CORRUPTION RISK ASSESSMENTS:
RED FLAGS FOR EFFECTIVE RISK ANALYSIS

What are companies doing now where risk assessments and due diligence are concerned? What are the areas to look out for and be wary of? In this session, you will learn how the UK Bribery Act and adequate procedures can help companies undertake business in higher risk jurisdictions without tripping up. You will also learn to identify red flags and how to protect your organisation from associate engagement in corrupt practices.

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I have been invited today to discuss corruption risk assessments and what red flags we should consider, and where effective risk analysis is required. Undoubtedly the global economic crisis continues to drive many organisations to take greater risks in response to the drive for growth and demands from shareholders for annual increases in dividends.

In spite of increasing legislation to combat corporate fraud and corruption, allegations continue to rise of companies in both the regulated and non-regulated sectors. There are year-on-year increases in the numbers of organisations under investigation by the Department of Justice in the USA for breaches of the Foreign Corrupt Practices Act (FCPA) and now by the Serious Fraud Office under the UK Bribery Act and this trend is set to continue. Regulatory authorities likewise are tightening their grip in an effort to get on top of an increasing problem.

Despite the best endeavours of the regulators and the legal enforcement agencies its seems almost daily that we hear of another major international company caught up in allegations of bribery, corruption, fraud and other financial crimes. In the last few months names such as Walmart, Rolls-Royce, Finmeccanica, HSBC, and Barclays have all been in the spotlight.

The ubiquitous horse-meat scandal in Europe has also exposed the very real risks to fraudulent practice in our supply chains.

International cooperation is increasing to get on top of the problem with several major countries implementing or considering implementation of new legislation including Russia, China, and India. However, the problems are
CORRUPTION RISK ASSESSMENTS

endemic and driven by global forces that many companies find very difficult to avoid in their businesses.

In addition to these factors, the issue of “how business is done” in many countries continues to trip up many organisations. Increased politicisation of organisations is another factor. The drive to find new business opportunities in emerging and frontier markets also opens up organisations to increased risk. However from an analysis of our own work, exposure to financial corruption risks is by no means limited to these markets. It is just as prevalent in mature and developed countries and market sectors.

As professionals in the area of fraud and corruption investigation, never has it been so incumbent upon us both to root out the problems and expose corrupt practices but equally, to ensure that our organisations stay the right side of the law and keep out of trouble.

Thankfully there is a good deal of help available both from major not-for-profit organisations such as the OECD, Transparency International, The Egmont Group, and others not to mention governmental organisations such as the Department of Justice in the US and the MOJ in the UK.

As part of the increasing range of commercial organisations involved in this work my own organisation Thomson Reuters set up its governance, risk, and compliance division two years ago with a vision to provide a complete solution of information services dynamically connected through software-based delivery solutions to provide a single point of contact to client companies. I came from World-Check and we were acquired by Thomson Reuters in 2011.

Initially, World-Check was established to assist the financial community where the looting of the public purse
by foreign national dictators was concerned, notably, Sani Abacha of Nigeria. We were tasked with the job of assisting the financial community in identifying not only the main individuals, but also family members and facilitators for transferring and lodging funds in foreign based reputable institutions.

Then September 11th happened, and we were asked by the Wolfsberg committee to distribute our best of breed terrorism data to the world’s leading financial institutions. Over the past 12 years, the focus still remains on financial services to improve and maintain higher standards. However, where we have seen our work in greatest demand is from the corporate sector across EMEA and some of the best-known brands in automotive, pharmaceuticals, petrochemicals, construction, aerospace and defence and retail sectors. Our work is seen as best practice by our clients and most of our new work is always referred.

Today, we will take our lessons from our work and impart some of our experience to you.

If there is one point to take away today, it is this: Are you told what you want to hear? Or, are you told what you want to know? And, just because I am told something, does it mean I believe this? Today, I will provide some useful examples on what questions you should ask and why third-party verification is key.

Having a programme in place is fine, but, any programme needs to be perpetual and on-going—again, we will look at the key points.

Foreign Public Officials: World-Check has been at the forefront of FPOs since FATF 40+9, just after September 11th, when Politically Exposed Persons were first talked
about. Prior to September 11th, we presented the idea of PEPs and what care should be taken where know your client and due diligence are concerned. But, please don’t think a PEP is some kind of alien or is a strange disease. PEPs can be excellent for business, if the contract and the relationship is undertaken and maintained in the correct manner.

