

Control Risks



RISK ASSESSMENT



ASSESSING
CORRUPTION
RISKS



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ASSESSING CORRUPTION RISKS

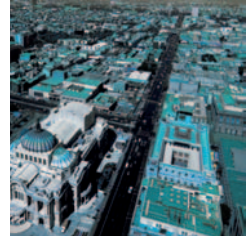
Wherever multinational companies are active, they are subject to more anti-corruption legislation than ever before. Meanwhile, as international legislation becomes increasingly strict as well as more widespread, corruption itself remains a broad and complex problem.

'Corruption' can include graft, bribery, facilitation payments or other forms of improper business practice. Corruption can assume all kinds of local nuances which may be euphemisms for illegal and unethical business practices. Terms such as 'chai' in East Africa and 'baksheesh' in the Middle East may sound innocuous to some, but generally amount to bribery.

The business world is increasingly globalised, regulated and litigious and, in this environment, understanding how and where your organisation is likely to encounter corruption and integrity risks will help you manage such risks effectively. The best approach is to conduct a comprehensive corruption risk assessment, and the more tailored the assessment is to your operations and requirements, the better your organisation will be protected against the risks that might occur.

Scrutiny from anti-corruption regulators can have severe reputational and financial costs for a company. The table on page 3 illustrates the impact on share price of a number of companies after FCPA-related news and announcements. In addition to financial and reputational considerations, companies need to think about the direct business and operational implications of corruption, even if their activities are never scrutinised by regulators. Encounters with corruption, such as an employee's refusal to submit to a bribe demand, can have direct, negative implications for establishing and running a business. However, payment of bribes, even small ones, can lead to escalating demands (without any promised outcomes), extortion and violence. Refusal to pay, without a clear, company-wide strategy and a strong anti-corruption message, can freeze a project at a crucial stage. Corruption can also have implications for staff morale and, in certain circumstances, for their health and safety.

THE BENEFITS OF A BESPOKE INTEGRITY RISK ASSESSMENT



By conducting a corruption risk assessment at an early stage of a project, companies can take steps to manage corruption risks. Such an assessment will determine the level of corruption risk the project is likely to face, and identify any particularly challenging areas, such as at a specific stage of the business cycle or a particular aspect of a company's interaction with governments, bureaucracy or private-sector players. With this information, a company can implement measures to protect itself from exposure to corruption and prepare its employees to respond effectively and consistently if they encounter corruption. The organisation can also use the information provided by the assessment to introduce measures such as anti-corruption policies, and training appropriate to the political and business environments in which the company will be operating.

Off-the-shelf country corruption ratings can give some indication of where significant corruption problems lie around the world, and generic toolkits for resisting corruption can provide guidance on best practice. However, as stringent anti-corruption legislation comes into force, you should be conducting a more specific assessment of the risks your company faces. You will need to know whether or not your organisation can operate commercially in a given environment, and in compliance with all relevant legislation. In the case of the UK Bribery Act, the Serious Fraud Office (SFO) states that corruption cases involving

companies that can prove they have 'adequate procedures' in place to mitigate against corruption risk are more likely to avoid charges for single offences. A bespoke corruption risk assessment is an essential first step towards adhering to the six general principles that make up the SFO's 'adequate procedures' (see text box).

WHAT ARE ADEQUATE PROCEDURES?

The UK's six anti-corruption general principles:

- Risk Assessment
- Top-level Commitment
- Due Diligence
- Clear Practical and Accessible Policies and Procedures
- Effective Implementation
- Monitoring and Review

MARKET-ADJUSTED PRICE REACTIONS TO FCPA-RELATED NEWS AND ANNOUNCEMENTS

COMPANY	DATE POTENTIAL FCPA ACTION	PRICE REACTION	MARKET CAP IMPACT
Syncor International Corporation	6/11/2002	-44.95%	(343.17)
Willbros Group, Inc.	16/5/2005	-39.04%	(133.95)
Immuco, Inc.	2/11/2004	-19.21%	(176.38)
FARO Technologies, Inc.	15/3/2006	-18.37%	(42.07)
InVision Technologies, Inc.	30/7/2004	-14.37%	(121.80)
Schnitzer Steel Industries, Inc.	1/12/2004	-12.71%	(145.45)
Diagnostic Products Corporation	14/2/2003	-6.59%	(63.36)
Schering-Plough Corporation	19/11/2003	-5.27%	(1,251.43)
BJ Services Company	10/3/2004	-5.01%	(350.35)
The Titan Corporation	13/2/2004	-4.83%	(86.24)
Baker Hughes Incorporated	13/6/2003	-3.90%	(461.55)
Textron Inc.	23/8/2007	-2.59%	(377.96)
Statoil ASA	10/9/2003	-2.59%	(529.84)
ABB Ltd	3/11/2003	-1.14%	(73.85)
Oil States International, Inc.	27/4/2006	-1.06%	(20.48)
York International Corporation	9/12/2005	-0.81%	(19.01)
Westinghouse Air Brake Technologies Corp.	17/3/2006	-0.51%	(8.02)
Technologies Corp.	11/9/2003	-0.45%	(349.22)
Chevron Corporation	8/1/2007	-0.32%	(4.77)
Delta & Pine Land Company	29/10/2004	-0.31%	(17.14)
El Paso Corporation	13/2/2007	-0.01%	(4.40)
Dow Chemical Company	28/10/2005	0.18%	117.07
Siemens Aktiengesellschaft	27/8/2008	0.39%	8.36
Con-Way Inc.	15/11/2004	0.39%	46.27
Monsanto Company	6/4/2004	0.53%	97.01
Lucent Technologies Inc.	22/2/2006	0.85%	111.16
Fiat SpA	16/3/2005	0.99%	142.84
Ingersoll-Rand Company Ltd.	13/2/2006	1.69%	42.46
Flowserve Corp.	26/9/2007	2.06%	21.22
Bristow Group Inc.	2/1/2006	2.26%	430.50
AB Volvo	15/3/2007	3.06%	628.96

