Anti-corruption internal audits
A crucial element of anti-corruption compliance
In 2013, corruption risk continues to be a significant concern for global companies. Enforcement efforts in the US continue to increase, while outside of the US, the UK Bribery Act has been in place two years this past July. Countries such as China, India and Russia have enacted or are in the process of passing new anti-corruption legislation. Many European countries are increasing their enforcement efforts. The OECD Working Group on Bribery – Report 2013 reported that there were 320 investigations of corruption by governmental authorities ongoing as of December 31, 2012, many of which could result in multimillion-dollar fines, individual prosecution of executives and restrictions placed on their business. Tips to the authorities increased in the US with the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act. In November 2012, following its first year of enactment, the SEC reported receiving approximately 110 FCPA-related tips under Dodd-Frank’s whistle-blower bounty provisions, which provide financial incentives to any person worldwide for reporting securities laws violations.

As the risk of prosecution grows, more and more companies have established anti-corruption compliance programs including policies, financial controls, training, anti-corruption compliance internal audits and other monitoring mechanisms. At EY, we believe that anti-corruption monitoring, including anti-corruption internal audits are perhaps the most crucial element of an effective anti-corruption program. This paper discusses leading practices in conducting anti-corruption internal audits.
Purpose of anti-corruption internal audits

As many US companies are viewing corruption risk as their highest compliance priority, we have seen a synthesis between traditional corporate compliance programs and additional policies and controls focused on bribery and corruption. The wisdom of this approach was recently endorsed by the US Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) in A Resource Guide to the U.S. Foreign Corrupt Practices Act. In the Guide, which was issued in November 2012, the regulators merge the two concepts in their description of the “Hallmarks of Effective Compliance Programs.” These hallmarks include:

- Commitment from senior management and a clearly articulated policy against corruption
- Code of conduct and compliance policies and procedures
- Oversight, autonomy and resources
- Risk assessment
- Training and continual advice
- Incentives and disciplinary measures
- Third-party due diligence and payments
- Confidential reporting and internal investigation
- Continuous improvement by periodic testing and review

All of the above elements are very important for companies in mitigating the risk of bribery and corruption; however, the last, periodic testing and review, may be the most significant. Given the demands of business, in even the most highly ethical company, compliance policies and controls will not be followed unless they are mandated and compliance is monitored. Accordingly, anti-corruption monitoring and internal audits are an indispensable element of a comprehensive and effective anti-corruption compliance program.

For most companies, anti-corruption internal audits are the most comprehensive and effective means for conducting anti-corruption monitoring. Anti-corruption audits should have two main points of focus:

- Audit for compliance with the various elements of the anti-corruption compliance program
- Test for substantive compliance

Anti-corruption audits act as a powerful motivator to promote compliance with the anti-corruption program requirements, as well as detect and deter potential improper activity. Knowing that someone is looking and you might be caught doing something improper is clearly a deterrent, just as the lack of monitoring could provide incentive or opportunity. Conducting anti-corruption audits sends a powerful message that management means what it says and is committed to anti-corruption compliance. Anti-corruption audits raise awareness, provide powerful feedback as to how the program is working and often uncover new risks not previously seen or fully appreciated. To this last point, they act as part of an ongoing corruption risk-assessment process. Providing remedial action in response to audit findings is a crucial aspect of keeping the compliance program fresh and evolving as the business and its risks evolve.

Desired competencies

Creating an effective anti-corruption audit program requires having the right people, processes and technology. Anti-corruption audits are very different from other internal audits usually conducted by a company’s internal audit group. The auditors need to be trained in the particulars of the FCPA, the UK Bribery Act and local anti-bribery laws. It is also useful to have an understanding of leading compliance practices related to these laws. Core skill sets beneficial to have on the audit team include: good interviewing skills, the knowledge and experience necessary to select high-risk transactions for testing and to recognize red flags, indicating potential violations. Some companies choose to have their internal audit department conduct these audits. Others employ different strategies – pairing legal or compliance department personnel with internal auditors or using outside forensic accountants.

Key reasons for using experienced forensic accountants include the ability to select meaningful transactions for review and experience in recognizing corruption red flags. An experienced forensic accountant who understands the FCPA and UK Bribery Act, and has been involved in corruption investigations and anti-corruption audits, applies technical knowledge, experience and seasoned judgment in selecting testing samples and reviewing transactions. Knowing where to look is an important intangible factor that greatly increases the value of the exercise. A random sampling selection will offer limited opportunity to detect and therefore deter potentially problematic transactions. Corruption investigation experience is required to understand, when you get into certain areas, how far back you need to probe or “peel the onion.” This is where an inexperienced financial auditor often struggles.

