European fraud survey 2011

Recovery, regulation and integrity

Quality In Everything We Do

Contents

Foreword

Competitive success is proving elusive for many firms. The turbulent economic outlook and ongoing political instability in some markets have left many fighting for survival. Pursuing the three fundamental drivers of organic growth — entering new markets, creating new products or services, and developing the new skills required to deliver enhanced or cheaper offerings — is becoming even harder. A continuing need to cut costs remains an overarching focus of business.

At the same time, tougher anti-bribery legislation has been introduced in a number of countries. One example is the Bribery Act in the United Kingdom, which increases demands put on companies to re-evaluate ethical guidelines and understand the risk of bribery in all facets of the business. This establishes the context for this survey: the incentives to commit fraud or act unethically remain high, while the potential risks of non-compliance with legislation have never been higher.

In 2006, Ernst & Young performed its first survey of European organizations to find out employees' perceptions towards fraud risks and how management and board members were responding to these challenges. Since then, the size and scope of our survey have increased significantly. The *2011 European Fraud Survey* reflects the views of more than 2,300 respondents — from the factory floor to the C-suite — in 25 countries. It contrasts the views found in the mature markets of Europe with those found in the developing markets on matters including employee perceptions of fraud, bribery and corruption, their companies' responses to the challenges posed by these risks, and the response of regulators and law enforcement.

The findings of our survey remain as relevant and business-critical today as they have ever been. They indicate that there remains a widespread tolerance of unethical behavior that goes to the very top of a business. They show that, across Europe, bribery and corruption are considered to be rife, while few individuals are willing to recognize that it could happen in their own industry sectors. Despite this, respondents to our survey indicate that there has been a decline across the board in the use of anti-fraud and anti-bribery measures precisely during a period when the incentives to act unethically have been the highest.

There remains, therefore, a real need for companies and those charged with their governance and oversight, to revisit their focus on the risks of fraud, bribery and corruption. Cross-border cooperation among enforcement agencies, including with the US Securities and Exchange Commission and Department of Justice, raises the stakes even further. More robust anti-fraud and anti-corruption efforts are an imperative.

The picture of corporate ethics today, however, is not entirely negative. Our survey indicates that there are economic benefits for those companies with high ethical standards and not just serious commercial and legal risks for those without. There is an expectation among our respondents that economic growth would not suffer as a result of the introduction of tougher anti-bribery legislation.

This survey was conducted in 2011 on behalf of Ernst & Young's Fraud Investigation & Dispute Services practice. We would like to acknowledge and thank all of the respondents for their contributions.

David L. Stulb

Global and EMEIA Leader
Fraud Investigation & Dispute Services

Executive summary

A fragile and slow recovery

While there is a general consensus that the worst has now passed, those interviewed for our current survey remain negative about the economic prospects for the next 12 months. For example, 64% expect more companies to get into financial difficulties in the coming year. This is an improvement on the outlook expressed two years ago, but clearly acknowledges the pressures that businesses face.

Businesses continue to focus on cost-cutting, which is seen as a major challenge by 60% of our respondents. This will, inevitably, place pressure on non-revenue generating functions such as Internal Audit and Compliance that are so critical in managing the risks of fraud, bribery and corruption.

The pressure to comply with regulations is seen as a significant burden by only about a quarter of our respondents. This response may be understandable given businesses' recent focus on their day-to-day survival, but it fails to recognize the significant regulatory challenges and compliance risks that businesses are likely to face.

Unethical behavior still tolerated

Companies must be prepared for the challenges posed by greater regulatory scrutiny. However, our survey indicates that a large proportion remain tolerant of unethical conduct across all levels of organizations:

- Almost 1 in 5 company employees, regardless of grade, considers it acceptable to pay bribes to win or retain business

This is not new. This finding is similar to the results from our survey in 2009. It does, however, indicate that companies are not making progress in strengthening their ethical culture.

This internal change must come, of course, through the establishment of the proper tone at the top of each organization. The following responses indicate that this will be a major challenge:

- A quarter of our respondents do not trust their management to behave ethically
- 59% of those interviewed expect management to cut corners in order to achieve targets, and half of management agrees

Bribery and corruption still widespread

The fragile market conditions and the ethically challenged culture of companies may create an environment conducive to fraud, bribery and corruption.

- Two-thirds of those interviewed informed us that bribery and corruption are widespread in their country; a situation that, according to 40% of them, has become worse during the economic downturn

However, our respondents are not as concerned about bribery in their sector.

- Three-quarters of our respondents do not believe that bribery and corruption is a widespread issue in their sector

If employees believe that bribery is someone else's problem, there is a very real risk that such unethical behavior will go unidentified and unchallenged.

Major gaps in the corporate response to fraud and corruption

Our survey indicates that many companies have a long way to go to address the challenges of fraud and corruption. Fraud remains a very real risk in the current environment, and companies are still failing to address this risk in a robust manner.

"A good reputation in business is earned, not bought."

Kenneth Clarke, UK Secretary of State for Justice

Fewer respondents think that their companies have anti-fraud measures in place than 2 years ago, and almost 1 company in 10 apparently has no anti-fraud measure in place at all. This indicates a lack of attention to fraud and is a particularly concerning decline given its coincidence with a period of economic slowdown during which the risk of fraud, bribery and corruption is elevated.

- Only 56% of those interviewed are aware that their company has an anti-bribery policy
- Only approximately one-third think that the policy contains clear guidance

Anti-bribery training has declined at a time when there is increasing extraterritorial enforcement under anti-bribery statutes such as the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act. This lack of employee training may expose more of these companies to prosecution.

Companies are failing to provide those individuals who potentially present the greatest bribery risks with appropriate anti-bribery training and communication.

- Almost a quarter of sales, marketing and business development respondents cannot see the relevance of their company's anti-bribery policy to them

Integrity delivers business benefits

Our survey indicates that real business benefits can be achieved by companies that act with integrity:

- Two-thirds of our respondents agree that there are commercial advantages for companies with strong reputations for ethical behavior
- 45% would be unwilling to work for a company involved in a major bribery or corruption scandal
- 53% of respondents state that they would be unwilling to hire suppliers or agents involved in a major bribery or corruption case

Employees backing greater regulation

In the absence of an effective internal response to fraud, bribery and corruption, employees are looking to regulators to accomplish what their management has failed to do. The proportion of respondents agreeing strongly that there should be more supervision by regulators has more than tripled since our 2009 survey, increasing from 13% to 45%. In addition:

- 68% believe that regulators are either unwilling to pursue convictions for bribery and corruption offenses or are ineffective in doing so

These respondents recognize, however, that regulators face significant challenges in this area:

- 53% think that bribery and corruption is too widespread to be tackled
- 30% believe that regulators lack the necessary legal powers
- 28% believe that regulators lack the necessary resources

In an environment of shrinking governmental budgets, this situation is likely to get worse.

