator checks what the reason for an unsuccessful procedure is, should it be declared unsuccessful. It signals a risk, if one of the following of the possible reasons for lack of success listed in the Public Procurement Act²⁸ occur: 1. only invalid tenders (requests to participate have been submitted); 2. the contracting authority declares the procedure unsuccessful due to its becoming incapable to conclude the contract; 3. the contracting authority decides to invalidate the procedure due to action by a tenderer or candidate that severely damages the fairness of the procedure or the interests of the other tenderers or candidates. It is apparent from the above that different problems and red flag risks may be behind the three reasons for lack of success.

6. Unsuccessful procedure without statement of reason

The red flag indicator signals, if the information notice does not specify the reason for the procedure’s lack of success, even though the procedure is unsuccessful (no winner declared), and the obligation to inform is stipulated by legal regulations²⁹. This omission in the notice is an infringement. It is also a required safeguard in accordance with the principles of transparency and publicity that the contracting authority should provide appropriate information about the reasons why the procedure was unsuccessful.

7. Successful procedure without contracting

This red flag indicator signals a risk if the public procurement procedure was successful (there is a winner), but the parties still do not conclude the contract based on the procedure. (The contracting authority has to inform also about this fact and its reasons in the notice.) The occurrence of this situation may be lawful³⁰, but – in line with indicator no. 5 above (one of the cases of unsuccessful procedure) – it carries a significant risk, especially because the prerequisites of a relief of the contracting obligation are strict, and in such a case the entity who won the procedure is already known.

²⁸ Section 76 of the Public Procurement Act

²⁹ Section 18 of Decree 92/2011. (XII. 30.) of the Ministry for National Development (NFM)

³⁰ Paragraph 9 of Section 124 of the Public Procurement Act: The contracting authority may only be relieved of its obligation to conclude the public procurement contract with the successful entity (person) and the successful entity may only be relieved of its obligation to contract (he is no longer bound by his tender) within the period stipulated by Section 124(5) herein, if – due to unforeseeable and unavoidable reasons beyond its control – material circumstances arise after he is sent the written summary of the evaluation of tenders, which render it incapable of, respectively, concluding or performing the contract.

8. Duration of evaluation (long)

This red flag indicator assesses procedures based on cross-referencing and interpreting selected data in the contract notice and the contract award notice. (Other data may also be cross-referenced, but other similar indicators will not be developed in this project; see also Section 4). This indicator signals if in the given procedure the actual period of the tenders' evaluation (i.e. the period up to the dispatch of the written summary on the procedure from the opening of tenders to the evaluation) exceeds the maximum length of time stipulated by the Public Procurement Act³¹, i.e. the evaluation period ended past the deadline stipulated in legislation for any reason. As the deadline defined in legal regulations provides sufficient time to carry out the assessment and evaluation, – which may indeed consider several factors and be complex – an evaluation process extended past this latest possible deadline is definitely indicative of problems in addition to being unlawful. The indicator only assesses the duration of the tenders' evaluation, and not the evaluation of requests for participation. As there is insufficient data in such cases, only open procedures may be assessed with the above method.

9. Final value of the contract is too high

This redflag indicator signals if a contract of significant value was concluded. The reason for this is that contracts of significant value poses potential risks simply because of the size of the contract and winning it. This indicator signals if the estimated value was previously not communicated. The threshold is 1,5 billion HUF for works and 1 billion HUF in case of goods and services.

³¹ The assessment has to be performed and communicated to the tenderers during the validity period of the tenders, the maximum duration of which is stipulated in the Public Procurement Act, as is the maximum length of extension. Time limits under the Public Procurement Act: 30 days following the opening of tenders (or more precisely following the deadline for the submission of tenders, which two dates have to be identical), and 60 days for construction developments and if controls are included in the process, which deadlines may be extended once by 60 days. The legally permissible deadline is therefore altogether a maximum of 90 days, and for construction developments and if controls are included in the process 120 days.

