CONFLICT OF INTEREST: GATEWAY TO CORRUPTION

All acts of corruption contain an inherent conflict of interest and can remain undetected in an organisation for years, if indeed they are detected at all. Anatomising the corrupt act can illustrate how employee corruption can begin and evolve even from benign situations, and how good management can mitigate the risk of corruption occurring internally. In this session you will learn new strategies to prevent, manage, and detect corruption risk within an organisation.

PAUL CATCHICK, D.PROF, CFE
Senior Investigator
Organization for Security and Co-operation in Europe (OSCE)
Austria

Paul Catchick has more than 20 years of experience with law enforcement and government agencies in Europe, Africa, and the Asia-Pacific region. This has included criminal investigation work with the UK Serious Fraud Office and a period as Head of Investigations for a national anti-corruption agency. Subsequently, he moved to the United Nations where he investigated internal misconduct, specialising in large-scale fraud cases. He then left to establish the internal investigation section at the Organization for Security and Co-operation in Europe. More recently, he was awarded a doctorate in policing.

“Association of Certified Fraud Examiners,” “Certified Fraud Examiner,” “CFE,” “ACFE,” and the ACFE Logo are trademarks owned by the Association of Certified Fraud Examiners, Inc. The contents of this paper may not be transmitted, re-published, modified, reproduced, distributed, copied, or sold without the prior consent of the author.
**Introduction**

Corruption cannot exist without a conflict of interest. Each and every corrupt act is driven by an underlying conflict. This session aims to alert organisations’ management to the importance of this connection, and to highlight that if conflicts of interest can be controlled, corruption will be minimised.

Aside from the natural desire to avoid being a victim of corruption, management’s need to demonstrate financial integrity in an era of compliance and regulation is more urgent than ever before. It can be important to take active measures to guard against corruption perpetrated or assisted from within. Understanding the relationship between conflicts of interest and corruption can lead to new ways to deter and detect misconduct.

Controlling corruption is a task for which staff members across an organisation have responsibilities. Management, internal audit, and investigators can each share responsibility for preventing and identifying corruption. Individuals must also take responsibility for their own actions, but an organisation can more easily hold individuals accountable if it has first set out its rules and expectations.

**Conflict of Interest as an Integral Component of Corruption**

There is a curious lack of attention given to the role of conflicts of interest in corruption. While whole industries revolve around ethics and conflict of interest issues, its key role as an integral component of corruption is largely overlooked. Even the United Nations Convention Against Corruption (UNCAC) makes only cursory reference to conflicts of interests, despite being the backbone of corruption legislation worldwide.
CONFLICT OF INTEREST: GATEWAY TO CORRUPTION

Part of the reason might relate to the difficulties in understanding the exact nature of conflicts of interest. Different understandings can apply in differing governance contexts, which may help explain why some western media and officials perceive that other cultures often give scant regard to the concept (see for example www.economist.com/node/17674075). Indeed, it can be difficult enough to explain the concept of corruption—let alone conflicts of interest—to societies whose values are traditionally based on familial or tribal relationships, or those in post-conflict, failing, or failed states.

Nevertheless, corruption exists to some degree in almost any culture. Even societies or sectors that traditionally have minimal corruption are increasingly exposed to different ideas and values through the effects of globalisation.

To understand why corruption must always involve a conflict of interest, let’s look at the definitions of the respective terms.

The Organisation for Economic Co-operation and Development states: “Conflict of interest occurs when an individual or a corporation (either private or governmental) is in a position to exploit his or their own professional or official capacity in some way for personal or corporate benefit” (www.tinyurl.com/ltvyc4h).

In other words, a conflict of interest exists when someone could abuse his or her official position for private gain.

Turning to the definition of corruption, the World Bank has provided a very succinct definition: “the abuse of public office for private gain” (www.tinyurl.com/pdwhkg9). While the World Bank definition focuses on public-sector corruption, the definition is largely interchangeable with
private-sector corruption since the term *public office* can equally apply to any official or any office—whether public or commercial—held by an employee.

Comparing these definitions shows why the two concepts are so closely intertwined. A conflict of interest exists where an official *could* abuse their position for private gain, whereas corruption exists where an official *does* abuse their position for private gain. Thus while a conflict of interest doesn’t always lead to corruption, corruption always requires a conflict of interest.

For example, accepting bribes is an example of corruption. The bribe taker has put his or her private gain—the receipt of the bribe—above the need to act in the best interests of his or her employer. Thus, there’s both a conflict of interest and resulting corruption. Acts of corruption in response to blackmail and extortion are similar. A person being blackmailed into committing a corrupt act is putting private interests (for example, maintaining their reputation) ahead of his or her fiduciary responsibilities. While the motivations may differ, the corrupt act is committed after the employee decides to put private interests ahead of official responsibilities.

Corruption does not have to involve two or more parties in wrongdoing. A single person in a position of trust can break corporate rules for their own benefit. For example, an immigration official who issues an unauthorised passport in his own name or an employee who furtively gives business to another company under his control. These are still acts of corruption.