Governments may be tempted to water down legislation or reduce enforcement for fear of damaging businesses in a weak economy. Our respondents do not share this caution:

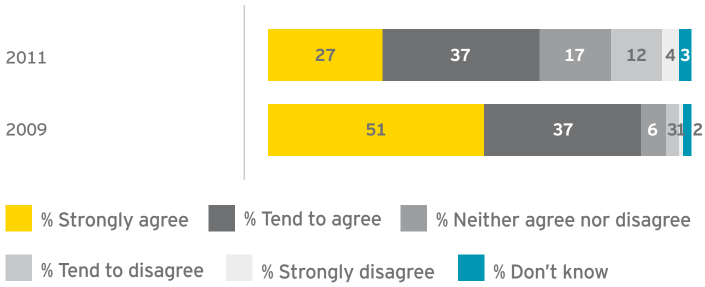
- 70% of our respondents think that new anti-bribery legislation would have little impact on economic growth: a positive message for companies and governments to note

Ongoing challenges to business

The economic turbulence of the past 2 years has been a significant feature of business dealings across Europe. While there have been fewer business failures than many feared, substantial numbers have still struggled to manage their costs while maintaining revenues. More recently, the emerging risk of inflation has received more attention, driven by high global commodity and energy prices.

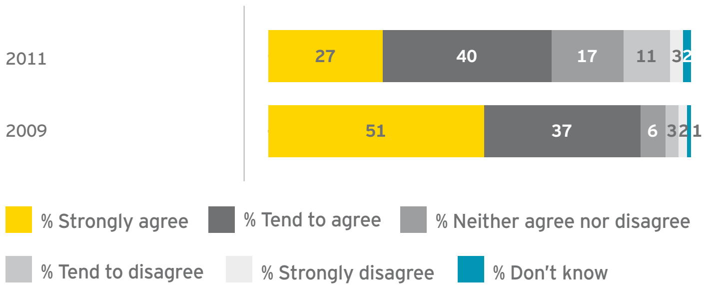
With such challenging economic conditions, it is not surprising that employees are nervous about the performance and long-term viability of their companies. Respondents were more positive about the overall economic situation than two years ago, however, two-thirds of those responding to our survey continue to expect more companies to get into financial difficulties in the next 12 months. This figure has fallen by a quarter since 2009, but it remains the majority. Similarly, this year, two-thirds of our respondents expect to see an increase in the number of layoffs. So, while there has been some improvement in economic confidence, many respondents remain cautious and concerned about the economic outlook.

Figure 1
Many companies still facing financial difficulties



Q: To what extent do you agree or disagree with the following statement about the impact of the current global economic situation? More companies will get into financial difficulties over the next 12 months.
Base: All respondents 2011 (2365); 2009 (2246)

Figure 2
Fewer anticipated layoffs than in 2009



Q: To what extent do you agree or disagree with the following statement about the impact of the current global economic situation? There will be an increase in the number of redundancies as companies cut costs.
Base: All respondents 2011 (2365); 2009 (2246)

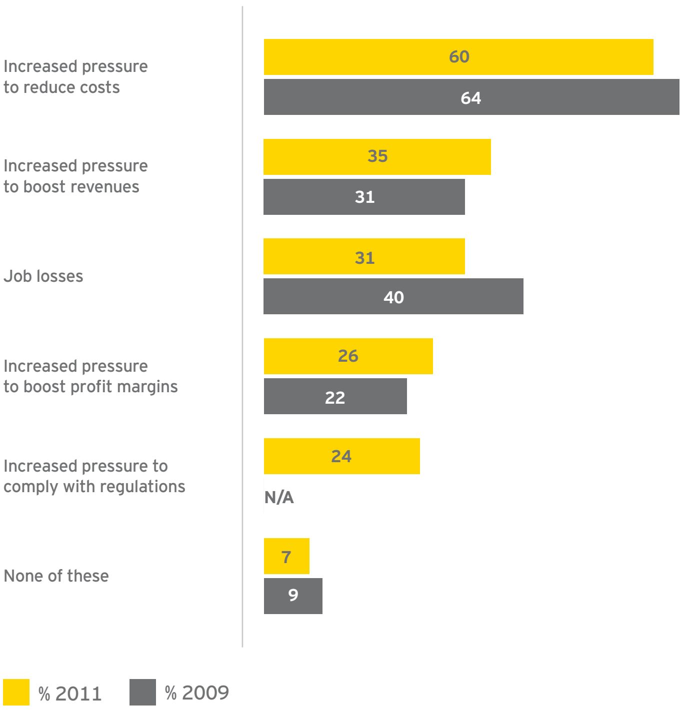
> "Stagnant or declining wages mean many people are now more willing to commit fraud or accept bribes."
>
> Customer service professional, Poland

Continuing drive to cut costs

When asked about their own company, the need to cut costs remains the predominant pressure felt by employees, with little reduction from two years ago. Again, there are indications of a subtle change in outlook, with a resurgent focus on revenues as the fear of job loss recedes. However, boosting revenues is still considered to be only half as significant as the continuing focus on cost-cutting. Overall, respondents feel that managers are subject to the same level of pressure to deliver good financial performance as two years ago.

Figure 3

Businesses remain under pressure



	Mature markets	Emerging markets
Increased pressure to reduce costs	66	51
Increased pressure to boost revenues	36	33
Job losses	30	32
Increased pressure to boost profit margins	28	24
Increased pressure to comply with regulations	24	25
None of these	7	7

Q: Following the difficult economic conditions of the last two years, which of the following do you expect to be the biggest pressures affecting your company in the next 12 months?

Base: All respondents 2011 (2365); 2009 (2246)

Compliance complacency?

Employees from all business functions generally agree on the most significant pressures affecting their companies over the next 12 months.

Respondents across different functional areas agree that the most significant pressure on businesses is the need to cut costs, a factor identified by 60% of our respondents.

There is a similar cross-functional agreement that increased pressure to comply with regulations will not be a significant issue for businesses in the next 12 months. Only 24% of our respondents cite the need to comply with regulations as a major pressure. This was true even in those functions more likely to be at risk of fraud, bribery and corruption, such as sales and finance.

Where there is a lack of awareness of the risks of non-compliance with regulations, individuals may commit unintentional violations of relevant statutes.

With employees and management under constant pressure to deliver strong financial performance under challenging economic conditions, business integrity is frequently a casualty of circumstances.

Figure 4
Consensus over key pressures on companies

	All	Operations	Finance	HR	Mktg/ Comms	Customer Service	Sales/BD
Increased pressure to reduce costs	60%	65	62	60	61	58	53
Increased pressure to boost revenues	35%	38	48	33	46	44	49
Job losses	31%	34	28	36	30	33	26
Increased pressure to boost profit margins	26%	29	37	19	44	30	38
Increased pressure to comply with regulations	24%	25	29	34	24	29	24
None of these	7%	5	5	5	7	6	6

Q: Following the difficult economic conditions of the last two years, which of the following do you expect to be the biggest pressures affecting your company in the next 12 months?
Base: Operations/Production (506); Finance (239); HR/Personnel (154); Customer service (422); Marketing/Communications (98); Sales/Business Development (250)

> "Any competitive advantage gained through corruption is a mirage."
>
> Robert S. Khuzami, Director of Enforcement, US Securities and Exchange Commission

Unethical business practices persist

In the current economic environment, businesses will need a strong corporate culture to fight the risk of fraud, bribery and corruption — a culture which, by necessity, must start at the top of an organization. However, our survey suggests that a significant minority in management are still prepared to do whatever it takes to help their business survive and grow.