2.2.3. Summary list of indicators

Contract notice

1. Contracting authority has been convicted by final judgement, or has bad reputation
2. Framework agreement with a tenderer
3. Framework agreement with several tenderers (with less than 3 tenderers participating)
4. Term of the framework agreement (long)
5. Total estimated value of framework agreement (high)
6. Object of public procurement (cartel risk)
7. High estimated value (contract of outstanding value)
8. Amounts too uncertain (great difference allowed)
9. Contract can be renewed (several times, or for a longer time, or without any information)
10. Term of the contract (long or indefinite)
11. Omission of the definition of compulsory grounds of exclusion
12. Economic and financial ability – no minimum requirements
13. Economic and financial ability – conditions for capital (levels)
14. Economic and financial ability – required sales revenues > estimated value
15. Economic and financial ability – statement of sales revenues (period)
16. Technical capacity – no minimum requirement defined
17. Technical capacity – reference value > estimated value
18. Technical capacity – period of reference requirement
19. Technical capacity – requirement of a reference performance under a contract
20. Technical capacity – requirement of references co-financed by the EU
21. Technical capacity – setting geographical requirements
22. Technical capacity – experience of experts involved (number of years)
23. Accelerated procedure (use, and/or without statement of reasons)
24. Competitive procedure as legal grounds
25. The actual or predefined number of participants is low
26. No criteria specified for the limitation of participant numbers
27. Award criterion – definition is incomplete (no constituent factor or at least 2 constituent factors; basically no method defined)
28. Award criterion – payment deadline
29. Time limit for tendering/participation (short)
30. Opening date of tenders (differs from the time limit for tendering/participation)
31. Tender guarantee (amount)

Contract award notice

1. Procedures without prior publication
2. Number of tenders received (low)
3. Winning economic actor(s) – related information
4. Ratio of the total final value and the estimated value
5. Unsuccessful procedure for risky reasons
6. Unsuccessful procedure without statement of reason
7. Successful procedure without contracting
8. Duration of evaluation (long)
9. Final value of the contract is too high

2.3. EU STANDARD FORMS, EU LEGISLATIVE ENVIRONMENT

Under this point, we will go through the indicators based on whether they can be possibly used under other national legislations if the elements that go beyond EU legal requirements³² and specific to Hungary are removed, while still taking the common EU regulatory environment into consideration. This approach may fundamentally mean two types of differences. On the one hand, red flag indicators will be eliminated that are based on regulations specific to Hungary, yet in another national public procurement environment the automatic warning system may be altered or new indicators may be added. On the other, new indicators may be added to the list where due to Hungarian regulations the system does not give a warning (signal an infringement), but in other legislations the given matter may be a concern. In addition, setting the signal threshold of the individual red flag indicators may also depend of national specificities.

It is worth highlighting that in addition to the adaptation of red flag indicators to other national legal and cultural environments, it may also be of outstanding importance to generate or amend indicators to cover other risks, as opportunities and solutions are perhaps more versatile within other countries in this respect.

For a more transparent overview, we created a summary table, and only added more information where new indicators are possible. (Deviations from point 2.2 are also highlighted.)

³² Based on Directive 2004/18/EC and regulation 842/2011/EU.

2.3.1. Contract notice

Contracting authorities convicted by final judgement or having bad reputation – *if such a database exists, or can be generated*

Framework agreement with a tenderer

Framework agreement with several tenderers (with less than 3 tenderers participating)

Term of the framework agreement (long)

Total estimated value of the framework agreement (high) – *the definition of outstanding value may differ between member states*

Object of public procurement (cartel threat) – *the definition of such objects of public procurement may differ between member states (data from the competition authority)*

Estimated value high – *the definition of outstanding value may differ between member states*

Amount too uncertain (permitting big differences) – *if the use of such a criterion is permissible under national legislation*

Contract can be renewed (several times, or for a longer time, or without any information)

Term of the contract (long or indefinite)

Omission of the definition of compulsory grounds of exclusion

Economic and financial ability – no minimum requirements

Economic and financial ability – conditions for capital (levels)