Source: NERA Economic Consulting, 28 January 2009, FCPA Settlements: It's a Small World After All

EXAMINING CORRUPTION IN THE LOCAL CONTEXT



A project-specific corruption risk assessment involves detailed research into the potentially corrupt or unlawful transactions a project could face during its lifespan. Such an assessment will include rigorous analysis of the likelihood of corruption occurring, and the potential impact on business operations. Typically, the assessment will cover broad aspects of corruption risk, as well as addressing the specific corruption risks a company could face in its dealings with:

- individual government officials, ranging from presidents and cabinet ministers, and foreign diplomats, to senior bureaucrats with lower public profiles;
- bureaucracies in the host country, including the customs service, the tax authorities, law-enforcement bodies and the judiciary;
- the private sector, including when competing for contracts or using agents and intermediaries; and
- its own staff, including the risks of corruption and nepotism associated with local hiring, and the risk of employees being involved in fraud and embezzlement, possibly in collusion with organised criminal networks.

GOVERNMENT-LEVEL CORRUPTION

A corruption risk assessment helps a company understand the specific threat involved in dealing with senior political figures and

institutions. Research would explain the government's reputation for corruption, and would clarify whether or not the government was involved in the sector under consideration, either transparently and directly, or in opaque ways. Government involvement in specific deals or sectors can have a range of implications. In Latin America, the involvement of state-owned companies in oil tenders generally reduces the level of transparency and competitiveness. In Africa, the direct involvement of a president in a deal can either radically reduce – or vastly increase – the risk of a company facing demands for bribes.

Similarly, while a country's government may have a negative reputation for transparency and corruption at a general level, research may uncover a lower risk for a specific project, perhaps because the official terms of a deal are considered acceptable for the government or because the government is content with its current level of involvement in a particular sector. In such a case, a corruption risk assessment would advise on the prevailing level of risk, and offer scenarios in which the corruption risk could increase, for example, in the event of a change of government or a shift in the internal political power balance.

If, on the other hand, research concluded that the risk of opaque government interference in a project were high, a corruption risk assessment would provide guidance on whether or not a company



should go ahead with a deal. If it were to proceed, getting practical advice on what actions you could take to reduce the risks would be vital - establishing positive political communication and anti-corruption strategies, for example.

CORRUPTION WITHIN THE BUREAUCRACY

Corruption within the bureaucracy is less likely to be a deal-breaker in most situations. However, in addition to the risk of regulatory scrutiny, bureaucratic corruption in, for example, tax and customs systems can create lengthy delays and have significant financial repercussions for investors. A corruption risk assessment will help a company understand the extent and nature of bureaucratic corruption, and the potential impact on its business.

Investors in former Soviet Union countries such as Russia and Kazakhstan, for example, often experience unwanted scrutiny and inspections by tax, environmental, and health and safety regulators. In such cases, investors need to know that these inspections generally fall into one of three categories:

- genuine routine checks in a highly bureaucratic system;
- attempts by low-to-mid-level bureaucrats to make short-term financial gains; or

- politically motivated regulatory action originating much further up the political chain, which can be part of a more serious attempt to undermine the company's activity or change contract terms.

A risk assessment can highlight the types of problems prevalent in a particular sector or location, and can help a company prepare a response to suspicious visits or demands.

PRIVATE-SECTOR CORRUPTION

In the private sector, it can be hard for a multinational company to know where the key corruption and integrity risks might lie, particularly if the company is involved in several jurisdictions and if it has multiple agent or intermediary relationships. Such relationships often present a company with corruption and reputational risks. It can be easier for a smaller, intermediary company to be bribed than a large foreign multinational. It is important to bear in mind that, according to the UK Bribery Act, the multinational is responsible for the behaviour of its intermediaries: it could be penalised if any corrupt activity is uncovered. A corruption risk assessment can help a company identify specific problems with transparency in intermediary relationships, and commit the appropriate level of resources in developing a focused anti-corruption strategy.



