

THE REAL IMPACT OF CORRUPTION

**2013 Cruywagen-IRMSA Risk Foundation
Risk Lab**

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Corruption and fraud statistics in South Africa and Africa

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2011 PwC Global Economic Crime Survey: Key findings

- Globally, economic crime increased slightly from 2009, from 30 per cent to 34 per cent.
- In South Africa, there was a slight decrease from 2009, from 62 per cent to 60 per cent because anti-fraud frameworks are becoming more effective at detection.
- The most common South African economic crimes of asset misappropriation, bribery and corruption, and financial-statement fraud also decreased, but are still significantly higher than globally.
- The perpetrator profile in South Africa shifted to senior management, from 17 per cent in 2009 to 36 per cent in 2011.

2011 PwC Global Economic Crime Survey: Key findings (2)

- The impact of the non-financial consequences of economic crime are significantly higher in South Africa than globally.
- In South Africa, the negative impact on employee morale (36 per cent) is the most significant non-financial consequence.
- Other areas on which economic crime has a significant impact in South Africa are business relations (27 per cent), the organisation's reputation and brand (27 per cent) and relations with regulators (22 per cent).
- The negative impact on the share price of a listed company is over three times higher in South Africa (7 per cent) than globally (2 per cent).

2011 PwC Global Economic Crime Survey: Key findings (3)

- South African organisations used more stringent measures – such as civil or criminal action and notification of regulators - to deal with internal perpetrators than their global counterparts.
- In South Africa, dismissal was used less often than globally.

Source: Cybercrime in the spotlight: 6th PwC Global Economic Crime Survey, South African edition, November 2011 (<http://www.pwc.co.za/crimesurvey>)



Africa Attractiveness Survey

- Ernst and Young's (E&Y's) Africa attractiveness survey calculates foreign investment in Africa at US\$150 billion by 2015.
- This number might be far higher if fraud could be contained.
- Ernst and Young's states that precautions are being taken to prevent fraud on a major scale. It, however, seems that many companies that commit fraud in Africa are unaware of the risks they are taking.
- The theory that African authorities have a lack of resources or inadequate legal powers to compete with fraud is systematically being proved wrong, since several African countries already have robust anti-corruption laws.

Africa Attractiveness Survey (2)

- Many African countries that have anti-corruption laws are including extra-territorial reach and ban facilitation payments.
- Currently, US prosecutors are investigating several companies for alleged violations of the US's Foreign Corrupt Practices Act of 1977, and these companies are also being investigated by African regulators.
- E&Y's survey states that: *"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."*
- Source: <http://www.ey.com/GL/en/Services/Assurance/Fraud-Investigation---Dispute-Services/Global-Fraud-Survey---a-place-for-integrity---Africa>

KPMG Africa Fraud Barometer

- KPMG launched the first Africa Fraud Barometer in April 2012 to:
 - measure the prevalence of fraud in Africa; and
 - expose the risk of fraud for companies in their operations on the continent.
- The Africa Fraud Barometer distinguishes between:
 - the number of reported fraud cases;
 - type of perpetrator;
 - victims of fraud;
 - type of fraud;
 - countries; and
 - targeted industries.

Second Africa Fraud Barometer: Overall findings

- The findings of the second Africa Fraud Barometer in respect of the first half of 2012 were released in November 2012.
- There was a decline in both reported fraud cases and their monetary value from the second half of 2011 (first Barometer).
- Fraud and misrepresentation had the highest number of reported cases at 37 per cent, a decrease of 10 per cent.
- Government officials (18 per cent) committed the most fraud, followed by business people (15 per cent) and employees (14 per cent).
- Government was still the hardest hit by fraud and corruption (at 18 per cent, an increase of 1 per cent).
- Government is therefore a high-risk area in terms of both perpetrator and victim.
- **Source:** KPMG Africa Fraud Barometer – Assess your risk before doing business in Africa, period reported on: 1 January 2012 to 30 June 2012

Second Africa Fraud Barometer: Findings – South Africa

- South Africa has the highest number of reported cases in Africa. This is to be expected because of the size of its economy.
- In South Africa, vigilant media contribute to the reporting of fraud and corruption cases.
- Police statistics show a decline in fraudulent activities, a positive trend.
- Multinational anti-fraud legislation is forcing companies to be more accountable about fraud and corruption.
- The legislation helps to measure fraud-risk awareness and to manage the risks.
- More cases of fraud and corruption in the public sector have been reported, and the Public Prosecutor plays an important role.
- The prosecution rate remains relatively low.

