

# Bribery and Corruption Red Flags: “How to Respond to Corruption Risk Indicators”

In the past few years, the UK Bribery Act—along with the French Sapin II, the Spanish Criminal Code, the Italian “Bribe Destroyer” bill, the German “Law to Strengthen Business Integrity” and many other Anti-Bribery and Corruption (ABC) laws and regulations—has been gaining traction in enforcement. Bribery and corruption is prohibited, illegal and the source of fines, penalties, reputational damage, and in some cases criminal liability. This is equally true when the bribes are offered by third parties.

Companies are expected to evaluate their corruption risk through regular risk assessments and adequate due diligence of third parties. These initiatives may turn up acts of corruption by spotting risk indicators commonly referred to as ‘red flags’ – suspicious activities or behaviors that merit further investigation. These red flags, or risk indicators, can be internal or external to the organization and are often specific to, among other things, the location of its operations, the industry sector, and the third party used.

Compliance activities should not only increase as risk indicators surface but it is also important to respond appropriately to them and document the actions taken. The way red flags are addressed is one of the key indicators of the overall ethics & compliance program effectiveness.

## Legal Requirements

Before examining some of the common red flags and the appropriate courses of action to take, reviewing the various legal requirements is advisable. When designing your anti-corruption program, it may be most useful to start with these guiding measures which have assisted organizations in establishing a strong legal defense in the event that a bribe does occur.

These measures are having ramifications across the globe and they inform many of the components of the best anti-corruption programs in place today.

- **The U.K. Bribery Act Guidance 2010** **requires** organizations to assess the nature and extent of their exposure to potential external and internal risks of bribery. Taking a proportionate and risk-based approach, organizations should apply due diligence and other procedures in respect of persons who perform or will perform services for or on their behalf, as well as examine internal organizational structures or procedures that may themselves add to the level of corruption risk.
- **Germany's Law on Fighting Corruption 2015** significantly **expanded** the criminal offences of taking and giving bribes in commercial practice, as well as of bribing public officials. The new **"Law to Strengthen Business Integrity"** (**expected** to be enacted later in 2021) will introduce criminal liability of companies and incentivize compliance measures as a legal defense. This is likely to produce a transformative **effect** on the German corporate landscape: an effective compliance program is now a must.
- **French SAPIN II** **states** that an effective anti-corruption program must include "a mapping of risks intended to identify corruption risks according to the business lines and geographical areas where the company carries out business, including procedures for assessing the situation of customers, leading suppliers and intermediaries with regard to the risk map". According to the French Anti-Corruption Agency Guidelines (last **updated** in January 2021 risk mapping and following management of the identified risks, together with the senior level commitment, are the three inseparable pillars of an ABC program.
- **Italy's so-called "Bribe Destroyer" bill** 2019 **aimed** to combat public sector corruption and introduced some important changes regarding the liability of private sector entities provided for by the Legislative Decree 231/01. This law further underscores the importance of an effective anti-corruption program: in cases where organizations demonstrate active collaboration during the investigation and an effective program ("Modello 231") is in place to prevent further crimes of the kind to occur, the penalties for a corruption violation may be significantly reduced.
- *In the* **Netherlands**, foreign bribery enforcement **ramped up** following the establishment of specialized investigative and prosecutorial teams. The new "Instruction on the Investigation and Prosecution of Foreign Corruption for the Dutch Public Prosecution Service" (entered into force in late 2020) **states** that the involvement of third parties does not exempt legal persons from criminal liability for bribery. It is, therefore, advisable that organizations conduct thorough due diligence procedures to fully understand the nature and scope of their activities to mitigate this additional corruption risk.
- Pursuant to the **amendments** to **Spanish Criminal Code in 2015**, a company's directors were legally obligated to adopt an 'organisation and management model', i.e. a compliance program, supervised by a body or individual authorized to exercise high-level control. The Criminal Code provided companies with an exemption from criminal liability for crimes committed by their officers or employees, provided the company meets certain requirements set forth under the law, including the adoption and effective execution of a compliance program, a rigorous risk assessment and adequate internal controls.

## Voluntary Guidelines

In addition to regulatory requirements, there are many voluntary guidelines and frameworks available for organizations to build adequate procedures to protect themselves against corruption risks.

### OECD's 13 Good Practices on Internal Controls, Ethics, and Compliance

The Organisation for Economic Co-operation and Development (OECD) Good Practice **Guidance** helps companies in, "establishing and ensuring the effectiveness of internal controls, ethics, and compliance programs or measures for preventing and detecting the bribery of foreign public officials in their international business transactions."

### The ISO Standard 37001:2016 Anti-Bribery Management System

The International standard ISO 37001:2016 **specifies** requirements and provides guidance for, "establishing, implementing, maintaining, reviewing and improving an anti-bribery management system. The system can be stand-alone or can be integrated into an overall management system."

### GRI 205: Anti-Corruption

GRI 205 is part of the set of GRI Sustainability Reporting Standards. It **sets out** the reporting requirements on several anticorruption topics including a disclosure on "company operations assessed for corruption risk", as well as "the number of cases when contracts with business partners were terminated or not renewed due to corruption risk or corruption-related violations."

## Identifying Red Flags with a Robust Risk Assessment

Every organization will have a unique corruption risk profile, with the varying risks defined by the location of its operations, the industry sector, the regulatory landscape, potential clients and business partners, transactions with foreign governments, payments to foreign officials, use of third parties, gifts, travel, and entertainment expenses, and charitable and political donations. Regulatory agencies have made it clear that companies are expected to adopt

A risk-based approach to ethics and compliance to ensure their program devotes appropriate resources and scrutiny to high-risk areas and transactions. A thorough assessment of your organization's risk profile can help you understand where corrupt behaviors might occur. The work doesn't stop there – you should further investigate and resolve the identified red flags, as well as update your policies, procedures, and controls in light of lessons learned from your periodic risk assessments.