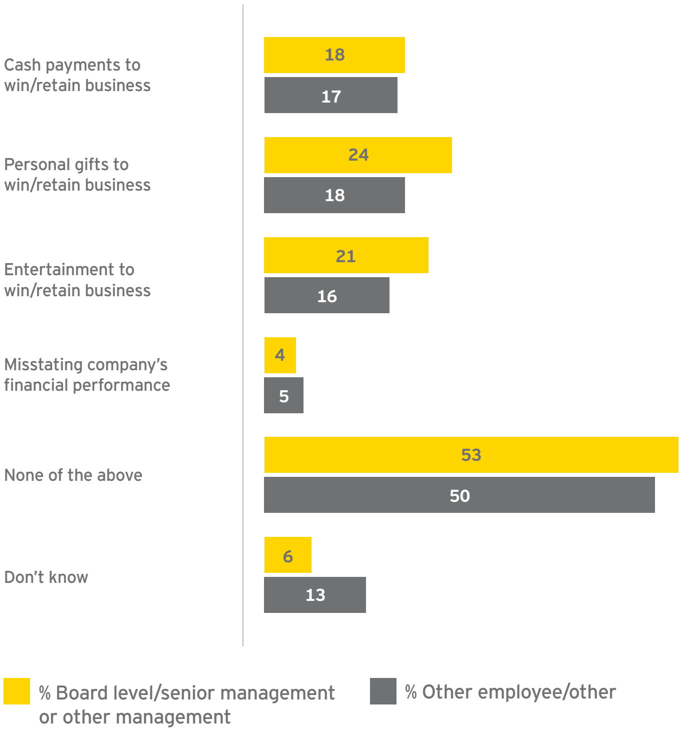
Success — but at what cost?

To help their company survive or grow, more than a third of all respondents are prepared to offer cash payments, gifts or entertainment to win business.

Our respondents make little distinction between the actions that can be justified to save a business from collapse and those that can be justified to deliver growth. While we might expect some people to be prepared to go to any lengths to save their business from failure, this same view of "acceptable" behavior persists even when business survival is not at stake.

Most significantly, board-level and management employees are just as likely as other staff to view these actions as justifiable. About a fifth of managers still say that they are justified in offering cash payments, gifts or entertainment if it will help to win business, with some even prepared to misstate the company's financial performance. This is truly disturbing coming from management. Only half of the managers we asked would reject taking any of these actions to help the business survive or grow.

Figure 5
Unethical behavior is widespread



	Mature	UK	Germany	Spain	Emerging	Russia	Turkey	Czech Republic
Cash payments to win/retain business	15	13	10	23	21	39	36	23
Personal gifts to win/retain business	17	16	10	20	23	26	32	26
Entertainment to win/retain business	17	22	13	21	17	25	11	26
Misstating company's financial performance	4	-	3	6	7	13	7	3
None of the above	57				43			
Don't know								

Q: Which of the following do you feel can be justified if they help a business achieve growth?
Base: Board level/senior management or other management (709)
Other employee/Other (1656)

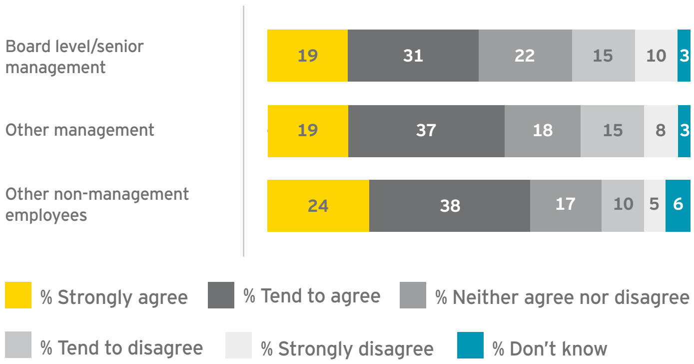
Ethical leadership

Given these results, it is not surprising that employees' perceptions of the ethical standards of management are also negative.

Of our respondents, 59% expect company managers to cut corners to meet targets when times are tough. Even management agrees, with half of our board-level and management interviewees saying that they would cut corners to meet targets.

> "Companies need to raise awareness of their anti-bribery policies across their whole organization. Many employees think, 'This is not my problem; it doesn't apply to me.'"
>
> Finance professional, Austria

Figure 6
Management perceived to be likely to cut corners



Q: To what extent do you agree or disagree that company management is likely to cut corners to meet targets when economic times are tough?
Base: All board level/senior management (172); Other management (537); All other non-management employees (1656)

What is more disturbing is that, a quarter of our respondents do not trust the management of their own company to behave ethically.

If those responsible for setting an ethical tone in the organization cut corners, it is difficult to imagine how they will be able to positively influence the behavior of others.

One potential explanation for the shortcomings in management behavior may be that a third of respondents have seen employees with questionable ethical standards being promoted within their company.

Given that corporate conduct is driven by individual actions, it is important to consider how to better promote and reward ethical behavior. One suggested approach is to link behavior to individual performance reviews. Such an approach is endorsed in the guidance to the UK Bribery Act. Although half of our respondents, including three-quarters of senior managers, say that this is already the case, our survey results show that there is still more to do.

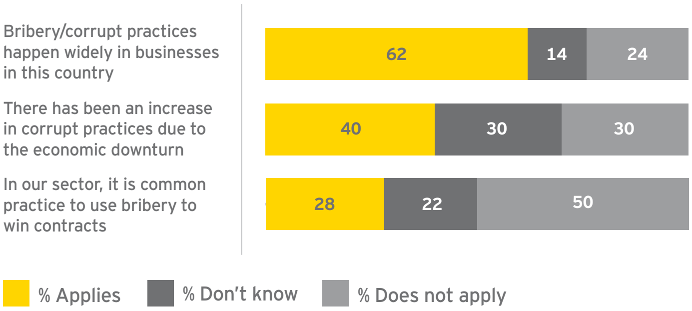
Bribery and corruption considered commonplace

With such a high proportion of respondents prepared to do whatever it takes to succeed, one might expect an environment conducive to fraud, bribery and corruption. Our respondents agree, with almost two-thirds telling us that bribery and corruption are widespread in the country where they are based. Responses varied significantly by location, with more than 80% of people in emerging markets saying that bribery and corruption are widespread, compared with half of those in mature markets. 40% say that the situation has become worse during the economic downturn.

The scale of the task facing businesses and regulators is striking. More than a quarter of respondents (28%) told us that it is common practice in their sector to use bribes to win contracts. Only half of those we interviewed say that bribery and corruption is not widespread in their sector.

