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GLOBAL ENERGY INSTITUTE

The growing global challenge

Managing anti-bribery and corruption compliance in energy and natural resources

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The **Growing** global challenge of managing anti-bribery and corruption compliance

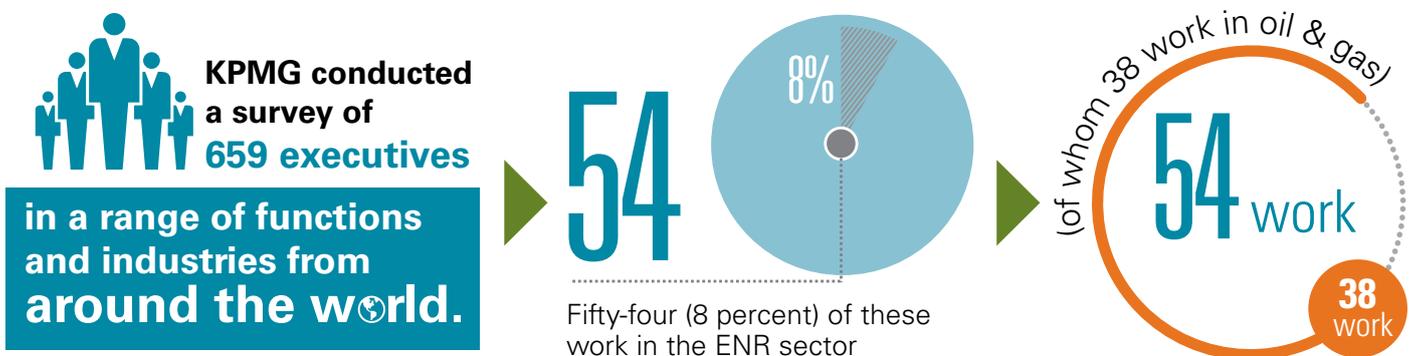
Companies in the energy and natural resources (ENR) sector face an increasingly complex operating environment around the world, not least in the field of compliance – and especially in the area of anti-bribery and corruption (ABC). As ENR companies push further into lesser known geological regions, risks proliferate and become more difficult to measure. Companies are continuing to expand into a growing number of countries whose politics and societies make it exceedingly difficult to calibrate an effective ABC compliance framework. Falling commodity prices have exacerbated the challenges faced by compliance functions as they compete with other parts of the business for scarce funding.

Two factors are creating new compliance risks for ENR companies. First, a growing number of governments around the world are tightening ABC regulations or introducing new ones. Second, as companies globalize their operations, they rely more heavily on third parties than before to do business in far-flung parts of the world, often in areas where there is a high risk of corruption.

The potential cost of failing to comply with ABC regulations somewhere in the world is significant: sizeable fines, the possibility of imprisonment, and the loss of corporate reputation. But it is expensive to create a framework to prevent, detect and respond to corruption. At a time of weak commodity prices, ENR companies face severe

cost constraints in implementing, maintaining or enhancing a framework to mitigate the risk of non-compliance. However, by taking the correct approach to the problem, organizations are able to develop a fit-for-purpose compliance framework that manages the risk without breaking the bank.

In order to assess the risk of ABC compliance, KPMG conducted a survey of 659 executives in a range of functions and industries from around the world. Fifty-four (8 percent) of these work in the ENR sector (of whom 38 work in oil & gas). All were asked a series of questions about the most challenging aspects of ABC compliance, and the oil & gas executives were given additional questions specific to their industry. The findings presented in this report are



Source: Global Anti-Bribery and Corruption Survey, KPMG International, 2015

taken from the responses of: the oil & gas industry; the ENR sector including mining; and all 659 executives.

The most striking finding of the survey is a sharp increase in the proportion of respondents in all sectors who say they are highly challenged by the issue of ABC, compared with a survey KPMG conducted 4 years earlier. In 2011, we asked executives in the US and the UK their views of ABC and were able to compare their responses to the responses of executives of listed UK and US companies in the latest research. More than double the number than in 2011 found it difficult to monitor and evaluate compliance. "A growing number of companies are finding it more difficult to deal with ABC issues, because of their complexity, increasing globalization of their operations and the need to deal with these matters in many different jurisdictions," says Jimmy Helm, Global Head of Anti-Bribery & Corruption

Services, KPMG in Czech Republic. "There's a greater understanding of the issues faced, but this doesn't mean they are easier to deal with."

