



Growing Beyond:  
a place for integrity  
12th Global Fraud Survey

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# Foreword

Companies worldwide are battling to survive and grow in what have continued to be highly adverse economic conditions. In this environment, growth and ethical business conduct can sometimes appear to be competing priorities. Many mature economies are struggling, while some growth markets in Asia and South America are decelerating. As a result, management and boards are increasingly focusing their attention on “the next BRICs.” Whether one is speaking of Indonesia, Nigeria, Mexico or Turkey, among others, the opportunities to secure new revenues in rapid-growth markets are significant.

Part of evaluating these opportunities is to understand the associated risks. Many of these markets have historically been perceived as having high incidences of fraud, bribery and corruption. Those responsible for prosecuting corporations and their executives, including the US Department of Justice, have a long history of focusing on conduct in rapid-growth markets.

In this changing regulatory environment, Ernst & Young undertook the 12th Global Fraud Survey. We interviewed chief financial officers and heads of legal, compliance and internal audit, to get their views of fraud, bribery and corruption risk and how their organizations are mitigating them.

Though many companies have intensified their efforts to combat bribery and corruption, especially given the aggressive enforcement environment, our research shows that much remains to be done. Executives, especially those in many mature markets, must overcome a certain degree of institutional fatigue about anti-corruption compliance initiatives. This is especially critical given that this year’s survey shows that tolerance for unethical conduct has increased in the last two years.

This is the largest survey we have produced in this series. More than 1,700 interviews were conducted in 43 countries between November 2011 and February 2012, and the results highlight important issues for boards of directors.

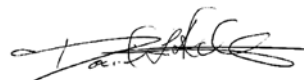
This year we have gone even further to get behind the trends of the global survey and gain insight into how leading executives are managing the risks they face. Our partners held discussions of the survey’s findings with senior executives of blue-chip companies to explore their perspectives on the challenges they face in combating these risks in a number of key markets. These leading practice interviews have added depth to our understanding of the challenges facing businesses when they operate in growing markets and what they are doing about them.

The executives’ comments remind us of the importance of having local knowledge of both the commercial culture and regulatory environment. These interviews highlighted specific risks, many of which could be missed without awareness, careful due diligence and oversight. Rigorous risk assessments must be conducted and revisited regularly. Policies and procedures to mitigate these risks in the field must be tailored to the specific business and geography, and supported with adequate local language training.

Our survey indicates that companies’ awareness of the risks posed by fraud, bribery and corruption is high, and that a substantial majority of these companies are doing many of the right things to mitigate the risks. Despite this, there remain significant weaknesses in many organizations’ responses. The use of forensic data analytics and other technology-related tools occurs too infrequently. Robust compliance audits, including transaction testing, are not common practice. The implications of this should raise serious concerns at the board level.

We hope that this survey contributes to the ongoing conversation on these important topics. This extensive research is part of Growing Beyond, Ernst & Young’s flagship program that explores how companies can grow faster by expanding into new markets, finding new ways to innovate and implementing new approaches to talent management. We would like to acknowledge and thank all of the respondents and business leaders, including those who met with us in person, for their contributions, observations and insights.

Sincerely



**David L. Stulb**

Global Leader  
Fraud Investigation & Dispute Services

# Executive summary



## Risks are rising, standards are not

Bribery and corruption are widespread, with 39% of respondents in our survey reporting that bribery or corrupt practices occur frequently in their countries. The situation is significantly worse in rapid-growth markets.

## Increasing acceptance of unethical behavior

Respondents to our survey were increasingly willing to make cash payments to win or retain business, and a greater proportion – including CFOs – expressed an increased willingness to misstate financial performance.

- ▶ Globally, 15% of respondents are prepared to make cash payments, versus 9% in our last survey
- ▶ 5% of respondents might misstate financial performance, versus 3% in our last survey

## Control environment not strong enough

Despite the risks, companies are failing to take sufficient preventative measures. Mixed messages are being given by management – with the tone at the top diluted by the failure to penalize misconduct.

## An independent view on compliance is demanded

There is growing interest in using external parties to provide assessments on the effectiveness of compliance management systems. Companies listed in Germany are adopting the new assurance standard (AssS 980) and companies outside Germany may find its principles a useful roadmap for maintaining an effective compliance program.

## Preparing for new challenges

Companies pursuing opportunities in rapid-growth markets face a wide range of new risks. Our survey shows that businesses acknowledge these issues – although a significant minority (20%) do not recognize that new markets bring new risks.

## Managing third parties a top priority

Companies are often compelled to use third parties when navigating new markets, and in doing so, are exposed to significant risks. Monitoring anti-corruption controls in third parties, however, is still underdeveloped in many businesses. Due diligence on third parties is expected by regulators, but 44% of respondents report that background checks were not being performed.

## Acquisitions pose similar risks

US companies lead the field in conducting pre-acquisition due diligence (77% always do so) – but businesses in other countries are lagging behind. This exposes them to an area of risk regularly highlighted in bribery and corruption prosecutions. Anti-bribery/anti-corruption (ABAC) due diligence needs to start early, and often it needs to be followed by further, post-acquisition due diligence. Once identified, gaps in controls and compliance programs must be swiftly addressed in a robust manner.

**“The demand from people for the accountable use of power and an end to corruption is indeed one of the key social drivers of our time.”**

Cobus de Swardt  
Managing Director, Transparency International

## CFOs in the spotlight

The CFO role is arguably the most influential one in the organization. CFOs are a crucial link between the business and the board. Stakeholders rely on the CFO as a key interface with the business. However, as has been seen in numerous high profile financial statement frauds, an unethical CFO can override controls.

Given this, the survey responses of a larger than expected minority of CFOs are concerning. The results are not consistent with the CFOs that we have worked with, but responses among the nearly 400 CFOs interviewed should be cause for alarm for stakeholders.

- ▶ 15% of CFO respondents said that they would be willing to make cash payments to win business
- ▶ 4% said that they would be willing to misstate financial performance
- ▶ Only 46% had attended ABAC training

No strong patterns were identified in relation to the jurisdictions, industries or types of companies where these issues were more acute.

For their part, boards and audit committees need to remain appropriately skeptical. Developing channels of communication with contacts across the finance function and other executives within the business will help boards ensure that they have a full and an accurate picture.

## Pressure on the board

Boards are ultimately responsible but, according to our respondents, they are sometimes seen as out of touch with conditions on the ground. As many as 52% of c-suite respondents think that the board needs a more detailed understanding of the business if it is to be an effective safeguard against fraudulent or corrupt practices. This is a concern that was identified in our previous survey and an area where there does not appear to have been much progress. Board understanding is seen as being in particular need of development by respondents in rapid-growth markets.

Given the lack of progress since our last report on this issue, it is clear that boards need better and not just more information. Some feel swamped by voluminous risk management and control information and need more tailored, responsive and focused reporting.

## Dodd-Frank increases the risks associated with whistleblowers

According to prosecutors, the introduction of the Dodd-Frank Act has led to an increase in the quantity and quality of whistleblower claims. Companies need to take a dual approach to the issue: strengthen compliance and ethics programs – provide employees with credible alternatives to external whistleblowing; and be prepared for external whistleblowing complaints – have the right processes in place to investigate and to cooperate with regulators.

# Rising risks and slipping standards



Businesses continue to face a challenging economic environment. Driven by market uncertainties and declining economic growth forecasts, many companies are struggling to maintain margins. With fewer remaining opportunities for cost-cutting, many businesses are now focused on opportunities in rapid-growth markets. Even these markets, however, are feeling the effects of a weakened global economy.

In this environment, our 12th Global Fraud Survey's findings are, unfortunately, a further cause for concern. They suggest that bribery, corruption and fraud remain widespread. At the same time, many countries are strengthening their enforcement regimes, for example the UK, with the introduction of the Bribery Act, and India, with a range of proposed anti-bribery/anti-corruption (ABAC) legislation.

As regulatory activity intensifies, the risk of external scrutiny of corporate activity also increases. Senior management must do more to ensure that they and their companies are not found wanting should their activities come under the spotlight.

## Growing markets, growing risks

Bribery and corruption remain pervasive. On a global basis, 39% of respondents reported that bribery or corrupt practices occur frequently in their countries. The challenge is even greater in rapid-growth markets, where a majority of respondents believe these practices are common. For example in Brazil, 84% responded that corruption was widespread. Multinational businesses inevitably have to confront this challenge.

Regulators have recognized this. In 2011, enforcement actions under the US Foreign Corrupt Practices Act (FCPA) continued to focus on conduct in rapid-growth markets. Thirty-one of the thirty-six reported FCPA cases related to activities in Asia, Eastern Europe and Latin America. Many of these prosecutions related to payments to employees or officials at state-run enterprises.

**Figure 1**  
Bribery and corruption are widespread



	% applies to					
	Brazil	China	Czech Republic	Indonesia	Mexico	Turkey
Bribery/corrupt practices happen widely in business in this country	84	14	80	72	60	52
In our sector, it is common practice to use bribery to win contracts	18	8	12	36	38	6
Bribery/corrupt practices have increased because of the economic downturn	20	26	8	52	44	56

**Q:** For each of the following, can you tell me whether you think it applies, or does not apply, to your country/industry, or whether you don't know?  
 Base: All respondents (1,758)  
 The "Don't know" and "Refused" percentages have been omitted to allow better comparison between the responses given. China results include Hong Kong.

Selected country results are contrasted with global results to the left for illustrative purposes.