Second Africa Fraud Barometer: Findings – Zimbabwe/Central Africa

- Fraud has been increasing in Zimbabwe.
- “Dollarisation” of the economy caused significantly reduced income for some, who have therefore resorted to fraudulent activities.
- There is a great deal of procurement fraud in that prices are inflated for personal benefit.
- Some custodians of financial records fraudulently misrepresent figures reported to regulators.
- There has been an increase in fraudulent microfinance institutions, which offer much higher rates for deposits and often disappear.
- More fraudulent transactions involve individuals, but if companies are affected, the values are much higher.
- Government is not directly addressing fraud, but business and the media have increased awareness.



Second Africa Fraud Barometer: Findings – Kenya/East Africa

- Kenya stands out with 7,75 percent of reported fraud cases, well ahead of Uganda (2,98 per cent) and Tanzania (2,79 per cent).
- Most fraud in Kenya targets government and the financial sector.
- Fraud, misappropriation, bribery and corruption are high.
- Many cases in Kenya are never reported because people do not have faith in the system in terms of prosecution and conviction.
- Kenya, however, is becoming more serious about fraud prevention, and two tourism officials received heavy jail sentences and fines for misappropriation of public funds.
- People in Uganda and Tanzania do not seem to be comfortable reporting cases of fraud.
- A positive example is Rwanda, where fraud has dropped to an all-time low.

