Auditing for Corruption in Emerging Markets:
Applying fraud detection skills to reduce corruption

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"At any given moment, there is a certain percentage of the population that's up to no good."

J. Edgar Hoover

Objectives

- Demonstrate the differences and similarities between auditing for fraud and auditing for corruption in developing global markets
- Provide real-life examples to highlight the challenges of auditing for corruption
- Learn strategies for detecting and investigating fraud and corruption
- Understand similarities and differences that may affect audit strategies in different countries

Discussion Contents

- Current Corruption Environment
- Risk Areas and Red Flags of Corruption
- Corruption Risks in Key Emerging Market Countries
- Internal Audit Procedure Considerations

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CURRENT GLOBAL CORRUPTION ENVIRONMENT

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Corruption vs. Fraud

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Corruption:

Takes place in the form of providing illicit benefits; harder to find; narrower scope than fraud.

- **Bribery**
- **Embezzlement**
- **Extortion**
- **Influence Peddling**
- **Unlawful gratuity favor or commission**
- **Nepotism**
- **Illegal Political contribution**

Fraud:

Deriving undue benefit by bypassing some controls or bending some rules. Fraud schemes are used to commit corrupt activities.

- **Asset Misappropriation**
- **Financial statement irregularities**
- **Corruption**

Anti-Corruption Foundation

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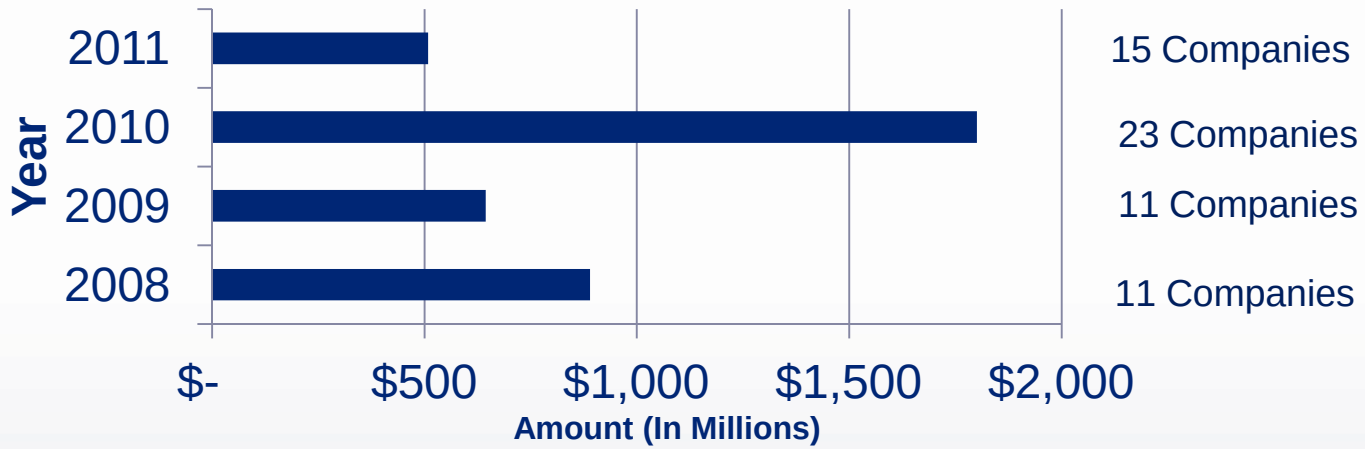
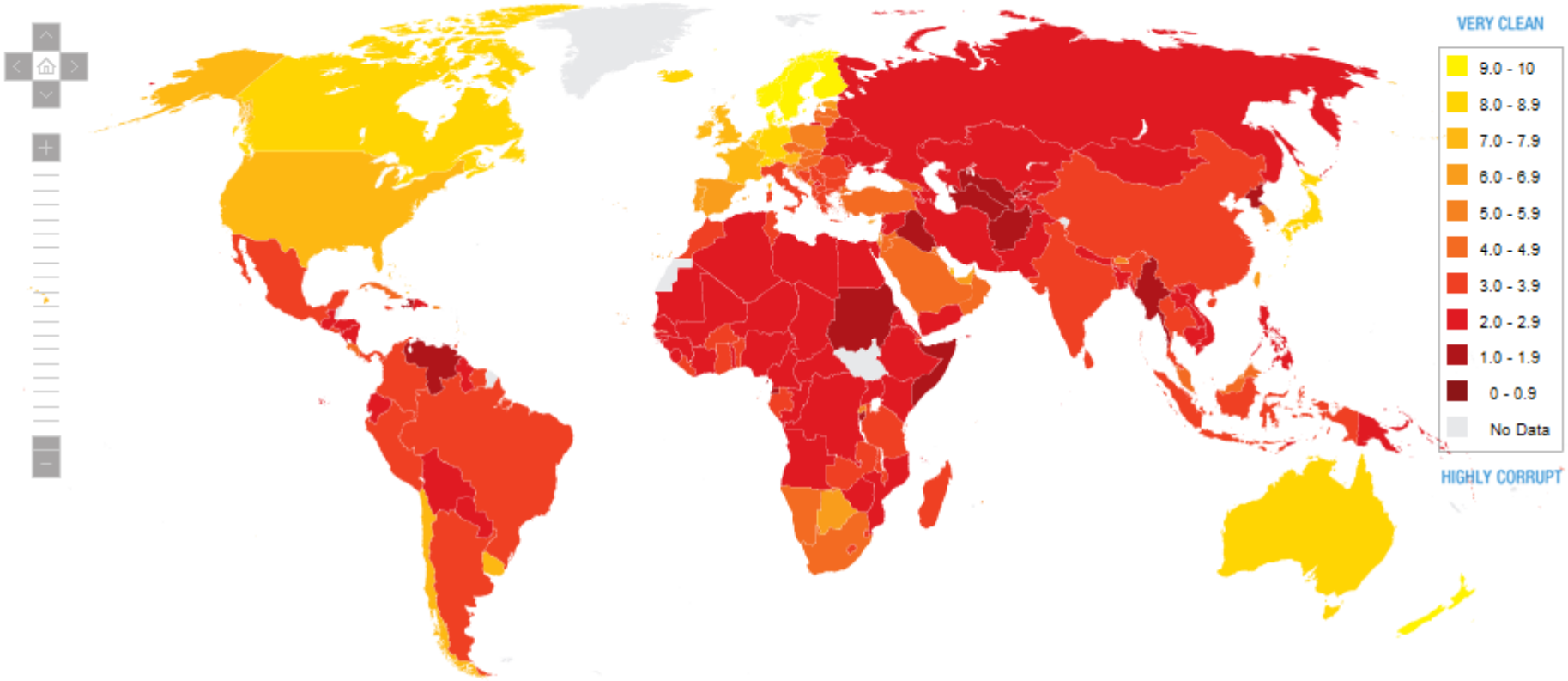
Where are the issues – DOJ Enforcement Actions