**“Strong rules. Zero tolerance.  
You pay a bribe; you’re fired.”**

Chief Financial Officer, US

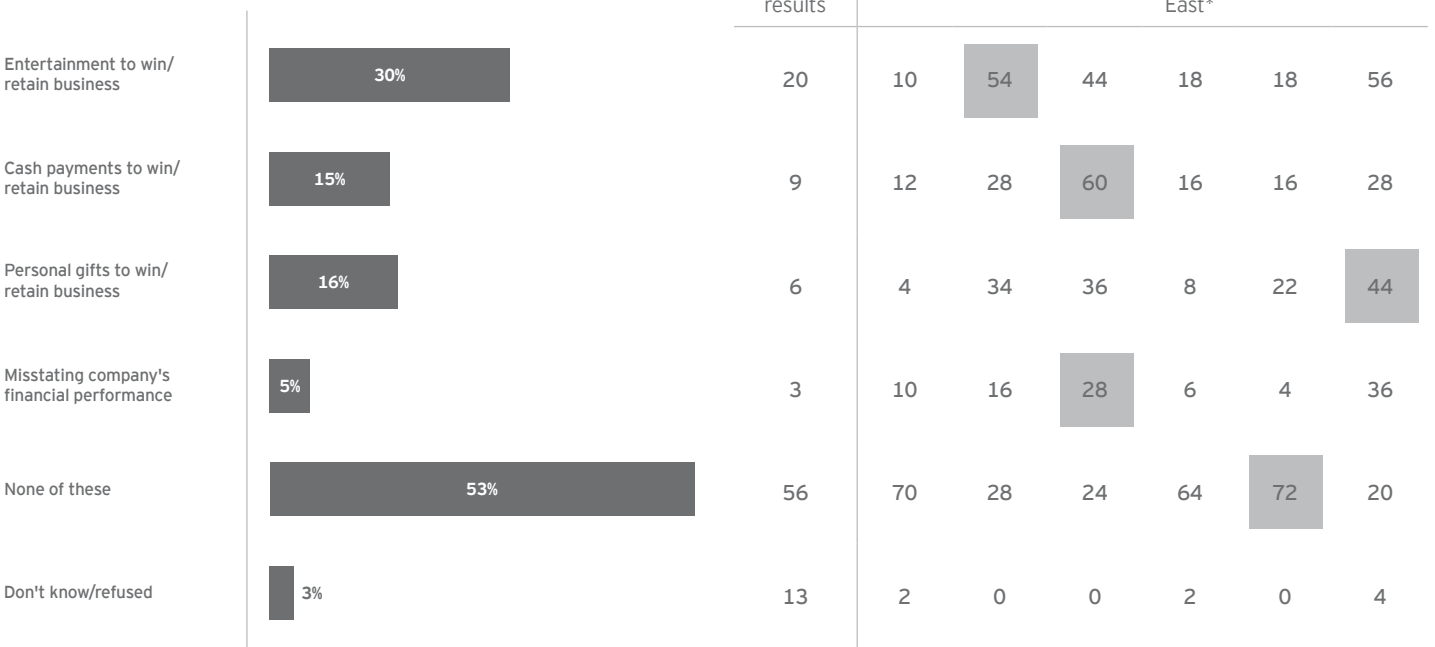
We also note the apparent inconsistency between perceptions of corrupt practices in the respondents’ country and their industry sector. This has been observed in previous surveys and may suggest a corruption perception gap, with individuals too optimistic about their own industry’s risk exposure.

### Hard times strain ethical standards

There is little question that the current economic situation has exerted negative pressure on employees. One of the most troubling findings of the survey is the widespread acceptance of unethical business practices. It is particularly alarming that respondents are increasingly willing to make cash payments (15% versus 9% in our last survey) and misstate financial performance (5% versus 3% in our last survey) in order to survive an economic downturn.

The findings from Far East Asia, where 15% of respondents think that financial performance misstatement can be justified are particularly shocking. In Indonesia, 60% of respondents consider making cash payments to win new business acceptable. In Vietnam, 36% of respondents consider it acceptable to misstate a company’s financial performance. It is no coincidence that this is a region where conduct has been heavily scrutinized by US authorities.

**Figure 2**  
Increased willingness to pay bribes or misstate financial statements



**Q:** Which, if any, of the following do you feel can be justified if they help a business survive an economic downturn?

Base: All respondents (1,758)

\* UAE and Jordan



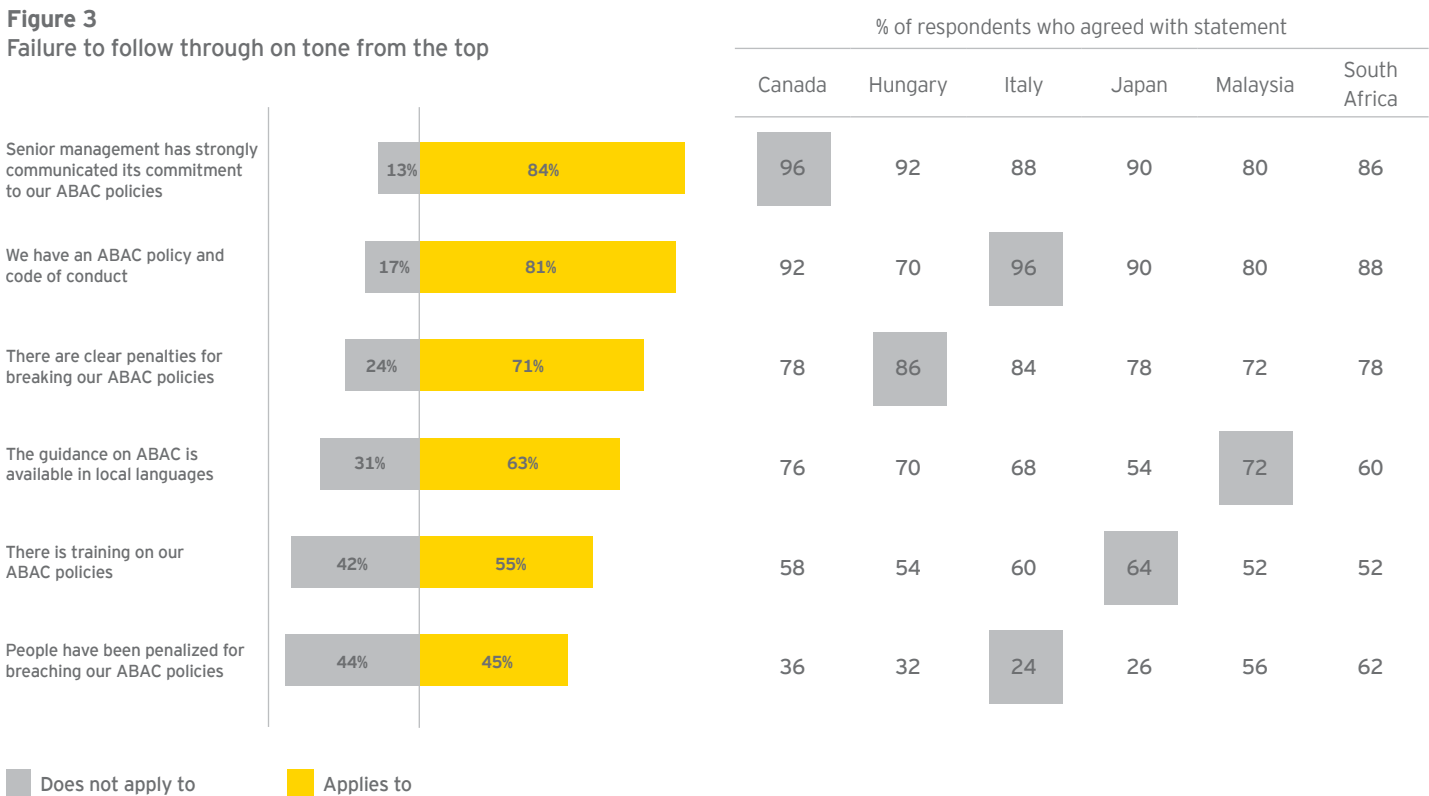
### A weak control environment

Despite the risk, companies are still failing to do enough to prevent bribery and corruption. From the responses of our interviewees, it would appear that mixed messages are being given by management, with the overall tone often diluted by a lack of widespread training and a failure to penalize breaches.

While 81% of respondents say ABAC policies and codes of conduct are in place and a similar proportion agree that senior management strongly communicates its commitment to these, nearly half tell us that they do not believe people have been penalized for breaching ABAC policies.

After years of cost cutting, relatively labor-intensive measures and activities were less frequently cited as examples of ABAC controls in the respondents' businesses. For example, as internal audit and compliance functions are trimmed back, their lower priority areas of responsibility, such as training, also appear to have suffered. As many as 42% of respondents had not received training on ABAC policies. Without adequately trained employees, the ability of companies to identify issues or robustly investigate and act on allegations is also likely to be diminished.

**Figure 3**  
Failure to follow through on tone from the top



**Q:** For each of the following, please tell me whether it applies, or does not apply, to your organization, or whether you don't know?  
 Base: All respondents (1,758)  
 The "Don't know" percentages have been omitted to allow better comparison between the given responses.



**“Employees are the number one defense against fraud and need to be intensively trained.”**

Chief Risk Officer, Germany

## Seeking an independent view on compliance

Perhaps as a result of resource pressures on internal audit and compliance, the role that professional services firms are playing in assisting senior management in this area is expanding. External audits were identified as a tool for monitoring ABAC compliance by 75% of respondents. Furthermore, 33% of respondents use regular reviews by external law firms or specialist consultants.

There is an increasing recognition that external advisors can contribute to the effectiveness of a company’s compliance management system, and the recent issuance of a German assurance standard dedicated to this issue has received much attention. The standard sets out a framework by which an external firm can review and offer an opinion on the effectiveness of such systems.

This standard is being voluntarily adopted by an increasing number of German listed companies. Other companies may find its principles a useful roadmap for maintaining an effective compliance program as they enter new markets.

### CMS assurance principles (IDW AssS 980)

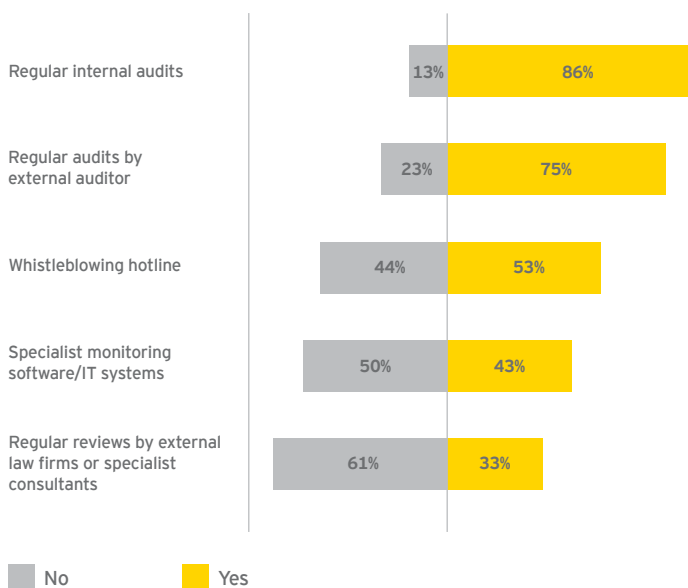
This standard emerged from the demand of German companies for independent practitioners to provide a conclusion on specific aspects of their Compliance Management System (CMS).

The standard describes the basic elements that a CMS could be expected to address. Among these elements are the compliance culture, compliance risks, policies and procedures to respond to these risks and the monitoring and improvement of the CMS.

In brief, the standard measures the extent to which companies have:

- ▶ Designed a compliance management system in response to a risk assessment
- ▶ Implemented the system
- ▶ Ensured the ongoing effectiveness of the system

**Figure 4**  
Types of compliance monitoring processes in use



**Q:** Which of the following systems or processes does your organization have for monitoring compliance with anti-bribery and anti-corruption laws?

Base: All respondents (1,758)

The “Don’t know” and “Refused” percentages have been omitted to allow better comparison between the responses given.

# Preparing to meet new challenges



As companies expand their businesses in rapid-growth markets, they are confronted by a wide range of risks that must be actively managed. A majority of our respondents have taken the important first step by acknowledging the challenges. Nevertheless, a significant global minority of one in five respondents do not recognize that new markets bring new risks.