We will also impart some hopefully useful knowledge for you in respect of due diligence where China is concerned; post the Neil Hayward case and what this means for foreign based businesses doing business in China.

Can we have a show of hands to the following question: Who has heard of the Egmont committee?

Egmont is critical to the success of future and current corruption, fraud and terrorism investigations on a global basis. Using the Egmont committee, investigators can gain a global view on the movement of money in respect of corruption. The U.S. Department of Justice and the UK Ministry of Justice are now undertaking more joint investigations than at any other time. These investigations sometimes span five continents and are highly complex.

Through the cooperation of countries involved in Egmont, the investigators have the information they need in respect of financial transaction records and beneficiary information and who remitted the funds. The intelligence network of understanding not just the target we are looking at, rather, who are the other players and individuals and companies is understood through the network of joining the dots together.

The City of London Overseas anti-corruption unit has a focus on foreign based corruption where the funds are held
in the UK. Again, this body works closely with foreign agencies. What I am saying is the proceeds of large scale corruption are becoming more difficult to conceal, due to the investigative and information sharing powers and the focus of the Egmont committee in dealing with financial transactions.

The powers vested in national financial intelligence units (FIUs) include the use of Suspicious Activity Reports (SARs) and Suspicious Transaction Reports (STRs) provide a powerful mechanism for cooperative investigation. As a result the number of successful repatriations of misappropriated monies through such work is on the increase. Many examples are available to read on the Egmont website and on the websites of the national FIUs.

Related to the specific work of Egmont is the work of the Financial Action Task Force (FATF). FATF is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF is therefore a “policy-making body” which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

So as we can see we work with a backdrop of more and more international cooperation to combat the pervasive and corrosive nature corruption.

Let’s turn our attention to the very specific things that we call red flags. First of all what do we mean by the term red flag? A dictionary definition of the term is “A warning
signal. Something that demands attention or provokes an irritated reaction.” Extending the definition into our world—a red flag is a pattern, practice, or specific activity that indicates the possible existence of corruption, unethical practice or fraud.

So our challenge is to find the red flags, understand them and then to take appropriate action depending on their severity.

There are many examples of red flags and I would like to highlight some of the most common ones:

We started with undertaking checks to analyse the possible involvement of government officials. The sorts of behaviours we look for are of the following type:

- When something of significant personal value is requested in return for say, inclusion on a government tender list or before a contract is awarded
- When a commission payment is requested for carrying out normal work
- When it is requested that invoices are inflated in value after the contract is won
- When intermediaries or consultants are introduced into a contract with payments to be made for ill-defined work
- Requests for foreign travel including family members to tourist locations
- Requests for payments to charities in exchange for business contracts
- Requests for monies to be transferred to a nominated third part account or to a different country

Beyond this area other typical red flags include:
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<td>❑ When an Agent or Intermediary requests a fee that is higher than the market level for comparable work without substantive justification</td>
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<td>❑ When training and travel costs exceed reasonable levels</td>
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<td>❑ When substantial gifts such as luxury items, tickets to sporting events, and so on are asked to be given to indirectly associated persons</td>
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<td>❑ When expense claims and reports or petty cash payments are made and contain insufficient documentation and evidence</td>
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<td>❑ Provides references which, when taken up provide evasive answers or cannot be contacted at all</td>
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<td>❑ Operates within a business that seems inappropriate for the type of work being undertaken or ill-equipped for it</td>
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<tr>
<td>❑ Refuses to provide written assurances about compliance with all anti-corruption policies and legal requirements in the country</td>
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The above red flags are just some of the warning signs that we need to be looking out for in conducting our due diligence checks on all types of intermediaries. Even greater care needs to be taken if the business operates in a high risk market sector such as mining or oil and gas for example.

Most of the above examples mainly occur at the time of the transaction and require vigilance, procedures and accountability with the transacting parties particularly the supplying company.

However, past performance needs also to be checked through the use of enhanced due diligence procedures. However before getting into this area let’s take a closer look at one of the hottest areas commissions paid to agents.
The U.S. DOJ have said: An agent who is paid 20 percent or more in commission is an immediate red flag. So careful monitoring of payments made to agents is an essential process. Have you looked at the agents’ books and records to understand where the 20 percent paid is spent? Will independent inspection stand up to close scrutiny? Have you asked all the relevant questions to be sure you fully understand payments made to agents and intermediaries by your organisation? Do the books balance? Is it possible that part of your 20 percent commission is being paid to other third parties and aiding bribery?

