



Lakelet Advisory Group LLC

Focusing on Business Results

NEWSLETTER

www.LakeletAG.com

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Collusion in the Bidding Process – Part II

Recall from Part I

Collusion has a major impact on the median losses a company faces due to fraud – jumping from \$80,000 for a single perpetrator to \$355,000 if three individuals are working together. In addition, collusion is extremely difficult to detect because the involvement of two or more individuals generally renders a good system of internal controls ineffective. Our last article titled “Collusion: What Are The Signs – And How Can You Prevent It?” spoke of internal collusion, identified red flags, and suggested preventive measures; this time we will discuss how collusion at different stages in the procurement procedure can occur.

Collusion in the Bidding Process

An area especially susceptible to collusion is the procurement/competitive bidding process, where a number of contractors or suppliers are vying for contracts in an extremely aggressive environment. PricewaterhouseCoopers 2014 *Global Economic Crime Survey* found that procurement fraud was one of the highest commonly reported types of economic crime and 29% of organizations had experienced it – second only to asset misappropriation. They further reported that 61% of the survey respondents found that the fraud occurred during the vendor selection phase of the procurement

process. That being said, procurement fraud can occur between many different parties, at every stage throughout the bidding process.

The Pre-solicitation Phase

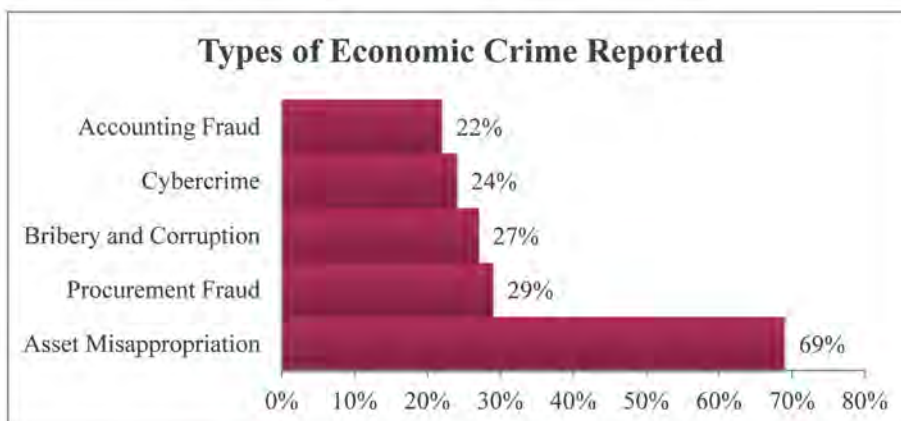
At this phase in the bidding process there are a few different ways that collusion can occur. The first way is when an employee of a company creates a false need within the company to initiate the bidding process. This employee usually receives either a kickback from the project or gift from the contractor. Another form of collusion within this phase is in association with the specifications of a project. The employee who is creating the contract specifications does so in a way where elements, materials, or relevant requirements for the project are tailored to one specific vendor. When that vendor ultimately wins the contract, the employee gets either a kickback or gift from the vendor.

Both of these situations take advantage of the organization. The first instance creates unnecessary costs for the victim organization – the only reason the contract is being offered is through a false need within the company. The second gives an advantage to a specific vendor and results in the most qualified vendor not being utilized for each contract, which eliminates the benefit received from a true competitive market.