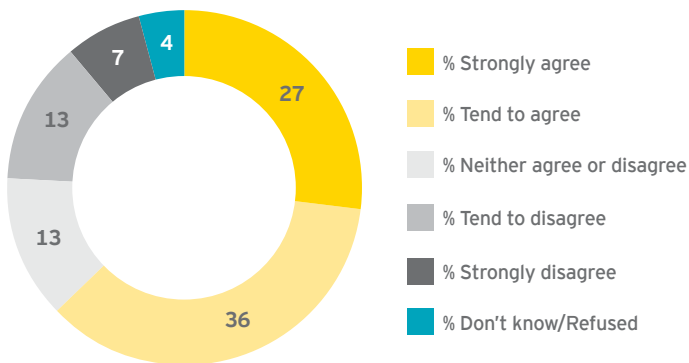
## Managing the risks arising from third parties

When entering new markets, the need for local contacts and procedural knowledge leads many companies to engage the support of third-party agents or business partners. Such relationships can expose companies to significant ABAC compliance risks.

There have been many publicized enforcement actions by regulators which highlight the significant costs to companies of breaches by their third parties. In fact, more than 90% of reported FCPA cases involved third-party intermediaries.

Of these cases, one of the most significant was the Panalpina case of 2010. Among other charges levelled at the company by the US Department of Justice (DoJ) and the US Securities and Exchange Commission (SEC), Panalpina was alleged to have made payments on its customers' behalf to local officials to speed up import procedures across a number of countries. The case served as a wake-up call for many companies, and provided a further example of how the DoJ was willing to consider enforcement against companies whose third parties had paid bribes on their behalf.

**Figure 5**  
Inconsistent level of recognition of the risks of investing in new markets



	% disagree
Australia	14
Brazil	52
Chile	32
China	2
Germany	8
Japan	12
Malaysia	8
Poland	42
Spain	22
US	8

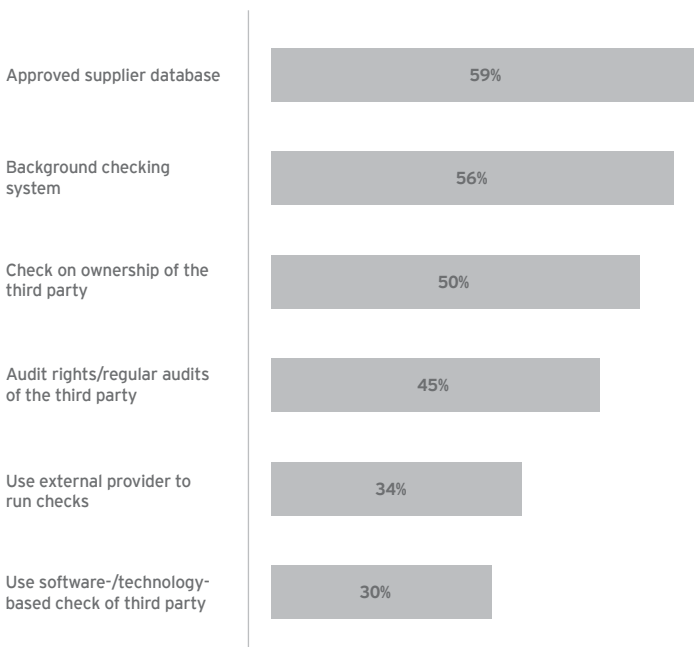
**Q:** To what extent do you agree or disagree with the statement "planned investment by my company in new markets will open us up to new risks"?  
Base: All respondents (1,758)

**“The management of third parties is the biggest blind spot for companies today.”**

Global Head of Internal Audit, US

Yet, despite the significant risks and specified demands of regulators, our survey suggests that the corporate response to mitigating third-party risks is still inadequate. Many companies are failing to adopt even the most basic controls to manage their third-party relationships.

**Figure 6**  
Approaches adopted in managing third-party relationships



**Q:** Thinking about third parties that your organization uses, what systems or processes do you have in place to manage and monitor those relationships?  
Base: All who use a third-party (1,268)

These results are concerning and indicate that many companies are unlikely to know enough about the third parties with whom they do business. By failing to check the ownership or backgrounds of third-party suppliers, almost half of our respondents' companies may be leaving themselves open to the possibility of making payments to politically exposed persons or government officials without realizing it. Only 59% of respondents report using an approved supplier database – a worryingly low uptake for a simple mechanism which helps ensure that only legitimate and bona fide third parties provide the company with services. The apparent lack of knowledge held by companies about the third parties they deal with is a real problem.

### Knowing who you are dealing with – effective third-party due diligence and compliance audits

Third-party due diligence is increasingly expected by multiple regulators. US regulators, through both the US Federal Sentencing Guidelines and FCPA settlement agreements, have made it clear that third-party due diligence and monitoring are important aspects of an FCPA compliance program. Guidance issued by the UK authorities on the UK Bribery Act also specifically addresses the need for an effective third-party due diligence process.

An effective anti-corruption regime requires consistent processes and a risk-based approach. The importance of taking a risk-based approach is highlighted by both the Organisation for Economic Co-operation and Development (OECD) anti bribery guidelines and the UK Bribery Act guidance.



In order to implement a risk-based approach, companies need to consider a number of key questions, including:

- ▶ Have all third parties been identified and are there processes in place to ensure that they continue to be identified on an ongoing basis?
- ▶ What criteria should be used in risk assessment? Consideration should be given to matters including country corruption risk, the nature of the activity performed by the third party, the ownership of the third party, the likelihood of interaction with government officials, the volume of business done with the third party and whether the third party is a regulated entity.
- ▶ How can companies ensure that the process is independent and consistent? Companies should weigh the benefits of checks being performed centrally with more independence and at a lower cost or within the business unit with better on-site local knowledge.
- ▶ Does the company have the resources to implement the process? There may be a large volume of information to be processed. Can the company produce a robust audit trail that is defensible when subjected to regulatory scrutiny?
- ▶ Is the process sustainable once established?

Many companies struggle with the number of third parties they deal with globally, and the volume of information they need to consider in preparing a robust risk assessment. The use of technology to analyze large quantities of data can improve the cost effectiveness of performing third-party due diligence. Not only are costs reduced, but the likelihood of identifying red flags is increased.

Effective third-party management does not end at the performance of due diligence. Third parties also should be monitored on an ongoing basis, including regular compliance assessments and audits.

It is therefore worrying that only 45% of respondents identified audit rights or regular audits of the third party as a process in place to monitor the relationship. As with due diligence, the scope of audits should be determined by the risk profiles of the third parties. It is essential that contractual terms allow for an appropriate scope and level of scrutiny – one which does not simply allow the third party to tick the box on a superficial compliance questionnaire. Audits should generally involve site visits and interviews as well as controls and transaction testing.

### Leveraging technology in third-party due diligence

Implementation of the right technology can be a vital element of an effective program of risk-based due diligence on third parties. It can quickly help to focus on those agents and business partners which pose a threat to the company's integrity. As part of a robust compliance program, the right technology also serves to demonstrate, should any illegal acts subsequently be identified, that a company has sought to put appropriate procedures in place to mitigate the risk. Such technologies can enable a company to:

- ▶ Identify indicators of risk within enormous volumes of third-party information
- ▶ Conduct effective checks against varied sources of data in multiple languages
- ▶ Treat each third party consistently and objectively against established criteria
- ▶ Increase the automation of due diligence processes and the effective reporting of emerging issues
- ▶ Provide a robust and defensible audit trail to demonstrate that appropriate actions have been taken

Forensic data analytics can help to focus the company's limited resources on identifying, and then assessing, those third parties that represent the greatest risk. Through the analysis of transactional data, patterns of behavior can be identified either based upon the identification of known indicators (such as the use of unexpected banking locations) or through the detection of behavior that is simply anomalous when compared to the norm for a class of vendor or location. Such analysis can be achieved using the right combination of text mining, statistical analysis and pattern matching with the results presented using advanced visualization techniques to enable rapid and effective review.

**“Conducting pre-acquisition due diligence, with special focus on the client and business portfolios of the acquisition targets, is key.”**

Chief Compliance Officer, Netherlands

With tuning and tailoring, forensic technology tools can focus effort on the most relevant results, filtering out false-positives.

## Managing acquisitions

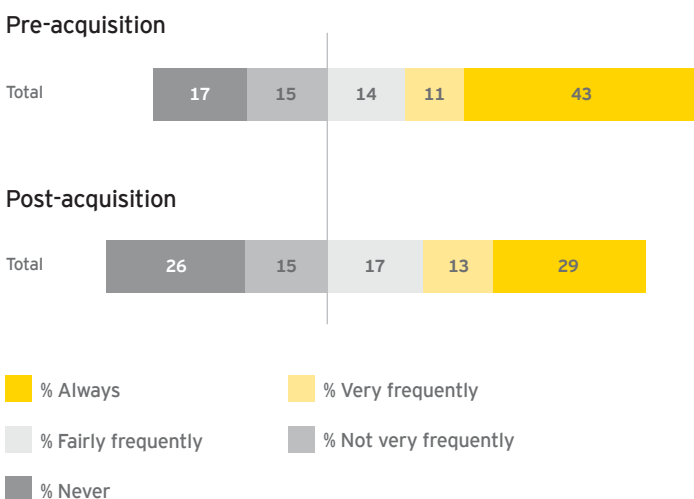
A significant amount of enforcement activity continues to relate to acquired entities. In 2011 alone, there were three FCPA settlements that related to prior violations by recently acquired subsidiaries. Through these and other settlements, the DoJ has reinforced the importance of pre-acquisition and post-acquisition due diligence.

According to our survey research, US companies continue to lead the field in consistently performing pre-acquisition due diligence; 77% of US respondents report that pre-acquisition due diligence is always performed. This compares to a global figure of only 43%.

There is evidence that countries in some regions are cutting back on due diligence. For example, the proportion of China respondents reporting that ABAC pre-acquisition due diligence is rarely or never performed has doubled to 50% since our last survey, while the proportion of India respondents giving the same answer has gone from under 30% to over 50%.

It is not just a matter of whether ABAC due diligence is performed but also when. It is essential that ABAC due diligence starts early. The earlier issues are identified, the sooner an acquirer can understand the corruption risks of a deal, discuss any issues with the relevant regulators or walk away should that prove necessary.

**Figure 7**  
Frequency of conducting due diligence into fraud and corruption risks



This can avoid significant expenditure on a transaction that ultimately falls through because of compliance concerns identified late in the process. It can also prevent an acquirer experiencing reduced profits because certain revenue streams were dependent on corrupt payments or from subsequent regulatory fines.

ABAC due diligence will often, in the earlier stages, involve performing background checks on target companies, key individuals, third parties and agents. It will also involve interviews with key executives, a high-level risk assessment and review of the target’s ABAC policies and procedures. The arduous and time-consuming nature of these activities means many companies seek external assistance. Whichever approach is adopted, it is essential the appropriate local resources and knowledge are brought to bear, or key evidence can be missed.