"In reply to several enforcement actions in the US, multinational players in the ENR sector have, over the past 5 years, been actively driving ABC policy, compliance and training programs across their operations. With this accomplished to a greater or lesser degree, however, many of our ENR clients are experiencing an increase in reports of alleged breaches. This is placing a burden on resources to be reactive in investigating the reports and to be less proactive in monitoring and detecting ABC violations. The need for technology and data analytics to assist in the detection (and prevention) role is therefore something we see as an emerging trend in the sector," says Roy Waligora, Global Forensic Sector Leader, ENR, KPMG in South Africa.

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Global Forensic Sector Leader,
ENR
KPMG in South Africa

Among ENR respondents, there is only a small difference in response to a wide range of issues that were worrying executives, including matters involving third parties. But the three biggest concerns are: variations in countries' regulations; the low level of awareness among the workforce

of ABC requirements; and training & communications. Eight-nine percent of ENR executives say each of these three issues is challenging. By contrast, 80 percent say it is challenging to audit third parties for compliance. This is some way behind the three biggest concerns, but is still a high number.



89% of ENR executives say each of these three issues is challenging.



80% By contrast, 80 percent say it is challenging to audit third parties for compliance.

Source: Global Anti-Bribery and Corruption Survey, KPMG International, 2015

Tracking the go-betweens

Managing third-party risk is the biggest challenge that companies face across all sectors in the field of bribery and corruption. We asked our respondents to rank a number of key issues in terms of the level of difficulty. Their answers showed that third parties posed the greatest challenge, ranking first in terms of auditing third parties for compliance and third in conducting due diligence over them. (The second biggest challenge is dealing with the variation in national regulations pertaining to bribery and corruption.)

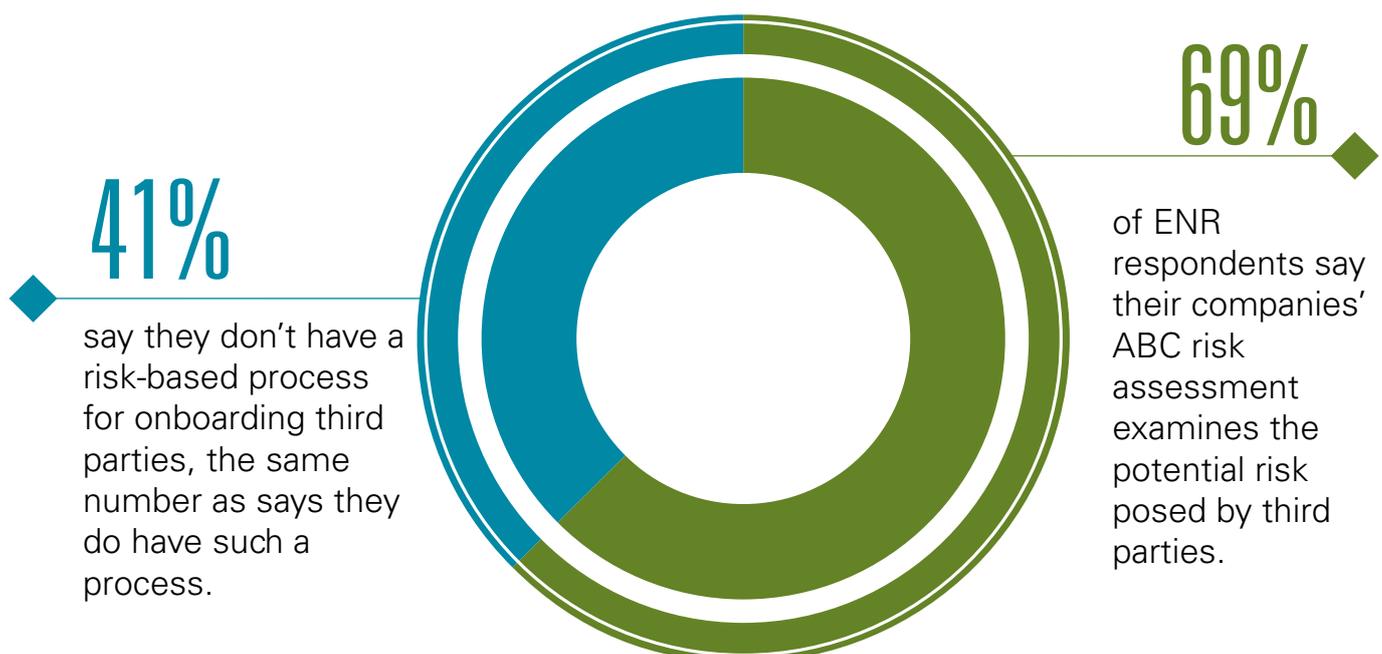
These and other challenges noted in the survey are especially worrisome because a high proportion of bribes are now paid either by third parties to the ultimate recipient or to seemingly unrelated third parties acting on behalf of the ultimate recipient. The interposing of third parties makes it harder to police, says Michael Schwartz, US Forensic Sector Leader, ENR, KPMG in the US.