Second Africa Fraud Barometer: Findings – Nigeria/West Africa

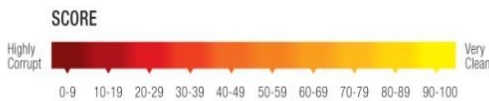
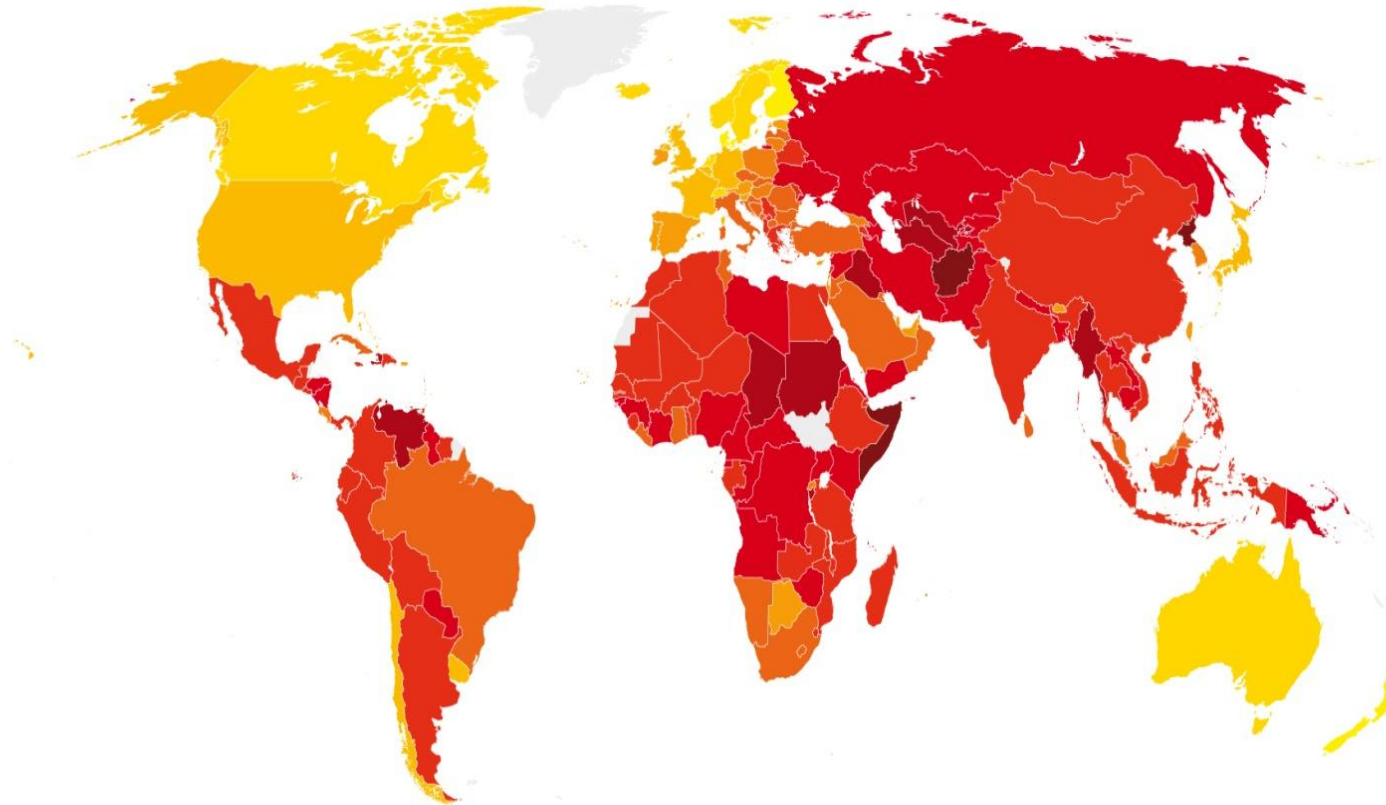
- Nigeria has high levels of fraud and corruption, which are exacerbated by the oil sectors.
- The most common types of fraud are bribes in the private and public sectors, misappropriation and contract inflation.
- Public officials and private-sector senior management commit most fraud.
- Nigeria's media report fraud cases consistently.
- Although cases involving the banking and oil-and-gas sectors, as well as government, have been taken up by the legal system, many cases end with a plea bargain or are closed without conviction. The legal system is thus not seen as effective.
- There are fears that Nigeria's increasing fraud and corruption may spill over to other countries in the region, such as Ghana, where oil has been found.

Transparency International Corruption Perceptions Index



CORRUPTION PERCEPTIONS INDEX 2012

The perceived levels of public sector corruption in 176 countries/territories around the world.



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TI Corruption Perceptions Index (2)

- Transparency International (TI) launched its annual Corruption Perceptions Index (CPI) in 1995.
- The CPI measures the perceived levels of public-sector corruption in countries and territories around the world.
- The CPI has widely been credited with placing the issue of corruption on the international policy agenda.
- Countries are scored from 0 (perceived to be highly corrupt) to 100 (perceived to be very clean).
- Although some countries score well, no country scores a full 100.
- Two thirds of the 176 countries measured in the 2012 CPI scored below 50.
- This shows that public institutions have to be more transparent and powerful officials have to be more accountable.



TI Corruption Perceptions Index (3)

- In the 2012 CPI, the least corrupt countries were Denmark, Finland and New Zealand, each scoring 90 out of 100.
- The most corrupt countries were Afghanistan, North Korea and Somalia, each of which scored only 8 out of 100.
- In 2012, Africa remained the most corrupt continent, followed by Eastern Europe and Central Asia.
- In Sub-Saharan Africa, 90 per cent of countries scored below 50.
- Botswana was ranked best of all African countries; it was in 30th place worldwide and had a score of 65 out of 100.
- South Africa received a score of just 43 out of 100 and dropped to 69th place worldwide, from 64th place in 2011 and 43rd place in 2007.
- **Visit: <http://cpi.transparency.org/cpi2012>**