It is essential that the acquirer moves quickly after the purchase to flush out any historic or ongoing corruption issues or control gaps in the acquired business. It may prove impossible to make all of the changes required at once; therefore, key risk areas should be identified for initial remediation. Acquired companies will often require higher levels of monitoring in the immediate period post acquisition. The roles that the board and senior management play in supporting the acquired organization to make the necessary transitions are significant.

	% very frequently/always	
	Pre-acquisition	Post-acquisition
China	32	29
Czech Republic	9	8
Japan	33	11
Mexico	56	51
Nigeria	9	8
US	84	59

**Q:** How frequently has your company conducted due diligence into fraud and/or corruption-related risks before acquiring a new business in the last two years?  
**Q:** How frequently has your company conducted fraud and/or corruption-related post-acquisition due diligence in the last two years?  
 Base: All respondents indicating a business acquisition (957)

# CFOs in the spotlight



The role of the CFO is broad and complex. The CFO is now arguably the most influential role in the organization, particularly at a time when economic uncertainty continues to cause greater volatility in demand for goods and services, complicating the task of managing the cash flow and the balance sheet. Traditional CFO skills are at their most important.

CFOs are a crucial link between the business and the board. They provide a more detailed understanding of the company for the board's strategic decision-making. Boards rely on the CFO for financial information, but also in many cases for operational and compliance detail. Additionally, regulators and other external stakeholders rely on the CFO as a key interface with the business. Yet it must be recognized that some of the biggest financial statement frauds have been perpetrated by or with the complicity of CFOs. It is the level of responsibility placed on the CFO that makes them almost uniquely positioned to override controls.

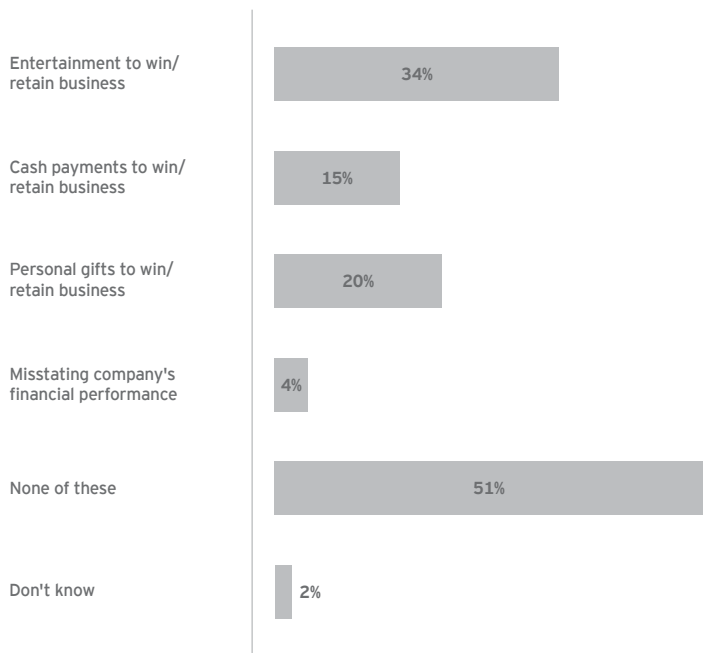
Given this, the survey responses of a larger than expected minority of CFOs are concerning. This group of executives (while not large in absolute number) responded that unethical – potentially criminal – actions in the interests of business survival can be justified. Many appear to be insufficiently aware of significant corruption risks.

While these findings are not consistent with our own experience of CFOs, responses among the nearly 400 CFOs interviewed should be cause for alarm for stakeholders.

Specifically, our survey found that:

- ▶ When presented with a list of possibly questionable actions that may help the business survive, 47% of CFOs felt one or more could be justified in an economic downturn (Figure 8)
- ▶ Worryingly, 15% of CFOs surveyed would be willing to make cash payments to win or retain business and 4% view misstating a company's financial performance as justifiable to help a business survive

**Figure 8**  
CFOs justify actions to help business survive downturn



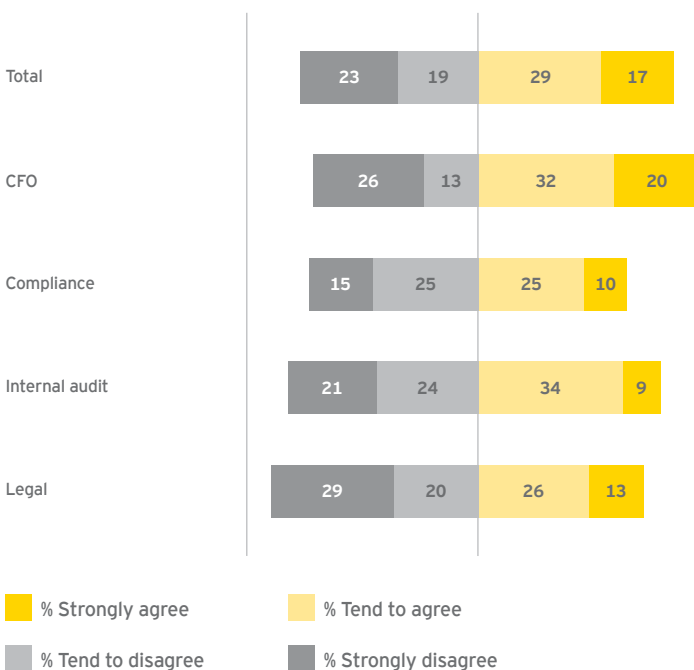
**Q:** Which, if any, of the following do you feel can be justified if they help a business survive an economic downturn?  
Base: All CFOs (372)

- ▶ While 46% of total respondents agree that company management is likely to cut corners to meet targets, CFOs have an even more pessimistic view (52%) (Figure 9)
- ▶ Only 46% of CFO respondents had attended ABAC training
- ▶ 16% of CFO respondents do not know that their company can be held liable for the actions of third-party agents (Figure 10)

**“The Commission’s FCPA enforcement program incentivizes companies to self-assess and update their compliance and internal controls ... .”**

Mary Schapiro  
Chairman, US Securities and Exchange Commission

**Figure 9**  
CFOs believe management is likely to cut corners to meet targets



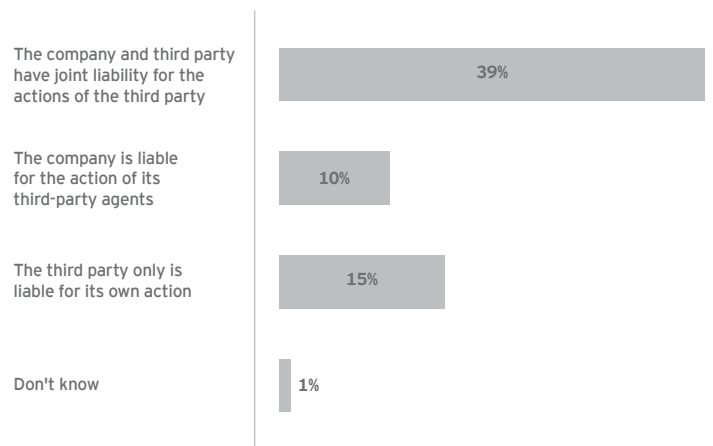
**Q:** To what extent do you agree or disagree that company management is likely to cut corners to meet targets when economic times are tough?  
Base: All respondents (1,403)  
The “Don’t know,” “Neither agree or disagree” and “Refused” percentages have been omitted to allow better comparison between the responses given.

## CFOs to set the tone – boards to challenge

The majority of respondents think that senior management has strongly communicated its commitment to ABAC policies. Yet our survey results also suggest that CFOs need to redouble their own efforts to set the tone: they need to be trained, to increase their awareness and to clearly demonstrate support for initiatives to manage fraud, bribery and corruption risks. This is particularly relevant since, according to those interviewed, the CFO is most likely to have responsibility for ABAC compliance.

For their part, boards and audit committees need to remain appropriately skeptical. Developing channels of communication with contacts across the finance function and other executives within the business will help boards ensure that they have a full and an accurate picture.

**Figure 10**  
Limited awareness of liability for third-party actions



**Q:** Many companies make use of third-party agents as part of their normal commercial activities, particularly around sales and distribution. Which of the following is closest to your understanding of the liability companies have for the actions of third-party agents acting on their behalf?  
Base: All CFOs (372)  
The “Not relevant” and “refused” percentage have been omitted to allow better comparison between the responses given.

# Pressure on the board



The board, and in particular the audit committee, has a key role in assisting the company to mitigate the risk of bribery and corruption. Regulators have made it clear that a top-level commitment to an ABAC culture is required from the board. Key elements of an effective ABAC compliance program require significant board input and sponsorship. The audit committee is, among other things, responsible for overseeing fraud, bribery and corruption risk assessments and the related controls and compliance programs. Against these expectations, how are boards performing?

## Insufficient knowledge of business operations

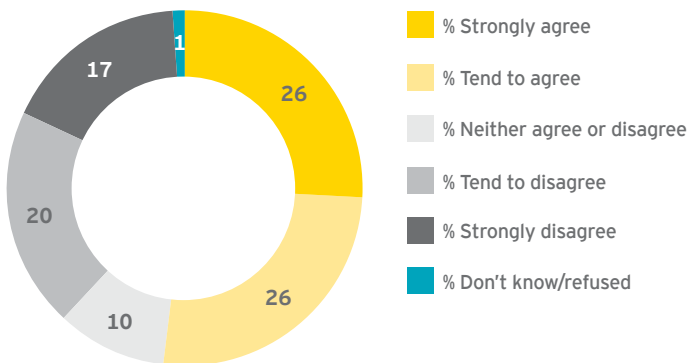
Our survey respondents suggest that not all boards are seen to be doing enough to properly understand the way their company is conducting business. Globally, 52% of c-suite interviewees think that the board needs a more detailed understanding of the business if it is to be an effective safeguard against fraud or corrupt practices. This is a concern that was identified in our previous survey and an

area where there does not appear to have been much progress. In particular, respondents in rapid-growth markets see board understanding as being in need of development. This is a worrying development as many commentators argue that it is precisely these markets that pose the highest fraud, bribery and corruption risks.

## A need for better, not more, information

From our leading practice interviews, we found many boards felt increasingly swamped by risk management and control information. Combined with a growing sense of ABAC compliance fatigue, this contributes towards a 'tick the box' approach to managing risk. While it is inevitable that the board will have a less detailed understanding of the business than senior management, board members need to be deep enough into the detail of the operations to be able to focus on key areas of risk. In our experience, this can best be achieved by demanding more tailored and more focused reporting to the board.