According to the Foreign Bribery Report of the intergovernmental Organization for Economic Co-operation and Development (OECD)¹, more than three-quarters of 427 corruption cases analyzed involved third parties. Clearly, a lot more needs to be done to manage third-party risk, from the vetting and selection of suitable intermediaries and suppliers to the continuous monitoring of transactions with these third parties.

A number of weaknesses with regard to third party risk come to light in the survey. Some 69 percent of ENR respondents say their companies' ABC risk assessment examines the potential risk posed by third parties. But 41 percent say they don't have a risk-based process for onboarding third parties, the same number as says they do have such a process. This is an important gap in the program, because a proper procedure to vet third party agents during the onboarding stage

“The interposing of third parties makes it harder to police”

Michael Schwartz
US Forensic Sector Leader,
ENR
KPMG in the US



Source: Global Anti-Bribery and Corruption Survey, KPMG International, 2015

1. 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>

“Companies need to take a risk-based approach to the ABC due diligence of vendors.”

Roy Muller

South Africa Head of Anti-Bribery & Corruption Services
KPMG in South Africa

can prevent the contagion of corruption spreading through the organization.

Even earlier than onboarding, companies need to make a greater effort to assess third party risk. Despite the difficulty of monitoring their business dealings with third parties, only 48 percent identify high-risk third parties; 37 percent do not and 15 percent don't know. “Companies need to take a risk-based approach to the ABC due diligence of vendors.

However, a material weakness is where companies indicate that ABC risk is considered, there is often no audit trail or a very poor one to identify high-risk third parties and no clear ranking of them according to the level of risk.” says Roy Muller, South Africa Head of Anti-Bribery & Corruption Services, KPMG in South Africa.

Once on board, it is important to draft contracts that protect the organization from possible illicit dealings of intermediaries. But only 56 percent say they have right-to-audit clauses in third party contracts. It is highly likely that companies that actually do have right-to-audit clauses are not exercising them. In the general survey, only 41 percent of respondents that had right-to-audit clauses have actually exercised the right. ENR companies remain sensitive about maintaining good relations with key agents, intermediaries or suppliers, but the risk of not doing enhanced due diligence can often outweigh the risk of upsetting the third parties. It is also advisable to make third parties aware of the company's policies and procedures for ABC compliance. Yet only 30 percent distribute their ABC policies and procedures to third parties, while 74 percent say they are given out to their employees. Annabel Reoch, UK Head of Anti-Bribery & Corruption Services, KPMG in the UK, says that “prosecutors and regulators may not take kindly to this head-in-the-sand approach to third party risk mitigation. By not exercising third party audit rights, unethical conduct may continue unchecked, risking greater fines, penalties and business disruption when the issue eventually surfaces.”



Source: Global Anti-Bribery and Corruption Survey, KPMG International, 2015

Challenges in many areas

The survey also shows a variance in attitude among those who were challenged by compliance matters. Among the 16 ENR executives who said ABC is “exceedingly” challenging, the biggest issue is a lack of resources, followed by a lack of corporate emphasis on compliance, and the company’s expansion into high-growth economies. Among the 38 who say ABC is “highly” challenging, cultural and language issues were the most problematic, followed by difficulties in identifying and assessing risk, and auditing third parties for compliance.

