



Whitepaper

Conflicts of Interest in the Award of Contracts

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Background

Purpose

This White Paper sets out a framework to deal with conflicts of interest in the awarding of contracts. The framework will help to improve accountability, transparency, fair and equitable treatment, value-for-money and good corporate governance, and significantly reduce risks associated with corruption.

Background

Conflicts of interest are often poorly handled, particularly in the awarding of contracts. For example a past Chairperson of the Corruption and Crime Commission in Western Australia stated: “Many influential holders of public office wouldn’t recognise a conflict of interest if it walked up and kicked them in the backside.” The Victorian Ombudsman noted about conflicts of interest: “Despite multiple reports and investigations by my office into this issue, it continues to be a significant theme in many complaints to my office” and “I have observed a growing trend in complaints about conflicts of interest in procurement ...”

People involved in the awarding of contracts often fail to recognise, declare or manage conflicts of interest, or take reasonable measures to protect themselves or their organisation. The result is frequently personal and organisational reputational damage, political fallout, litigation, and financial and other significant costs.

This White Paper sets out a framework that should help to mitigate risks associated with conflicts of interest in the awarding of contracts. It is applicable to both the public and private sectors. The framework should be useful for designers of contract award processes, people involved in the award of contracts, auditors, probity auditors and investigators.

There are many definitions of conflicts of interest. In broad terms a conflict of interest may be considered to exist where a reasonable person might perceive that an individual may be influenced in their work to place their own interest ahead of the organisation’s interest.

An example of a definition is: “A conflict of interest is a set of circumstances that creates a risk that an individual’s ability to apply judgement or act in one role is, or could be, impaired or influenced by a secondary interest. It can occur in any situation where an individual or organisation (private or government) can exploit a professional role for personal or other benefit.”

Discussion

Issue

Conflicts of interest in the award of contracts have been associated with corruption and improper conduct in probably every jurisdiction. Reports by anti-corruption organisations, corporate governance officials, regulators, compliance professionals, auditors and investigators have emphasised the corrosive effect of conflicts of interest in the awarding of contracts, and the need to deal appropriately with conflicts of interest.

History

Conflicts of interest has become recognised as one of the most important components of good governance. The Institute of Internal Auditors White Paper ‘Conflicts of Interest: A Framework’ deals with the measures an organisation should take to control conflicts of interest. Legislation has been passed that covers ethical behaviour, some of which explicitly or implicitly cover conflicts of

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interest. Courts have emphasised the need for fair dealing when a public body is involved in a tendering process, and even held that a fiduciary duty to avoid a conflict of interest may arise between parties. Specific measures to deal with conflicts of interests have been considered by the courts. Australian public sector jurisdictions have introduced requirements for the government award of contracts that cover conflicts of interest.

Discussion

Leading practice is to have a process in place that incorporates:

- Awareness of conflict of interest issues.
- Practical avoidance of conflicts of interest.
- Formal declaration of interests.
- Formal consideration whether there is a conflict of interest.
- Formal plan for managing the situation.
- Proposal documents requiring suppliers to notify conflicts of interest.
- Formal consideration of supplier's declared conflicts of interest.
- Reporting of compliance and non-compliance with an approved management plan.
- Dealing with breaches.

Whilst this framework is useful for award of contracts generally, it is particularly useful for instances where risks associated with corruption are greater. These might include where the contract is particularly important to the organisation due to high cost, safety implications, potential effect on brand or reputation, or where the likelihood of corruption is greater due to an environment of perceived dishonesty.

Application of this framework should cover not only those involved in evaluating proposals, but all people with a role that could allow them to influence the awarding of the contract, or reasonably be perceived as being able to influence the award. This includes people preparing the tender specifications, selecting the members of the evaluation panel, choosing the tender method, deciding on the evaluation criteria, communicating with tenderers, collecting or opening tenders, providing advice or testing in the evaluation stage, preparing records of evaluation meetings, and making, approving or reviewing the contract award decision.