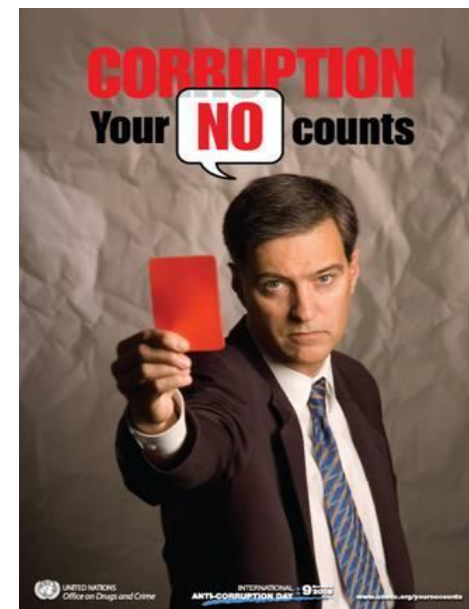
Legislative and best-practice imperatives against corruption and unethical practices

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UN Global Compact

- The UN Global Compact is a framework for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, the environment and anti-corruption.
- The UN Global Compact is not a regulatory instrument – it does not police, enforce or measure the behaviour or actions of companies that participate.
- Many companies have signed their commitment to the guidelines in the UN Global Compact.

Source: http://www.unglobalcompact.org/Issues/transparency_anticorruption/index.html



UN Global Compact (2)

- The rapid development of rules of corporate governance around the world is also prompting companies to focus on anti-corruption measures as part of their mechanisms to protect their reputations and the interests of their shareholders. The internal controls of companies are increasingly being extended to a range of ethics and integrity issues, and a growing number of investment managers are looking to these controls as evidence of companies undertaking good business practice and being well managed.
- The UN Global Compact has partnered with the UN Office on Drugs and Crime (UNODC), Transparency International (TI), the International Chamber of Commerce (ICC), the World Economic Forum Partnership Against Corruption Initiative (PACI) and the World Bank Institute (WBI).
- Thereby, UN Global Compact contributes to the fight against corruption, provides a platform for learning and dialogue and offers guidance to companies on how to implement principle 10.

UN Global Compact - 10th Principle

- **Principle 10:** “Businesses should work against corruption in all its forms, including extortion and bribery.”
- **Objectives:**
- Adoption of the tenth principle commits UN Global Compact participants not only to avoiding bribery, extortion and other forms of corruption, but also to developing policies and concrete programmes to address corruption. Companies are challenged to join governments, UN agencies and civil society to realise a more transparent global economy.





US Foreign Corrupt Practices Act

- The US Foreign Corrupt Practices Act of 1977 (FCPA) has extraterritorial application.
- Over the past 10 years, the US has invested in its capability to enforce the provisions of the FCPA, and the number of reported FCPA cases has consequently increased significantly.
- Not only US incorporated companies, but also non-US incorporated companies (non-US companies) have been the target of the increased number of FCPA enforcement actions.
- Cases include Ahold, ABB, DaimlerChrysler and Siemens.

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US Foreign Corrupt Practices Act (2)

- Non-US companies listed on US exchanges often appear to be ignorant about the fact that they are subject to the FCPA's provisions and the serious consequences that a violation may have.
- Such companies are often inexperienced on how they should respond to an enforcement action by the US authorities, who tend to have “sharper teeth” than the companies' national authorities. The result of such ignorance and inexperience can result in severe sanctions.
- **FCPA provisions:** The FCPA has two main parts:
 - Part 1 prohibits and criminalises the payment of bribes to foreign government officials.
 - Part 2 requires companies to maintain proper books and records.

US Federal Sentencing Guidelines

- The US Federal Sentencing Guidelines, first published in 1991 and updated in 2004, encourage ethical conduct in US corporations. Businesses have to:
 - “Ensure that they have an effective compliance and ethics programme;
 - evaluate periodically the effectiveness of the organisation's compliance and ethics programme; and
 - periodically assess the risk of criminal conduct and ... take appropriate steps to design, implement, or modify each requirement ... to reduce the risk of criminal conduct identified through this process.”