Even though these numbers are alarming, there is a notable difference between the 62% of people who think that bribery is common in their country and the 28% saying that it is common in their sector. This suggests a corruption perception gap, with individuals perhaps too optimistic about their own risk exposure. One explanation for this difference may be the media focus on grand corruption – the corrupt conduct of politicians and other senior public sector officials – in contrast to the relative lack of attention focused on various business sectors. Businesses operating in environments where people face commonplace demands for bribes from doctors, police and judicial officials would be naive to think that this corrosive conduct does not affect their businesses. Even when local anti-bribery enforcement efforts have been limited, the increasing willingness of local authorities to support US-led prosecutions heightens the risk. There were more FCPA enforcement actions in 2010 than ever before, with 7 of the largest 10 settlements in the history of the FCPA involving firms headquartered outside the US.

Figure 7
Bribery seen as widespread



Q: For each of the following, can you let us know whether you think it applies, or does not apply to your country/industry or whether you don't know?
Base: All respondents (2365)

Perception gap between mature and emerging markets

Bribery/corrupt practices happen widely in businesses in this country

	% Agree
Mature markets	46
Emerging markets	81

There has been an increase in corrupt practices due to the economic downturn

	% Agree
Mature markets	33
Emerging markets	49

In our sector, it is common practice to use bribery to win contracts

	% Agree
Mature markets	20
Emerging markets	38

Companies blind to the risks of expansion

When contemplating expansion into markets perceived to be at high risk of bribery and corruption, companies should conduct a thorough corruption risk assessment. However, only one-third of respondents recognize that investing in new markets can open their company to new risks.

Companies should consider, as a minimum:

- To what extent will expanding the business involve close relationships with government officials: for example, in connection with public sector contracts, government approvals, permits or authorizations?
- The remuneration and hospitality policies common in the target market. For example, are fees proportionate to the related services delivered? What level of expenditure on travel, gifts and entertainment is considered appropriate, and how does this compare with international business standards?
- Whether third parties or agents will be necessary to conduct or obtain business

When dealing with agents or consultants, consider:

- Their ethical reputation and corporate governance structures
- The strength of their internal controls
- Contract provisions, including audit rights, to minimize the risk of bribes being paid on your organization's behalf and without your organization's knowledge
- The business need for the organization's services, and detailed information on the services to be provided

> "A poor culture at a firm often manifests itself in failures of governance or management – and in response to such failings, we have taken, and will continue to take, tough action."
>
> Hector Sants, CEO, UK Financial Services Authority

Corporate responses to the challenge

As we anticipated in our 2009 European Fraud Survey, companies appear to have lost focus on fraud and corruption over the past two years while other pressing matters diverted management's attention.

- Less than a third of our respondents tell us that their company has increased its efforts to combat fraud. Two-thirds report no difference or simply do not know

Given the potential extent of corruption and the perceived lack of management integrity, the need for a robust corporate environment to address fraud, bribery and corruption risk is clear. Not only is such an environment in the best interest of the company, but it is also increasingly demanded by regulators. Embedding anti-bribery and anti-fraud measures takes time and demands more than simply having the right controls.

It appears that many companies were willing to devote some resources to anti-fraud and anti-corruption programs in times of plenty. But in lean times, when the incentives to commit fraudulent and corrupt acts are greatest, companies appear to have neglected these vital initiatives.

Senior management set the tone

The ethical tone of the organization must be set by senior management and established through frequent employee communication and training. A company's intolerance of impropriety should be widely communicated throughout the organization in a clear and unambiguous way.

The company-specific design and implementation of a compliance management system is a challenging task for management and supervisory bodies. Compliance challenges vary according to each company's individual history and level of maturity. Fostering compliance is, therefore, much more than creating additional controls.

Compliance management systems

Every company is faced with the fundamental and difficult task of integrating compliance management into the corporate values and culture, business processes, reporting and controls of its organization. In practice, a three-pillar model has become the established structure for compliance management systems. In addition to compliance culture, compliance objectives and communication, this model also incorporates prevention, early detection and responses to compliance breaches and risks.

Culture, objectives, organization		
Prevention	Detection	Response
Policies and procedures	Compliance risk analysis	Sanctions
Training	Whistleblowing	Case management
Consultation	Compliance audits/ compliance due diligence	Remediation
Incentives	Investigations	
Communication		
Compliance system audits		

Communication is key

So what should companies be doing?

When building a strong anti-fraud and anti-bribery environment, companies must implement appropriate policies and procedures and communicate them effectively. Companies appear to have failed in this regard when only half of our respondents tell us that their company has an anti-bribery policy or code of conduct.

Even among those surveyed who acknowledge that their company has a policy, only 58% think that it contains clear reporting processes. Even fewer of them can identify specific guidance on difficult topics such as improper hospitality and promotional expenditures.

There is further evidence of our respondents questioning the rigor with which their anti-bribery policies and procedures are applied in practice:

- Only half of all our respondents tell us that employees in their company comply with its code on anti-bribery and anti-corruption
- Just 45% say that such codes are adequate for preventing and detecting these practices
- A third admit that the company's code on anti-bribery and anti-corruption has little impact on how people actually behave

In fact, a quarter of our board-level respondents whose company had a policy in place said it should be "more flexible to local needs," which is not encouraging. Such a mindset inevitably leads to local "work-arounds" and the inherent risk that they create. This suggests that the head office and senior management still have a long way to go in promoting compliance in their organization. With extraterritorial statutes like the US FCPA and the UK Bribery Act, employees operating in local markets need to understand that their actions must comply not only with local standards, but also with international standards which are generally more restrictive.

Spotlight on Germany

After the US, Germany is often seen leading the way in anti-corruption enforcement. By the end of 2010, 71 entities and individuals had been sanctioned for foreign bribery in Germany, compared with 107 in the US, 39 in Italy and 5 in the UK.[1]

Given such active enforcement, it seems remarkable that so few German companies are taking concrete steps to embed an effective anti-bribery and anti-corruption culture:

- Only 50% of our German respondents' organizations have a code of conduct and anti-bribery and anti-corruption policies
- Under a quarter of our German respondents say that there is training on their organization's anti-bribery and anti-corruption policies, and only 15% had received such training
- Less than 50% of our German respondents think that there are clear penalties for breaking these policies
- Only 44% of our German respondents think that ethical conduct plays an important part in their appraisal process
- Less than half of our German respondents think that there is a commercial advantage to ethical behavior

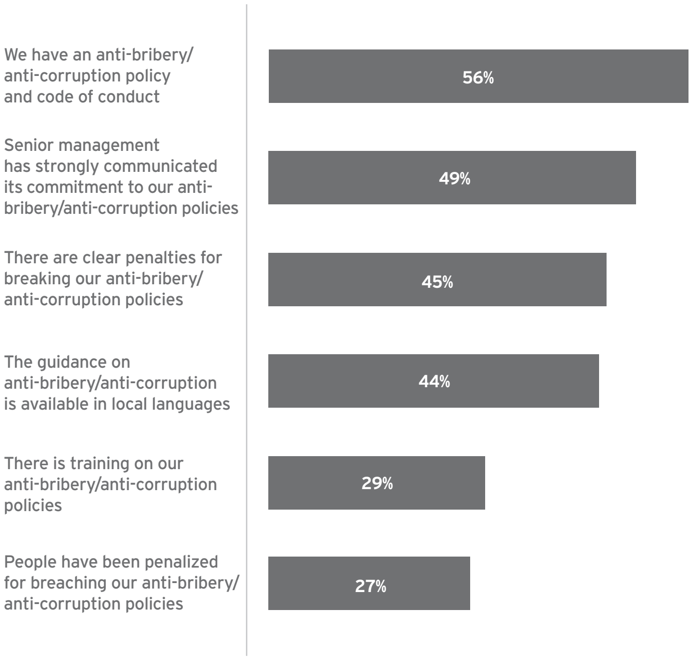
These companies are clearly exposing themselves to considerable regulatory risk from German federal and national authorities as well as foreign regulators.