Oil & gas executives were asked which business areas they perceive to be highly risky in their industry. The most frequently cited category is customs and export agencies. Half the respondents said corruption is a high risk at customs and export agencies, as companies negotiate ports, border crossings and airports to bring in equipment and goods to develop ENR projects outside their home countries. In second place is gifts and entertainment, with 47 percent, and licenses and permits with 45 percent. Both categories pose frequent problems for oil & gas companies in high risk parts of the world.

When asked how they manage the risk of bribery and corruption during the transport of equipment and

materials across borders, half the oil & gas respondents say they enhance the monitoring of invoices from third-party logistics providers. Forty-seven percent say they conduct follow-up investigations of allegations and take appropriate disciplinary action against employees and third parties. And the same proportion says it trains logistics managers on bribery and corruption.

In the overall survey, procurement and construction contracts are regarded



Source: Global Anti-Bribery and Corruption Survey, KPMG International, 2015

“Given that operations are often concentrated in remote locations away from head office scrutiny, and often coupled with a reliance on local supplier bases, it’s not surprising that the majority of matters we investigate in the resources sector relate to allegations of undisclosed conflicts of interest, kickbacks and the like”

Gary Gill

Australia Forensic Sector Leader
KPMG in Australia

as a high-risk area. The opportunity for fraud (as well as bribery) is considerable. Indeed, procurement fraud can be seen as bribery in a different form and Reoch notes that procurement fraud could be a prosecutable offence under the UK Bribery Act. Two of the most consistent themes in high-risk regions are undisclosed conflicts of interest and kickbacks. “Given that operations are often concentrated in remote locations away from head office scrutiny, and often coupled with a reliance on local supplier bases, it’s not surprising that the majority of matters we investigate in the resources sector relate to allegations of undisclosed conflicts of interest, kickbacks and the like,” says Gary Gill, Australia Forensic Sector Leader, KPMG in Australia.

These require enhanced levels of due diligence to look for ties between third parties and suppliers that may be buried below the surface and cannot necessarily be spotted in an invoice. But this is not always an easy task. Waligora notes that “the ability to conduct a cost-efficient and thorough due diligence varies considerably, depending on the country and availability of reliable public information. In many African countries, we are required to conduct public records inspections manually and physically inspect service provider

premises to verify supplier credentials that would take minutes in a developed country. In addition to the due diligence process, there is an onerous books & records burden on operators to ensure that there is visibility of the expenditure with the underlying service provider. In other words, from an accounting perspective, can you determine the ultimate beneficiary?”

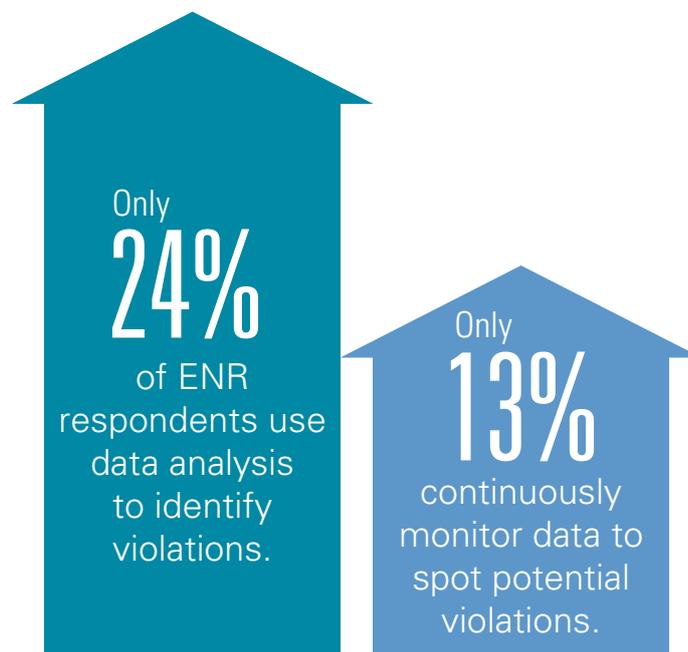
Oil & gas executives were also asked what controls they have when entering into a joint venture with a government-owned oil company. Almost three-quarters (74 percent) say they conduct enhanced due diligence of the joint venture partner and half say they provide additional ABC training for employees involved in the joint venture. Some 37 percent say they conduct enhanced monitoring of gifts, entertainment and travel expenses of these employees. Waligora says that “conducting the due diligence of the JV partner is a necessary step, but it is disappointing that only 37 percent conduct enhanced monitoring of gifts, entertainment and travel expenses. This is because it is just as important to ensure that suppliers to the JV have been vetted to limit the opportunity for corruption in the supply chain with related or connected parties.”