US Federal Sentencing Guidelines

The US Federal Sentencing Guidelines, updated in 2004, require organisations to take seven steps to encourage ethical conduct:

1. Establish ethics and compliance standards and procedures — develop and implement a Code of Ethics/Code of Conduct.
2. Assign high-level personnel to oversee compliance.
3. Exercise due care in delegating discretionary authority.
4. Implement ethics training programmes and ethics communication channels regarding the code of ethics and compliance procedures for all in the company.
5. Enforce the Code consistently (appropriate and consistent discipline).
6. Monitor, audit and provide safe reporting systems/mechanisms.
7. Respond to offences or deviances from the Code in a manner that tends to prevent recurrence.

King 3

- The King 3 Report and Code on Corporate Governance, published in South Africa, in 2009, requires organisations to build an ethical culture with a trusted reputation in order to prevent, reduce, or eliminate misconduct (unethical or unlawful conduct).
- Chapter 1 of the King Report says that companies must:
 - involve ethics in all company aspects and activities;
 - the board must show strategic ethical leadership; and
 - ethics must be actively managed in the company.
- Principle 1.3 of the King 3 report states that the board should ensure that the company's ethics are managed effectively.
- This is achieved through a prescribed ethics-management programme.
 - Refer to section 1 to 5, King 3 Report
 - **Resource:** <http://african.ipapercms.dk/IOD/KINGIII/kingiiiireport/>

JSE Socially Responsible Investment (SRI) Index

- The Johannesburg Stock Exchange's Socially Responsible Investment (SRI) Index prescribes certain ethics reporting criteria to listed companies.

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South African Companies Act

- The Companies Act of 2008 became effective in 2011.
- Parts of the King 3 report have been included in and the common law duties of directors have now been codified in section 76.
- In section 75(1)(a) of the Companies Act of 2008, a “**director**” is defined as including:
 - “(i) an alternate director;
 - (ii) a prescribed officer; and
 - (iii) a person who is a member of a committee of the board of a company (or of the audit committee*)
irrespective of whether the person is also a member of the company’s board; ”.

*Companies Amendment Bill

Companies Act of 2008 Prescribed officers

- Prescribed officers are described in the recently published Regulations to the new Companies Act (regulation 38) as anybody who :
- ***“exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company”***; or ***regularly participates to a material degree in such management or control*** irrespective of any title assigned by the company to an office held by that person, or function performed by that person.”

Companies Regulations, 2011: Social and ethics committee

- The Companies Regulations, 2011, are aligned to the Companies Act of 2008 and the Companies Amendment Bill tabled in Parliament in November 2010 and replace the old Regulations.
- Regulation 43 compels the following companies to appoint a social and ethics committee:

Reg 43(1)(a) every state owned company;

(b) every listed public company; and

(c) any other company that has in any two of the previous five years, scored above 500 points in terms of regulation 26(2).

Note: Regulation 26(2) refers to a company's "public interest score", calculated in terms of that regulation. Any company with more than 500 employees or a turnover of more than R500 million will fall into this category.

Functions of social and ethics committee

43(5) A social and ethics committee has the following functions:

- (a) To **monitor** the company's activities, having regard to any relevant legislation, other legal requirements or prevailing codes of best practice, with regard to matters relating to –
 - (i) social and economic development, including the company's standing in terms of the goals and purposes of—
 - (aa) the 10 principles set out in the United Nations Global Compact Principles; and
 - (bb) the OECD recommendations regarding corruption;
 - (cc) the Employment Equity Act; and
 - (dd) the Broad-Based Black Economic Empowerment Act;



Functions of social and ethics committee (2)

Other functions of the committee include:

- (ii) Good corporate citizenship;
 - (iii) the environment, health and public safety;
 - (iv) consumer relationships; and
 - (v) labour and employment.
-
- Many leading South African companies use the social and ethics committee to report on ethics management in the organisation.