Economic and financial ability – required sales revenues > estimated value – setting

Economic and financial ability – statement of sales revenues (period)

Technical, professional ability – no minimum requirement defined

Technical, professional ability – reference value > estimated value – setting

Technical capacity – period of required reference – partly depends on national legislation

Technical capacity – requirement of a reference performance under a contract

Technical capacity – requirement of references co-financed by the EU

Technical capacity – setting geographical requirements

Technical capacity – experience of experts involved (number of years) – **setting**

Accelerated procedure (use, and/or without statement of reasons)

Grounds for a negotiated procedure – it depends on national legislation, whether this needs to be specified

The actual or predefined number of participants is low

No criteria specified for the limitation of participant numbers

Award criterion – definition is incomplete (no constituent factor or at least 2 constituent factors; basically no method defined) – it depends on national legislation, whether this needs to be specified

Award criterion – no constituent factor for remuneration

Award criterion – payment deadline

+ Price of the specifications (amount) – not relevant under Hungarian legislation

Time limit for tendering/participation (short)

Opening date of tenders (differs from time limit for tendering/participation) – depends on national legislation, and if there is a difference, a longer period may carry a risk (definition of this)

+ Persons authorised to be present at the opening of the tenders (excessive restriction) – not relevant under Hungarian law

Tender guarantee (amount) – it depends on national legislation whether this has to be specified, as does determining an excessive amount

2.3.2. Contract award notice

Procedures without prior publication
Number of tenders received (low)
Winning economic actor(s) – related information – <i>if there is such a database, information; database may also be set up</i>
Ratio of the total final value and the estimated value
Unsuccessful procedure for risky reasons – <i>partly depends on national legislation</i>
Unsuccessful procedure without statement of reason – <i>it depends on national legislation, whether this needs to be specified</i>
Successful procedure without contracting – <i>it depends on national legislation, whether this needs to be specified</i>
Period of evaluation (long) – <i>partly depends on national legislation</i>

3.

METHODOLOGY

Following the introduction of the concept of the red flag warning system under Section 1 and the short analysis of the actual indicators under Section 2, we wish to give a summary of methodology issues in this section.

3.1. CONTEXT

The red flag warning system is based on the unified public procurement standard forms within the European Union and the European Economic Area, and the related EU regulations on public procurement. Above all, however, corruption risks can be interpreted in terms of the public procurements conducted in the national regulatory and jurisdictional environments that transpose the relevant EU regulations. All this provides an opportunity for the creation of a warning system based on a unified approach that after adaptation to the national legislation and practice of member states could at the same time allow for some form of comparison. In this project, the red flag warning system was developed relying on Hungary's legal environment. The reason for this is not only that this legal environment is the one we know best. It also appeared particularly practical to rely on the Hungarian legal context, because Hungarian legal regulations on public procurement are highly harmonised with EU requirements, and partly due to the relatively detailed legal regulations, notices typically provide more than the minimally required information. It is also worth highlighting that in Hungary's legal and institutional environment, it is still practice that authorities examine notices before publication, and some public procurements are centrally controlled. This has a noticeable effect on the content of notices. On the one hand, it is less characteristic for compulsory information to be missing, and also expressly unlawful conditions can usually be eliminated in advance. At the same time, experience so far suggests that even so, a warning system's existence is warranted, and in such a legal environment indicators signalling so called other risks (see below) are of greater importance.

3.2. COLLECTION, FILTERING AND TESTING OF INDICATORS

Based on earlier and current research, materials and experience summarised under Section 1, all potential indicators were collected that may help to point out critical issues with an influence on the integrity of any given public procurement procedure, and show corruption risks or a correlation with these. After that, the list of potential indicators was "cleaned", fine-tuned and categorised in several steps using several methods. (We relied on the results of expert dialogue in doing so. The testing and evaluation of indicators took place in a separate stage.) These main steps and intermediate decisions are as follows.