1 As used in this paper, the terms “anti-corruption internal audit”, “anti-corruption audit”, “audit” or “review” relate to internal company or organizational processes focused on corruption risk and anti-corruption compliance. Such terms do not relate to an audit of a company or organization’s financial statements by an external auditor or similar review or examination of financial statements or other forms of attestation as those terms are defined by professional accounting and auditing standards.
Approach

Anti-corruption audits are preferably stand-alone audits that are not integrated into a larger set of procedures. Generally integrating anti-corruption audit procedures into larger audit programs is not the most effective practice; it commonly leads to situations where the auditor doing the testing lacks the necessary training and experience, focus, supervision or time to do the work properly. To avoid “audit fatigue” commonly expressed by business units, the timing can coincide with an internal audit of the same business unit but the activity should remain separate.

In conducting substantive testing, the purpose is to identify potential corruption violations or red flags. The audit is not an investigation. It is a business process like other internal audits a company might undertake – a predetermined set of procedures designed to assess corruption risk and test for compliance with company policies. Serious violations or red flags uncovered in the audits are typically reported to legal or compliance professionals for further investigation. Protocols should be put in place for immediate consultation when a potential violation is uncovered. Often such audits are conducted at the direction of a company’s general counsel and are subject to the attorney-client privilege. This is so confidentiality is protected and legal advice can be provided in the event that a violation is uncovered.  

Main elements

Anti-corruption internal audits typically include the following principal activities:

- Risk assessment
- Pre-site planning and procedures
- Fieldwork
- Reporting
- Remediation and follow-up

Risk assessment

Anti-corruption audit programs should be focused on areas of elevated corruption risk faced by the company and test the effectiveness of controls in place to mitigate the risk. Audits should be conducted based on a periodic or annual risk assessment.

The risk assessment process informs decision making about:

- The business units and locations that should be subject to anti-corruption audits in the current audit-planning period
- The scope and duration of such audits
- The timing of such audits
- Achieving desired coverage of business units and locations within a desired time period

Some of the principal factors that could be considered in selecting audit locations and timing include:

- Business unit location and Transparency International’s Corruption Perceptions Index (CPI) country rating
- Size of the business (often judged by revenue) and nature of the work performed
- Volume of government business, including business with state-owned enterprises and regulatory interaction with government
- Use of third parties, particularly related to selling or interacting with governments
- Prior history/incidents reported of allegations of bribery or corruption

The anti-corruption audit risk assessment and deliberations on the current period audit plan should be documented. This is so the company can demonstrate, if required, that it went through a deliberative process in deciding where it should focus its resources in conducting anti-corruption audits.

Pre-site planning and procedures

Advance planning is an important part of the anti-corruption audit process. Pre-site planning procedures related to anti-corruption audits often include:

- Audit notification letter or other communication to the business unit to be audited
- Telephone conference(s) with business unit management to discuss the purpose of the audit, the process, and obtain initial information about the business and its specific corruption risks
- Information requests, including requesting financial data to begin the process of selecting samples for testing of transactions

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2 Companies vary in their approach concerning legal counsel involvement with the audit. Of course, the application of the attorney-client privilege depends on the specific factual situation.

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3 Transparency International is a non-governmental organization focused on bribery and corruption in international business. It annually publishes its CPI, which has become a widely accepted barometer for measuring corruption risk by country.
Anti-corruption internal audits a crucial element of anti-corruption compliance

• Determining persons to be interviewed and scheduling interviews
• Where cost effective and appropriate, conducting data analytics procedures to assist in the sample selection process
• Selecting preliminary samples for transaction testing and otherwise adjusting the work plan based on observations from initial information gathering
• Obtaining and reviewing documentation of the business unit’s current anti-corruption efforts

A robust process in advance of the audit will help the audit team “hit the ground running” and facilitate the audit being conducted in as efficient a manner as possible. It is also important, particularly the first time the business unit is undergoing an anti-corruption audit, to use this time to set the right tone for the audit, sensitize business unit management as to the purpose of the audit and allay any unwarranted concerns about the process.

Fieldwork
Fieldwork for anti-corruption audits is most commonly conducted in one to two weeks, and involves procedures on site at the business unit. There are two main points of focus:

• Test for compliance with the various elements of the anti-corruption compliance program
• Substantive compliance testing of potential violations or red flags

Fieldwork procedures generally involve:

• Interviews of business-unit employees
• Detailed review of selected transactions in potential high-risk areas
• Additional sample testing and/or follow-up of any potential corruption red flags or other areas of potential concern (following appropriate consultation, if needed)
• Analysis of compliance program and other information

Interviews
Interviews should be conducted at the start of the audit so that there is time for additional transaction review, selection and testing related to information coming from the interviews. Interviews are a very important part of the anti-corruption audit process and should be led by senior professionals experienced in anti-corruption. Interviews should be focused on understanding the business and its bribery and corruption risks. It is important
to speak to business-unit employees who are responsible for overseeing the anti-corruption program to understand the controls in place, as well as those who work in areas of high-corruption risk. A typical anti-corruption audit might include interviews of persons in the following positions:

- Business unit leadership
- Business development, sales, government sales
- Legal, regulatory and compliance
- Finance, treasury and accounting
- Procurement and logistics

Often persons being interviewed are nervous when discussing the topic of corruption. You should set them at ease in the beginning by describing the process and telling them why the company is conducting the audit. Make sure they understand that the audit is a business process designed to review anti-corruption compliance and not an investigation resulting from of any specific allegations.