There is frequently a perception of corruption where there is a conflict of interest, and in addition, something goes wrong or the procurement process is not diligently followed. Errors or deviation from process, that would be deemed to be acceptable in a normal procurement process, become matters of concern or upmost suspicion when there is a conflict of interest. The presence of a conflict of interest generally increases risks associated with the contract award process.

When there is a conflict of interest situation, whether dealt with appropriately or not, greater care needs to be taken in all aspects of the process.

Awareness of conflict of interest issues

All employees who participate in the award of contracts should be aware of probity issues related to gifts and benefits, conflicts of interests, security of information, and other relevant topics. There should be written policies and procedures, and training. It is advisable to provide every participant with clear written guidance for each contract award process.

Practical avoidance of conflicts of interest

Employees who participate regularly in the award of contracts, or who participate in the award of high risk contracts, should be given guidance in how to avoid being placed in conflict of interest situations where these are avoidable. Grooming by suppliers is a high risk consideration that call for special measures and training for employees.

Formal declaration of interests

Where procurement is at a level that triggers specific requirements, for example senior officer approval or institution of a tender process, employees should be required to make formal declarations of their interests relevant to that procurement.

Employees should be required to declare interests, or to declare they have no interests relating to the contract. This should be in writing and filed with other documents relating to the contract. This requirement is part of the procurement process and is in addition to, and separate from, any general requirement under a code of ethics or code of conduct to declare conflicts of interest.

It is preferable for employees to declare their interests

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in a contract, rather than only their conflicts of interests in the contract. This encourages fuller disclosure, and also encourages managers to make a more considered decision about the role of employees in relation to contract award.

Employees should be required to make full and clear disclosure of their interests. It is not acceptable to make incomplete, cryptic or misleading disclosures. All interests should be disclosed and significant interests highlighted.

Employees must disclose their interests, even if they have disclosed conflicts of interests in other forums, or through other processes, and even if their interest is well-known to their colleagues or managers.

Interests required to be disclosed should include any personal interests, which includes interests of those close to the employee. It is recommended interests required to be disclosed should include any secondary interests which could reasonably be seen as able to impair or influence the employee in the matter. This would require disclosure of interests not seen as personal interests. Examples might include work duties of the employee that might affect their ability to be impartial, significant workplace assistance provided by a supplier in the past, related party transactions between organisations, and employee involvement in professional associations.

In addition to disclosure of interests in the document, if there are formal tender planning and evaluation meetings, at the beginning of the first meeting and each meeting thereafter, every person present should be asked to confirm their interests and that it has been clearly and completely disclosed, or to state they have no relevant interests. This should be an agenda item, with the questions and responses formally minuted.

Employees should update their disclosures of interests if there are significant changes to those interests, particularly if new interests arise or existing interests intensify.

Formal consideration of interests

Managers or committees may ask the employee appropriate questions to understand the interest. If it is considered that interests are inadequately stated, the forms should be returned to the employee with the instruction to fully and completely disclose the interest. The onus of full and clear disclosure is always the

employee's.

The manager or committee should then assess whether the disclosed interest is likely to amount to a conflict of interest, or a reasonable perception that the employee could be influenced or impaired by the interest. Their assessment, the decision, the reasons for the decision, and the names of participants, should be formally recorded.

Formal plan for managing the situation

The manager and employee should develop a formal plan for managing interests that are conflicts of interest, or where there is a reasonable perception that the employee could be influenced or impaired by the interest. The plan should be documented, signed by the employee and manager, and a copy filed with the contract documents. The plan should ensure that all relevant probity requirements have been met.

Where the declared interest results in reasonable concern about the continued involvement of the employee, the default position should be for the employee to have no further involvement in the contract. Where this may not be practical or where the concern is small, alternative solutions may be considered. A risk management approach should be used.

Alternative solutions may include increased supervision, more checking and review, having other people involved, expanding the level of other people's involvement, increasing the degree of documentation, requiring key decisions to be made by more senior employees, developing a probity plan, appointing probity auditors, 'ring-fencing' information or activities, and changing reporting lines.