Those potential indicators had to be removed from the system where signals would have been entirely uncertain or typically misleading without a case-by-case assessment (e.g. the assessment of so called subjective constituent factors in the definition of award criteria; assessment of requirements for special contractual conditions; or evaluation of requirements for so called possible grounds for exclusion). In the current project, our aim was to develop an IT tool where a pre-filtering can be performed without human expertise. It must be noted that these issues include some particularly sensitive ones, which carry risks exactly because of a creative human approach and definition of conditions, and were therefore less suitable for IT modelling for now.

A distinction must be made however between the above and those potential indicators and the elimination of these, where the IT development of the indicator was merely impossible within the boundaries of this project so far but in a next phase of the project it could be theoretically possible with a different methodology. We see such cases therefore as temporary, and with further IT development, it may be possible to operate these indicators. Still, the difficulty here again is that the “technical” modelling of more complex contract notices and correlations requires different or more time-consuming development and testing. (This applies for example to the assessment of too many or not suitable ability criteria, and the assessment of determining too many evaluation sub-criteria.)

Indicators where for a more precise signal the links of the assessed data in the notice to other information should/could be evaluated, but signals are intelligible without that too, were kept, especially because in such situations the system signals a risk. (Such are for example these indicators: the overly uncertain definition of the amounts to be procured; the term of the contract; requirement for the performance of references under a contract; requirement for EU, co-financed references; or the indicator for geographical requirements.) With these, it is particularly the assessment of a correlation with the object of procurement and the contractual conditions that may arise. With such indicators, it is the involvement of the human factor, analysis as a secondary option that may lead to a more precise interpretation of the signalled risk, but even without these, the risk signal works.

It must be noted that with some indicators, it was the simple and real connections between available data that created conditions where generating an indicator became possible. So for example the basis for lawfully determining the amount of the tender guarantee is not the estimated value, still a data link to that can be assessed. If namely we assume that disproportionately high security (compromising equal opportunities) cannot be determined if the estimated value is lower, it is worth assessing and testing this correlation. Somewhat similarly, assessing the period of time between the opening of tenders and their evaluation may be a complex issue, but with a simple data link, at least the breach of the legally required deadlines – indicative a problem –, which leave enough time for evaluation, can be signalled.

The red flag indicators were tested in accordance with the restricted approach described in Section 2, on data from notices filled in on the basis of the Public Procurement Act of 2011. In this context, we could also especially highlight the threshold settings that stand for the limit values of certain red flag indicators under/above which the indicator does not signal a risk. (So the test results also helped to set the signals of the following indicators: term of the contract; as regards ability, requirements for the experience of experts involved; or the amount of the tender guarantee.)

3.3. GROUPING OF INDICATORS

It was reasonable to distinguish between the remaining indicators based on whether the signalled risk can be identified based on concrete information characteristics to the specific public procurement procedure, included in the contract notice or omitted, or a potential risk is signalled based on general information or threats experienced earlier in the given (in our case Hungarian) public procurement market in relation to the data included in the given notice. In the former case, signals are red flag signals (red flag indicators, red flags) based on the specific data of the given public procurement procedure. We have to distinguish these from indicators that give so called other risk signals (other risk indicators, “pink flag”), and highlight that based on earlier market or other database information the link to the given characteristic to the given public procurement act definitely merits attention, adds detail to the picture, but in itself does not determine the assessment of the given procedure. This latter group includes indicators, such as information on whether the contracting authority had been previously convicted by final judgement for public procurement offences, or what reputation he has in the market. The issue of potential cartel activities in relation to public procurements is another such indicator. Information and company data linked to the winning economic actor(s) are also suitable for signalling risks.