Any commission over 15 percent is viewed with great suspicion by the U.S. DOJ. Can you prove the commission you are paying is in line with the standard practice in the sector and geography you are operating?

The Avon Cosmetics case of alleged bribery of Chinese government officials illustrates what damage can happen when companies get caught in such situations. The FCPA investigation has been going on for a number of years, several key executives have either resigned or left. The firm’s reputation has been dented and the share price can be affected.

The real way to wake up a company, as the DOJ, MOJ, and other agencies have demonstrated, across all sectors is a major fine, restrictive practices on the company and the costs involved with getting their house in order.

For some companies, it can be the difference between the company becoming a takeover target, job losses, loss of shareholder confidence, potential loss of credit facilities and the way the markets view the company in terms of share price and value of the company.
And there are also the future costs. If the initial costs and high profile job losses were not enough. Let us remind ourselves of the loss of future revenue. The key phrase is “Know Before you Go.” Did Avon appreciate the risks and did they mitigate these before entering into the new marketplace of China for them?

The key lessons we can all learn from the Avon case is — who is a foreign government official (FGO) or foreign political official (FPO) and how do we identify them — we will cover this shortly.

For all companies involved in due diligence work, a significant percentage of this will be on Chinese companies and individuals. So what are the nuances of doing business in China and how should we protect ourselves? Do we understand them?

What are the Chinese regulations on gifts and travel and what impact does this have on our business?

Also, what impact does doing business in a totalitarian state have for the business — what are the issues and dangers?

*Guanxi* is the exchange of favours for travel and entertainment. How do we fit into local customs, whilst protecting ourselves from potential bribery and corruption, especially when the company needs to increase revenue in a new market?

The biggest change in China last year was the limitations on corporate data being released by the company registries. China has a decentralized system and each provincial/city Administration of Industry and Commerce (AIC). Last year, many AICs started limiting the amount of information available from filings, especially around directors and
shareholders. The limitation came after a scandal involving D&B, where the Chinese accused D&B of collecting private details from individuals and reselling data to marketing firms. So obtaining information can be challenging to say the least.

The answer: due diligence, procedures, ensuring adherence, tone from the top, on-going monitoring, to name a few points.

When looking for the red flags, you must ask the questions:
- What resources were appropriated for due diligence?
- How do I know that the risk assessment was objective?
- Were risks in the boardroom addressed?
- How was risk examined at vendor/agent level?

Was culture and attitude measured (tone from the top)?

So, how do we learn not only from the Avon case and from our work, which includes many thousands of individual pieces of due diligence globally?

The key risk areas are those involving third parties and having in place the correct levels of due diligence associated with the risk.

Supply chain and the remanufacture of goods is again a higher risk area. As mentioned above as we have seen recently here in Europe, the scandal involving horsemeat in the beef food chain. Should the purchasers take what assurances the abattoirs, buyers, and so on provide at face value or via self-declaration or self-audit? No, it’s the same as a contract in which the agent or third party says they do not pay bribes. Do we accept this without independently checking? So, let’s look at the books and records. Let’s
look at source comments or any litigation searches in multiple jurisdictions.

In relation to UK Bribery Act and the adequate procedures test, of the six principles, 1 and 3 are core to how we assist clients.

Principle 1 deals with risk assessment, and principle 3 deals with due diligence. However, the Act physically specifies the need for a policy and adequate procedures which must be determined by the company in the context of its own business and its assessment of risk exposure.

What is a high risk jurisdiction? What are the political, economic and financial risks in the country you are planning to do business? Do you fully understand them? Do you know how to conduct business ethically in that country? Have you undertaken full due diligence on your counter parties which doesn’t just rely on what they tell you? Does your policy recognise the widely varying nature of risk in different high-risk jurisdictions. Dictatorships and military backed governments, civil unrest such as happened in the MENA region since the “Arab Spring,” financial instability and lack of infrastructure, levels of education, availability of information on companies in the region and city in which you are working. All need to be taken into consideration and researched, understood and a risk evaluation made of the information obtained.