Proposal documents require suppliers to notify conflicts of interest

Consideration should be given to requiring suppliers to disclose their own conflicts of interest and any matters relating to your organisation's employees that could be considered a conflict of interest. It may be beneficial to send a copy of your organisation's code of conduct or statement of business ethics to suppliers invited to submit proposals.

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Formal consideration of supplier's declared conflicts of interest

There should be a formal consideration of any conflicts of interest disclosed by suppliers. This should be a standard committee agenda item and be included in relevant minutes.

Reporting of compliance / non-compliance with approved management plan

The concern that there has potentially been corruption tends to increase dramatically where there is both an employee with an interest in a matter, and there is also any deviation from the normal process for the consideration and award of the contract. In these situations, probity is increased by having decisions made one level higher than normal, or subject to additional review.

There should be periodic reporting of compliance or non-compliance with the approved management plan for managing the situation relating to the interest. The review should be documented. It should be an agenda item and included in the minutes.

Dealing with breaches

Failure to fully and clearly disclose interests should be notified promptly to relevant areas in the organisation such as the investigation unit, internal audit, legal and human resources.

Breaches should be appropriately dealt with. Actions may include additional probity controls, investigation, disciplinary measures, administrative or legal actions for damages, or recovery of funds from suppliers complicit in fraud or corruption, together with reporting to law enforcement authorities.

Conclusion

Summary

A framework for handling conflicts of interest in the award of contracts includes awareness of conflict of interest issues, practical avoidance of conflicts of interest, formal declaration of interests, formal consideration of whether there is a conflict of interest, formal plans for managing the situation, proposal documents requiring suppliers to notify conflicts of interest, formal consideration of supplier's declared conflicts of interest, reporting of compliance /

non-compliance with the approved management plan, and dealing with breaches.

Conclusion

Following the framework in this White Paper should reduce the risks of corruption associated with conflicts of interest in the award of contracts and increase accountability, transparency, fair and equitable treatment, value-for-money, and good corporate governance.

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Purpose of White Papers

A White Paper is a report authored and peer reviewed by experienced practitioners to provide guidance on a particular subject related to governance, risk management

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or control. It seeks to inform readers about an issue and present ideas and options on how it might be managed. It does not necessarily represent the position or philosophy of the Institute of Internal Auditors–Global and the Institute of Internal Auditors–Australia.

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Barry has over 20 years' experience in internal audit, fraud and corruption control, investigations, governance and compliance. He has contributed to books on fraud control, computer fraud, communications and sociology. He co-authored IIA-Australia White Papers on 'Fraud Risk Indicators', 'Corruption Indicators in Internal Audit', 'Corruption-Related Risks in Decision-Making' and 'Conflicts of Interest: A Framework'.

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Matthew has been involved in internal audit for 10 years in the New South Wales Government. Prior to this he was Financial Accountant for the Catholic Education Office Parramatta. He spent 15 years with the Audit Office of NSW, the last four as engagement manager. He has also served in a number of charities and the Wollongong Council Audit and Finance Committee. He co-authored the IIA-Australia White Papers on 'Fraud Risk Indicators', 'Corruption Indicators in Internal Audit', 'Corruption-Related Risks in Decision-Making' and 'Conflicts of Interest: A Framework'.

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About the Institute of Internal Auditors–Australia

The Institute of Internal Auditors (IIA) is the global professional association for Internal Auditors, with global headquarters in the USA and affiliated Institutes and Chapters throughout the world including Australia.

As the chief advocate of the Internal Audit profession, the IIA serves as the profession's international standard-setter, sole provider of globally accepted internal auditing certifications, and principal researcher and educator.

The IIA sets the bar for Internal Audit integrity and professionalism around the world with its 'International Professional Practices Framework' (IPPF), a collection of

guidance that includes the 'International Standards for the Professional Practice of Internal Auditing' and the 'Code of Ethics'.

The IIA-Australia ensures its members and the profession as a whole are well-represented with decision-makers and influencers, and is extensively represented on a number of global committees and prominent working groups in Australia and internationally.

The IIA was established in 1941 and now has more than 200,000 members from 190 countries with hundreds of local area Chapters. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.

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