Signals of red flag indicators signalling risks based on notice data related to the given public procurement procedure can be divided into two further groups, though the tool does not indicate this. The basis of the signals of red flag indicators in one group is the infringement on a legal requirement relevant for fair competition and corruption risks. This means that the basis for the development of the indicator is the compliance with legal requirements, but this does not inevitably mean that all signals stand for an actual infringement, even though the system is characteristically capable of signalling exactly that. The system for example signals an omission if in the case of the exceptional use of an accelerated procedure the grounds are not specified as required by legislation, but it is still possible that the information is provided, albeit in a different data field of the notice. This is less a shortcoming of the warning system than a result of the incorrect completion of the notice form. At the same time, a signal triggered for example by any occasion where in procedures of two- or more stages the contracting authority restricts the number of participants more than is stipulated in legislation (determines a lower maximum number of participants), is information that allows a conclusion to a definite infringement on legal regulations.

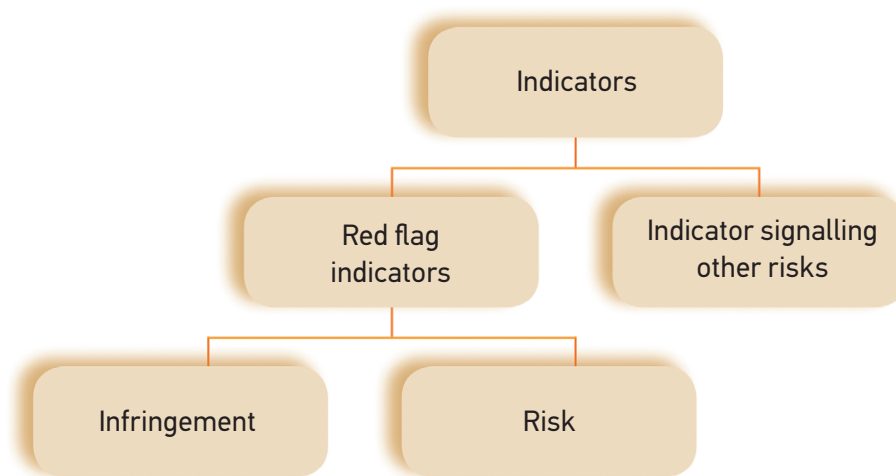
The basis of the signals of red flag indicators in the other group is a so called emergency relevant for fair competition and corruption risks that we identify as a risk factor. Publishing or setting certain conditions is namely not an infringement in itself, but has the potential to carry a true risk (e.g. use of an accelerated procedure in itself; conclusion of a public procurement contract for an indefinite or long term; or a so called one-tenderer procedure based on the data in the information notice; or a situation where a procedure was declared unsuccessful due to the fact that only invalid tenders were submitted).

It must be noted that there are indicators which are based on the assumption of an infringement, but due to the complexity of the topic or at the current level of development, they were rather classed as risks (e.g. the red flag indicator for the requirement of EU, co-financed references). Red flag indicators signalling issues on the border of an infringement and a risk can also be interpreted. Here the possible room for action within the framework of the conditions of the relevant legal regulation is determined by legal practice (e.g. ratio of sales revenues requirement to the estimated value as an ability criterion).³³

The distinction between indicators based on infringements and those signalling risks is not marked by the system when a notice is flagged, but it becomes clear from the summary and explanation of the indicators.

³³ Remark: Several of these items determined by jurisdiction have been included in the new public procurement regulation as requirements.

Figure: Grouping of indicators



3.4. INTERPRETATION OF INDICATOR SIGNALS – METHODOLOGY IN A NARROWER SENSE

In this project, a simplified approach and method to the aggregated interpretation of indicator signals in the automatic system was accepted. We will discuss the options of further development under Section 4.

The gist of this approach is that based on the notices, the warning system shows how many indicators were triggered (in what fields, and on what grounds), i.e. how many red flags and “pink flags” marking other risks did the given notice receive. These automatic signals show for example how many of the currently working 32 indicators were triggered and in what form (“red or pink flags”) by a contract notice launching a public procurement procedure. For now, this approach is quantitative, i.e. we do not rate the importance of red flags, their relations to each other, or other possible differentiating factors. As we have already indicated, the development of a corruption index was also not our goal in this phase, however the architecture of the program allows the further development in this direction. In this project, risks (potential infringements) are identified and summarised.