1 *"Data on Enforcement of the Anti-Bribery Convention"* OECD, 20 April 2011. http://www.oecd.org/dataoecd/47/39/47637707.pdf

> "Training needs to be relevant to the employee and engage their interest. Classroom training brings the messages to life."
>
> Customer service manager, Ireland

Figure 8

Embedding anti-bribery/anti-corruption culture in business



	Board/Senior management	Other management	Other employees
We have an anti-bribery/anti-corruption policy and code of conduct	64	64	52
Senior management has strongly communicated its commitment to our anti-bribery/anti-corruption policies	65	55	45
There are clear penalties for breaking our anti-bribery/anti-corruption policies	57	53	42
The guidance on anti-bribery/anti-corruption is available in local languages	52	51	41
There is training on our anti-bribery/anti-corruption policies	35	31	27
People have been penalized for breaching our anti-bribery/anti-corruption policies	34	32	25

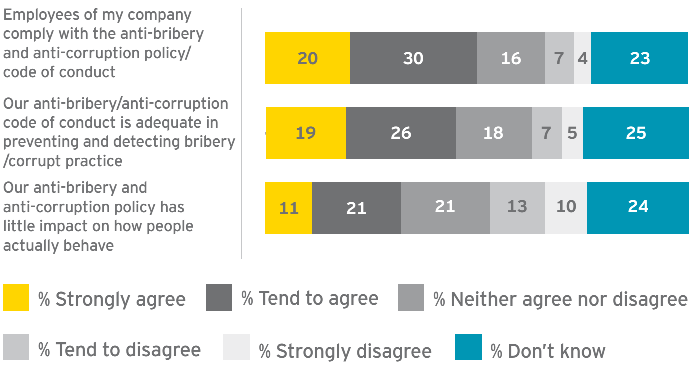
Q: For each of the following, please let us know whether it applies, or does not apply, to your organization, or whether you don't know?

Base: All board level/senior management (172); Other management (537); All other non-management employees (1656)

To make matters worse, 43% of respondents who say their company has an anti-bribery and anti-corruption policy could not identify who they should contact to report concerns of impropriety.

Anti-corruption legislation is complex, and incidents involving corruption are rarely straightforward. Employees therefore need an appropriately qualified resource to turn to for support and guidance. Organizations that fail to provide this support face an increased likelihood that incidents will go unreported and that misunderstandings will perpetuate. Appropriate incident response and reporting channels need to be established to avoid unintended disclosure or complications in any subsequent disciplinary action. Careful consideration needs to be given to the appropriate reporting channels so as to maximize potential claims to legal professional privilege, should it be available.

Figure 9
Impact of anti-bribery/anti-corruption measures on corporate behavior



Q: To what extent do you agree or disagree with the following statements?
Base: All respondents 2011 (2365)

When concerns are identified, management must demonstrate that compliance with anti-bribery policies is viewed as a serious business issue. It is therefore important that penalties for non-compliance are communicated and enforced. Less than half of those surveyed say that there are clear penalties for breaching their anti-bribery code, and only a quarter can recall an instance where someone was penalized for doing so. Whether this low level of awareness is due to a lack of publicity about enforcement is harder to tell.

Embedding integrity through training

Even when companies have managed to produce a code of conduct and an anti-bribery policy, a declining proportion are ensuring that their staff are trained on them. Training is a key part of an effective anti-bribery system, and the absence of training is regarded by regulators as unacceptable. The guidance issued by the UK Government in relation to the UK Bribery Act highlighted communication, including training, as one of the six key principles of "adequate procedures." It is likely, therefore, that companies that have lost focus on training will be exposed if regulators scrutinize their business.

Overall, less than a quarter of employees, and less than a third of board directors, have received any anti-bribery or anti-corruption training — hardly indicative of the appropriate tone from the top.

While it might appear positive that more than 60% of respondents working in higher-risk functions like marketing, sales and business development say that their company does provide anti-bribery or corruption training, less than 40% of these departments have themselves received such training. This perhaps explains why almost a quarter of marketing, sales and business development respondents could not see the relevance of their company's anti-bribery and anti-corruption policy to their work.

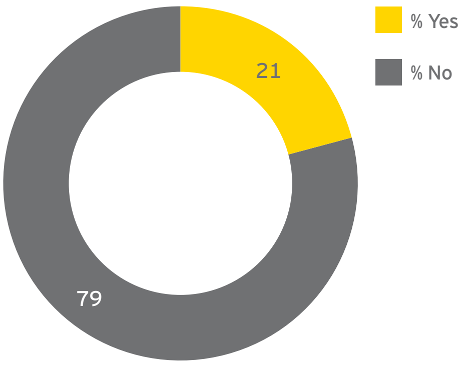
Employees in sales and marketing are high-risk because of their potential incentive to pay bribes to win business. It is leading practice that all employees within these functions receive training appropriately tailored to fit their grade and role to explain bribery and corruption risks and the practical implications for their work. Similarly, it is vital that other key employees who are in a position to expose the company receive such training.

It is not up to the individual employee to interpret complex legal or regulatory provisions. However, it is appropriate to convey the regulatory framework and provide awareness and context. At a minimum, training should be designed to ensure that all employees are familiar with the issues and are aware of their responsibilities both to act appropriately and report any fraud or corruption suspicions.

"Aggressive enforcement of the FCPA is essential in a world of increasing interdependence."

Cheryl J. Scarboro, Chief of the Foreign Corrupt Practices Act Unit, US Securities and Exchange Commission

Figure 10
Extent of anti-bribery/anti-corruption training



	% yes
Mature markets	23
Emerging markets	18

	% yes
Board director	29
Senior management	29
Other management	25
Other employee	19

Resp. business area (Top 5 mentions)	% total
Finance	31
Sales/Business development	28
IT	28
Marketing/communications	23
Customer service	22

	% yes
Romania	41
Ireland	38
Norway	32
Switzerland	32
Greece	29
UK	26
Italy	22
Slovakia	22
Sweden	21
TOTAL	21
Turkey	20
Poland	18
Russia	18
France	17
Hungary	17
Portugal	17
Spain	17
Netherlands	16
Austria	15
Germany	15
Ukraine	14
Czech Rep	13
Baltics	11
Croatia	5

Q: Have you personally received anti-bribery/anti-corruption training?
Base: All respondents (2365)

UK Bribery Act

The UK Bribery Act (the Act), which comes into force on 1 July 2011, has transformed the UK law on combating bribery. All bribery is covered by the Act, not just bribery of public officials, and there is no exemption for facilitation payments.

