



cutting through complexity

Anti-Bribery and Corruption in CEE:

Rising to the challenge in
the age of globalisation

kpmg.com/abc

KPMG IN CENTRAL AND
EASTERN EUROPE



Contents

Introduction	02
Executive summary	04
Tracking the go-betweens	06
Enforcing compliance	10
Managing cross-border risks	11
Better controls needed	12
Finding the needles	13
Conclusion	14
Methodology	16
Contributors	17
Acknowledgements	17



Introduction



The globalisation of business continues unabated, with cross-border trade flourishing. This poses greater challenges for Anti-Bribery & Corruption (ABC) compliance than ever before, with two trends dominating the need for change:

- First, a growing number of governments around the world are tightening ABC regulations or introducing new ones. Enforcement agencies are working together to stem corruption. Companies that conduct business across borders, including Central & Eastern European (CEE) based companies that take full advantage of their country's membership of the European Union, have to create a strategy of ABC compliance.
- Second, corporations rely more heavily on third parties than before to do business. Once the business partner is on-boarded, differences in corporate culture, processes and systems can result in liability for ABC non-compliance of the corporation for which the third party works.

In 2013 the World Bank estimated¹ that the amount of bribes worldwide totals USD 1 trillion a year. Despite efforts to eradicate the growing threat, corruption continues to corrode the global economy. For example, 18 years after member governments of the Organisation for Economic Co-operation and Development (OECD) signed a convention² to establish legally binding standards to criminalise the bribery of foreign public officials, there still appears to be little or no enforcement of the Convention in CEE³ and other countries.

Despite the enactment of appropriate ABC laws in these countries, the most recent Transparency International (TI) assessment thereof⁴ paints a bleak picture across the CEE region: only Hungary of the CEE signatories showing limited enforcement, and the rest having been assessed as exhibiting little or no enforcement of the Convention. Issues cited in the TI report for this poor showing include:

- Political influence over prosecution, with Hungary and the Czech Republic being singled out;

¹ <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20190295~menuPK:34457~pagePK:34370~piPK:34424~theSitePK:4607,00.html>

² <http://www.oecd.org/corruption/oecdantibriberyconvention.htm>

³ In CEE, signatories to the Convention are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Poland, Slovakia and Slovenia.

⁴ Transparency International (2015), Exporting Corruption, Progress Report 2015: Assessing Enforcement of the OECD Convention on Combatting Foreign Bribery, http://files.transparency.org/content/download/1923/12702/file/2015_ExportingCorruption_OECDProgressReport_EN.pdf

- Inadequate sanctions having been introduced, with the criminal law of Estonia, Latvia, Poland and Bulgaria not appropriately covering criminal liability of legal entities;
- Failure to adequately deal with the protection of whistleblowers.

On a brighter note, over the past few years there has been a noticeable increase in the enforcement of regulations and the introduction of new legislation to combat bribery and corruption on domestic soil in the CEE. These include:

- High profile prosecutions and convictions of former politicians, including the former Prime Minister of Croatia (who has recently been granted a retrial as a result of procedural errors), the former Minister of Health in the Czech Republic (the matter is now before the court of appeal), and the former Prime Minister of Romania (imprisoned);
- The successes of the Directia Nationala Anticoruptie in Romania (with a reported 90 percent conviction rate⁵);
- The programmes of the Centralne Biuro Antykorupcyjne in Poland, for example the introduction of training to employees in public administration, issuance of guidance to the private sector through anti-corruption handbooks for entrepreneurs and companies;
- The work of the Commission for the Prevention of Corruption in Slovenia; and
- The recent passing of whistleblower protection acts in Hungary, Slovakia and Serbia.

Nevertheless, illicit payments to counter-parties continue to burden economies, diverting resources from people and places where they could do most good. Companies may consider themselves sandwiched between counter-parties asking for bribes and regulations attempting to curb the practice, but this would be a mistake. Rather than succumbing to a sense of victimhood, every company needs to ask itself some fundamental questions about why they are in business

and what it's going to take to conduct themselves ethically everywhere.

KPMG recently conducted a worldwide online survey among 659 respondents to determine the strengths and weaknesses of their companies' programmes to combat bribery and corruption. In this report we look at the responses received from 93 respondents that are based at companies in CEE, whose companies are either unlisted, or listed outside of the United States (US) or the United Kingdom (UK). The rationale behind this is to analyse responses received from respondents in jurisdictions that have not been subject to longstanding scrutiny of regulators active in the enforcement of anti-bribery and corruption.

Among others, this report seeks answers to the following questions:

- How active are CEE companies in fighting bribery and corruption compared to their global peers?
- What ABC compliance measures do they commonly take?
- Is the awareness of specific ABC tools and procedures in the CEE higher or lower compared to the global average?



