

Corruption and public works: Maintaining an integrity edge



A Tale of Two Companies

A global construction and engineering firm found itself under investigation over a large Prevailing Wage and Disadvantaged Business Enterprise scandal involving federally funded public works. As bad as the investigation and subsequent settlement were, the reputational harm that resulted from news coverage of the scandal led to significant delays in the awarding and payment of hundreds of millions of public dollars in other jurisdictions. Although the company had focused on defending itself against the federal investigation, it was blindsided by the reputational damage — and severely challenged in winning back the trust of public entities by assuring them of the soundness of their integrity and new compliance programs.

A local construction firm with a long history of ties to organized crime — now under new ownership — had “cleaned house” and implemented robust new compliance programs. Still, they recognized that the stigma attached to the brand in the minds of law enforcement and public contracting agencies would not be so easy to overcome. So the company commissioned an outside independent monitor to conduct a comprehensive review of its compliance environment. They also had the monitor accompany them to meetings they had proactively scheduled with major public contracting agencies in order to address the “elephant in the room” — and to demonstrate the great lengths to which the company had gone to strengthen its culture, compliance program and controls.

Although the hurdles may have seemed higher for the second company because of its reputation and smaller size, its willingness to address these issues head on gave comfort to procurement officials — who are answerable to the public — and allowed it to more quickly and effectively “get ahead” of the issues that plagued the first company in the bidding and award processes.

Corruption risk is a special challenge for firms engaged in public works

Corruption threatens companies in every industry, but construction and engineering firms face special challenges. Those risks are higher still in the sphere of public works contracting — which is, according to Transparency International, the most bribery-prone sector globally¹ — especially given the scope, visibility and use of public funds in such projects.

First, of course, is the issue of public safety. Shoddy or substandard workmanship or materials enabled by unscrupulous side deals can carry catastrophic consequences for both workers and the public at large. Then there’s the issue of public financing, which triggers added layers of compliance and accountability, often at multiple levels of government.

Finally, there is the potential legal exposure for a parent company — and even individual executives — which can accompany revelations of corruption. Not only are firms held accountable for the actions (or omissions) of subcontractors, suppliers and other third parties, public works contracts also require additional vetting procedures and compliance with more stringent regulations. A breakdown can create a long chain of business, legal and reputational headaches.

¹ Transparency International-USA, a non-profit, non-partisan organization focused on fighting corruption in government and international business and development, scores sectors on scale of 0-10, where a maximum score of 10 corresponds to the view that companies in that industry never bribe, and a 0 corresponds with the view that they always do.

Despite the amplified risks triggered by contracting in the public works sphere, there are several steps construction and engineering companies can take to stay ahead of both potential problems and competitors. The key is to focus on maintaining an *integrity edge*.

Third-party risk: Ignorance is no defense

Otherwise-sound compliance programs often fall short when it comes to third parties — especially in the highly interconnected construction industry, with relationships that typically involve chains of subcontractors, suppliers, trades, unions and other third parties.

The traditional “red flags” may not be readily apparent due to complex payment mechanisms and contracting strategies, and more-sophisticated corruption strategies might not be identified through standard internal controls, project oversight or governance. The audit trail for revenues and expenses can become extremely complex, often making it more difficult for management to maintain accurate and reliable financial records — a challenge that’s amplified for those who conduct business internationally.

Accepting integrity risks — or otherwise unacceptable behavior and payment practices — when working outside of the U.S. as “local custom” or “business as usual” is no defense: even if carried out by partners or subsidiaries, the risks to the parent company remain the same. In fact, as we stress below, they are growing.

The business consequences of enforcement actions

A successful prosecution for corruption in public works contracting can result in debarment from future government contracts and create significant cost overruns, delays, and brand damage. But the reality is that virtually *any* enforcement action can carry significant problems for a construction company — especially given the sometimes narrow window of opportunity in the government bid or request for proposal processes.

Reports of a criminal investigation into public contracting agencies can stall pending projects and hinder a company’s ability to land new contracts. Should a contractor have real or perceived integrity issues, the bid can be compromised; even an awarded contract or ongoing job can be lost. Past problems can also have adverse implications for an organization’s reputation, a stigma that can be difficult to overcome.

Finally, responding to a government investigation can introduce significant costs, particularly for firms who lack a proactive response strategy. And, even if the company itself is ultimately cleared, reputational challenges can linger, potentially giving pause to clients, prospects, employees and other stakeholders.

Limiting vicarious, civil and criminal liability

Businesses involved with public works projects should be prepared to navigate widely varying vetting procedures and degrees of due diligence, and should understand the scale of the compliance risks they face. The absence of strong internal controls or a lack of understanding about the practices of subcontractors and vendors can expose them to investigations, enforcement actions and prosecutions.

Laws governing public works, such as the Davis-Bacon Act, often extend civil liability for transgressions by subcontractors to the general contractor or construction manager. A company also can find itself dragged into a costly and brand-damaging criminal investigation involving a subcontractor.

And now there’s a new white-collar dimension to the enforcement angle. The Justice Department recently released a high-profile memorandum that instructs its prosecutors and civil attorneys to ensure that *individuals* behind corporate misconduct are investigated and fully prosecuted. The so-called “[Yates Memo](#)²” sends a very clear message to organizations and their counsel about their responsibilities in identifying individual culpability through internal investigations. Quantifying a loss and writing a check are no longer enough: individuals behind bad decisions are liable to be investigated and charged — and, crucially, companies will have to play a key part in connecting the dots, in order to avoid being denied cooperation credit.

² <https://www.justice.gov/dag/file/769036/download>

So how to avoid falling into a liability trap? A proper due diligence process can help guard against entering into business relationships with high-risk third parties. A credible internal anticorruption program, bolstered with robust monitoring and internal controls, can help root out weak spots before they become major issues. And an effective crisis-response plan can swiftly convince regulators and prosecutors that the company should be viewed as a witness to — or even a victim of — fraud, rather than as the target of an investigation.

Maintaining an integrity edge: Five steps every construction company should take

It is often challenging for a contractor to develop one set of consistent standards across the complex thicket of construction stakeholders. But with the right support and informed decision making, a company can enhance its understanding of third-party risks and the federal and local contracting processes. The ability to recognize potential hazards that can precipitate or complicate a government investigation can position your entity to make a responsive, transparent and compelling case to a contracting or regulatory agency if the need arises.

The key to maintaining an integrity edge is to be proactive in protecting the company's reputation, both at home and in foreign markets. Here are five steps that can help you get there:

- Internally, develop clear anticorruption policies, backed up with robust internal training and monitoring, with a focus on continual improvement
- Externally, strengthen the due diligence and vetting process for subcontractors and other third parties
- Communicate and consistently reevaluate ethics and compliance standards for all subcontractors
- Monitor projects mid-stream, with random anticorruption reviews
- Build constructive working relationships with regulators, law enforcement and state and local officials, and promote the company as an ethics thought leader with industry groups and other stakeholders

The way forward

Public-works corruption diverts public funds, inflates project costs, and can lead to crippling consequences, both legal and financial. But it doesn't have to go that way. The ability to recognize potential hazards — and act before falling victim to them — can help companies stay out of trouble. And if they should ever end up in a compliance breakdown, being able to point to their integrity edge can help them find the optimal resolution.

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