**Figure 11**  
Boards would benefit from a deeper understanding



	% agree
Argentina	78
China	93
Indonesia	100
Mexico	73
Nigeria	83
UK	27

**Q:** To what extent do you agree or disagree that your board needs a more detailed understanding of the business if it is to be an effective safeguard against fraud, bribery and corrupt practices?  
Base: All C-suite directors (736)



**“Boards and senior managers need to lead by example – to demonstrate their commitment to deal with fraud.”**

Board member, Kenya

### Leading practices for compliance reporting to the board

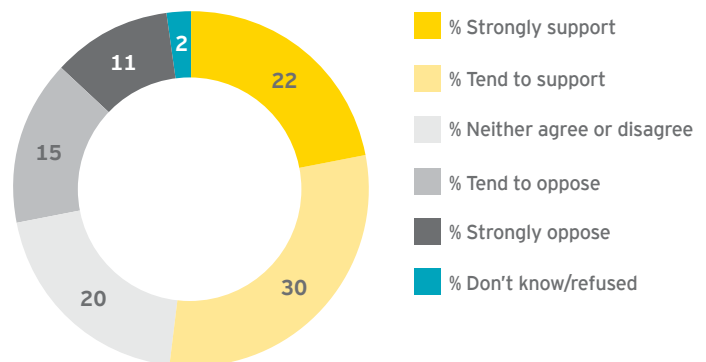
Leading companies frequently:

- ▶ Ensure that operational business units are accountable for the reporting of instances of non compliance
- ▶ Employ globally standardized reporting templates and definitions of what must be reported
- ▶ Have a central hub for consolidation and analysis of reports that provides an opinion to the board on the information presented

Effective compliance reporting to the board:

- ▶ Focuses on the reputational and economic exposures of instances of non-compliance
- ▶ Includes long-term trend analysis by geographies and sectors
- ▶ Identifies emerging risks and trends based upon changing market conditions or business strategy
- ▶ Indicates remedial actions and other improvements to the compliance management system for consideration by the board

**Figure 12**  
Support for whistleblower bounty schemes



	% supporting
Australia	30
Canada	48
France	22
Mexico	74
Namibia	84
Singapore	64

**Q:** To what extent would you support or oppose compensation schemes for whistleblowing being established in your country?

Base: All respondents (1,758)

### New rewards for blowing the whistle

In 2010 the US adopted the Dodd-Frank Act which, among many other regulatory changes, created new financial incentives for whistleblowers. This marked a further evolution in the tools available to US regulators. The Act established a whistleblower bounty program for providing original information of misconduct leading to a successful enforcement action. According to prosecutors, the Act has markedly increased both the quantity and quality of whistleblower claims.

While American companies, perhaps predictably, regard this development equivocally, respondents in rapid-growth markets express strong support for similar schemes. The regions most in favor of such a scheme include Africa, with 79% in favor, and Far East Asia, with 74% in favor. The support among our respondents may reflect a high degree of skepticism about the ability of local regulators to effectively deal with persistently high levels of corruption. It also suggests a failure of some companies operating in these regions to implement effective policies to encourage and follow up on whistleblowing within their organizations.

**How can companies respond to the risks of external whistleblowing? We recommend that companies take a dual approach.**

First, companies must strengthen their compliance and ethics programs. Employees have choices, so the company should provide a credible alternative to external whistleblowing. Companies must not only ensure that the effective mechanisms are in place for internal whistleblowing – for example, 24-hour hotlines in local languages – but also that the corporate culture encourages internal reporting of issues. They also should have robust risk assessment, compliance and monitoring processes to prevent and detect problems.

Second, companies need to be prepared to deal with investigations and enforcement actions resulting from whistleblowing complaints made directly to regulators. Processes need to be in place for prompt investigation and communication with enforcement agencies.



### Courtroom set-backs for regulators

Respondents appear to be looking to regulators to tackle the problem of senior management's perceived inadequate response to the risks of fraud, bribery and corruption. Globally, 69% of respondents would like greater supervision by regulators. North America is the only region where this is a minority sentiment.

The US findings act as an indication of the increasing frustration surrounding the FCPA in US companies. The requirements of the statute itself as well as DoJ/SEC enforcement efforts have come under criticism from some US trade groups and their external lawyers. The DoJ responded to public critiques from the US Chamber of Commerce by calling for dialogue. The DoJ also announced it would prepare additional FCPA guidance to aid companies in their effort to avoid running afoul of the law.

US and UK authorities have also encountered setbacks in court that have drawn significant media attention. US prosecutors failed to win convictions in a number of the high-profile Gun Show cases and asked that previously filed charges against 16 other defendants be dismissed. The UK Serious Fraud Office was heavily criticized by a High Court judge for its conduct relating to search warrants used to support dawn raids and its practices were the subject of an official inquiry.

### A corporate culture of compliance

Among other actions, the Dodd-Frank whistleblower program can be seen as a call to boards to establish a corporate culture of compliance and ethical business conduct. Yet from our leading practice interviews, we have found that boards can sometimes struggle to bring about fundamental cultural changes. This is a particular challenge for companies seeking to establish a corporate ethos when entering new markets. Changes do not happen overnight.

# Regional insights – what leading businesses are experiencing

During March and April 2012, partners in our Fraud Investigation & Dispute Services practice held focused one-to-one discussions with general counsels, chief compliance officers, heads of internal audit and senior finance executives from leading companies about the survey's findings, their own experiences of fraud and corruption across their markets and how they were addressing the risks they faced.

Our leading practice interviews were conducted with executives at the headquarter level. They focused on issues in Africa, Brazil, China, Eastern Europe and India: markets where businesses are looking for growth and that are perceived to present higher fraud, bribery and corruption risks.

Our global survey shows that 39% of respondents perceive that bribery and corrupt business practices are common in their country. Respondents from the markets that we focused on in our leading practice interviews, however, indicated that (in most cases) the prevalence of corruption was perceived to be higher than this global average.

The most significant themes that emerged from our discussions were the need for companies to:

- ▶ Develop strong local knowledge to understand the risks specific to the market
- ▶ Identify whether additional or adapted measures needed to be taken to address these risks
- ▶ Use local knowledge effectively when responding to alleged incidents

In the following sections, we have highlighted a number of key issues for each region that were seen as being particularly challenging or significant.

## We would like to thank the following executives for participating in these frank and illuminating discussions:

ABN AMRO Group N.V. – Adriaan van Dorp

Alstom – Romain Marie

AstraZeneca Plc – Crawford Robinson

Balfour Beatty Plc – Andrew Hayward

Bayer AG – Rainer Meyer

BHP Billiton – Stefano Giorgini

Deutsche Telekom AG – Manuela Mackert / Sebastian Scheidt

E.ON AG – Alexander Miras

ENI S.p.A – Vincenzo Larocca

Ericsson AB – Peter Johrén

GlaxoSmithKline Plc – Simon Bicknell

F. Hoffmann-La Roche Ltd. – Urs Jaisli

Hasbro Inc. – Mark Monday

Henkel AG & Co. KGaA – Dirk-Stephan Koedijk

Ingram Micro Inc. – Jeanette Hughes

Johnson & Johnson – Gary Fair

Koninklijke Philips Electronics N.V. – Caroline Visser

MAN Group – Philip Matthey

Novo Nordisk A/S – Kurt Hungeberg / Jacob Fossar Petersen

Panalpina Welttransport (Holding) AG – Markus Heyer

Procter & Gamble – Ken Schappell

Skanska AB – Michael McNally

Smurfit Kappa Group – Ken Bowles

Suncor Energy Inc. – Gary Wagner

United Parcel Service Inc. – Mark Burns

Vodafone Group Plc – Jacqueline Barrett

Zurich Insurance Group AG – Jason Schupp / Thomas Tidiks

# Africa



Africa has some of the fastest growing economies in the world, in large measure driven by the extractive industries. High commodity prices and demographic trends continue to attract substantial investment. The resulting strong GDP growth, including positive consumer spending trends, creates further investment opportunities. Ernst & Young's Africa Attractiveness Survey 2012 estimated that new foreign direct investment projects will amount to US\$150 billion by 2015.

This growth could be ever stronger if not for constraints arising from high levels of fraud and corruption. Across all the geographies surveyed, Africa respondents are the most likely to have experienced a significant fraud in the last two years. Similarly, corruption is consistently named in our Africa Attractiveness Surveys as one of the main perceptual barriers to investing in Africa. High-profile enforcement actions by Western regulators for corrupt conduct in Africa reinforce this perception.

However, according to data from our respondents, many African companies seem unaware of the risks they take. For example, while 85% of our Africa respondents are confident that their company is effectively managing the risks associated with third parties, only 55% reported that all their third parties are required to comply with their ABAC policy.

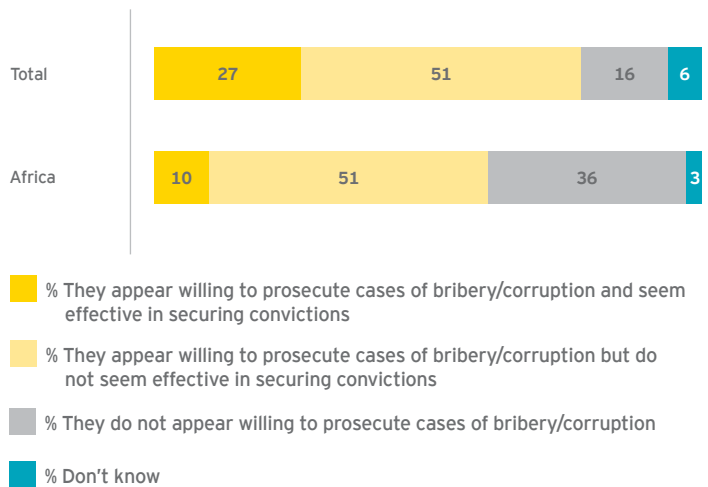
## Towards greater accountability?

Until recently, African regulators launched comparatively few enforcement actions. Our survey shows significant concerns about resource or legal constraints hampering the effectiveness of local regulators with 36% of our respondents in Africa thinking that the authorities are not willing to prosecute. The two main reasons for this are insufficient resources (39%) and inadequate legal powers (35%).

In fact, many African countries already have robust ABAC legislation, a number of which include extra-territorial reach and ban facilitation payments. Additionally, in the last few years we have started to see African regulators commencing derivative actions against companies already under investigation by US prosecutors for alleged FCPA violations. Nigerian authorities, for example, have imposed multi-million dollar fines, comparable in size to US penalties, on companies and senior executives that have also settled cases with the US DoJ.

It remains to be seen whether these prosecutions foreshadow a more robust enforcement environment. In any case, the boards of companies with African operations need to be aware that they risk costly and possibly uncoordinated investigations by multiple enforcement agencies.

**Figure 13**  
Perception of regulators and law enforcement authorities



**Q:** Thinking about regulators and law enforcement authorities in your country, which of the following statements best describes their approach to cases of bribery/corruption?  
Base: All respondents (1,758) / Base: Africa respondents (125) (Africa countries surveyed: Kenya, Namibia, Nigeria and South Africa)

**“If you’re doing business in Nigeria you’ve got to hire people that understand where the boundaries are. It’s easier to say no when you haven’t said yes before.”**

Chief Compliance Officer, Switzerland

## Help law enforcement to help you

In cases where companies wish to bring criminal charges, either to set an example or to support a claim under fidelity insurance, they may find that prosecuting authorities in Africa lack sufficient resources and/or technical expertise to respond appropriately. In some jurisdictions it is common practice for the company to start the investigation then hand the matter over to the relevant enforcement authority and continue to support them as the action progresses. This is often the case when specialist industry knowledge is required, complex accounting or transactional data needs to be analyzed or electronic evidence needs to be secured.