Interviews and areas of follow-up review resulting from the interviews are often documented and included in the audit work papers.

**Transaction testing**

As previously noted, transaction testing is an integral part of the anti-corruption audit. During the planning and fieldwork phases, transaction data is obtained and analyzed to identify transactions for testing. Information gleaned from interviews is also used to identify issues and potential areas for testing. Common areas that are subject to transaction testing in anti-corruption audits include:

- Payments to sales representatives/consultants/third-party sales intermediaries and other high-risk vendors, particularly relating to sales to governments
- Payments related to licenses, permits and other dealings with regulatory authorities
- Gift giving, travel and entertainment, particularly to government officials
- Cash transactions, including cash advances and petty-cash transactions
- Payments denoted as facilitating payments
- Charitable donations
- Political contributions
- Payments to shipping/logistics providers
- Payments with vague or incomplete descriptions, such as miscellaneous payments

The testing selection process could include walkthroughs of significant financial control processes related to anti-corruption, such as vendor payment controls, bank reconciliation processes and processes around cash advances, petty cash and employee expense reimbursements.

Samples of transactions to be tested are selected on a judgmental basis. This is one of the most important aspects of an anti-corruption audit and is often overlooked by persons not having sufficient experience. Making good judgments about risky areas and transactions that should be reviewed is crucial to the quality of the audit.

Transaction testing includes analysis of certain documents, e.g., significant contracts, such as contracts with sales representatives/consultants and logistics providers, invoices, check and wire details and other transactional documents. Contracts should be analyzed to identify anti-corruption language and adherence with corporate policy. Also, testing should be performed on a sample basis to test that payments are in line with contractual obligations.

**Analysis of compliance program and walk-throughs**

A significant portion of the anti-corruption audit should include testing of the effectiveness of current anti-corruption compliance program. This often includes developing an understanding whether:

- Adequate company compliance and whistle-blower processes and resources are in place and are being appropriately leveraged in the area of anti-corruption
- Anti-corruption policies and controls have been properly disseminated and implemented
- Anti-corruption training has been provided and documented
- Additional anti-corruption program requirements have been implemented

The audit should test whether defined requirements have been effectively implemented and, if not, obtain an understanding of why not.

**Reporting**

Anti-corruption audit reports vary in format and content by company. A typical anti-corruption audit report focuses on audit exceptions. A draft report or “issues matrix” may be circulated to the business unit for review prior to finalization of the anti-corruption audit report. We have found it very useful to review and confirm audit exceptions in writing with the business unit prior to leaving the audit location. This helps to keep surprises in check and begins the discussion of potential remedial action. Setting firm deadlines for business-unit response and issuing of the audit report is also recommended to avoid prolonged discussions over the findings, which should be agreed to at the cessation of fieldwork.
Anti-corruption analytics

As financial software increasingly becomes more sophisticated, companies are turning more often to forensic data analytics as a tool for compliance monitoring. Forensic data analytics is the wave of the future, and will be used more and more in the years to come to monitor all types of compliance and financial issues.

At EY, we utilize a robust anti-corruption analytics product called Anti-bribery and Corruption (ABC) Analytics as an integral tool in our anti-corruption monitoring service offerings. ABC Analytics focuses on general ledger entries, T&E data and vendor disbursement information. It leverages text mining, leading visualization tools, and statistical techniques and a library of fraud and anti-corruption tests to identify anomalous and potentially suspicious transactions and trends in financial accounting data. The data is organized in electronic “dashboard” interfaces that the experienced anti-corruption auditor can use in reviewing transactions and selecting samples for testing.

We have found that ABC Analytics can be highly useful prior to the audit in helping the anti-corruption auditor uncover potential high-risk transactions for testing and for making judgmental sample selections. It is also very useful to have in the field for identifying transactions that may be related to new information coming to light during the audit.

ABC Analytics can be offered to clients as part of an anti-corruption risk assessment, audit or as a stand-alone monitoring project. It should be noted that ABC Analytics does not involve the use of on-line live company data but instead involves the receipt of electronic data from the client, which is then loaded into our ABC Analytics software.

In conclusion, anti-corruption internal audits are a key element of an effective anti-corruption program. We are assisting many clients in performing these audits and they have become a significant service offering of EY’s FIDS practice. This paper discusses a general framework for conducting anti-corruption audits based on leading practices EY sees at its most sophisticated companies. As all companies have different risk profiles, available compliance resources and needs, we would be happy to discuss with you how we might assist your company in this area.
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SCORE No. WW0309
1307-1103613 BSC
ED 0114

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