Cost-effective ABC

Even though there is room for improvement in ENR companies' ABC compliance programs, it is clear that organizations are aware of the growing problem of corruption and are taking steps to raise the bar. Eighty percent of ENR respondents say their company has a formal, written ABC compliance program (17 percent said they do not). Indeed, a clearly articulated policy on compliance is an essential step. Also, many companies have an array of weapons in their arsenal to combat corruption. Between half and 69 percent have a several elements in their program, including whistleblower mechanisms, training programs, continuous monitoring, a full-time ABC compliance officer, and ABC compliance risk assessments. But there are some gaps: only a third of ABC respondents gathers periodic compliance certifications. This is important in such a fast-changing field where ABC regulations are proliferating around the world.

Respondents complain at a number of points that anti-corruption resources are stretched, especially at a time of tight budgets. It is the biggest issue for those who say ABC is exceedingly challenging. But it is clear that organizations are not availing themselves of tools that can help manage compliance efficiently. Data analytics is an increasingly important and cost-effective tool to assess ABC controls. Yet only

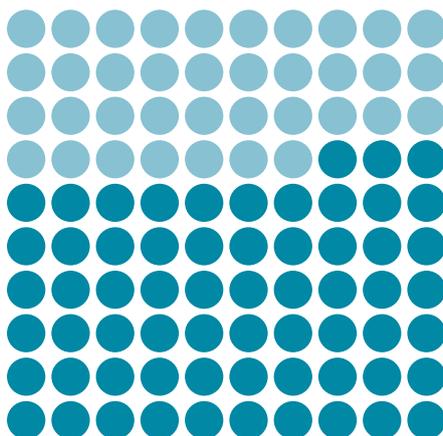
24 percent of ENR respondents use data analysis to identify violations and only 13 percent continuously monitor data to spot potential violations. A mere 17 percent employ data analytics to focus on third party payments and only four percent use it to monitor gifts and entertainment expenses. Reoch notes that data is the first item the regulators and prosecutors will look at, if an allegation is made. It is far better for a company to be on the front foot, actively reviewing data and pre-empting issues before they escalate, rather than obtaining data post-event.



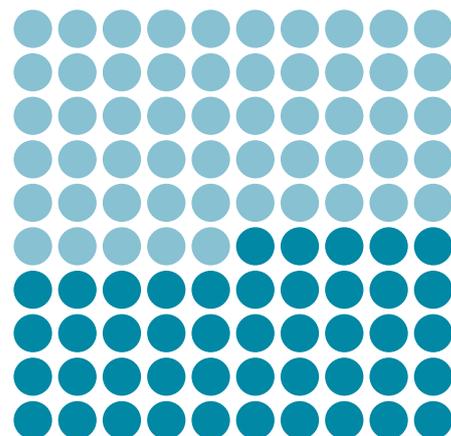
Source: Global Anti-Bribery and Corruption Survey, KPMG International, 2015

There are other cost-effective measures than can be taken, for example to conduct proper due diligence by means of powerful search engines that can investigate intermediaries and acquisition targets. Merely “Googling” a name is far from sufficient. This is extremely important in the current ENR market, with a heightened level of consolidation. Caveat emptor: 63 percent of ENR companies indicate that M&A is part of their growth

strategy but, of these, only 45 percent are aware that acquirers can be held liable for corruption committed before the acquisition, according to the US Foreign Corrupt Practices Act and other ABC regulations. Nevertheless, 52 percent include ABC considerations of part of pre-acquisition due diligence. Many therefore understand the need to comply with ABC rules, even though they lack knowledge of key areas of the law.