UK Bribery Act

- On 8 April 2010, the United Kingdom Parliament enacted the Bribery Act 2010 (the “UK Bribery Act”), thereby passing into law one of the most far-reaching anti-corruption initiatives in the world.
- The UK Bribery Act came into force on 1 July 2011.
- The UK Bribery Act provides for strict criminal liability for companies that negligently fail to prevent their employees or agents from engaging in bribery. This is the position even when the company management had no knowledge of the corruption, fraud or bribery. In these circumstances, management needs to demonstrate that they have an adequate fraud- and bribery-prevention scheme, or “adequate procedures” to prevent bribery.
- The UK Bribery Act thus imposes a duty on companies to ensure that they take appropriate steps to prevent bribery from occurring. Companies who are found to have neglected this duty make themselves guilty of an additional offence under the Act.

UK Bribery Act (2)

In March 2011, the UK Secretary of State for Justice published some guidance to companies on what is considered to be appropriate steps to prevent bribery. These include:

- Proportionate procedures: Companies need to take measures to prevent bribery that are proportionate to the risk environment in which they operate.
- Top-level commitment: The board and executive management of companies should foster a corporate culture that discourages bribery.
- Risk assessment: Regular assessments need to be done to determine the risk of bribery to which a company, its supply chain and business partners are exposed.
- Due diligence: Companies have to conduct due diligence procedures on their suppliers and business partners to ensure that they are not involved in bribery.

UK Bribery Act (3)

- Communication (including training): Companies should ensure that anti-bribery policies are institutionalised in the organisation and that their staff, suppliers and business partners are well aware of these policies.
- Monitoring and review: Companies need to conduct regular reviews of their bribery-prevention policies and programmes and make improvements when necessary.

Sources:

- Foreign and Commonwealth Office (<http://www.fco.gov.uk/en/global-issues/conflict-minerals/legally-binding-process/uk-bribery-act>)
- Prof Deon Rossouw, CEO of the Ethics Institute of South Africa



Risk materialised: Cross-border case study



Cross-border case study

- The US government launched an investigation after a whistle-blower reported a company using sales agents to pay bribes to Brazilian public officials in order to secure licences and obtain permits.
- Similar allegations were made about the company in Malawi.
- After thorough investigation, the US Department of Justice (DoJ) convicted the company of corruption in terms of the Foreign Corrupt Practices Act (FCPA) and imposed a fine of U\$4,5 million.
- The American Securities Exchange Commission imposed an additional fine of U\$4,5 million for recording the payment to the public official as “special expenses” in the company books. This amounted to a separate transgression in terms of the FCPA.