4.

THE RELEVANCE OF THE RED FLAG WARNING SYSTEM AND OPTIONS FOR FURTHER DEVELOPMENT

4.1. MULTIFUNCTIONAL TOOL

The red flag warning system may be used for different purposes. First of all, it helps predict corruption and other risks in relation to individual public procurement procedures, so its preventive function must be emphasised. At the same time, based on the assessment of the connections between the contents of the contract award notice and certain data in the two other notices, the system may give signals that may highlight important characteristics and risks related to the public procurement procedures, albeit only in retrospect. In addition to the above, based on the involvement of large amounts of available structured data and further databases further analysis may become possible, which allow conclusions beyond the direct public procurement procedures, and make the assessment of contracting authorities, tenderers, or a specific public procurement practice in the market possible for certain characteristics. Following the tested adaptation of the so called basic version of the warning system, there is also an opportunity for comparisons at European level.

4.2. OPPORTUNITIES FOR FURTHER DEVELOPMENT

The steps – resulting from the restricted approach that we applied in this project – that we introduce in the following may involve the development of all functions.

Extending assessment to other notices

The assessment of notices may/is to be amended with notices outside the scope of so called classic notices based on the public procurement directive. Among others, it is primarily the notices related to the special public procurement procedures of public service providers and separate notices related to certain defence procurements that could be reasonably covered by the system, and the assessment of certain special notices also arises (e.g. notices of concession procurements).

Another extension could possibly involve the assessment of notices of public procurement procedures below the EU value threshold, of smaller value or in general those conducted in so called national procedures, with special regard to the fact that the threat of corruption risks is present in this sector as well, and is even more pronounced. To this end, certainly, another data input would be needed, since the system works on the basis of the TED database at the moment.

We have to mention here that in case of developments in relevant legislation in the meanwhile, the warning system needs to be updated of course, as the appearance of new standard forms in the EU, the process of transposing the latest EU directives on public procurement into national law, and the new Hungarian public procurement act and its implementing regulations entering into force are new developments, that affect the daily use of the red flag system. All this does not affect the concept of the warning system, only makes its fine-tuning necessary in line with the new developments.

Adding indicators

We already mentioned in the methodological description that there are opportunities for the IT development of certain indicators, especially where more complex or creative solutions need to be modelled. It is mainly the generation of red flag indicators assessing the data of contract notices that is relevant here. Another “reserve” that we mentioned above lies in linking further data contained in contract notices, and contract award notices, and also extending the assessment in the warning system to other available documents of the given public procurement procedure (e.g. the specifications or in Hungary the notices on contract modifications).

Using indicators suitable to signalling other risks represents a separate potential, which is based on linking other databases, relevant data collections, and information (see e.g. information on the identity of the contracting authority and the winning tenderer, or the object and value of the public procurement. This may not only have benefits for the risk rating of certain public procurement procedures, but also for identifying other correlations, more general conditions involving risks.

We must also mention in relation to the generation of indicators that in several areas, data are lacking or data reporting is not sufficient, and the question, what initial and subsequent information should be made available for an assessment of corruption risks in the warning system also arises at conceptual level.

Adapting the system in other EU member states

Since the system builds on EU data and notices, it seems to be evident to make it applicable in other member states as well. This is our obvious aim, however due to the different public procurement practice and the characteristics of filling out the standard forms, this can only be possible, if in case of each member state an expert pre-assessment is to be prepared, and the indicators are to be modified according to the results. It is also important to take into account the language factor, the program may not be replicated by a simple translation.

Adding details to the methodology

The simplified approach in this project is capable of giving adequate risk warning, but also offers opportunities for further development, mainly because the system currently does not distinguish between the different levels of corruption marked by the indicators, nor does it compare indicators for example. On other methodological foundations, it is possible to even achieve the development of a corruption index.