- While 2011 was slower on the corporate side, it was busy for individuals (38 in total) in all categories -- indictments, trials, sentences, dismissals, mistrials, and appeals
- FCPA is likely not your only concern anymore…

High Risk Markets for Corruption – 2011



Emerging Markets

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RISK AREAS AND RED FLAGS OF CORRUPTION

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Corruption – risks and red flags

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Emerging Markets:
While emerging markets can present opportunities to access new customers and resources, they also bring significant integrity and corruption risks

- **Agent /Dealer Payments (third-party intermediaries)**
- **Consultant Payments**
- **Employee Expenses – gifts and hospitality**
- **Facilitation Payments**
- **Contributions to charitable or political organizations**
- **Direct payments or reimbursements to foreign officials**
- **Logistics and shipping expenses (customs)**
- **Others**

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CORRUPTION RISKS IN KEY EMERGING MARKET COUNTRIES

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Key Corruption Risks

Country		Tender and contracting	Customs payments to minimize duties and taxes	Expediting licenses and permits	Payments for service execution	Fictitious invoices/paperwork	Free trips/lavish gifts	Cash (loans/slush funds)	Hidden interests/contract awards	Unique corruption mechanisms
	Russia	✓		✓	✓					• Bribers to obtain services (medical/educational) • Payments to avoid confiscation of property by district prosecutors • Use of shell companies to facilitate bribes
	India	✓	✓			✓	✓	✓	✓	• Slush funds • Excessive commissions • Awarding lucrative contracts to relatives of public officials • Charitable contributions to relatives of public officials
	China					✓	✓	✓	✓	• Red envelope (cash) • Wine, liquor , cigarettes. Baby formula (in excessive quantities) • “Loans • Hidden interests of public officials in contracts/vendor arrangements
	Brazil	✓	✓	✓						• Vague contract definitions • Bids rigged by public officials • Payments to customs / tax officials
	Mexico		✓				✓			• “Mordida” or “bites” – low level bribes • Use of third-parties to funnel funds to government officials • Customs payments to facilitate import/export of goods (particularly raw materials)