Every conflict of interests requires one party to be in a position of trust, and every instance of corruption requires a both a conflict of interests and a breach of that trust.
Thus, the elements of corruption include:

- A position of trust
- A conflict of interest between that position of trust and a private concern
- A resultant action that breaches that trust—the corrupt act

Note that the conflict of interest only appears on one side of the equation. In bribery, for example, the bribe-payer is getting the bribe-taker to abuse his position of trust. It is the person who has been corrupted who abuses his trust through a conflict of interest. This knowledge facilitates the employer’s task of preventing and detecting conflicts of interest and corruption.

Corruption might not involve only money or physical items. There could be other motivations, such as honours, educational qualifications, friendship, or societal or family pressure. Conflicts of interest that exist in a job recruitment process might lead to nepotism or cronyism, which are both forms of corruption.

In addition to actual conflicts of interest, there exist perceived conflicts of interest and potential conflicts of interest:

- Perceived conflicts exist where there might be no actual conflict, but third parties might reasonably believe that a conflict exists. Even though no actual conflict exists, the perception can be damaging to the reputation of the parties who are believed to have one. In addition to reputational damage, there could be an indirect financial impact as better value suppliers might be reluctant to go to the trouble of preparing quotes if they perceive that their efforts will be in vain.
Potential conflicts exist where there might be no actual conflict, but the possibility of one existing in the future is reasonably foreseeable.

Prevention
The potential exists for confusion over the definitions, meanings, and applications of conflicts of interest, particularly in a globalised or multicultural environment. The solution is to ensure that those in a position of trust (i.e., the staff in an organisation) are able to understand and recognise all types of conflicts of interest and are made aware of the procedures for handling such a conflict.

Very often, conflict of interest and corruption awareness is aimed at procurement officials. While an important area to control, all staff—and in particular those who deal with external parties—are at risk of having a conflict of interest. Even in a purchase transaction, staff other than procurement officials could gain from a relationship with a supplier. For instance, those involved in the requisition of goods might influence the award of business to some extent, while those in accounts might have some control over payments. Stock control and warehouse staff might also be able to abuse the supplier relationship. Organisations will additionally benefit from ensuring that those staff members not directly involved in engaging with external parties are aware of conflict of interest issues, both from the point of view of (i) avoiding perceived conflicts, and (ii) encouraging staff to identify and report misconduct among co-workers.

The aim should be to create an environment where staff are comfortable declaring any conflicts to management so that the conflict can be handled appropriately. Employees should be encouraged to declare actual, perceived, or potential conflicts and to seek advice when in doubt. (Some
organisations are beginning to employ ethics officers to address this need. If in any subsequent investigation the employee is able to show that they properly declared a conflict to managers, the onus will then be on management—rather than the employee concerned—to justify their handling of the situation.

Of course, the mere act of having a conflict of interest isn’t necessarily, in itself, inappropriate or even avoidable. After all, employees can’t be faulted simply for having financial or family connections to businesses that their employers subsequently decide to trade with. What’s important is how the employees and their employers respond to the conflicts of interest. It’s the response—rather than the conflict itself—that determines whether the employee has acted with integrity. This will be most clearly demonstrated if the employee declares the conflict.

There are various solutions for resolving conflicts of interest, some of which can be taken by the employee, and some by management:

- **Register** all potentially conflicting interests (regular and ad hoc processes).
- **Restrict** job-relevant conflicting interests.
- **Recruit** people who do not have conflicting interests.
- **Recuse** the employee from the conflicted decision-making responsibility.
- **Remove** the conflicted decision-making responsibility.
- **Resign** from the conflicted position. (Where this involves the employee in a business relationship with a third party, the employee could resign from either of their positions to remove the conflict.)

The best advice for any employee in a conflict of interest is simply to **declare** it. Then, the onus is on management to deal with the situation. This often requires no more than
removing the conflicted employee from the situation. This may be for just one particular event (e.g., a tender exercise in which a procurement official is connected to a bidding company) or it may be ongoing (e.g., keeping a payroll clerk away from handling any payments related to any relative who is also an employee).

Only where the conflict is too large to manage by removing an employee from temporary or specific duties should management consider more active measures to manage the conflict, but it is important that the decision is fair and proportional. The most extreme strategy is resignation by the employee concerned, but this should normally be a matter for the employee alone to decide. Asking staff to resign their employment to avoid a conflict of interests as a matter of routine might actually discourage other employees from reporting conflicts of interest.

**Detection**

Law enforcement officials have a host of measures available to them when investigating corruption. This includes powers of entry, court orders giving access to private records and bank accounts, and the authority to compel external witnesses. Such tools are unavailable to most organisations, so employers must examine alternatives.

Establishing the conflict of interest is key to establishing the motive for the corrupt activity. This knowledge allows the fraud examiner to formulate additional detection strategies. By seeking out conflicts of interest, this can open the door to detecting corruption.