4.3. POSSIBLE “BRANCH-OFFS”, LINKS AND OTHER DEVELOPMENTS

One of the measures of an automatic warning system mostly based on data contained in notices, but also capable of data links beyond these is the feedback from external users. The simplifications applied in the project serve the easier interpretation of the system’s output by civil and professional interested parties, journalists and media figures. We have to stress at this point, but also in a wider context, that this red flag tool is intended to show risks, and not to identify concrete corrupt activities. It may help with the latter, but in itself it is obviously not capable of performing all complementary analytical and evaluation activities, which would be essential for the actual identification of such situations.

Involving human factors, public procurement analytical expertise to complement the automatic warning system is therefore an opportunity for the future, that can be best realised in two possible ways: it may prove useful but not essential in relation to the further interpretation of certain indicator signals in the light of notice data, or even for the hidden motivation and correlations behind notice information. Further, more in-depth analyses and targeted research may be carried out on the data in the red flag database or by linking it to other databases.

During the testing of the red flag warning system for example several ideas arose that were related to the further investigation of certain problems and correlations using this tool (e.g. the different interpretation options of certain points of notices, interpretation problems of the CPV code system, analysis and interpretation of a decreasing number of tenderers). The use of the tool may uncover further issues and links worthy of analysis.

The use of the warning system in combination with other tools is also a possibility. The red flag warning system provides a kind of benchmark support. Based on that, the possibility of using integrity pacts or encouraging such may arise in the case of some contracting authorities, that published characteristically risky notices or ones with risks well above average risk levels. The cooperation in line with integrity pacts, the civil monitoring incorporated into the process is namely capable of uncovering in-depth shortcomings and problems integral to the system, in addition to preventing corruption.

If the red flag warning system is successfully interpreted and positioned as a supportive tool, it is capable of creating important interactions during further development or further measures. The signals of the system will impact on the behaviour and practice of contracting authorities, and may influence the attitude of tenderers to public procurement. It could also have an impact on legislation or the control of notices. It is namely a legislative matter what data are compulsory to provide in notices, and what information are sufficient to provide in the documentation of procedures that may not be public. The transparency of contract modifications or the publication of certain data related to the performance is also a legislative decision. The approach employed by member states in these matters can greatly vary beyond the minimally required EU harmonisation.

In addition to a kind of statistical modelling of the contents of notices (in Hungary see the statistics of the Public Procurement Authority), the database and signal-development of the red flag warning system could enable the generation of further data, perhaps not only based on information contained in notices, but also if indicators are incorporated that signal other risks. As the new EU public procurement directives put an even greater emphasis on monitoring and statistical data processing at member state level, this tool can also be involved in the realisation of such tasks.

If the red flag tool is adapted to different member states, it will be possible to compare national public procurement data and analyse those at European level. Adaptation at member state level means on the one hand that certain national specificities may be identified both in regulations and in jurisdiction. On the other, based on the data generated by a basic version of the warning system without any adaptation to a given member state, the same factors can be compared on a unified basis.

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http://siteresources.worldbank.org/INTDOI/Resources/Red_flags_reader_friendly.pdf

APPENDIX

Indicator: 6. **Object of the public procurement (cartel risk)**

II.1.5) Short description of the contract or purchase(s):

Basic proposal: We treat objects of public procurement where according to experience so far (Competition Office) there may be a more severe cartel threat as risky (motorway construction, road construction, road reconstruction, railway track construction, IT system development).

http://www.gvh.hu/szakmai_felhasznaloknak/kozbeszerzesi_kartellek

http://www.gvh.hu/data/cms1000059/koz_b_kartell_epitesi_kartell_ugyek_2013_12_05.pdf (last update: 05/12/2013)

Priority: motorway construction, road construction, road reconstruction, railway track construction, IT system development.