## On guard for offset obligations

Foreign companies are often obliged to make investments in local projects as a condition of being awarded a contract. These offset obligations are particularly common in defense, oil, gas or mining contracts with African states. Offset obligations almost always involve negotiations with government officials and, since the sums involved are often large, they can be used as a covert way of paying bribes.

Regulators are increasingly focusing on these transactions. Additionally, the US Dodd-Frank Act imposed new disclosure requirements on US-listed companies and other jurisdictions, like the EU and UK, are considering similar measures.

Corporate compliance officers at companies involved in an offset agreement should ensure they have detailed ABAC controls in place governing the agreements. It is also advisable for additional steps to be taken such as background checks on offset service providers to establish their independence from the benefactors of the offset. With NGOs playing an important role in delivering on offset agreements in some markets, and understanding that their compliance programs may be relatively less mature, companies need to be particularly diligent.

## Interaction with customs and logistics agents requires constant monitoring

As can be seen from a spate of recent enforcement actions, customs officials’ refusal to provide services without unofficial payments is a regular challenge faced by businesses operating in Africa. The officials attempt to force the company executives into a position where they feel that, in order to continue operating competitively, they need to pay bribes. In Nigeria, for example, freight forwarding companies, often with the consent of their

customers, had been making payments to officials to ensure that these officials do not unnecessarily delay the import and export of customer cargo.

Company executives who authorize third-party payments to officials create significant risks for themselves and the company’s reputation. Under most ABAC legislation they can be held liable for their agents’ actions. There have been several enforcement actions against both logistics companies and their customers for bribing customs officials to prevent paying the appropriate duties, overlook incorrect documentation, circumvent restrictions on importing banned items or to avoid excessively restrictive import quotas.

Compliance officers need to ensure that these third parties comply with the ABAC policies and procedures of the company engaging them and that channels exist to monitor any complaints or allegations made against the logistics companies.

Regular audits of freight forwarders’ compliance training and procedures should be carried out. Other key questions to consider are how frequently their policies and training material are reviewed and updated, whether compliance logs are maintained, what, if any, infringements have been detected and how offenders have been dealt with.

## Aren’t we all in this together?

Businesses with major operations in Africa would likely benefit from participation in collective action initiatives. A number of these initiatives are beginning to show potential for combating fraud, bribery and corruption. For example, the continued efforts of the Extractive Industry Transparency Initiative (EITI) to increase transparency around transactions with governments could reduce the ability of companies and governments to mask improper payments.

Local industry-led initiatives are also beginning to emerge in several African countries. Members are typically drawn from international companies operating in the region, local and international law enforcement and local regulators. These working groups promote open discussion and disseminate information on emerging risks to their members. They also serve as a forum to engage with government and regulatory agencies.

Several of these working groups are creating databases where members will provide details of any companies with which they have experienced fraud, bribery or corruption issues. Once created, these databases will act as reference tools for members considering contracting a new supplier.

# Brazil



Fraud, bribery and corruption are significant issues in Brazil. A recent study by the Federation of Industries of São Paulo found that corruption costs Brazil between 1.4% and 2.3% of its GDP each year, roughly US\$146 billion. In the Transparency International Corruption Perceptions Index 2011, Brazil was ranked 73rd of 182 countries.

Possibly as a result of increased media coverage, the public has demanded that more be done to address corruption in public life. A series of anti-corruption marches took place in 2011.

There is evidence to suggest that the current administration is seeking to address the problem. The recent resignation of several ministers in connection with corruption allegations suggests a tougher approach in government. Furthermore, in 2011, Brazil allowed the OECD to review public sector integrity in the country, the first such report into a G20 country. The report praised Brazil for its progress over the past decade, acknowledging its public sector reforms. The National Congress is also considering a draft bill that would create direct liability for individuals and other entities caught trying to bribe foreign public officials. The corporate penalties could include fines of up to 20% of annual revenues and a ban on participation in bidding for government contracts.

Brazil was also one of eight founding members of the Open Government Partnership. In September 2011, members issued a declaration which made a series of commitments in relation to public integrity including:

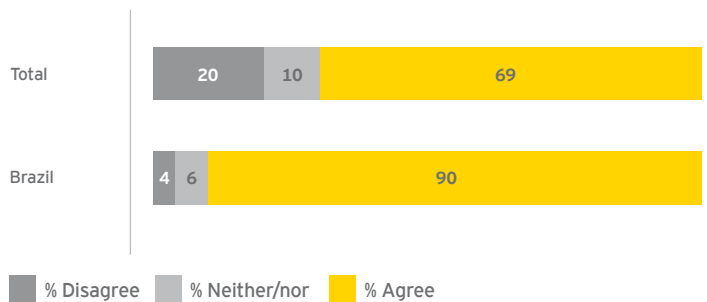
- ▶ Implementing robust anti-corruption policies
- ▶ Releasing information on the income and assets of high-ranking public officials
- ▶ Enacting and implementing rules that protect whistleblowers

## Call for greater action by regulators

The 2011 Transparency International Progress Report into enforcement of the OECD Anti-Bribery Convention found that the country had “little or no” anti-bribery enforcement, with significant inadequacies in the legal framework and the enforcement system.

Respondents to our survey agreed, with 90% saying that there should be more supervision by regulators. A further 96% think that senior management should receive criminal penalties if it is shown that they have not done enough to prevent fraud, bribery or corruption.

**Figure 14**  
Support for more supervision by regulators



**Q:** To what extent do you agree or disagree with the statement, “There should be more supervision by regulators and government in the future, to try and reduce the risk of fraud, bribery and corruption.”

Base: All respondents (1,758) / Base: Brazil respondents (50)

The “Don’t know” and “Refused” percentages have been omitted to allow better comparison between the responses given.

**“It is my duty ... to see an end to the impunity which shelters many of those accused of involvement in corruption ... .”**

President Dilma Rousseff  
Federative Republic of Brazil

## Stick to your standards

- ▶ 84% of Brazil respondents think that bribery and corruption happen widely in the country
- ▶ The percentage of executives that believe misstating a company's financial performance can be justified is 10% – twice the global average
- ▶ The proportion of respondents that believe cash payments to win or retain business is justifiable has doubled since 2010 (to 12%)

With such a challenging market, it is essential that parent companies carefully consider how they will ensure that their local operations actively address fraud, bribery and corruption risks. Training remains a key part of this process.

Our leading practice interviewees emphasized how important it is for management to acknowledge that rejecting bribery demands may result in lost sales and make clear to employees that, even in these situations, the local team should follow policy.

They also told us that, in the past, it has been both time-consuming and risky to take legal action in Brazil against employees for fraud, bribery and corruption breaches. The common corporate perception was that court decisions often favored the employee. Our interviewees added that the perceived challenges of taking legal action have made it harder to demonstrate their top-level commitment to addressing bribery and corruption. However, we have recently observed more companies choosing to take cases to court, with more verdicts in favor of the employer.

## Bribery – a barrier to entry?

With bribery and corruption widespread, refusal to pay bribes can prove a barrier to entry. In one leading practice interview, we were told that incumbent suppliers can try to retain contracts with state agencies by threatening to withhold maintenance and servicing associated with prior agreements. In addition to the challenge of winning new contracts, customer defections can occur following acquisitions if bribe payments are not maintained. This needs to be considered when performing pre-acquisition due diligence. Processes for escalating important local compliance and sales challenges also need to be established.

Joint venture arrangements are also frequently demanded in Brazil on large and complex projects. Such arrangements can expose each joint venture party to fraud, bribery and corruption risks associated with the conduct of the other parties to the joint venture. In such circumstances performing appropriate due diligence is vital.

## Attracting attention

Looking ahead, Brazil is destined to attract worldwide attention with the forthcoming arrival of both the World Cup in 2014 and the Olympics in 2016.

Recent high-profile coverage of fraud allegations against the security director of the 2016 Olympics, along with the resignation of the President of the Brazilian Confederation of Soccer, suggests the possible magnitude of the challenge.

However, the launch by the Ethos Institute and the United Nations Global Compact of a five-year anti-corruption project to monitor public spending and to facilitate reporting of potential irregularities linked to the World Cup and the Olympics is encouraging. The project will establish separate anti-corruption agreements with companies from the construction, energy, transportation and health equipment sectors.

Events such as the World Cup and Olympics also present local businesses with compliance challenges when looking to maintain relationships in a competitive market. Leading practice interviewees told us that they are working to ensure that processes are in place to record all gifts and entertainment in order to demonstrate that conduct is reasonable and proportionate. In order to encourage employees to follow these processes, management must ensure that the compliance and internal audit functions are adequately resourced and respected by the business.

# China



Over the last decade, China has experienced unparalleled economic growth. While growth rates may be slowing in 2012 compared to recent years, increasing incomes and the rising purchasing power of ordinary citizens will continue to prove China attractive to international investors.

However, these investment opportunities are not without risk. China has been featured in the media for a string of high-profile financial frauds involving recently listed Chinese companies on US and other overseas exchanges. The prevalence of state ownership, high levels of bureaucracy, and at times seeming inconsistencies in the application of laws or regulations, also create heightened corruption compliance challenges.

Sustaining rapid growth will mean increasing the focus on these risks since bribery, corruption and fraud create market inefficiencies and hamper the development of broad-based economic development. Even the existence of such concerns make it more difficult for Chinese companies to access leading market practice through tie-ups with Western companies recently sensitized to ABAC risk. They also make it harder for Chinese companies to list abroad or complete foreign acquisitions.

Partly in recognition of the danger this poses to economic growth, the Chinese leadership has continued to make the fight against bribery and corruption a high priority. China's President, Hu Jintao, warned at the CPC Anniversary Gathering last year that the fight against corruption "is crucial in gaining popular support for the Communist Party and ensuring its very survival."

## Be aware of local enforcement trends

Combined with President Hu's statement, Chinese authorities have announced a further crackdown on domestic bribery and corruption and have reinforced this message with a number of high-profile prosecutions and legislative changes.

In 2011, China passed the Eighth Amendment to the Criminal Law of the People's Republic of China, which criminalizes for the first time under Chinese law, the payments of bribes to foreign government officials. Like the FCPA, this applies to all Chinese citizens, all persons located in the China and all companies organized under Chinese law.

In 2012, China's Supreme People's Procuratorate announced that provincial-level databases listing individuals and companies found guilty of bribery offenses would be integrated into a nationwide record. If implemented effectively, this could prove to be a powerful tool in assessing in-country third-party risks.

Chinese authorities are taking local enforcement seriously and this view is reflected in the results from our respondents. Those interviewed in China are almost twice as likely to think that local regulators are willing and effective at prosecuting corruption as the global average. President Hu's statement and local enforcement actions further reflect this. The Administration of Industry and Commerce has investigated more than 30,000 business-to-business corruption cases in the last five years, according to a report released during a 2011 Financial Procuratorial Forum. The Chinese Police have investigated a further 6,500 national corruption cases over the same period, according to the Ministry of Public Security.