Jimmy Helm
Head, Forensic in Central
& Eastern Europe
Global Head of Anti-Bribery
& Corruption Services

⁵ <http://www.economist.com/news/europe/21644209-romania-anti-corruption-agency-makes-welcome-waves-cleaning-up>

> **Executive** summary



The significant challenges to ABC compliance identified by our CEE respondents, are summarized hereunder. These answers to other questions posed in the survey would suggest that CEE-based companies might consider the following:

- Conducting a top-down bribery and corruption risk review and risk assessment. This would help companies to identify key country-, industry- and process-specific risks. This will also allow companies to direct their limited resources and funds to addressing key risks.
- Mitigating the risks posed by third parties, including agents and other high risk intermediaries, by
 - utilizing the wide range of available public record information in CEE to initiate due diligence over, and identify high risk, third parties;
 - introducing and enforcing rights to audit over their third parties in respect of transactions with the company.
- Communicating their ABC policies, procedures and compliance issues to their suppliers and customers on a regular basis.
- Focusing their training to include business ethics matters, bribery and corruption risks, and red flags. High risk / front-line functions should then undergo tailored ABC trainings.
- Making use of data analytics procedures to identify violations.

Ranking of five top ABC Challenges

	CEE Respondents	US Listed Companies	UK Listed Companies
1	Auditing third parties for compliance	Auditing third parties for compliance	Auditing third parties for compliance
2	Lack of internal resources	Cultural / Language issues	Difficulty in performing due diligence over foreign agents / third parties
3	Difficulty in identifying and assessing risk	Variations in country requirements – data privacy etc.	Variations in country requirements – data privacy, etc. (3)
4	Developing effective mechanisms for communication and training	Difficulty in performing due diligence over foreign agents / third parties	Difficulty in identifying and assessing risk (3)
5	Difficulty in conducting due diligence over foreign agents/third parties	Company’s expansion into high growth economies	Lack of internal resources

Source: Global Anti-Bribery and Corruption Survey (data concerning selected CEE companies), KPMG International, 2015

> **Tracking** the go-betweens





As part of the global survey we asked our respondents to rank, against a number of key issues, their greatest challenges in complying with ABC regulation. The answers that our CEE respondents provided showed:

- That managing third-party risk is the biggest challenge that CEE companies face in the field of bribery and corruption;
- The second biggest challenge is dealing with the lack of internal resources to fight bribery and corruption.

These rankings are especially worrisome because a very high proportion of bribes are now paid either by third parties to the ultimate recipient, or to seemingly unrelated third parties acting on behalf of the ultimate recipient. “The interposing of third parties makes it harder to police,” says Jimmy Helm, who heads KPMG’s Forensic practice in CEE and leads KPMG’s global Anti-Bribery & Corruption proactive services. He points to the recent Foreign Bribery Report of the OECD⁶ which highlighted that more than three quarters of the 427 corruption cases analysed, involved third parties.

“Clearly, a lot more needs to be done to manage third-party risk throughout the whole life cycle of the business relationship. This commences with the vetting and selection of suitable third parties, the ongoing assessment of the third parties and the continuous monitoring of transactions with these third parties, particularly those deemed to be high risk. In order to afford the protection and detection needs outlined above, companies require more resources in their risk or compliance functions,” says Helm.

CEE respondents clearly acknowledge the problems in managing third-party risk. We note the following responses from them:

- Only 56 percent of CEE respondents assess third-party risk; 78 percent of all global respondents whose

companies are listed in the US and/or UK assess third-party risk;

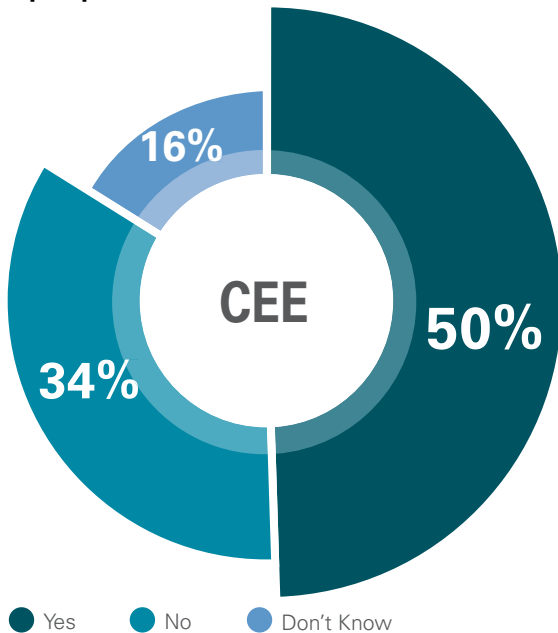
- Thirty-four percent of the respondents state that they do not formally identify high-risk third parties; only 22 percent of all global respondents whose companies are listed in the US and/or UK do not formally identify high-risk third parties;
- Only 35 percent of CEE respondents that do have a formal process to identify high-risk third parties, indicated that they have right-to-audit clauses in their contracts with third parties. Further, only 13 percent of those with such clauses have actually exercised such right. These responses are not that far off from the global responses received to the survey.