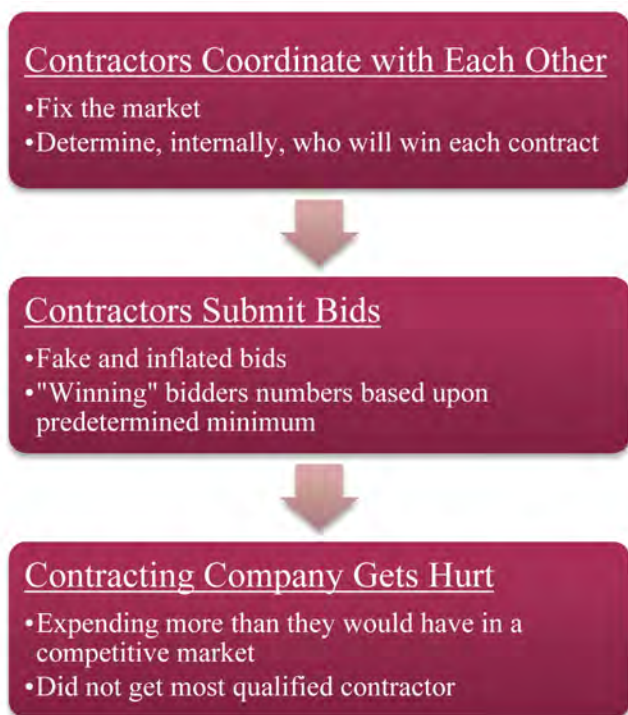
The Solicitation Phase

Bid pooling is the process of bidders working together to split up contracts. This ensures that each one gets a certain amount of work and it sets a low price. Bidders decide amongst themselves who is going to be the lowest bidder for each upcoming contract. In this way, they are all ensured to get work, and they can conspire together to set and raise prices on projects and fix the market by removing the competitive process.

continued on page 4



continued from page 1



The Submission Phase

At this phase of the process the company reviews all of the contracts to find the right bidder for the job. In this phase the collusion is no longer between the contractors fighting for jobs, but instead it is a deal between the employee who is reviewing the bids and another contractor. The employee who has access to the bids allows the vendor to submit their bid last, sometimes after the deadline, so they can adjust their bid accordingly to ensure winning the contract – oftentimes the employee who let this happen receives either a kickback or gifts for their part in the scheme. In similar situations, vendors seek out the employee, in order to bribe them for information on how to prepare their bids, extend of control bid openings, or to pressure for late receipts. These situations hurt the company because they hinder the proper bidding process, which is intended to ensure the most qualified and lowest bidding competitor wins those contracts.

Detecting Collusion

Contractors conspiring together in a bid pooling scheme often tips off the organization that there is collusion taking place among their vendors. If the contractors are not careful with the numbers that they choose to bid with, an unusually large bid – put in with the intent to make sure

another contractor wins – will set off red flags. In addition, an unexplained price difference among all the bidders is another indication of collusion. Companies who frequently bid out jobs should take special care in monitoring price trends so they can determine when there are deviations. Also, monitoring which companies win bids can be indicative of bid rigging when a pattern over time becomes clear. For example, over a series of contracts the winning bidder goes as follows:



- Contract 1 : Company A
- Contract 2 : Company B
- Contract 3 : Company C
- Contract 4 : Company A
- Contract 5 : Company B
- Contract 6 : Company C

This obvious pattern suggests that all three companies are colluding to ensure they all get contracts on an agreed upon, preconceived price.

One after-the-fact way of catching bid rigging is to monitor change amendments. Most contracts cannot be finished to the exact penny originally suspected, but a large number of change orders, which dramatically change the price of the contract from the original bid, can be an indication that the contractor conspired with someone to ensure they were the lowest bid.


continued on page 3

continued from page 2

Monitoring the application process can also bring to light red flags – for example, Company X was the last to submit their bid for the last seven projects and they won six of those last seven by a very small cost margin. Is there a reasonable explanation as to why they are always the last to submit? Or, is the only explanation one that indicates the company is working with someone who is in charge of the bids, giving the company access and information necessary to ensure winning.

What You Can Do

The best way of preventing losses due to bid rigging and collusion among contractors is to know the market you are in and to know the bid prices for comparable projects. If you are a company that participates in the procurement process often, special precautions should be taken to ensure that collusion is not taking place internally or externally. Having set guidelines and best practices in place within an organization can help deter collusion in both the pre-solicitation and submission phases of the process. Training employees on detecting the signs of collusion is also encouraged – if they know the signs of bid rigging, price fixing, and other types of collusion they are less likely to award a contract to a bidder involved in those activities.