While UK regulators have expressed a desire to enforce the new Act rigorously, how it will be enforced in practice remains to be seen.

In summary, the Act creates four offenses:

- Two general offenses covering the offering and receiving of a bribe by private individuals
- A separate offense of bribing a foreign public official
- A new corporate offense of failing to prevent bribery

This last offense is of particular note, because it includes the activities of third parties acting on behalf of the organization (for example, agents or subsidiaries) anywhere in the world.

It is a defense for a company accused of failing to prevent bribery to demonstrate that it had "adequate procedures" in place. In March, the UK Ministry of Justice issued guidance on "adequate procedures" that companies should put in place to prevent bribery. This guidance stresses the need for proportionality in the implementation of anti-bribery policies and procedures.

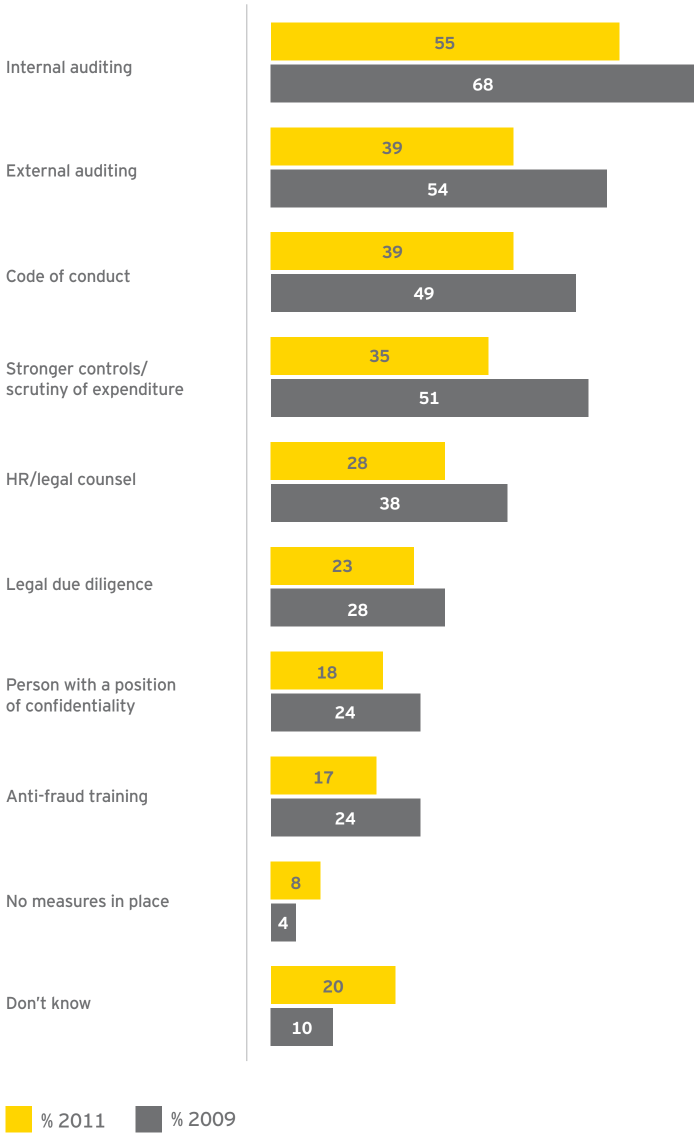
A weakening control environment?

Unfortunately it is not just anti-bribery policy with which many respondents are not familiar. Our survey results suggest a lack of appreciation for anti-fraud measures more broadly. In 2009, when concerns about reduced resources and smaller budgets for compliance were prevalent, we asked about the anti-fraud measures in place inside companies. The results showed that many respondents were aware of activities and initiatives such as internal auditing, a code of conduct and greater scrutiny of expenditure.

This year, however, the situation has significantly worsened. The numbers have fallen for every category of anti-fraud measure, in many cases by substantial margins. Twice as many people are now reporting that their company either has no anti-fraud measures in place or that they are unaware of them.

Either the corporate focus has moved away from the risk of fraud, or employees are now simply less aware of their employer's anti-fraud strategy. In particular, there has been a substantial reduction in the proportion of employees identifying stronger controls and scrutiny over expenditure. Even anti-fraud training has decreased, all while the risk of fraud, bribery and corruption remains high.

Figure 11
Anti-fraud efforts falling behind



Q: Does your company have any of the following anti-fraud measures in place?
Base: All respondents (2365); 2009 (2246)

Employees want more effective regulation

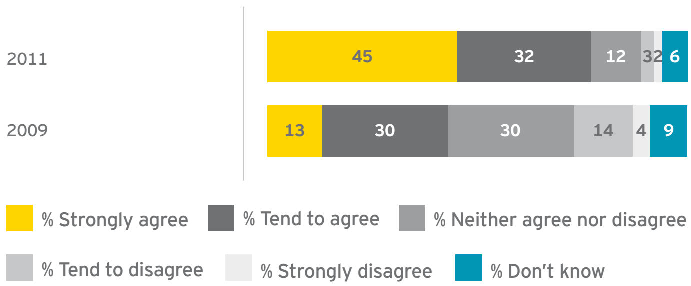
Our respondents think that the current corporate response to fraud, bribery and corruption risk is inadequate. In this pressurized environment, employees look to regulators to raise the cost of inappropriate conduct and thereby drive positive change.

Perhaps unsurprisingly, the economic downturn appears to have had a significant impact on people's expectations of regulators and what they want regulators to do to protect them.

In 2009, less than 15% agreed strongly with the idea that there should be more supervision by regulators to reduce the risk of fraud, bribery and corruption. This year, 45% agree strongly, rising to 57% in emerging markets, with another third of our respondents tending to agree.

55% of people say they would feel more secure in their job if government regulators were to scrutinize their company more closely. In 2009, the figure was 41%.

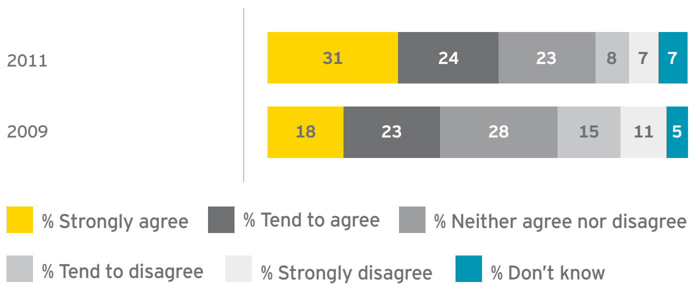
Figure 12
Demand for increased supervision by regulators



	% Strongly agree
Mature markets	37
Emerging markets	57

Q: To what extent do you agree or disagree with each of the following statements? There should be more supervision by regulators and government in the future, to try to reduce the risk of fraud, bribery and corruption
Base: All respondents (2365); 2009 (2246)

Figure 13
Employees want more aggressive regulatory oversight



	% Strongly agree
Mature markets	25
Emerging markets	39

Q: To what extent do you agree or disagree with each of the following statements? I would feel more secure in my job knowing that government/regulators were scrutinizing our company more closely
Base: All respondents (2365); 2009 (2246)

The regulatory fallout of the economic crisis

The connection between the economic crisis and the desire for greater regulatory oversight is perhaps clearest when one considers the responses from some of the countries in the Eurozone that have been most affected.