Implementing and executing regular “Know Your Supplier” procedures should not be such a big challenge if these third parties are based in the CEE. “In many CEE countries electronic records are maintained and easily accessible, allowing for examination of company records,” says Michael Peer, Partner, KPMG Forensic in CEE and Head of Corporate Intelligence. “Legislation to enforce transparency over ownership of companies (for example, prohibiting bearer shares) has been implemented in many of the CEE countries. Online archives of press and other media articles, which deal with corruption-related issues, also help clients gather intelligence concerning potentially high-risk counterparties,” says Peer, who adds: “Corruption is one of the most widely covered topics in CEE media.” Ongoing monitoring can also be dealt with by outsourcing this to service providers with access to relevant databases to monitor third parties continually to identify changes that might affect the risk rating, according to Peer.

These low numbers suggest there are big gaps in companies’ ABC compliance programmes that need filling urgently.

⁶ OECD (2014), OECD Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials, OECD Publishing <http://dx.doi.org.10.1787/9789264226616-eng>

Q. Do you have a formal process to identify high risk Third Party Intermediaries/Associated Persons from an ABC perspective?



Source: Global Anti-Bribery and Corruption Survey (data concerning selected CEE companies), KPMG International, 2015

Some 31 percent of CEE respondents to the 2015 Survey admit they do not have formal risk-based on-boarding processes for third parties, opening companies to the possibility of corrupt practices spreading contagion. "When CEE companies claim they conduct due diligence at the third party's on-boarding, it is mostly around VAT registration and credit risk," says Maroš Holodňák, Director, KPMG Forensic in the Czech Republic.

A lot of the problems could be tackled at this point by screening the third party more deeply, says Michael Peer, who offers this guidance. "Get as much detail as possible from the counterpart and be clear that you want the detail. As it is becoming a standard practice in the market, be wary of those reluctant to provide sufficient detail," he warns.

The risk or compliance functions should be involved in the on-boarding process as a second line of defence, says Holodňák. "They need to assess issues such as political affiliations and relationships of the third parties that might harm the reputation of the company, and provide input into the risk profile of the third party before it is on-boarded."

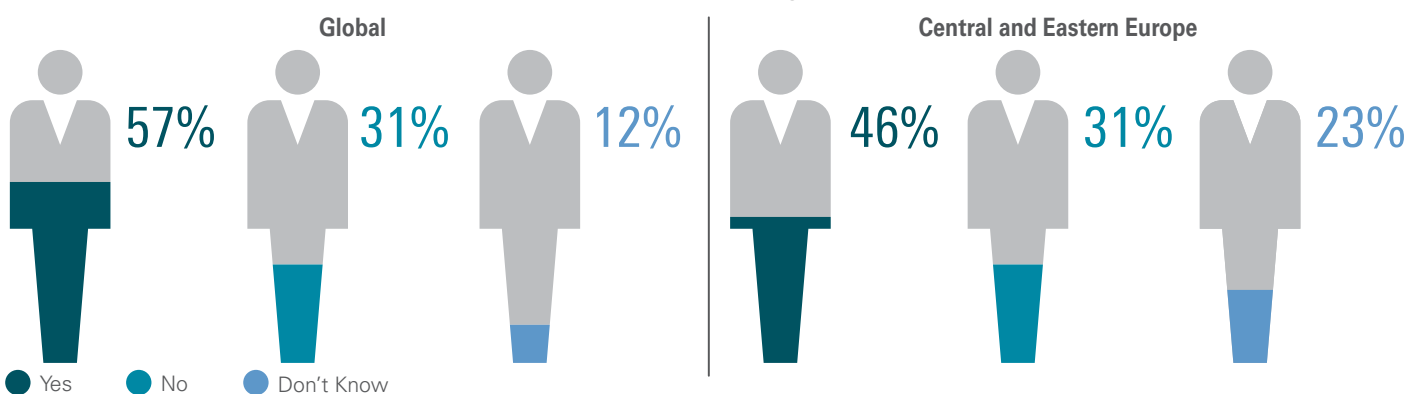
Although 56 percent of our CEE respondents have indicated that they do conduct a third-party risk assessment, their responses would indicate that the questions asked are not comprehensive enough: as example 50 percent don't ask whether the third parties provide high-risk services.

Once on board, third parties should be made aware of, and possibly subject to, the compliance standards of their customer. Seventy-one percent of the CEE respondents told us that their companies have a formal ABC compliance programme in place, but only a minority thereof communicate the policies and procedures to third parties, such as agents and joint venture partners (22.7 percent), or other selected third parties (18.2 percent). These responses are well below the responses from the global UK/US listed entity respondents: 38 percent distribute their policies and procedures to agents and joint venture partners.

