

# Forensic FOCUS

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## Defending Against Unwanted Surprises: Bribery and Corruption Due Diligence

Purchasers investing around the globe are faced with the increasing challenge of responding to a changing legislative and business environment connected with the fight against bribery and corruption. For example, in recent years there have been changes to the Canadian Corruption of Foreign Public Officials Act ("CFPOA"), increased attention on the UK Bribery Act and new anti-bribery laws introduced in Russia and China. Meanwhile, the US continues its rigorous enforcement of the Foreign Corrupt Practices Act ("FCPA") with fines, penalties, and settlements costing companies millions of dollars (in addition to professional fees required to investigate or remediate compliance violations).

Globalization poses greater challenges than ever before. Investing internationally creates both legal and business risks if the threats of bribery and corruption are not properly managed. A recent [KPMG International report](#) analyzes some of the key risks companies face when dealing with bribery and corruption. The survey of companies around the world shows that companies are attempting to rise to the challenge but that a great deal more needs to be done to create a sturdy compliance structure.

Investing internationally creates both legal and business risks if the threats of bribery and corruption are not properly managed. These risks can have an impact on the valuation of a transaction, as well as an impact on the return on investment from the acquisition. If bribery and corruption is not identified prior to closing, the problem is inherited by the purchaser, along with the associated potential harm to profitability, civil and criminal liability, and perhaps most importantly, damage to reputation.

The following outlines some anti-bribery and corruption ("AB&C") considerations through the transaction process.



### Today's Reality

- There is a global trend of increased merger and acquisition activity.
- Enforcement of rigorous anti-bribery and corruption legislation is on the rise worldwide.
- Mergers and acquisitions of international counterparts can introduce new compliance requirements as relevant jurisdictions expand.
- The combination of these factors increases the importance of compliance-related acquisition due diligence, including addressing bribery and corruption risks in the context of the post-acquisition legislative requirements.





## Pre-Acquisition

It is important that the acquiring company send the message that bribery and corruption is not tolerated. This starts with clear messaging from senior leadership, and is demonstrated by an appropriate and effective AB&C program. Ideally, a comprehensive AB&C program should address due diligence considerations to simplify the process going forward. It is also important for an AB&C program to include due diligence considerations as it is optimal for this type of work to be integrated with legal, financial and other due diligence during the acquisition process.

In advance of proceeding into the due diligence process, acquisition teams should consult with forensic accountants and legal advisors to gain any geography-specific bribery and corruption insights to right-size the due diligence effort in this area.

## Assessing the need for AB&C Due Diligence

- Does the target have an international footprint and operate in countries with high incidents of corruption?
- Does the target operate in an industry with significant interactions with government officials
- Does the target utilize a significant number of third parties to manage its sales or operations in other countries?
- Has the target had previous issues regarding fraud, regulatory noncompliance or tone at the top?

## Due Diligence Period

The focus of an AB&C due diligence exercise is to measure any potential unmitigated exposure. This can be accomplished through evaluation of existing compliance programs, obtaining a deeper understanding of unique risks, probing into relationships, and examining books and records to identify irregularities.

It is critical that the nature and extent of AB&C due diligence align with the assessed level of AB&C risk. Such risk is best understood by focusing on the geographic and industry factors and risks that are specific to the target organization, such as a history of or reputation for corruption. An unwillingness for the target to participate in this type of due diligence may be a significant red flag on its own, increasing the risk associated with the transaction.

The vast majority of FCPA enforcement cases involve allegations that the books and records were inaccurate and/or that internal controls were deficient. These cases highlight that a critical aspect of bribery and corruption cases hinge on whether a company has complied with applicable accounting standards. Experience has shown that AB&C due diligence can involve financial reviews of transactions that can extend through many countries with record keeping questions often at the forefront.

## Potential consequences of acquiring bribery issues:

- Criminal, civil and financial proceedings and related costs and sanctions.
- Diminished asset values and returns/distortion of market value.
- Reputational damage and adverse media attention, resulting in business instability.
- Debarment from government contracts and other regulatory authority restrictions.
- Liability of directors, partners, and officials and potential loss of key people in target company.
- Introduction of a culture of dishonesty and corruption.

Beyond the jurisdiction of the FCPA or other legislative requirements, the accurate books and records combined with sound financial controls supports the operation of an effective compliance culture.

Forensic accountants conducting AB&C due diligence need to dive deep into the books and records for the true trail of transactions to identify potential issues as well as process-level risks and control weaknesses. The results of such detailed analysis should be provided to the Acquisition Committee (or its equivalent), to develop the appropriate strategy to address highlighted corporate issues and exposures, assess the residual risk and determine whether and how these risks can be managed. As with any other risks, if substantial issues are noted, the transaction should proceed cautiously, with a plan to address these risks if the transaction is completed.