**“The Party is soberly aware of the gravity and danger of corruption ... .”**

President Hu Jintao  
The People's Republic of China

## Certain confirmation or clever counterfeit?

Numerous recent fraud allegations have hinged on the legitimacy of supposedly official documentation, for example, regarding property ownership or the use of natural resources. Such documents vary widely across the country and range from deeds that are centrally catalogued and hard to forge to pro-forma templates that can be easily reproduced. This creates significant difficulties for due diligence teams when trying to authenticate documentation.

Risks to be aware of include:

- ▶ Imaging software being used to copy the official company chop for reuse in false documentation
- ▶ Spreadsheets preloaded with official bank logos and letterhead where users simply enter the transactions and balances they want
- ▶ Large quantities of “refurbished” official tax invoices available online, where the amounts and vendor details have been erased
- ▶ Internet sites offering point-of-sale credit card machines that can be used to produce card slips as proof of transactions without transmitting the transaction details to the bank

Companies considering expanding into China are therefore encouraged to scrutinize all supporting documentation closely to verify its adequacy and consistency, including identity of counterparties and other essential information. Companies should look for manual and electronic signs of tampering and trace the information to independent sources, for example, agreeing the tax invoice number to the database maintained by the tax office.

Where appropriate, organizations should also consider:

- ▶ Benchmarking acquisition costs or disposal amounts against similar deals
- ▶ Independently assessing the business rationale for a sample of high-value or high-volume transactions, such as consulting fees or subsistence expenses
- ▶ Conducting follow-up inquiries and/or site visits to major customers and suppliers to verify the amounts, signatories and authorizations on the relevant documentation

## Use audit clauses to gain visibility over undisclosed banking activities

Examples have been encountered where companies in China have funded their activities through undisclosed bank accounts. These include using the bank accounts of key employees, undisclosed related companies or even fictitious companies as a method of moving questionable transactions, such as bribes or “round-trip” transactions to inflate revenue, off the company’s books.

It is very difficult to detect these transactions without access to the underlying documentation, which, due to bank privacy restrictions, is frequently unavailable without the explicit consent of the individual or related company account holder. However, failing to do this means that organizations run the risk of investing in, or contracting with, a company that is financially weaker than represented or which is engaged in unethical business practices.

## A brighter future?

Given that business conduct in China has featured in approximately 20% of the US DoJ FCPA enforcement actions over the past five years, the market presents considerable challenges for international investors. However, as the domestic enforcement statistics attest, significant progress has already been made and the ongoing commitment of the Chinese political leadership to address these issues is likely to intensify the regulators’ efforts further.

# Eastern Europe



Exports to the Eurozone and easier access to foreign currency loans played a major role in the economic growth of Eastern Europe prior to the 2008 financial slowdown. More recently, the Eurozone crisis has made access to credit difficult, made it harder to reduce existing debts and weakened local currencies. The result is that many East European economies now face significant challenges.

The last few years have also seen a substantial increase in Western (particularly US) regulatory enforcement relating to business conduct in the region. In some cases local regulators have provided cooperation, while in others they have brought their own actions. The Polish enforcement agencies in particular have started to take more robust steps in tackling bribery and corruption. The Central Anti-Corruption Bureau (CBA) has been leading this effort, including a systematic enforcement approach focusing on high-risk industries such as life sciences, defense and technology.

## Better guidance, better governance

The increase in enforcement activity, however, has not convinced our East European survey respondents that fraud, bribery and corruption will be prosecuted. Only 14% of respondents think that national regulators were willing and effective in securing convictions. Of those who think the authorities were not willing to prosecute, 48% feel that this is due to bribery and corruption being too widespread.

ABAC legislation across the region varies by country. In several jurisdictions, local statutes and enforcement agencies do not provide strong frameworks for businesses to measure their compliance functions against.

A noticeable omission in some jurisdictions is the lack of special legal protection for whistleblowers. This may be one of the drivers for our East European respondents viewing whistleblowing hotlines as less effective in combating fraud when compared to other regions.

In addition, few East European regulators incentivize companies to self-report and cooperate with investigations. Furthermore, prosecutors do not appear to take the effectiveness of a company's compliance program into account when calculating penalties. But leading organizations operating in the region recognize that ethical business is good business. Effective compliance programs can protect them against reputational harm that reduces shareholder value.

## Are you allowed to look at that email?

Through our leading practice interviews with companies operating in the region and our own experiences, we have noted data privacy legislation as being a challenging issue when conducting investigations.

Data privacy laws vary widely by jurisdiction, but noteworthy points emerging during our interviews include the following:

- ▶ In some jurisdictions, there are laws preventing employees' email correspondence being reviewed without their prior consent, while others prevent data being transferred outside the jurisdiction. This can significantly limit how an internal investigation is conducted.
- ▶ In some instances, key witnesses have given consent for investigators to use email or interview evidence only to withdraw consent just before the investigation is completed. Any reference to that witness and the evidence that they provided then had to be removed and alternative evidence sought. Corporate investigators should therefore gather as much corroborative material as possible and not rely exclusively on evidence that could be subsequently deemed inadmissible.
- ▶ Further data protection requirements may restrict investigators' ability to establish an individual's personal details or assets, both of which are important when assessing possible collusion between employees and third parties attempting to defraud the company.

**“The fight against corruption needs priority attention ... we have seen that implementation among EU member states is very uneven.”**

Cecilia Malmström  
Commissioner for Home Affairs, European Commission

Investigators always need to work closely with in-house and external counsel to understand where the relevant data is held, what rules apply and adjust their investigation strategy accordingly. Failing to do so risks invalidating the results or, in a worst-case scenario, leaving the organization facing penalties for breaching local data privacy and protection laws.

### Recognize the local attitudes towards compliance and internal audit

According to those interviewed, Eastern Europe trails behind other regions in the use of anti-fraud and ABAC measures. For example, the East European organizations sampled in our survey are less likely to have ABAC policies, clear penalties for policy breaches or to hold training when compared to the global average.

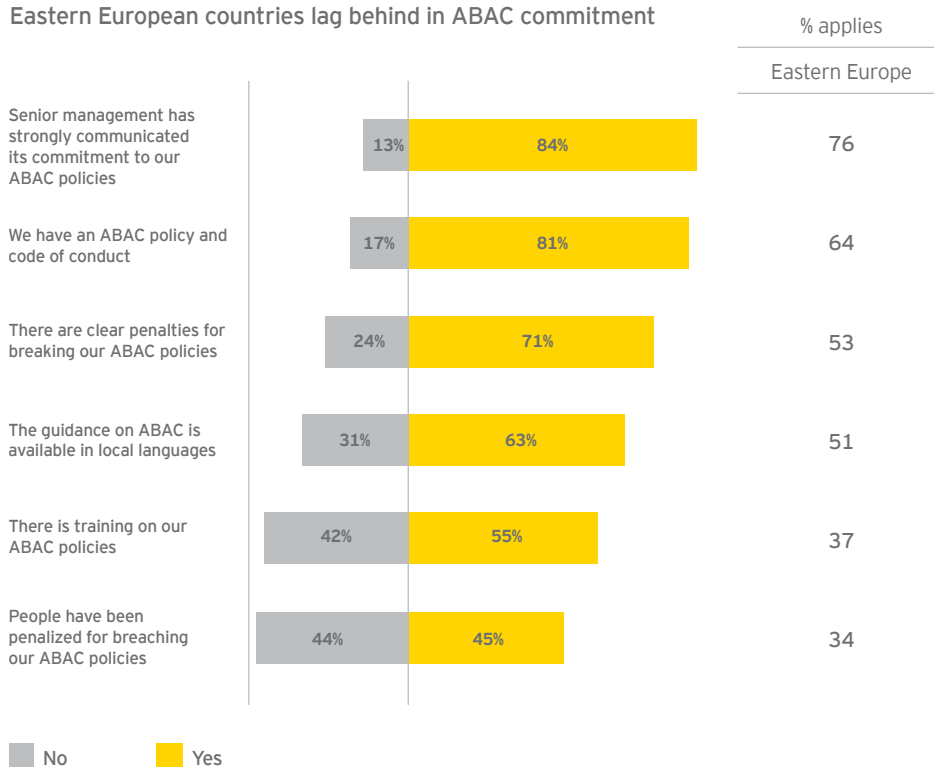
This is also reflected in organizational challenges. Our respondents indicated that businesses in Eastern Europe are the least likely to have a compliance or internal audit function. The data also showed

that East European respondents were the most likely to lack confidence that these functions can effectively protect the business from fraud, bribery and corruption risks.

Our experience supports this. Compliance is changing from being an aspect of corporate jargon to an integral component of corporate culture – but only slowly. Where compliance functions exist, they tend to be secondary roles assigned to in-house finance or legal professionals. Perhaps as a result, these individuals tend to focus on reacting to events rather than implementing proactive measures.

Indeed, respondents in the region tend to be skeptical about whether self-policing actually works, and most would like to see more external oversight. Three-quarters would specifically like to see more regulatory supervision. This is a significant consideration for international investors, who will need to gauge how much reliance to place on internal audit or compliance reports they receive from East European third parties.

**Figure 15**  
Eastern European countries lag behind in ABAC commitment



**Q:** For each of the following, please tell me whether it applies or does not apply to your organization, or whether you don't know?

Base: All respondents (1,758) / Base: Eastern Europe respondents (405)  
(Eastern Europe countries surveyed: Latvia, Lithuania, Estonia, Czech Republic, Hungary, Poland, Romania, Russia, Turkey and Ukraine)  
The "Don't know" and "Refused" percentages have been omitted to allow better comparison between the responses given.

# India



Even allowing for a recent slowdown, the Indian economy continues to grow faster than many other G20 countries. However, with Indian GDP growth rates below the trend of the last decade, pressure on companies to meet expectations is rising, increasing in turn, the risk of fraud, bribery and corruption.

Although India continues to be a favored destination for foreign investment, with 71% of respondents to the 2012 Ernst & Young India Attractiveness Survey keen to invest in the country, growth opportunities are constrained by regulation and bureaucracy. A recent report from the World Bank ranked India 132nd out of 183 economies for ease of doing business, and as low as 181st for dealing with construction permits and 182nd for enforcing contracts. Similarly, the World Economic Forum Global Competitiveness Report for 2011-2012 ranked India 96th of 142 economies for burden of government regulation.

The combination of a market with significant investment potential and a high level of bureaucracy has resulted in many seeking to bypass, accelerate or influence decisions. Media coverage from India has featured a series of corruption scandals over recent years, including a number involving national and state government representatives. Coverage intensified in 2011 following high-profile protests over the pervasiveness of corruption in the country.