Educational measures are an important step that might form an integral part of the detection response. CFEs will be familiar with Cressey’s Fraud Triangle, which proposes
that fraud can occur when the individual has the motivation and opportunity to commit fraud, and the ability to rationalise their act. By embarking on educational measures and setting out expectations and consequences of undeclared conflicts of interest, this can inhibit the ability of employees to be able to rationalise a failure to declare. Further, fraudsters will be deterred from committing fraud if they think they will be caught. Fear of detection can only be enhanced if all employees are aware of the ramifications of having an undeclared conflict and are exercising vigilance as result. Thus, educating all staff as to the organisation’s policy on conflicts of interest can serve to encourage staff to bring management’s attention to a conflict being engaged in by co-workers. Awareness sessions have often proved to be a catalyst for reporting potential misconduct.

Where conflicts exist, it is not so much the declared conflicts that are of interest to the fraud examiner, but rather the undeclared conflict. Failure to declare is most likely to arise in one of three main situations:

1. The employee doesn’t understand the potential seriousness of having a conflict of interest or the organisation’s policy relating to it.
2. The employee doesn’t feel that management will be supportive of them once they have declared a conflict.
3. Assuming that (1) and (2) are not valid, there is every chance that the employee is deliberately trying to hide the conflict. There can be few valid reasons for staff not declaring conflicts of interest, assuming that employees have been made fully aware of their responsibilities. However, it may be helpful to allow a temporary amnesty for pre-existing conflicts of interest to allow for staff who might otherwise have been ignorant of the rules to come forward without threat of reprisals.
Thus, while an employee with a conflict of interest might not necessarily engage in corruption, management might view a failure to declare with a high degree of professional scepticism. An undeclared conflict is often the precursor to fraud, corruption, or other misconduct.

Conflicts of interest can often be detected by conducting basic due diligence. This should be performed each time a new supplier is selected. It should also be performed periodically thereafter, for instance when a contract is renewed or the level of trade suddenly increases. This applies even with longstanding contractors. Relationships can evolve over time, and even if no conflict existed at the selection stage, it is possible for staff to become close to suppliers as they work together.

Various methods exist for identifying conflicts of interest. Fraud examiners will be familiar with many of the strategies for detecting conflicts of interest between staff and suppliers, some of which can be performed through data analytics. These include:

- Comparing employees’ names with those of vendors
- Checking employee contact details against bidders and suppliers
- Cross-referencing employee payroll bank accounts against those of vendors
- Assessing whether the level of contact between individual staff and suppliers appears excessive
- Examining correspondence files to assess whether the relationship between staff and suppliers appears overly familiar
- Vetting incoming mail for irregular contact between suppliers and employees (e.g., frequent package deliveries from a company being addressed to a named individual)
## CONFLICT OF INTEREST: GATEWAY TO CORRUPTION

- Awareness of high levels of corporate hospitality offered to staff

(Note: these are in addition to the numerous red flags for identifying fraud, including procurement fraud and bid rigging).

Where these checks do reveal a possible undeclared conflict of interests, this will provide a sound basis for initiating further inquiries into possible corruption.

Detection rates can be further enhanced if internal auditors are proactively looking for conflict of interest. Auditors are a prime source of intelligence, and they could uncover undeclared conflicts of interest. Where searching for conflicts of interest has not traditionally been an internal audit priority, it can be helpful to incorporate a conflict of interest element into the standard audit plans. This helps to ensure that this issue is highlighted and considered on audits of any areas of business activity. According to the Institute of Internal Auditors (IIA), “The internal audit activity must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.” (IIA Internal Audit Standard 2120.A.2, emphasis added).

Auditors should also be checking that due diligence has been performed. The absence of due diligence is itself a red flag for various types of misconduct.

Even if auditors do not detect conflicts of interest in the course of their assignments, their very presence can be a deterrent to corruption if the audit team keeps conflict of interest issues on their agenda by discussing and highlighting the issue with the employees. This can include introductory or refresher presentations. Having auditors and other anti-fraud professionals physically present can also
encourage employees to come forward voluntarily with information.

Upon encountering such information, auditors might want to pass it onto a specialist investigator, compliance officer, or fraud examiner if they are unable to handle any resultant inquiries themselves. As per IIA standard 1210.A.2, “Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.”

Whether it is the audit team, management, specialist trainers, or others who give conflict of interest awareness sessions, it can be helpful to get a register of attendees. This can help in any subsequent investigation should the subject claim ignorance of the rules surrounding conflicts of interest.

**Conclusion**
Conflicts of interests can exist in any organisation or cultural setting. Through a holistic approach of education and detection, an employer should aim to create an environment where staff members are comfortable declaring any conflicts they might find themselves in. Undeclared conflicts are then a legitimate cause for concern and might require an investigative response.

In summary, any organisation that is able to effectively manage conflicts of interest will automatically be managing its exposure to corruption.