Construction Fraud: Corruption

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Fraud, a five letter word that keeps some business owners up at night. For others, it is a five letter word that never crosses their mind until it happens to them. As constructions contracts have been growing in size and complexity, a contractor's time is likely spent trying to manage the contract, rather than devoting time to preventing fraud. No business is perfect, and fraud can occur even at the most vigilant companies. What many business owners fail to realize is that fraud is more than just people stealing your money or supplies. According to the Association of Certified Fraud Examiner's 2014 Report to the Nations on Occupational Fraud and Abuse (ACFE Report), corruption is one of the most common types of fraud in the construction industry, occurring in approximately 47% of the cases included in their analysis. Corruption schemes are broken down into four areas, but the two most common types, and potentially most costly to construction companies, are bribery and conflicts of interest.

Bribery can be costly to a construction company, not only due to the legal problems that may arise, but financially as well. An influential bribe paid to the right individual could improperly influence a decision to select one subcontractor over others. This subcontractor may be substandard, or could be the highest cost subcontractor, leading to reduced contract margins or inaccurate bids. In addition, a bribe from a competitor may also influence individuals not to bid on projects, allowing the competitor to win and the contractor to lose out on a potentially profitable contract. Bribes can take many forms and is not limited to cash. The intent of a bribe is to influence a decision, so be careful when evaluating gifts and other incentives from subcontractors, as some may be a simple thank you for your business.

Conflicts of interest often arise when an individual is in a position to personally benefit from a relationship at the expense of another. For example, an employee is a partial owner of a potential subcontractor on a significant contract. This employee has the ability to influence the decision related to what subcontractors are awarded work, and uses this influence to direct the work to this subcontractor. This could negatively impact the performance of the contractor, potentially resulting in reduced contract margins or substandard work and products. Although, this subcontractor could also be the lowest bid, so these types of relationships should not be fully excluded, but should be monitored closely.

As you can imagine, bribery and conflicts of interest are difficult to detect, but there are steps you can take to help reduce your exposure. First, establish a clear tone at the top and build into your company's code of conduct, policies related to the acceptance of gifts from subcontractors. Employees should be required to report gifts to their employer and they should not personally benefit from receipt of these gifts. Many organizations set a value threshold for reporting gifts to management, and the determination of this threshold should be clearly documented. In addition, establish an internal and external hotline and allow employees and subcontractors to call and report information anonymously to a designated individual. According to the ACFE Report, tips from employees is the top method for detecting fraud.

Finally, if the law allows, require your subcontractors to disclose to you their ownership and include right to audit clauses related to ownership and financial performance in your sub contract. By holding and enforcing these clauses, it is possible to reveal unknown financial relationships with current employees or deter them from occurring. Bribery and conflicts of interest occur and no company is immune to their impact. With a little planning, training, and monitoring of employee and subcontractor relationships, the financial impact suffered could be minimized.

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