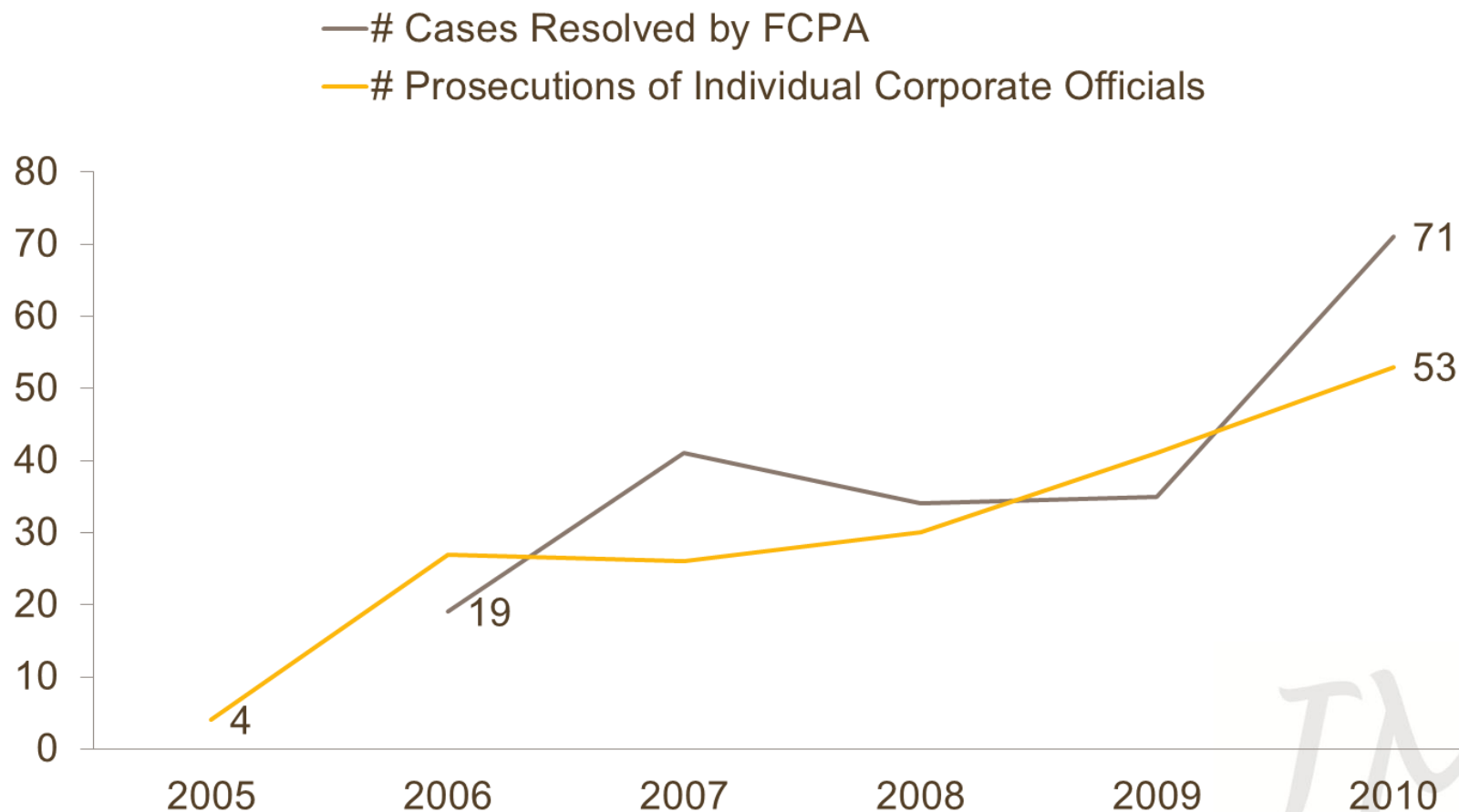
Cross-border case study (2)

- The FCPA enforcement agencies appointed a law firm as a corporate monitor for a period of three years, ending October 2013. The monitor's bills are for the account of the company.
- The monitor discovered that the company lacked a comprehensive compliance framework and that its anti-corruption training was insufficient.
- New compliance policies had to be written, including a gift policy, a whistle-blowing policy and an exceptions payments register.
- Compliance committees had to be appointed at every location to ensure legal compliance with anti-corruption legislation and implementation of the new compliance framework.
- The company also had to provide intensive training to staff covering all compliance and anti-corruption policies and procedures.

Cross-border case study (3)

- Due-diligence procedures had to be performed on all third parties to the business and a register of approved third parties had to be kept.
- All high-risk third parties (such as sales agents and joint venture partners) had to be submitted to invasive additional due-diligence questionnaires to ensure they were not involved in any dishonest business practices. They also had to attend the anti-corruption and compliance training.
- Anti-corruption clauses had to be included in contracts with third parties enabling the company to take civil action against them should a bribe be offered or paid by them.
- Should the corporate monitor and his team not be satisfied that their recommendations have been implemented fully by the end of their appointment, they may request an extension from the DoJ.
- This entire process has been very costly and time consuming.
- **NOTE:** The monitor never recommended ethics training!

Foreign Corrupt Practices Act (FCPA) prosecutions



Conclusion

Thank you for your attention!