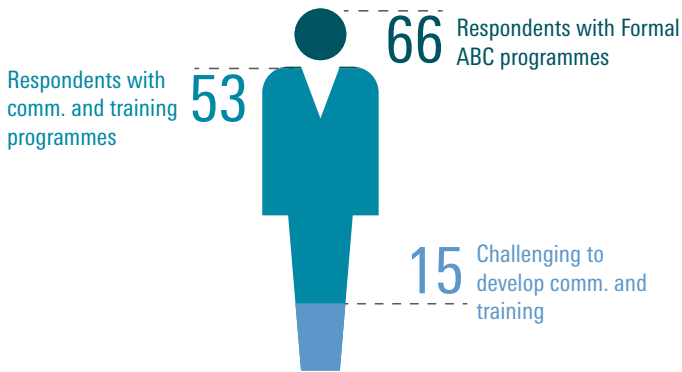
Of the 66 CEE respondents with formal ABC compliance programmes, over 80 percent have communication and training programmes. Twenty-eight percent of those, however, stated that the development of effective mechanisms for communication and training programmes is highly or exceedingly challenging. "This response is surprising, given that communication and training issues appear to have been overcome to a large extent at the global level," Agnieszka Gawronska-Malec, Director, KPMG Forensic in Poland, says. She offers that "Perhaps this is an issue that is not appropriately prioritised by CEE management. After all, what is the value of an ABC programme if you don't communicate your policies to the stakeholders and train your staff on the implementation thereof and adherence thereto."

The failure to communicate their programmes to third parties and the generally low right-to-audit clauses enforceability indicate that the companies that our CEE respondents

Q. Do you have a formal business risk based process for on-boarding your Third Party Intermediaries/Associated Persons?

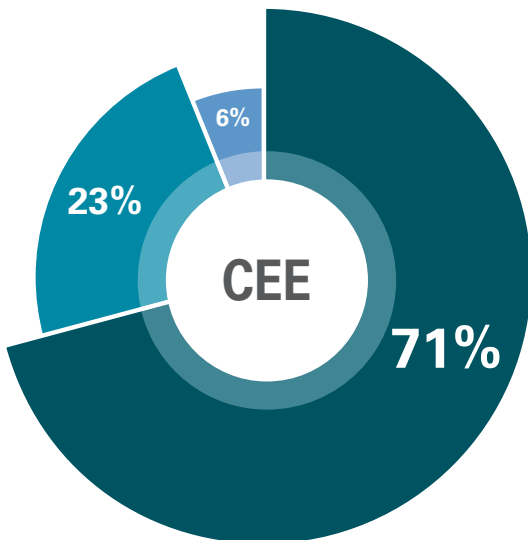
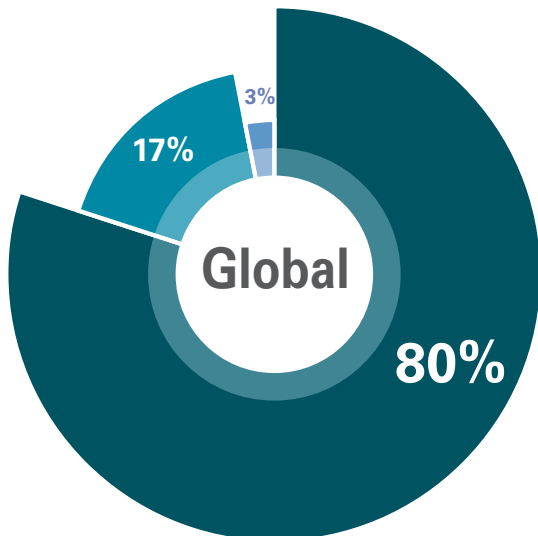


Source: Global Anti-Bribery and Corruption Survey (data concerning selected CEE companies), KPMG International, 2015



Source: Global Anti-Bribery and Corruption Survey (data concerning selected CEE companies), KPMG International, 2015

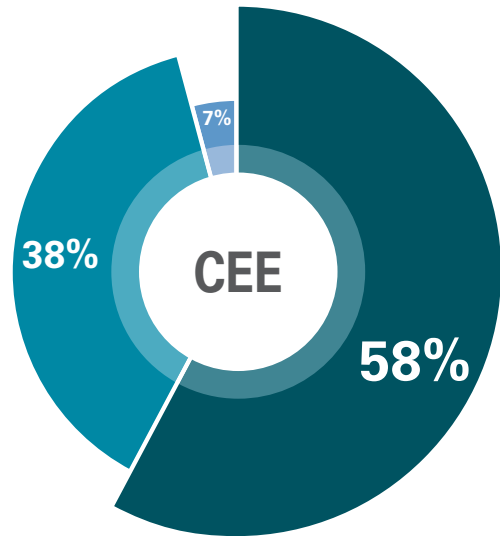
Q. Does your company have a formal, written anti-bribery and corruption compliance programme?



● Yes ● No ● Don't Know

Q. Are your anti-bribery and corruption policies and procedures translated into multiple languages?

Among those who have a formal, written anti-bribery and corruption compliance programme



● Yes ● No ● Don't Know

Source: Global Anti-Bribery and Corruption Survey (data concerning selected CEE companies), KPMG International, 2015

represent are reluctant to police their third parties directly. "There's a significant internal reluctance from the likes of the procurement function and the sales force to enforce compliance on third parties - management are often hesitant to offend them, particularly strategic suppliers or distributors," says Jimmy Helm.

Then there is push-back by the corporate's business partners; on the other side, third-party corporations can be equally shy about opening their books to customers. One answer is to engage an independent service provider, under a confidentiality agreement with the third party, to perform regular audits in line with the contractual obligations, and to then report only on issues governed under the contract and pertaining to the business of the customer in the third party's books and records.