Complete (by final judgement):

Vj-174/2007	line section reconstruction works track construction works rails construction works track rehabilitation works
Vj-130/2006	road construction works bridge construction works and reconstructions
Vj-97/2006	introduction of an integrated financial-economic system (revision of an integrated enterprise resource planning IT system)
Vj-66/2006	extension and reconstruction of an institution (construction)
Vj-40/2005	development of IT systems?
Vj-21/2005	related to HR and payroll accounting?
Vj-20/2005	introduction of an IT system?
Vj-162/2004	integrated management information systems, and hospital IT systems implementation
Vj-102/2004	gas-insulated high-voltage switch-gear
Vj-74/2004	construction of a condominium for a local government
Vj-56/2004	reconstruction of main roads outside the capital
Vj-25/2004	road reconstructions; works on roads and structures
Vj-28/2003	renovation of building (headquarters)
Vj-27/2003	motorway construction
Vj-154/2002	construction works, construction of a multifunctional centre for a university
Vj-138/2002	road reconstruction works

Final proposal (with consideration also to identification by CPV codes):

<p>1.</p>	<p>Road construction works (simplified umbrella term; the right-hand column and the list items without strikethrough were used for development)</p>	<p>45233000-9 Construction, foundation and surface works for highways, roads</p> <p>45233100-0 Construction work for highways, roads</p> <p>45233110-3 Motorway construction works</p> <p>45233120-6 Road construction works</p> <p>45233121-3 Main road construction works</p> <p>45233122-0 Ring road construction work</p> <p>45233123-7 Secondary road construction work</p> <p>45233124-4 Trunk road construction work</p> <p>45233130-9 Construction work for highways</p> <p>45233131-6 Construction work for elevated highways</p> <p>45233139-3 Highway maintenance work</p> <p>45233140-2 Roadworks</p> <p>45233141-9 Road-maintenance works</p> <p>45233142-6 Road-repair works</p> <p>45233162-2 Cycle path construction work</p> <p>45233200-1 Various surface works</p> <p>45233210-4 Surface work for highways</p> <p>45233220-7 Surface work for roads</p> <p>45233223-8 Carriageway resurfacing works</p> <p>45233224-5 Dual carriageway construction work</p> <p>45233225-2 Single carriageway construction work</p> <p>45233226-9 Access road construction work</p> <p>45233227-6 Slip road construction work</p> <p>45233228-3 Surface coating construction work</p> <p>45233300-2 Foundation work for highways, roads, streets and footpaths</p> <p>45233310-5 Foundation work for highways</p> <p>45233320-8 Foundation work for roads</p>
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2.	Railway construction	<p>45234000-6 Construction work for railways and cable transport systems</p> <p>45234100-7 Railway construction works</p> <p>45234110-0 Intercity railway works</p> <p>45234111-7 City railway construction work</p> <p>45234113-1 Demolition of tracks</p> <p>45234114-8 Railway embankment construction work</p> <p>45234116-2 Track construction works</p> <p>45234120-3 Urban railway works</p> <p>45234121-0 Tramway works</p> <p>45234122-7 Underground railway works</p> <p>45234123-4 Partially underground railway works</p> <p>45234124-1 Underground passenger railway transport</p> <p>45234125-8 Underground railway station</p> <p>45234126-5 Tramline construction works</p> <p>45234129-6 Urban railway track construction works</p> <p>45234130-6 Ballast construction works</p> <p>45234140-9 Level crossing construction works</p> <p>45234210-1 Cable-supported transport systems with cabins</p> <p>45234220-4 Construction work for ski lifts</p>
3.	Bridge construction	<p>45221000-2 Construction work for bridges and tunnels, shafts and subways</p> <p>45221100-3 Construction work for bridges</p> <p>45221110-6 Bridge construction work</p> <p>45221111-3 Road bridge construction work</p> <p>45221112-0 Railway bridge construction work</p> <p>45221113-7 Footbridge construction work</p> <p>45221114-4 Construction work for iron bridges</p> <p>45221115-1 Construction work for steel bridges</p> <p>45221119-9 Bridge renewal construction work</p> <p>45221120-9 Viaduct construction work</p> <p>45221121-6 Road viaduct construction work</p> <p>45221122-3 Railway viaduct construction work</p>

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flags