INTERNAL INTEGRITY RISKS

It is perhaps hardest for a company to prevent or root out corrupt activity within its own workforce. The recruitment and management of a local labour force can expose companies to corruption, nepotism and compliance risks. Companies need to strike a balance between vetting and supervising their local employees, while also trusting and empowering them to perform their job effectively.

A corruption risk assessment can help an investor identify an area of local employee management in which corruption might be a particular problem. It can also highlight common practices, such as small- or large-scale fraud and embezzlement, that have caused problems for other companies. A risk assessment can explain the politics of local hiring. It will identify, for example, whether an investor is likely to come under pressure to hire from a particular ethnic group or among individuals close to a political grouping or elite. An assessment does not eradicate the problem, but it helps focus management attention and supports the appropriate allocation of hiring responsibilities between head office and local offices.

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THE KEY BENEFITS OF AN INTEGRITY RISK ASSESSMENT

AN APPROACH THAT TAKES INTO ACCOUNT THE SPECIFIC ASPECTS OF A PROJECT

A corruption risk assessment will provide an in-depth understanding of how and to what extent corruption could affect an investor's specific operations and reputation. A generic or anecdotal approach could distort this picture. This type of assessment also contributes to a broader understanding of how business works in a country, which is useful for everyday operations.

A CRUCIAL FIRST STEP TOWARD MEETING 'ADEQUATE PROCEDURES'

As new anti-corruption legislation comes into place and is more frequently enforced, a corruption risk assessment will be a first step toward meeting the 'adequate procedures' required by the SFO in the UK, and will demonstrate to other regulators that senior management is engaged in preventing corruption. A corruption risk assessment will support the preparation and implementation of anti-corruption measures, thereby satisfying external investors concerned about anti-corruption regulation as well as the regulators themselves.

A CORE PART OF COMPANY POLICIES, PROCEDURES AND TRAINING

A corruption risk assessment – when regularly updated to match changing local situations – can be of long-term use. The assessment can form a core part of staff training. Assessments can be used to test and, where necessary, modify or supplement, existing anti-corruption

policies and procedures, helping to ensure that these remain relevant in changing investment and legislative environments.

SUPPORT FOR INTERNATIONAL BUSINESS DEVELOPMENT

Rather than highlighting a compliance burden that restricts business development, a tailored corruption risk assessment will often reveal an environment that is more palatable than expected. This can create a more attractive, rather than a less attractive, business opportunity, and can help companies move into challenging environments with greater confidence.

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SAFEGUARD YOUR BUSINESS FROM CORRUPTION

Control Risks works with international organisations worldwide, enabling senior leadership teams to assess, manage and mitigate integrity risk. We understand where, when, and how corruption is likely to occur, and how to prevent it. We assist our clients across a full spectrum of anti-corruption initiatives, from developing strategic policies down to assessing individual operations. Our advice and guidance is tailored to specific sectors and markets, and to the distinctive characteristics of each individual organisation.

WE OFFER A TOTAL SOLUTION TO YOUR ANTI-CORRUPTION REQUIREMENTS

- **Consulting services** – helping you devise, implement and manage an anti-corruption programme. We provide advice and guidance on: policy design and implementation; establishing codes of conduct; identifying best practice; and managing internal and external integrity hazards.
- **Training.** We run bespoke scenario-based workshops drawing on real-life experience which are designed to help leadership teams prevent, detect and respond to corruption risk. Together with our partner, Eukleia Training, we also provide company-wide e-learning programmes.
- **Whistleblowing helplines.** We set up and run compliance lines enabling employees and agents to seek confidential guidance on ethical dilemmas, and to report potential violations of company policy.
- **eDiscovery:** Our aim is to ensure that your information management and compliance policies are robust enough to prevent an investigation. However, if a triggering event occurs, we will rapidly implement a defensible and cost effective eDiscovery response plan including data analysis and collection, data processing and hosting, early case analysis and comprehensive project management and production services.
- **Crisis management.** We work with you to develop and implement systems and strategies to enable you to manage an integrity crisis. We also design and run simulations to test your plans and prepare your senior management. And in the unfortunate situation of a crisis occurring, our consultants have the specialist expertise to enable you to respond effectively.
- **Risk assessment and risk management, including a range of due diligence services.**
 - **Third party and agent screening programmes.** We offer various tiers of due diligence, ranging from a fast sweep of public records to on-the-ground enquiries with trusted sources.
 - **Audits and reviews.** These include reviews of existing policies and procedures; audits of compliance programmes; financial investigations (including reviews of financial controls and records); investigations following disclosure to regulators; and assessments of the effectiveness of current checks, balances and controls; internal communications.
 - **Country and sector risk assessment.** We provide country-specific and sector-specific analysis to help companies anticipate corruption risks in individual markets.

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