Enforcing compliance



Inadequate management of third-party risk is part of a wider problem of implementation. The U.S. Foreign Corrupt Practices Act (FCPA) has been in effect since 1977 and the UK Bribery Act since 2011, so it would be rare to find a global company that doesn't address ABC to some degree within its compliance programme.

In this respect, the survey clearly showed that UK and US based companies outperform CEE companies in terms of having a formal ABC policies. Only 71 percent of the CEE companies declared that they had a formal written anti-bribery and corruption compliance programme compared to more than 91 percent of UK and/or US listed companies.

But how effective are their ABC compliance efforts? "Companies often argue they have developed a sturdy programme, but when we review it, we find that this is not the case," says Helm. "They may have sound internal policies, but they struggle to communicate them. They have not conducted an ABC risk assessment. They have not implemented detective procedures to identify red flags."

Taking up the issue of ABC training, Gawronska-Malec notes that "Training of staff tends to be commonplace in companies where an ABC programme is reasonably well-developed and not in its infancy. But all too often we see generic training, usually online, that simply reiterates legislation, policies

and procedures. Awareness training, particularly in high risk industries where there are significant government touchpoints, must go beyond the rudimentary message of 'Don't give bribes, as it can damage you, the company and the shareholder', and needs to focus on ethical and cultural aspects, and provide in-depth insights into the risks of bribery and corruption. Additional, specific training should be provided to the appropriate functions of the business on the risks, red flags and measures to prevent and detect bribery at process level."

Managing cross-border risks

Our respondents may have less involvement in driving cross-border mergers and acquisitions (M&A), with only 41 percent of CEE respondents (47 percent listed CEE corporations) in our poll stating that they engage in M&A compared to the global figure of 60 percent.

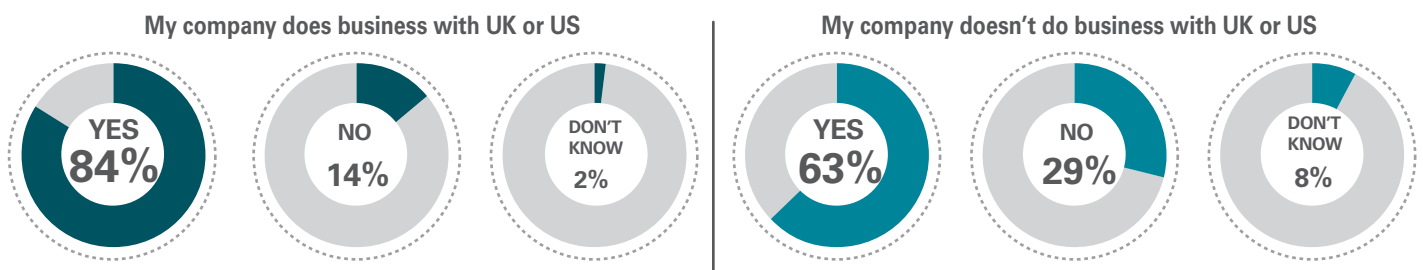
But the fact remains that M&A involving entities located in the CEE continues to grow. Alexander Verbeek, Partner and Head of KPMG Deals in CEE, confirms this: “Companies in CEE continue to remain attractive to investors and multinationals wishing to extend their reach into this area. Companies with a highly skilled workforce, coupled with attractive investment initiatives, including tax advantages, and the logistical advantages of EU membership, provide great targets for US, UK and Western European companies flush with cash. Although the era of major privatisations is over and the deals are of lower value, international interest remains high in niche local market players.”

Guidance issued by the U.S. Department of Justice (DOJ) and U.S. Securities and Exchange Commission⁷ encourages buyers to “conduct thorough risk-based FCPA/ anti-corruption due diligence procedures on potential new business acquisitions” to avoid successor liabilities and to avoid future bribe payments occurring. Verbeek confirms that for investors from the US and the UK, pre-acquisition procedures are no longer just limited to financial and legal due diligences – there is increasing demand for pre-acquisition ABC procedures to be performed over target entities in the CEE.

Verbeek agrees with the statements in the KPMG Global Survey that buyers do not always have the capacity to carry out full-fledged due diligence procedures over their targets, particularly in those situations where the buyer is a competitor of the target. But he endorses the view of KPMG’s Global Forensic team that these procedures should be done post-acquisition over the acquired entity, when the buyer has control over the entity.

Helm points out that M&A deals are sometimes scuppered by the fact that the ABC due diligence turns up negative findings. It goes without saying that if local companies have introduced ABC compliance programmes in line with their local legislation, this may smooth the path somewhat. He cites as example the fact that many CEE companies are already having to come to grips with complying with the ABC programmes of their UK⁸ and/or US business partners: The survey showed that CEE companies doing business with UK and/or US clients are more likely to have its own ABC programme (84 percent) than companies without a UK or US client base (only 63 percent have such a programme).