Respondents who would like to see more supervision by regulators to reduce the risk of fraud, bribery and corruption:

Portugal 90%, Italy 88%, Ireland 87%, Spain 85%, Greece 83% (European average 77%)

It is also striking that respondents from these countries are more likely to support harsher penalties for senior management where companies have been involved in fraud, bribery and corruption.

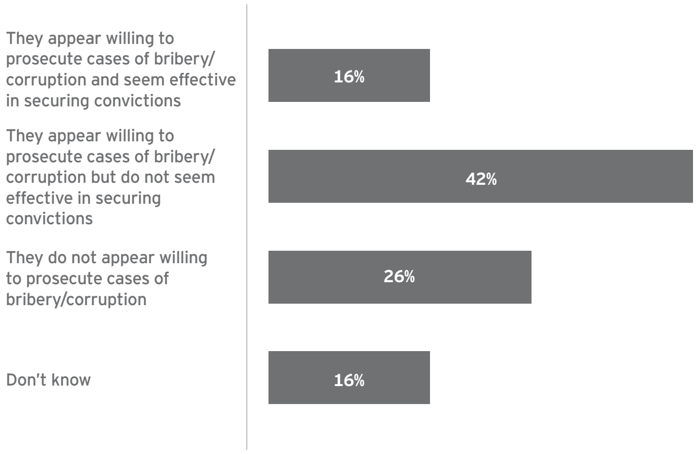
Respondents who think that companies' boards should be held personally liable for any corporate lapses in terms of fraud, bribery and corruption:

Ireland 85%, Italy 84%, Portugal 82%, Spain 82%, Greece 78% (European average 77%)

Respondents who believe senior management should receive criminal penalties if it can be shown that they have not done enough to prevent fraud, bribery or corruption:

Greece 81%, Portugal 81%, Ireland 80%, Italy 79%, Spain 75% (European average 74%)

Figure 14
Perception of regulators



Q: Thinking about regulators and law enforcement authorities in your country, which of the following statements best describes their approach to cases of bribery/corruption?
Base: All respondents (2365)

> "Management ought to set an example in their day-to-day behavior. When suspicions arise, they should be treated seriously and resolved appropriately."
>
> HR manager, Greece

Figure 15

Perceived challenges to the effectiveness of regulators

		Mature markets	Emerging markets
Bribery/corruption is too widespread to be tackled	53%	41	64
They lack the legal powers needed	30%	29	32
They don't have sufficient resources	28%	35	21
They don't want to damage businesses or force them to close	24%	28	20
They are afraid of damaging relationships with other countries	18%	24	13
Other	12%	11	12
Don't know	5%	5	4

Q: Why do you say regulators and law enforcement authorities are not willing to prosecute cases of bribery/corruption or are not effective in securing convictions?

Base: All respondents answering codes 2 or 3 at Figure 14 (1612)

Regulators are uniquely empowered in terms of both their rights of access to information and their ability to impose sanctions in a way that other market control mechanisms, such as external auditors and trade bodies, are not.

Not only do our respondents have high expectations of regulators, but results suggest widespread disappointment with the current level of regulatory enforcement. Fewer than 1 in 5 think that their local authorities are willing to prosecute bribery and corruption cases and are effective at securing convictions. A quarter feel that local authorities are not even willing to bring cases to court. Close to half think that regulators are willing to prosecute but have trouble securing convictions. In total, two-thirds of those in mature markets, and more than 80% of those in emerging markets, think that their regulators are either unwilling or unable to prosecute bribery and corruption.

Among those who feel that regulators are unable to address bribery and corruption in their country effectively, half think that the problem is simply too widespread to be tackled. More than one-quarter think that their regulators lack sufficient resources to be effective, a situation unlikely to improve as governments seek to tackle budget deficits.

While some commentators have suggested that robust anti-bribery and anti-corruption rules will harm business, our respondents disagree. Some 70% said that new regulations will have little or no impact on economic growth.

Overall, there is a cautious optimism about future enforcement developments. Almost 1 in 3 suggest that there would be more convictions if regulators were granted the powers and resources they needed to be really effective in tackling this problem.

Turning to the prosecution of individuals, few of our respondents would have much sympathy for a fellow employee who has participated in or sanctioned corrupt activity. They are particularly unforgiving of senior management. Over three-quarters of those surveyed think that company boards should be held personally liable for lapses by their organization relating to corporate fraud, bribery and corruption. Moreover, the same number would extend that criminal liability to all senior management for failing to take effective measures to prevent fraud, bribery or corruption somewhere in their organization (one of the crimes under the new UK Bribery Act).

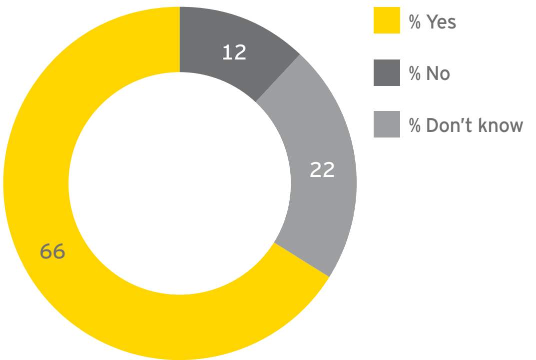
As well as being in favor of tough sanctions for those in breach of the rules, our respondents also want to encourage and reward whistleblowers. There is significant support for the kind of measures introduced by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in the United States. Under this law, whistleblowers who give new information to regulators about illegal corporate activity may receive as much as 30% of the resultant fines in certain circumstances. More than half of our respondents would support the introduction of a similar scheme in their country. Not surprisingly, senior managers are noticeably cooler toward the idea.

The US Securities and Exchange Commission (SEC) has sought to address company's concerns that encouraging the external reporting of illegal activity will negatively impact the compliance programs of its registrants. Regulations to implement the whistleblower portion of the Dodd-Frank Act have not yet been issued but, under the proposed guidance, whistleblowers may still qualify for a reward if they report a matter that they have reported internally to the SEC within the following 90 days. It is, therefore, crucial that organizations do everything they can to quickly identify issues and respond to allegations.

> "The demand from people for the accountable use of power and an end to corruption is indeed one of the key social drivers of our time."
>
> Cobus de Swardt, Managing Director, Transparency International

Figure 16
Employees encouraged by whistleblower rewards

The Dodd-Frank Act was adopted in the US in 2010. In summary, the Dodd-Frank Act's whistleblower provisions may make whistleblowers – employees (of any nationality) who reveal new information about suspected illegal corporate behavior of a US publicly listed company to the US securities regulator – eligible, in certain circumstances, for a substantial reward, up to 30% of any fines of more than $1million.



	% yes
Mature markets	63
Emerging markets	69
Board director	57
Senior management	70
Other management	66
Other employee	65

Q: Do you think such an approach will encourage employees of US publicly listed companies to report cases of suspected fraud, bribery or corruption?
Base: All respondents (2365)

Risk-based policy governance

New and emerging technology can spot patterns of corrupt or fraudulent activity in company data. Technology is, therefore, an essential part of a robust compliance environment and can be used to proactively monitor performance.