63% of ENR companies indicate that M&A is part of their growth strategy.



45% are aware that acquirers can be held liable for corruption committed before the acquisition.

Source: Global Anti-Bribery and Corruption Survey, KPMG International, 2015

Enforcement globalization trends

Schwartz notes, that in the past, companies have generally been more mindful of the FCPA and US regulators, due to the high level of enforcement action that has taken place in the US. While this activity is certain to continue, the ABC regulatory and enforcement landscape is evolving. Therefore, companies are well advised to build defendable and holistic ABC compliance programs that seek to comply with ABC regulation around the world. From China to Africa to South America, ABC regulation and enforcement is gaining momentum. This has particular relevance for the ENR sector, due to the multinational nature of operations, as can be seen in the comments from our regional practice leaders below.

Mark Bowra, ASPAC Forensic Practice Leader, KPMG in China, notes that giant ENR companies from Australia to Malaysia to China have been the subject of high-profile regulatory probes in recent years. These probes have resulted in significant fines and criminal prosecutions for providing improper hospitality, gifts and entertainment. China's ongoing "Tigers & Flies" anti-corruption campaign is being felt on the ground by officials and businesses across all industries in China, including state-owned entities in the oil and energy sector. Furthermore, officials who have fled abroad with the proceeds of crime are being investigated and extradited or voluntarily returned to

China under Operation Foxhunt. Bowra notes that China is now working with international regulators in ways that were never thought likely just a few years ago.

Gill notes that regulatory authorities have clearly communicated an increase in enforcement activity regarding allegations of bribery and corruption, which will become evident over the next 12 months or so. Within this timeframe, an Australian Senate Inquiry into foreign bribery will take place that will bring to the fore some of the challenging circumstances that Australian resources companies often encounter when operating in offshore locations, particularly susceptible to bribery and corruption, and how they manage the risk. In all likelihood, we can anticipate there will be legislative reforms that will affect the way Australian resources companies' structure their ABC compliance regimes in the future.

Claudio Peixoto, Managing Director, Forensic & Litigation at KPMG in Brazil, notes that the introduction of anticorruption laws there in January 2014 have had a major impact on Brazilian executives. Together with the high-profile and ongoing corruption investigations in the ENR sector, executives in Brazil have become very aware about ABC risk. This represents a cultural change in Brazil and is placing an emphasis on ABC risk assessment and ethics.

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Mark Bowra
ASPAC Forensic Practice Leader
KPMG in China

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Claudio Peixoto
Managing Director,
Forensic & Litigation
KPMG in Brazil

Doing the right thing

“Leading companies are approaching this risk assessment in an holistic manner with their overall enterprise risk assessment so that exposure to non-compliance is considered alongside other downside impacts and to bring clarity that the entire business, not just the compliance team has responsibility for compliance risk.”

“With many compliance teams lacking sufficient resources to, for instance, conduct the necessary monitoring and testing on their own, getting clear alignment through an integrated plan to team with other assurance functions, such as internal audit, to get that done is critical”

Michael Wilson

Lead Partner, Risk in the Boardroom and Global Lead, Energy Risk KPMG in the UK

This report sets out to show that companies are having a hard time rising to the challenge of managing their ABC risk, as globalization enters a new phase. Corporations with international operations are tightening their ABC controls and procedures, causing companies in their supply chains to fall into line. There is clear evidence they are trying to deal with more complex risks on the one hand and with the growing number of national ABC regulations on the other.

In these tougher times there is an increased burden placed on compliance functions to manage the risk in a cost-effective way. This may seem daunting, but it need not be. The first step is to undertake a global risk assessment to find the areas of greatest vulnerability, by geography, function, and operation. Based on this, compliance officers will be able to establish a clear set of priorities that will guide the allocation of resources. Such an assessment, if done well, will also reveal the weak points in a company's suit of armor. To find the gaps and fill them, companies must make better use of technology, coupled with a risk-based approach, to establish a defensible position.

“Leading companies are approaching this risk assessment in an holistic manner with their overall enterprise risk assessment so that exposure to non-compliance is considered alongside other downside impacts and to bring clarity that the entire business, not just the compliance team has responsibility for compliance risk”; says Michael Wilson, UK Lead partner, Energy Risk.