When conducting AB&C due diligence, traditional due diligence procedures, such as compliance program reviews and key personnel interviews, are enhanced with an expanded scope of review to address the increasing requirements of enforcement agencies. This can include the use of data analytics for the books and records “deep dive” mentioned above, and enhanced integrity research procedures to evaluate counterparties.

## Data Analytics

Forensic accountants with significant AB&C experience have developed sophisticated AB&C data analytic tools that add considerable power and efficiency when examining financial and accounting data. These tools can mine large volumes of data, such as travel and entertainment expenses or vendor payments with a view to identifying anomalies and areas of higher potential risk. This information can be invaluable to the transaction team to help identify bribery and corruption risks and develop investigative or due diligence plans. Data analytics can also assist with investigating suspicious payments through tools such as link analysis that can cull through large volumes of transactions to highlight certain relationships and transaction flows. These procedures can be used to identify payments made between a company to government officials, politically exposed persons, and third-party intermediaries.

## Third Party Integrity

Integrity due diligence of a company’s business partners, suppliers, agents, and other representatives is a vital element of an effective AB&C compliance program and related transaction due diligence. However, such information can be difficult to find especially when the individuals or entities are located in foreign jurisdictions. Enhanced due diligence intelligence tools are available that can scour worldwide public and proprietary databases such as sanctions lists, litigation

dockets, legal judgments, and adverse media reports—and very often in local languages. For example, KPMG’s Astrus™ platform provides a consistent, thorough public-source research tool to gather and analyze information about business partners, agents, and other third parties. These solutions are powerful tools to help companies and their legal counsel assess AB&C risks and understand who your business partners really are.

When conducting integrity due diligence and other aspects of AB&C due diligence in foreign lands, there is usually a need for assistance with local languages, translation, local practices, culture and customs. Having “boots on the ground” from the relevant country and with expertise and experience in dealing with AB&C issues can be critical for Canadian counsel when considering a major transaction.

## Post-Acquisition

In many situations, the information required to perform complete AB&C due diligence may not be available as the transaction is being assessed. This may be the case in hostile takeovers, minority investments, acquisitions of public companies or other situations where the deal faces time pressures. However, the lack of available information, combined with time pressures, should not deter the due diligence process altogether. Rather, the due diligence process should continue post-acquisition to ensure that AB&C risks are appropriately understood and any exposures are adequately managed.

During AB&C due diligence review, there are often accounting-related and compliance issues that have been identified that need to be remediated. For example, books and records might need to be corrected, internal controls enhanced, and accounting processes implemented. The direct and close involvement of experienced forensic accountants may continue after the transaction is completed to assess weaknesses in a control environment, design appropriate remediating controls, and help implement and test the controls for effectiveness.

If bribery is discovered at this stage, companies should consult with legal counsel in consideration of reporting it to the appropriate authorities. Identifying issues sooner, rather than later, and cooperating with the authorities can make the issues easier to resolve. For example, a representative of the US Justice Department’s Criminal Division has stated that it is committed to giving “meaningful credit to companies that self-report and cooperate with our investigations.”<sup>1</sup>

In summary, it is recommended practice to integrate a risk-based approach that is proportionate to the bribery and corruption risks into the due diligence process – it is not an area where you want to get more than you bargained for!

<sup>1</sup> <http://www.justice.gov/opa/pr/johnson-johnson-agrees-pay-214-million-criminal-penalty-resolve-foreign-corrupt-practices-act>, accessed July 16, 2015.

## 10 Good Practice Principles for Anti-Bribery Due Diligence in Mergers, Acquisitions and Investments<sup>2</sup>

Policies & Procedures	1. The purchaser has a public AB&C policy 2. The purchaser has an effective AB&C program that is compatible with leading practices
<b>Due Diligence: Pre-Acquisition</b>	3. AB&C due diligence is considered on a proportionate basis for all merger transactions, business acquisitions, private equity and other investments 4. The level of AB&C due diligence is commensurate with assessed risk 5. AB&C due diligence is embedded early in the transaction process 6. Senior management provides oversight to the AB&C due diligence process 7. The results of the AB&C due diligence is effectively communicated to the appropriate decision makers
<b>Due Diligence: Post-Acquisition</b>	8. The purchaser continues due diligence post-acquisition, as appropriate 9. The purchaser ensures that the target adopts an appropriate AB&C program 10. Bribery detected through due diligence is reported to the authorities

2 Adapted from "Anti-Bribery Due Diligence for Transactions: Guidance for Anti-Bribery Due Diligence in Mergers, Acquisitions and Investments," Transparency International UK 2012.

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KPMG Forensic (Canada) has offices and qualified forensic professionals throughout Canada, with major offices located in Halifax, Montréal, Ottawa, the Greater Toronto Area, Southwestern Ontario, Calgary and Vancouver.

### Contact us

For more information about anti-bribery and corruption, please visit us at [www.kpmg.ca/antibribery&corruption](http://www.kpmg.ca/antibribery&corruption), or contact:

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