Q. Does your company have an ABC compliance programme?



Source: Global Anti-Bribery and Corruption Survey (data concerning selected CEE companies), KPMG International, 2015

⁷ A Resource Guide to the U.S. Foreign Corrupt Practices Act, By the Criminal Division of the U.S. Department of Justice and the Enforcement Division of the U.S. Securities and Exchange Commission, 2012 <http://www.justice.gov/criminal/fraud/fcpa/guidance/guide.pdf>

⁸ The UK Bribery Act criminalises a corporation's failure to prevent bribery in the UK or abroad by an “associated person,” which it broadly defines as a person who performs services for, or on behalf of, the corporation.

> Better controls needed



The responses clearly indicate that there is a number of risks facing companies operating in the CEE region. It is imperative that once the risks have been identified, the company's ABC controls are evaluated to determine whether they are effective in mitigating the risks. This is a highly complex task: survey respondents say that the difficulty of identifying and assessing ABC risk ranks as the third most significant challenge that they face.

One difficulty is that this assessment requires money and manpower. In fact, the lack of resources ranked second overall among the top challenges facing the survey's CEE respondents.

"Many companies are not making a risk assessment a high enough priority. It is difficult to envisage how one can run an effective compliance programme without understanding and focusing on the key risks to the organisation," adds Holodřák. Only 54.5 percent of the CEE respondents who have a formal ABC compliance programme in place declared that the programme also provides for an ABC risk assessment process. Gawronska-Malec agrees: "It is essential to conduct a comprehensive top-down risk assessment. Only then can companies determine where the controls fall short and establish spending priorities for ABC compliance." If the ABC controls are not mitigating the risks identified, then they need to be redesigned, she says.

It is further apparent from the survey responses that many important elements of the ABC programme have not been implemented in the CEE-based companies, says Helm, drawing attention to the following responses from those responding that a formal ABC programme was in place:

- Only 59.1 percent stated that they had whistleblower mechanisms in place. The global response was that 81.5 percent had implemented these mechanisms;
- In line with the key challenge regarding the lack of internal resources, only 40.9 percent had a full-time dedicated ABC compliance officer in place.

> Finding the needles

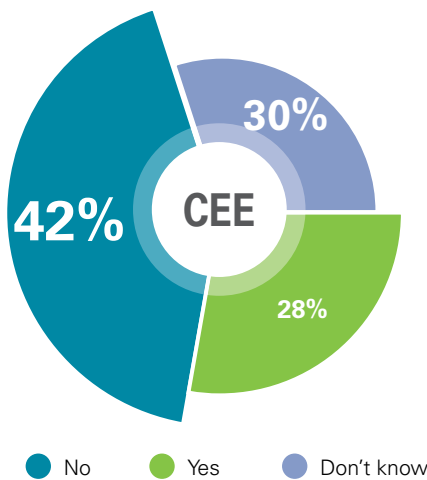
One of the most cost-effective ways to monitor ABC controls is by using data analytics. However, only 28 percent of CEE respondents use data analytics to identify controls violations and, of those that do, a mere 27 percent continuously monitor data to spot potential violations.

Although most companies could benefit from leveraging their data to address bribery and corruption risks, it's vital that analytic efforts are appropriately directed. David Watterson, Senior Manager and Leader of Forensic Technology at KPMG in CEE, notes "Analytic activity is not going to generate value unless you're asking the right questions of your data. Companies often obsess over selection of software tools, but fail to adequately consider the data that's available to them or the meaningful questions that their data is capable of answering." With this in mind, close collaboration between systems specialists, data analysts, compliance and business

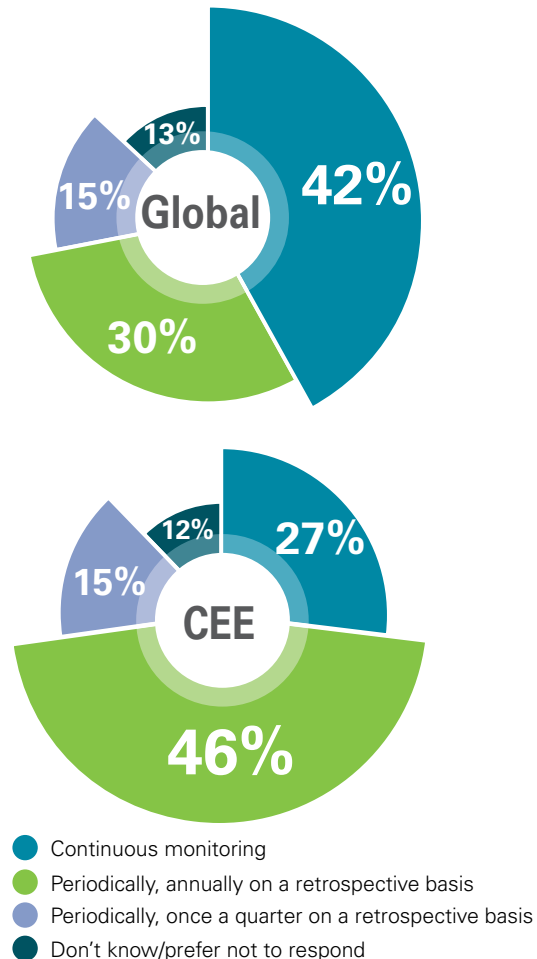
managers is needed to develop an effective data-driven approach to the management of ABC risks.