Despite better controls and stronger ABC policies, companies continue to fail to comply with the tougher regulations, and are fined heavily as a result. Why? Is it that ultimately, corporate executives are not focusing enough on ethical business conduct? Much has been said about “tone at the top”; yet we continually see failings at middle and lower management level,

which leads one to conclude that there is not enough focus on “tone at the middle”. Companies can have a perfect ABC program and yet continue to fall short, if they do not improve the way they do business. Indeed, an excellent ABC program may even lull the senior executives into a false sense of security. Alternatively, it might instill a sense of cynicism among corporate leaders, who may believe that a finely-tuned ABC program makes it unnecessary to conduct its affairs according to the highest standards of business ethics. The extent of this view is unclear in the ENR sector as there are encouraging examples of companies that are re-enforcing ethics as the way to drive good behavior rather than rules throughout the organization.

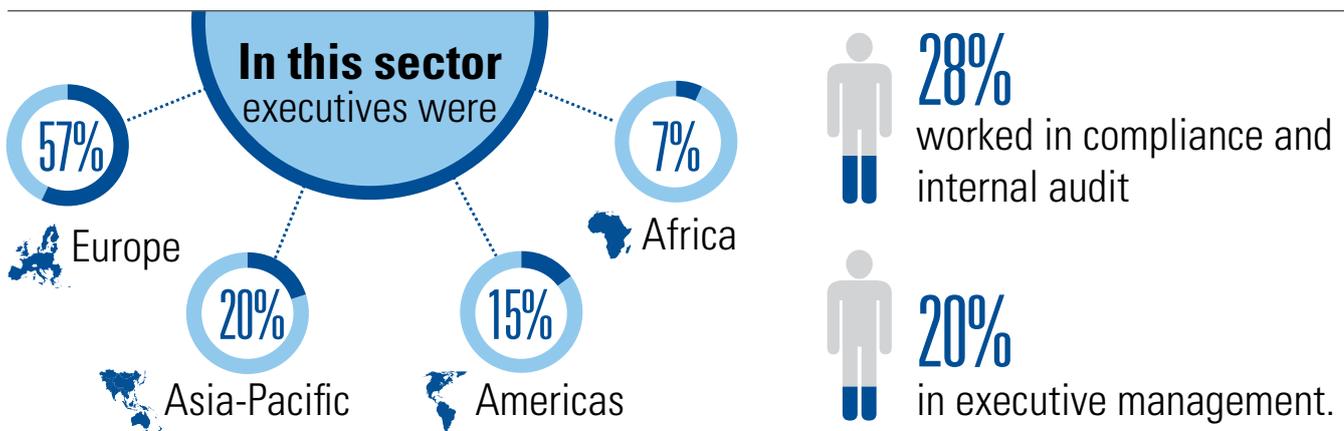
As the world changes, business conduct needs to change along with it. Both the business community and world leaders have recognized that progress can only be made through the joint action of government and the private sector. One forum where these issues are being discussed is the B20, a group of private sector organizations in the G20 economies that provide official recommendations to the G20 leaders on how to promote integrity and transparency in business. In the past 5 years the focus on anti-corruption has intensified, with business seeking a more harmonized global regulatory landscape that recognizes and encourages responsible business practices, as well as discouraging unethical behavior. This is key in the ENR sector where foreign governments are such large recipients of funds from ENR activity. The Extractive Industries Transparency Initiative² (EITI) notes at least US\$1.7 trillion in government revenues from oil, gas and mining that have been disclosed so far from complying stakeholders. Furthermore, the EITI indicates that since 2013 there has been improved disclosure by ENR companies about payments made to foreign governments, historically a controversial topic.

2. The EITI is a global Standard to promote open and accountable management of natural resources. It seeks to strengthen government and company systems, inform public debate, and enhance trust. In each implementing country it is supported by a coalition of governments, companies and civil society working together (Source: www.EITI.org).

About the survey

The survey targeted
659
respondents in **64 countries.**

Industries were widely represented, with energy & natural resources providing **54 responses (8 percent).**



\$ Some 61 percent of companies have annual revenues greater than US\$1 billion.

Source: Global Anti-Bribery and Corruption Survey, KPMG International, 2015

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