In this context, the financial services industry's response to the long-standing money laundering threat is instructive. Anti-money laundering policy is often enforced by near-real-time monitoring of new relationships or transactions against a set of key terms or risk indicators to generate and support the investigation of "red flags."

Developments in forensic data analytics and the ever-decreasing cost of processing power open up the opportunity to manage wider compliance requirements associated with fraud, bribery and corruption. Monitoring to detect these threats can encompass both structured and unstructured data, including text-mining emails for high-risk words and phrases and identifying unusual or unexpected patterns within accounting and customer data.

This is not primarily a question of the selection of the right tool – there are many choices – rather, it is a question of the development and implementation of solutions as part of a pragmatic strategy that identifies compliance risks and formulates a proportionate response.

Integrity really does pay

In spite of employees' skepticism regarding their companies compliance environment, and the motivation and effectiveness of regulators, our survey reveals a very positive message: not only is ethical behavior desirable, it is also good business.

Two-thirds of our respondents agree that a strong reputation for ethical behavior translates into a commercial advantage. Those interviewed put a premium on integrity and expect the market to do the same. In emerging markets, 75% of all those interviewed agree that there is a commercial advantage to ethical behavior, with more than half in strong agreement.

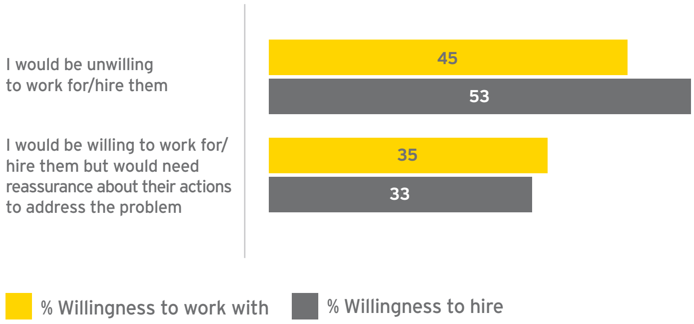
Our respondents think that being an unethical company damages the brand. Companies that find themselves involved in a major bribery or corruption case may have difficulty hiring or retaining talent. Almost half of our respondents tell us that they would be unwilling to work for such a company. A further 35% would need reassurance about the extent of action being taking to address the problem before they would accept employment.

Fraud and corruption prosecutions are highly disruptive and damaging for companies. Companies face significant costs arising from an investigation along with subsequent fines, profit disgorgement and possibly monitorships. But the impact does not stop there. Bribery and corruption allegations can also serve as a major management distraction and result in long-term damage to brand image, recruitment and retention.

Our survey also highlighted significant repercussions for relationships outside the organization. Over half of our respondents would be unwilling to buy products and services from a company involved in a major bribery and corruption case. In addition to the greater economic pressures arising from the consequent loss of business, companies charged with fraud or corruption will also need to engage in costly public relations exercises to reassure their remaining customers.

As our respondents' opinions suggest, rather than being merely an inconvenient requirement of the modern economy, acting with integrity can be good for business.

Figure 17
Perceptions of companies involved in a major bribery or corruption case



Q: Thinking about your perceptions of a company that had been involved in a major bribery or corruption case, which, if any of the following would apply?
Q: And if they were a supplier or agent, which, if any of the following would apply?
Base: All respondents (2365)

> "Corruption threatens the integrity of markets, undermines fair competition, distorts resource allocation, destroys public trust, and undermines the rule of law."
>
> G20 Anti-Corruption Action Plan, Seoul, 2010

Conclusion

Our survey indicates that the corporate response to fraud, bribery and corruption continues to face serious challenges:

- Management is failing to set a strong tone at the top of many organizations and, in many cases, is prepared to do whatever it takes to succeed
- A persistently high level of employees are willing to behave unethically
- Companies are not doing enough to implement and communicate anti-fraud and anti-corruption measures

These matters clearly expose companies to heightened financial, regulatory and reputational risk.

Although we have seen a focus on compliance by many of our clients in the past five years, the challenges highlighted by our survey suggest that many others remain to be convinced of the business benefits of compliance. The admission by half of our senior management respondents that they will cut corners to achieve targets can only support this view, as does the fact that a third of respondents believe that employees with questionable ethical standards are promoted in their company.

The necessary audit committee and board level management response

There are a number of ways in which companies can reinvigorate the push for integrity. The leadership of the organization must:

- Make ethical behavior a priority for the business and demonstrate its commitment to achieving this objective
- Conduct a fraud, bribery and corruption risk assessment and identify any gaps in current policies and procedures
- Where necessary, modify and develop policies and procedures
- Implement changes paying particular attention to training:
  - Be sure that training is truly tailored and relevant, reflecting the issues and day-to-day problems that their employees are likely to encounter and how to address them
  - Take a risk-focused approach to who should be trained, on what, in which manner and how often
  - Ensure that integrity is reflected in the appraisal systems of the business

These are largely commonsense measures that give employees a reason to care more about integrity by linking it to their work and their career advancement within the organization.

The Compliance functions and Internal Audit

If Compliance and Internal Audit are to increase their ability to change corporate conduct, it is important that they are seen as value-adding functions. As such, they must go beyond a checklist approach to ensure that they enable businesses to make better decisions.

It may not be easy to embed the necessary changes to internal corporate culture required to mitigate the challenges posed by unethical conduct. Our survey has indicated that companies struggle to ensure that what they have in place on paper is actually reflected in the underlying behavior of their staff. It is only through a concerted, risk-focused effort that targets areas of potential exposure that firms will be able to meet the expectations of regulators and, ultimately, their shareholders.

Survey approach

In January and February 2011, our researchers conducted a total of 2,365 interviews with employees in 25 European countries either by telephone, online or in person. Those interviewed worked for companies that were either stock exchange listed, multinational or employed more than 1,000 people.

Interviews were conducted using local languages in all countries.

Participant profile — region and country, company size, role, industry

Number of interviews	
Region and country	
Mature markets	1,335
Austria	103
France	101
Germany	105
Greece	102
Ireland	105
Italy	104
Netherlands	100
Norway	100
Portugal	102
Spain	103
Sweden	103
Switzerland	103
UK	104

Number of interviews	
Region and country	
Emerging markets	1,030
Baltics	101
Croatia	100
Czech Republic	101
Hungary	103
Poland	108
Romania	104
Russia	108
Slovakia	100
Turkey	105
Ukraine	100

Number of employees globally	%
Above 5,000	48
1,500 – 4,999	22
1,000 – 1,499	12
500 – 999	11
Less than 500	7

Role within organization	%
Board director	1
Senior management	6
Other management	23
Other employee	67
Other	3

Industry sector	%
Banking and capital markets	13
Consumer products	13
Manufacturing	13
Health sciences	12
Government and public sector	11
Telecommunications, communications and entertainment	11
Transportation	11
Real estate and construction	5
Extractive industries (oil, gas, mining, minerals)	4
Power and utilities	4
Professional firms and services	3

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