"Of those companies that use data analytics in the management of ABC risks, many apply such techniques only on an infrequent or ad hoc basis. Frequently this happens in reaction to a particular allegation," says Watterson. Although it may require some investment, setting up ongoing monitoring allows issues to be identified and addressed whenever they occur. Watterson explains: "With ABC risk, prevention is certainly better than cure. Well-designed continuous monitoring may enable companies to spot issues as they emerge, or even to halt questionable transactions before payments are approved. This is far better than discovering a series of questionable transactions a year or more after they began."

Q. Do you conduct ABC specific Data Analytics to identify potential violations



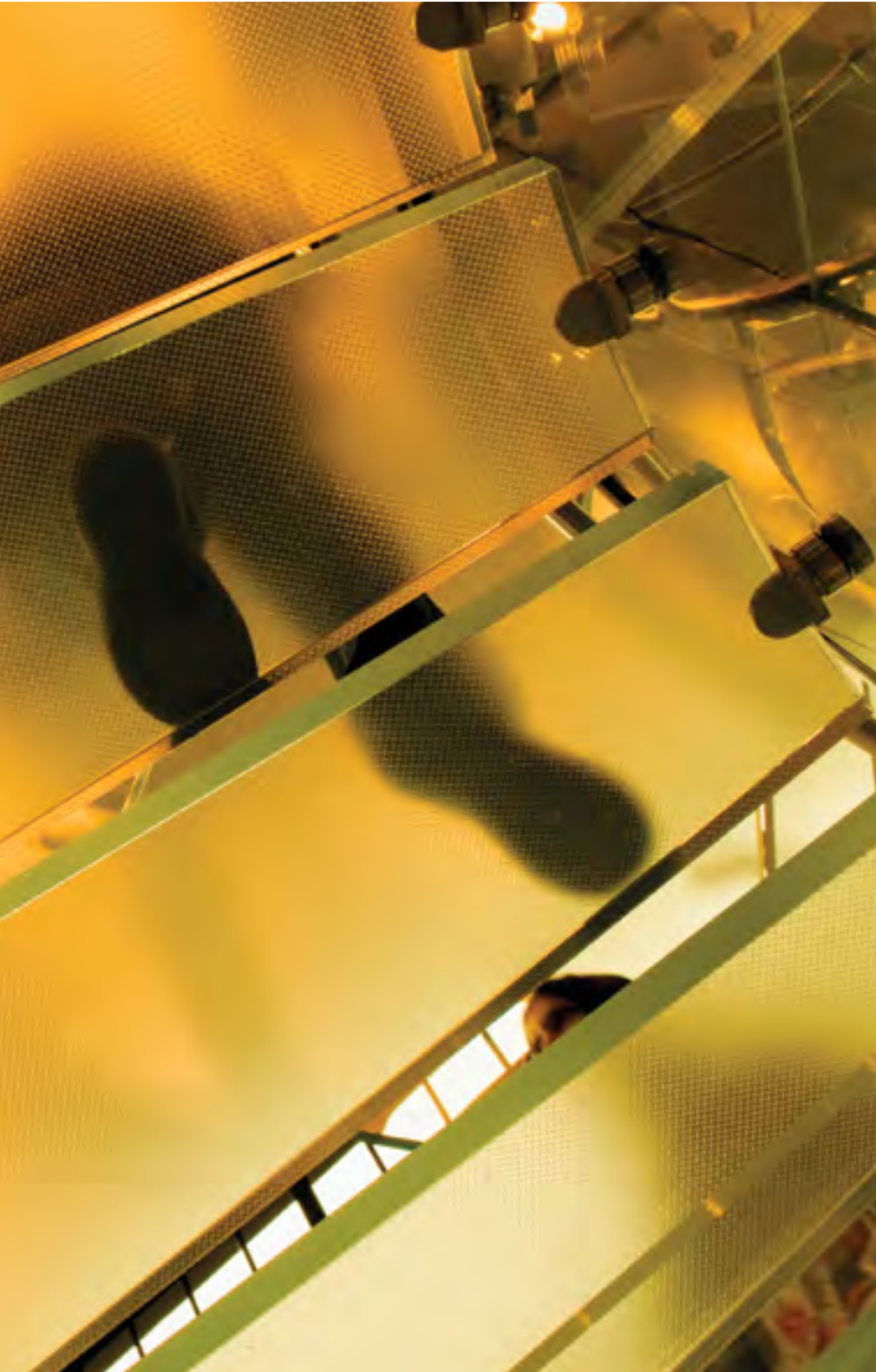
Q. What is the frequency of conducting the ABC Data Analytics?



Source: Global Anti-Bribery and Corruption Survey (data concerning selected CEE companies), KPMG International, 2015

> Conclusion





The world is changing, and business conduct needs to change along with it. Both the business community and world leaders have recognised that progress can only be made through the joint action of government and the private sector. One forum where these issues are being discussed is the B20, a group of private sector organisations in the G20 economies that provide official recommendations to the G20 leaders on how to promote integrity and transparency in business. In the past five years the focus on anti-corruption has intensified, with business seeking a more harmonised global regulatory landscape that recognises and encourages responsible business practices, as well as discouraging unethical behaviour. We have a long way to go to curb corruption, but the B20 is taking a step in the right direction.