Partnership risk: What are the higher risk areas of the relationship? Fixers and introducers? Commission for doing hardly anything? Is the partner using another partner? What commission do they pay and to whom—who is the end client and who exactly are the directors and senior management and the people the partner is dealing with?
Investigative due diligence is difficult to do especially when languages other than your native language are involved. Without the right resources and an exhaustive check of all open sources of information at best due diligence checks will be incomplete and at worst, they will potentially be very misleading. The reason for doing this in the first place is to protect your business from reputational risk and to know who you doing business with.

According to principle 3 of UK Bribery Act, investigative due diligence “may include”:

- Determining business reputation in the partner’s market
- Determining if partners are sufficiently qualified
- Identifying personal or professional ties to the government
- The right channels
- Using only publicly available information

And the key to all of the above points is: You can only use publicly available information — no rumour or hearsay and demonstrable verifiable information. Determining their reputation by considering:

- Is the partner organisation a state-owned enterprise?
- Identify the individuals involved—shareholders, beneficial owners, other key individuals.
- Identify their track record.
- Are they politically exposed?
- Are there any criminal records or litigation cases?

So far we have largely we have largely talked about the actions of individuals in the context of events that take place surrounding bribery and corruption.

However there are many red flags that we should be potentially concerned about in respect of corporate structures and their behaviour.
The first one relates to companies are state-owned enterprises (SEOs). An SOE can carry more inherent risk because of the propensity for the extraction of state funds via a SOE — i.e., an opportunity for corrupt practices. Companies operating in the Asian region where SEOs are commonplace structures need to be thoroughly checked including politically exposed individuals involved in the business. In a series of recent rulings, the U.S. Department of Justice (DOJ) obtained judicial confirmation of its long-held view that bribes paid to employees of SEOs are bribes paid to a foreign political official. Accordingly, payments to officers and employees of SEOs, like traditional government agency officials, for the purpose of obtaining or retaining business, constitute bribery and are prohibited by the Foreign Corrupt Practices Act (FCPA).

Another part of the due diligence process with regard to companies is to determine who are the ultimate beneficial owners (UBOs). UBOs can be individuals and special purpose companies. Inability to discover who they are thwarts AML due diligence efforts and the most likely route used for covering the movement of illicit money. Of particular interest is the extent to which an ultimate beneficial owner is also a PEP. The saying ‘follow the money’ is widely used by forensic investigators and due diligence professionals. Often the creation of complex UBO structures and using Offshore registered entities where it is almost impossible to obtain information on directors and shareholders.

Such structures represent significant red flags that need checking.

World-Check has been at the forefront of PEP identification and due diligence for 13 years, having worked on cases from Abacha to Fujimori to Montesinos.
and also probably the most famous failure as a result of PEP business, Riggs Bank. In China there has been a big internal crackdown on corruption.

Even if the company being checked is not an SEO, thorough due diligence needs to conducted on the legal status of the entity including verifying its registration and obtaining filings. We want to be sure that the company does exist and has legal standing and proper reporting. How long has it existed? What type of company is it? Who are the significant shareholders and directors and is there a key individual?

We also want to ensure that we know about all subsidiaries, sister companies, and as mentioned, shareholding entities. Risk can often manifest itself in the associated companies rather than the company we are looking at. You will also want to conduct global compliance checks on the related entities to ensure they are not on any sanctions or official lists or other forms of high-level risk including corruption.

Sometimes it will be important to check the physical presence of the company in its jurisdiction. On many occasions we have been asked to verify company’s location only to discover either that it doesn’t exist or is one of many companies operating from the same address. The advice is to never assume.

Red flags to be on the lookout for:
- Does the company exist?
- Do you know who owns it?
- Where is the office and who manages it? Physical office location?
- How long has it been in business?
- Is it owned or managed by entities connected to political figures?
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<td>❑ Is it newly incorporated, i.e. has it been established solely for your deal? Phoenix operation?</td>
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<td>❑ Is it established offshore? Who are the UBOs?</td>
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<td>❑ Are the principals criminals or money launderers?</td>
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<td>❑ Are they a risk to your reputation and your business?</td>
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<td>❑ What is their track record?</td>
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<td>❑ Do they have a history of paying or accepting bribes in the normal course of their business?</td>
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<tr>
<td>❑ Have you checked litigation records, bankruptcy and insolvency records?</td>
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<tr>
<td>❑ Conducted thorough media checks in local language.</td>
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<td>❑ Check for regulatory breaches e.g., major health and safety violations, environmental issues, poor labour practices?</td>
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Media checks are vital and as mentioned above must be conducted in local language and not just English. It should include all forms of media. Media searches need to be much more than a quick check on Google where often it’s the results in the first few pages that are looked at. Risk is often hidden and buried and deep web mining techniques are needed.