There are a few things a company can do to prevent collusion in the salutation phase, one of these is to expand the list of possible bidders. While this will not guarantee the elimination of collusion, it stands to reason the more contractors involved the less likely all of them are colluding together. In addition, when accepting bids, each bidder should be required to sign and submit a non-collusion affidavit – by them submitting this document they are subject to specific penalties for violating that affidavit. Lastly, it is extremely important to ask questions! If something doesn't make sense in the bids submitted, contact your vendors and ask them to justify themselves. They will either be able to explain themselves or give you more reason to suspect that collusion is taking place. 

LAKELET'S QUICK GUIDE FOR TROUBLED COMPANIES





80%

Percentage of business failures traceable to internal or management controlled factors.

Companies Susceptible to Trouble

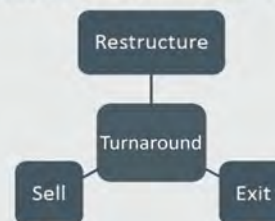


Symptoms

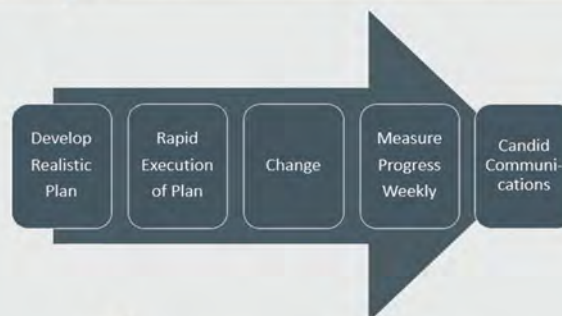
-  Sales decrease is more than a trend or the industry average
-  Loss of focus on core business
-  Debt level and line of credit are a daily concern
-  Accounts payable is reaching accounts receivable

Treatment

Implement the turnaround process in three ways with the assistance of an accredited turnaround firm.



Recovery



Lakelet Advisory Group LLC
Focusing on Business Results

SHARING THE RISKS
AND
Tangible Results



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*The true sign of intelligence is
not knowledge but imagination.
– Albert Einstein*

*The secret of getting ahead
is getting started.
– Mark Twain*

What's Happening With Lakelet This Quarter?

- Lakelet Advisory Group is pleased to announce the addition of Victor Tkachenko to the team. Victor brings extensive, cumulative knowledge — particularly with multimillion to billion dollar corporate restructuring and refinancing projects to Lakelet Advisory Group. His core experience lies in optimizing specialized industries such as oil, gas, mining and chemicals; highly specialized industries that present unique challenges and opportunities. His experience includes both public and private organizations at the international level.
- As of September 1, 2015, Lakelet will offer necessary capital to middle market businesses facing financial challenges (subject to meeting its criteria and diligence processes). Lakelet's target investments are financially distressed entities that have undergone a turnaround, but are still unable to secure traditional financing or entities that have a high promise of success entering the turnaround process. Target revenues are between \$5 and \$35 million USD. For more information please visit lakeletag.com/turnaround-financing.
- To proactively assist interested parties with measuring their risks either as a distressed entity or for potential financial fraud - Lakelet Advisory Group and Lakelet Financial Forensics Group revised their respective website Risks Assessment Barometers.
- On September 8th, Michael Koeppel moderated the NYSSCPA Committee for Bankruptcy and Restructuring panel "The Other Side of Bankruptcy." The panel consisted of three experienced bankruptcy and restructuring individuals who discussed the many non-legal and accounting implications.
- On September 22nd Lakelet will speak at the Claims and Litigation Management Alliance. Tim Crino and Michael Koeppel will speak about Collusion and the Internet as a tool.

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