Given the extensive media coverage, it is not surprising that fraud, bribery and corruption are seen as significant risks in India. This is shown by the fact that 70% of India respondents to our survey think that bribery and corruption are widespread in the country and 72% believe that management is likely to cut corners to meet targets. These findings are consistent with the decline in the ranking of India on the Transparency International Corruption Perceptions Index (down from 3.5 to 3.1 and from 72nd to 95th place in the rankings between 2007 and 2011).

With fraud, bribery and corruption risk so high on the domestic and international agenda, it is essential that companies with a presence in India actively address these risks.

## Understand local legislation

Indian ABAC legislation is rapidly evolving, partly as a consequence of concerted public pressure. Enforcement actions are also increasing.

Proposed Indian legislation includes the Prevention of Bribery of Foreign Public Officials and Officials of Public International Organizations Bill 2011, The Prevention of Corruption Amendment Act 2011, The Companies Bill 2011, The Anti-Corruption, Grievance Redressal and Whistleblower Protection Bill and The Public Interest Disclosure (Protection of Informers) Bill 2010. India also ratified the UN Convention against Corruption in 2012 and another bill currently under consideration, the Lokpal Bill, envisages the creation of an independent agency to investigate corruption.

Although domestic enforcement activity remains inconsistent, the increased focus on fraud, bribery and corruption risk has been matched by growing regulatory activity and more severe penalties in India. However, far from being a purely domestic affair, the implications for international investors can be considerable.

It is noteworthy that domestic regulators appear to be focusing their attention on sectors such as telecommunications, mining, oil and gas that rely on the award of operating licenses from government.

## Look around, risks are rising

With a recent Ernst & Young study finding that 52% of foreign direct investment projects in India come from the US, Germany, UK and France, the exposure of foreign investors to ABAC laws is significant. In recent years, international businesses in sectors such as mining, construction, food and manufacturing have been sanctioned for breaches of the FCPA in India, often relating to the award of licenses or payments in relation to sales contracts.

It is important for businesses with government contacts, whether as customers or suppliers, to pay particular attention to conduct in India. In a country that continues to make extensive use of cash to make payments, organizations must ensure that governance processes are embedded at the local level.

**“If we lose a contract because a bribe wasn’t paid, there’s a risk the focus will be on the lost sale; but we should be strongly rewarding this behavior.”**

Chief Risk Officer, India

Construction, one of the sectors that has been the subject of past FCPA enforcement actions, is likely to remain a high-risk sector given that the Government of India plans to double its infrastructure spending from US\$500b to US\$1 trillion in the next five years.

### Are business partners really as good as they seem?

Given the scale and unique nature of the Indian market, investors often work with local partners to access their knowledge and contacts. Dependent on these local contacts, investors may feel that they have given up some control of their business in order to access the market.

Responses to our survey suggest that investors are right to be concerned. Worryingly, 28% of India respondents are willing to make cash payments to win or retain business and 16% are prepared to misstate financial performance in order to help their business survive (Figure 16).

It is therefore critical to select a partner that not only offers local knowledge and contacts but is also prepared to work in accordance with the values of the parent company. A key part of this process is performing due diligence on business partners, including a pre- and post-acquisition review of practices.

The lack of a unique identification number and reliable rating data for entities and individuals, along with limited public information sources in India, has created an environment where it is difficult for companies to acquire knowledge about potential partners. However, there are signs that the government is seeking to address this lack of public information with a unique identification project underway across the country as well as the introduction of a Right to Information Act in relation to the release of information from government agencies.

With bribery and corruption seen as widespread, it is critical that the right partner is chosen and that appropriate behavior is encouraged.

### Mind – and monitor – the company you keep

Over 70% of India respondents to our survey think that the board needs a more detailed understanding of the business to be an effective safeguard against fraud, bribery and corruption, compared to 51% of all respondents globally. One area where management often lack visibility is the conduct of third parties.

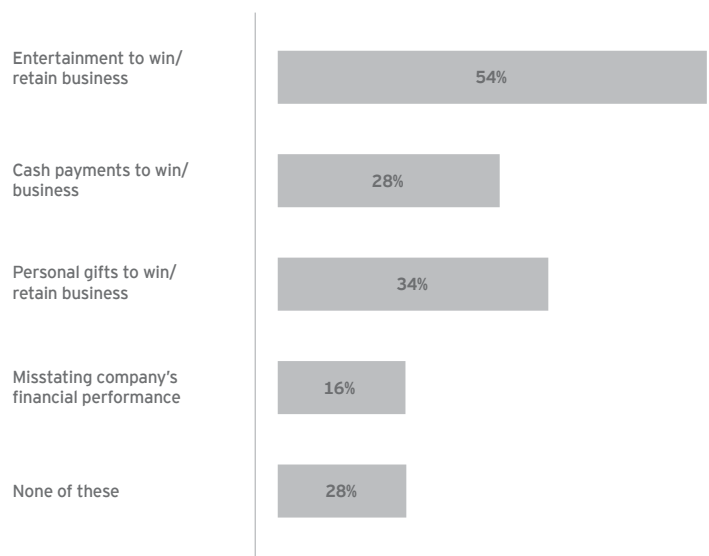
For example, one leading practice interviewee reported that they found their local third-party vendors making “octroi” (or consumption tax) payments to government officials.

Although these taxes were previously common in parts of India, they have now been largely abolished. However, officials continue to collect these payments. Many businesses fail to understand the conduct of third parties in sufficient detail to determine whether such payments are being made.

In order to monitor relationships with agents and intermediaries in an effective and timely manner, it is important to obtain and exercise a right to audit in such contracts. This is particularly true in India, where government organizations like the Canteen Stores Department adopt a decentralized operational structure. One area to consider is the way payments to intermediaries operating in such roles are structured and calculated. Payment using commission, rather than cost plus margin, can limit transparency, particularly if the business lacks visibility over secondary sales data. In addition to using audit rights, businesses should therefore perform analysis of payments to agents, for example, by comparison to other distributors in order to monitor conduct.

With slowing growth and increasingly active local enforcement, businesses in India must take action to address bribery and corruption risks. It is important that the conduct of intermediaries and joint venture partners is considered as part of this process.

**Figure 16**  
Actions that are justified to help a business survive



**Q:** Which, if any, of the following do you feel can be justified if they help a business survive an economic downturn?  
Base: India respondents (50)

# Conclusion



Record levels of fines, penalties and profit disgorgements secured by the US DoJ and SEC in the past year certainly raise the perceived and actual cost of non-compliance. Companies and their boards must weigh the upside and downside risks associated with varying degrees of compliance enforcement within their organizations. Moving into new markets, *into rapid-growth markets*, brings additional risk.

Our survey findings show that boards and audit committees continue to face significant challenges in tackling the risks of fraud, bribery and corruption in their businesses. Many companies are failing to do enough. Meanwhile, boards struggle to effectively absorb the large volume of compliance information they are presented with.

How can boards and those tasked with compliance respond to these challenges?

First, they must ensure effective lines of communication with a broad range of roles within the business. This will enable the board to question the information that they are given.

Second, improvements can be made to focus compliance reporting to the board.

Third, boards must make sure that they are asking the right questions. These could include:

- ▶ Does management at headquarter level understand local risks and have strategies been developed to deal with these specific risks?
- ▶ Can management demonstrate the contemporaneous effectiveness of its anti-corruption compliance efforts to its stakeholders?

- ▶ Does the company know how many third parties and agents represent it, particularly in dealing with those that could be considered “government officials”?
- ▶ Is management making the best use of the latest forensic data analytics techniques to monitor compliance in real time?
- ▶ Assuming that contracts with third parties normally contain audit rights, how many times has the company conducted an audit principally to gain comfort around bribery and corruption risk?
- ▶ Does the company have clear criteria to guide it with respect to how extensive pre- or post-acquisition anti-corruption due diligence should be, or whether to conduct it at all?

Growing beyond, therefore, requires a nuanced view of individual markets and cultural norms balanced against the statutory language of a proliferating number of ABAC laws.

Indeed, changes to a company’s culture to mitigate the risks of fraud, bribery and corruption cannot be made overnight. Organizations need to make concerted, risk-focused efforts that target areas of potential exposure, and management needs to lead by example.

Only then will companies be able to properly balance the priorities of growth and ethical business conduct while seizing opportunities in these highly adverse economic conditions.

# Survey approach

Between November 2011 and February 2012, our researchers, the global market research agency Ipsos Mori, conducted 1,758 interviews in the local language with senior decision-makers in a sample of the largest companies in 43 countries. The polling sample was designed to elicit the views of executives with responsibility for tackling fraud, mainly CFOs, chief compliance officers and heads of internal audit and legal departments.

## Participant profile – region and country

Number of interviews			
<b>Eastern Europe</b>		<b>Japan</b>	<b>Western Europe</b>
Baltic States†	405	50	602
Czech Republic	50		Austria
Hungary	50	<b>Latin America</b>	
Poland	55	Argentina	176
Romania	50	Brazil	25
Russia	50	Chile	50
Turkey	50	Colombia	25
Ukraine	50	Mexico	26
			50
<b>Far East Asia</b>		<b>Middle East, India and Africa</b>	
China (including Hong Kong)	150	India	225
Indonesia	25	Kenya	50
Malaysia	25	Middle East*	25
Singapore	25	Namibia	50
Vietnam	25	Nigeria	25
		South Africa	25
			50
		<b>Australia</b>	
		Australia	50
		<b>North America</b>	
		Canada	100
		US	50
			50

† Latvia, Lithuania, Estonia

\* UAE, Jordan



### Participant profile – job title, sector and revenue

Number of interviews		
Job title		
CFO/FD	372	21%
Other finance	372	21%
Head of internal audit/CRO	271	15%
Other audit/risk	111	6%
Head of legal	156	9%
CEO/MD/COO	110	6%
Head of compliance	61	3%
Business director/senior manager	57	3%
Company secretary	49	3%
Head of business unit/division	36	2%
Head of security	28	2%
Director/VP	25	2%
Corporate development officer	13	1%
Head of strategy	10	1%
Other management staff	87	5%

Coverage		
HQ	1436	82%
Subsidiary	322	18%

Sector		
Automotive	80	5%
Consumer products/retail/wholesale	421	24%
Financial services	185	11%
Life sciences	74	4%
Manufacturing/chemicals	289	16%
Oil, gas and mining	103	6%
Power and utilities	108	6%
Professional firms and services	98	5%
Real estate	127	7%
Technology, communications and entertainment	134	8%
Other transportation	84	5%
Other sectors	55	3%

Revenue*		
More than US\$5b	129	7%
US\$1b-US\$5b	437	25%
US\$500m-US\$1b	379	22%
US\$100m-US\$500m	493	28%
Less than US\$1m	317	18%
Above \$1b	566	32%
Below \$1b	1,189	68%

\* Respondents that did not provide a response to this question have been omitted.  
Base: All respondents (1,758)



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The Ernst & Young Fraud Investigation & Dispute Services practice has global reach. See below for a list of our country/territory leaders. For more information see [www.ey.com/fids](http://www.ey.com/fids)

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