In summary, companies operating in the CEE need to rise to the challenge of managing their ABC risks, in order to:

- Remain competitive in markets that are under increasing pressure to enforce ABC regulations;
- Attract the attention of foreign investors;
- Strengthen their trading opportunities with counterparties in highly regulated (ABC) jurisdictions.

The B20 coalition brings together business leaders from the G20 economies and advises on the views of more than 6.5 million small, medium and large companies. KPMG has been a member of the anti-corruption taskforce since 2013 and was co-chair of the group in 2014.

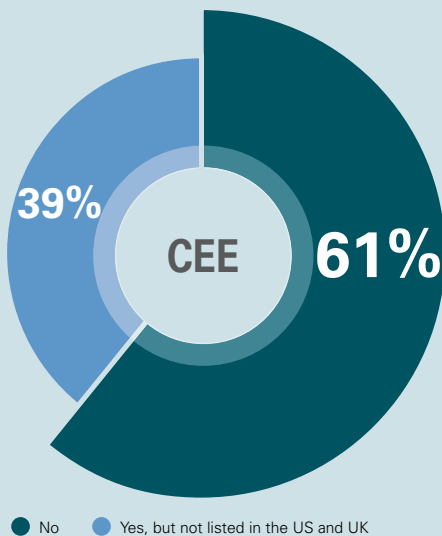
Methodology

KPMG, together with Singapore Management University, performed a survey across **64 countries**, receiving **659 responses** from persons who considered themselves “one of the most senior persons in charge of day-to-day ABC matters at their companies”.

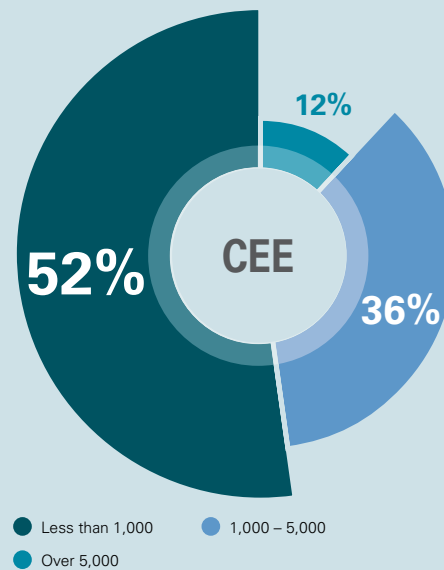
The respondents represented companies across the spectrum of industry and of varying size and revenue.

One hundred and twenty-eight of these respondents were based in the CEE, of which 93 worked for entities that are not listed in either the U.S. or UK. This report has focused on the latter 93 responses. Their demographics are as follows:

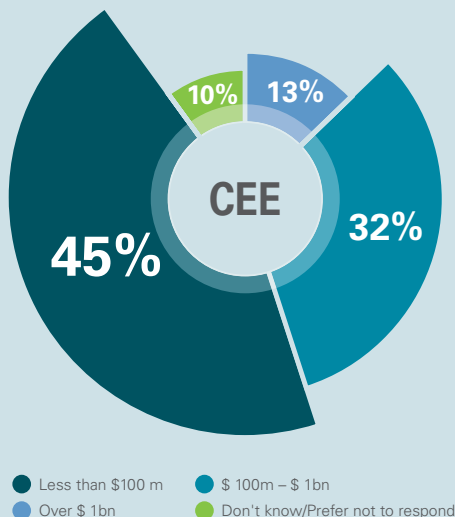
Q. Is your company or parent company listed?



Q. How many employees does your company have?



Q. What is the annual revenue of your company?



Source: Global Anti-Bribery and Corruption Survey (data concerning selected CEE companies), KPMG International, 2015

Contributors

Jimmy Helm, Partner, Forensic, Central & Eastern Europe

Michael Peer, Partner, Forensic, Central & Eastern Europe

Alexander Verbeek, Partner, Deals, Czech Republic

Maros Holodnak, Director, Forensic, Czech Republic

Agnieszka Gawronska-Malec, Director, Forensic, Poland

David Watterson, Senior Manager, Forensic Technology, Central & Eastern Europe

Acknowledgements

Michal Sticka, Manager, Forensic, Czech Republic

Contact

Jimmy Helm

Global Head of Anti-Bribery & Corruption

KPMG in Central & Eastern Europe

T: +420222123430

E: jhelm@kpmg.cz

Responsible for communication:

Andrea Dintser

T: +36 1 887 72 16

E: adintser@kpmg.com

kpmg.com/cee

kpmg.com/socialmedia



kpmg.com/app



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2015 KPMG Central & Eastern Europe Limited, a limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.

Designed by Evalueserve.

Publication name: Anti-Bribery and Corruption: Rising to the challenge in the age of globalisation