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INTERNAL AUDIT - PROCEDURAL CONSIDERATIONS

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Isolating fraud and corruption – IA tools and techniques

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1. Proper Prevention
   - Survey's
   - Risk Assessments
   - Prioritization
   - Training

2. Third-party due diligence
   - Know-your vendor
   - Business Intelligence

3. Data Collection and integration
   - FCPA Analytics

4. Pinpoint Transaction Analysis

Where to Audit: Analysis of High-Risk General Ledger Accounts/Transactions

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- Internal Commissions/bonus
- Travel Allowances
- Travel Expense
- Meals and Entertainment Expense
- Gift Expense
- Contributions and Donations
- Employee Loans and Advances
- Vendor Pre-Payments
- Consulting Fees and Services
- Professional Fees and Services
- Licenses and Permits
- Excess Payment and Facilitation Expense
- Customs and Brokerage (Import\Export) Expense
- Promotional Expense
- Marketing and Advertising Expense

Internal Audit Approach – Integrating Leading Practices to Reduce the Risk of Corruption and Fraud

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Common Practice

- Compliance generally driving process with minimal or no internal audit input
- Not doing stand-alone FCPA audits or FCPA risk assessments
- Internal audit not trained to detect FCPA violations
- Proactive testing, if any, is not risk based and often includes random selections
- FCPA policies do not adequately identify internal audit's role

Leading Practice

- Dedicated and properly trained audit team focused on FCPA
- Structured risk assessment and gap analysis
- Marriage of compliance, legal, and audit
- Stand-alone FCPA reviews
- Testing of high-risk locations on at least a rotating basis
- Use of electronic data anomaly tools to identify and test high risk transactions
- Regular, open communication channel with Legal an Compliance in order to have timely information on potential risk areas and to assist Legal/Compliance and/or adjust internal audit projects to address such risk areas.

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When Does An Audit Become An Investigation?

- Expand sample, expand scope, or perform additional procedures. Look for additional instances or patterns.
- Ask additional questions framed in the context of the internal audit (e.g., how could a situation like this occur?).
- Any indication of potential perpetrators?
- Cease audit work if there appears to be a predication for suspecting fraud
- Maintain copies of documents and data files that support the indicators/red flags of fraud.

Leading Today's Presentation

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Bill is a partner in the Forensic & Dispute Services practice of Deloitte Financial Advisory Services LLP in Chicago. He has managed and conducted a broad range of forensic accounting and corporate investigations for public and private companies, government agencies and private individuals. He has spent the past twelve years providing financial advisory services to clients in the manufacturing, construction, governmental, insurance, and not-for-profit industries, among others. The engagements have involved complex financial accounting related matters, including corporate investigations, accounting restatements, SEC investigations, white collar crimes and litigation support, as well as consulting with clients on FCPA compliance, fraud controls and anti-fraud programs.

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Elizabeth Truelove McDermott is Vice President, Audit, Ethics and Compliance Services at DeVry Inc. She began her career with DeVry in January 1992 as the state licensing specialist. Elizabeth has extensive experience at DeVry, working across three divisions, including Becker Professional Review, before assuming her current role. Most recently she has served as senior director of Internal Audit with responsibility for planning, directing, and administering a comprehensive risk-based internal audit program. She has provided audit leadership in the development, operation and evaluation of the organization risk-management program, as well as served as the organization liaison to external audit and regulatory reviews.

Elizabeth earned her Master of Business Administration from Keller Graduate School of Management. She also holds a bachelor's degree in business from Bradley University. In addition, Elizabeth is a Certified Public Accountant.

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Mark has more than 14 years of experience and focuses on client matters involving financial/fraud investigations, Securities and Exchange Commission (SEC) and other regulatory inquiries and investigations. He provides consulting services in the areas of proactive fraud risk management, forensic accounting and litigation support with a focus on entities in the public sector and manufacturing industries. Mark has managed investigations in Canada, Mexico, Germany, United Kingdom, India, Australia, Thailand, South Africa, and Korea, as well as numerous states within the United States. Mark joined the Deloitte Chicago office in 1999 after practicing as an external auditor in the Deloitte Detroit office for three years, performing financial audits for public and private companies of varying sizes and industries, control reviews, and regulatory compliance audits.

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QUESTIONS