Similarly searching methodology recommends using multiple alliterations of the subject names and all conceivable combinations. On a recent occasion of conducting due diligence on a company based in central Europe, it wasn’t until we used the initials of the subject name rather than any fully version that some significant adverse information was uncovered.

You may also wish to conduct a reputational analysis of the company and its key individuals. This can be helpful to obtain comments, feedback and local business intelligence on the subjects being investigated with information that is not available in open sources. This can cover the local
perception, reputation, integrity and ethics of the subjects and their track record in the market. A specialist firm can be engaged for this purpose including our own company. This work needs to be conducted ethically, sensitively and confidentially and in a manner which ensures that results are balanced and obtained from a wide range of reliable sources who actually know about your subjects.

As you can see from the above, to identify the red flags you must ask the right questions, be methodical and thorough. So, the client or partner has provided you with a corporate certificate of incorporation. What do we do? Take the partners document at face value? No. We undertake a search ourselves to validate the certificate is genuine and the company exists. I cannot begin to tell you how many times a client—usually a sales director has described a potential partner and what they do, only for us to find out the company does not exist.

Who owns it? Who is the UBO?

Where is the office—do not accept that the office is located in the BVI, Cayman Islands, or other opaque offshore location. Remember that is where the company is registered and not necessarily where the company physically undertakes its business activities. There is a key difference!

Such work is conducted by ourselves in every country in the world and we know what information is available in public domain and what can be obtained. This is a constantly changing picture and fortunately there is a global trend of placing increasing amounts of records in public domain and in electronic form.

It is a systematic, structured, and thorough search of all public domain sources and media sources in local language
coupled with a reputation analysis as described above if relevant that will ensure you can be confident in picking up the red flags.

Publicly available does not equate to easily accessible in all cases. Obtaining information is often a challenging and costly activity.

In some jurisdictions (e.g., China), there is a large amount of information available but not to everyone. In many cases you will need to have a licence or a local company to be allowed to obtain information from provincial government offices. Understand local informational peculiarities, stay on the public side of the line and aim for the best coverage possible.

And now to turn on its head what we have spoken in relation to red flags, where analysis of higher-risk jurisdictions, overseas partners, PEPs, and all those “nasty people” are concerned. Actually, perception tells us, because we don’t know of a party or territory, to be wary. Whereas if a person or company is from the West, for example, that is okay then? Not so, I am afraid. Stereotypes and preconceived ideas need to be put to one side by the investigator.

The final point is an obvious but often overlooked one. We operate in a rapidly changing business environment and things change quickly. Our due diligence procedures are followed and we find no red flags but will that be the case tomorrow? Consequently on-going checks in the form of a perpetual programme is essential for as long as the business relationship remains intact with your company.

“Perpetual” can range from a continuous screening against a reputable database of sanctions, politically exposed

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persons, high-level organised crime, financial crime, fraud and identity theft and terrorism. This can be designed to alert you to any changes as soon as they happen enabling you to react accordingly.

When you have compiled more in depth enhanced due diligence in report form, it is important to update the report at regular intervals. The frequency will be determined by your own risk assessment process. The important this is that the process is carried out just once and then forgotten.

**Conclusions**

The consequences of getting it wrong are now serious and the penalties on both companies and its key executives are potentially severe. As investigators of risk, we have an onerous responsibility to ensure that the right level of due diligence checking is carried out. That we have made every effort to identify red flags and when found, investigate them as thoroughly as possible and take appropriate action.

Our advice is that the risk based approach works best. This entails your categorisation of third party types, evaluating the risk for each category and having a clear set of guidelines in place to assist with conducting the right level of due diligence.

Prioritise the key risk areas (e.g., HRJs, partners, JVs, strategic suppliers, etc.) Ensure that your risk assessment is fully documented and auditable. There are no shortcuts in the process of carrying out a corruption risk assessment. I have mentioned on several occasions that the process needs to be robust and repeatable. That the methodology needs to systematically consider all the relevant and typical red flags.
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<td>You need a questioning mind, an eye for detail and a dogged determination to persist until you have gone as far as you can.</td>
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<td>The satisfaction that you have either uncovered something that could save your company from severe problems or that you are happy to give the green light to a transaction more than compensate for all the hard work!</td>
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