NAVEX Risk Assessment Guide offers a 12-step framework that will help you complete your own ethics and compliance risk assessment. Armed with your findings and action plan, you will be equipped to develop and implement an effective and ethics and compliance programme.

A robust and recurring risk assessment provides a solid foundation for other critical elements of an effective ethics and compliance programme, as follows:

- Clearly articulated anti-corruption policy
- Effective internal whistleblower mechanisms
- Adequate financial controls
- Risk-tailored anti-corruption training programme
- Well-publicized disciplinary regime for cases of misconduct
- Strong internal controls and monitoring system

# Examples of Red Flags or Corruption Risk Indicators

Red flags can be classified in many different ways but for the purposes of an anti-corruption risk assessment it may be helpful to understand that they can be organization-level or business process-specific.

To illustrate the difference, the UK Bribery Act 2010 provides the following list of commonly encountered organization-level corruption risk indicators:

- deficiencies in employee training, skills and knowledge,
- bonus culture that rewards excessive risk taking,
- lack of clarity in the organization’s policies on, and procedures for, hospitality and promotional expenditure, and political or charitable contributions,
- lack of clear financial controls,
- lack of a clear anti-bribery message from the top-level management.

Unlike the organization-level red flags which are mostly high-level and refer to the organizational culture, business process-specific red flags are tightly mapped to the business processes. Below are some examples of specific processes that are vulnerable to corruption and deserve extra attention when performing an anti-corruption risk assessment for your organization.

**Table 1: Corruption Red Flags in Specific Business Processes**

Business Process	Corruption Red Flag
Sales	<ul style="list-style-type: none"> <li>• excessive use of third-party agents, intermediaries, consultants</li> <li>• payments without invoices or complete receipts</li> <li>• gifts and entertainment: lavishness, unreasonableness, inaccurate records</li> </ul>
Procurement	<ul style="list-style-type: none"> <li>• unusual bid patterns</li> <li>• unnecessary/excessive purchasing</li> <li>• lowest bidder not selected</li> <li>• suspicious bidder/supplier (little or no expertise in the industry, financial difficulties)</li> <li>• shell company schemes</li> <li>• contract splitting</li> <li>• overbilling schemes</li> <li>• procurement staff appear to be living beyond their means</li> <li>• procurement staff refuse to take vacation</li> <li>• purchased works/services not delivered</li> </ul>
Import/Export Operations	<ul style="list-style-type: none"> <li>• customs clearance payments</li> </ul>
HR/Recruitment	<ul style="list-style-type: none"> <li>• requests from a third party for a job or internship to be offered to a particular person</li> </ul>
Interactions with Governments	<ul style="list-style-type: none"> <li>• state-owned corporations as clients</li> <li>• state-owned corporations as partners</li> <li>• obtaining licenses, permits, and visas</li> </ul>

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Business Process	Corruption Red Flag
'Voluntary' contributions	<ul style="list-style-type: none"> <li>• large charitable contributions in foreign countries</li> <li>• sponsorships</li> <li>• political support</li> <li>• contributions to social programmes/ infrastructure projects</li> </ul>

In addition to the examples specified in regulatory guidelines, there are numerous other sources for corruption red flags and best practice responses, either in list format or as part of scenario-based examples. The following are some excellent examples of both.

- OECD Due Diligence Guidance for Responsible Business Conduct [published](#) in 2018 is a practical tool for organizations that provides detailed recommendations on how to carry out a risk-based due diligence of company operations, supply chains, and other business relationships. The Guidance aims to address a broader spectrum of risks related to human rights, environment, bribery and corporate governance. The recommendations are illustrated with sample risk indicators, practical examples and explanations on every step of a due diligence process.
- The World Bank’s “Common Red Flags of Fraud and Corruption in Procurement” is a helpful starting point for a deep-dive into corruption-related risks associated with tendering and contract execution.
- The Anti-Corruption Guideline of Volkswagen Group, the largest carmaker in Europe, is full of scenario-based examples of typical situations where corruption is likely to occur, sample red flags and “golden rules” for employee conduct.

### External Red Flags - Adequate Procedures for Third Party Engagements

**Enforcement actions** clearly demonstrate that third parties, including agents, consultants, and distributors are frequently used to conceal the payment of bribes to foreign officials in international transactions. The engaging company may be held liable for bribes offered by third parties viewed as a direct extension of an organization.

“Common consensus tends to link, very directly, Bribery & Corruption with Third Party Risk Oversight & Management. These concerns combined create a major risk for company stakeholders.”

**Source:** NAVEX Anti-Bribery and Corruption Market [Report](#), 2018.

The universal elements present in most of the regulatory frameworks that prove critical in demonstrating adequate procedures for third party due diligence include:

- Written third party policies and procedures
- Appropriate due diligence prior to engagement
- Bona fide business purpose for engagement
- Ongoing monitoring and auditing of the third-party relationship
- Documentation
- Accurate books and records.

Third party due diligence is not a tick box exercise; it is a thoughtful process. Red flags are not necessarily evidence of actual corrupt activities but rather a starting point for further investigation. Any red flags identified need to be considered by knowledgeable stakeholders within the organization to make a careful judgement. After due diligence a company should apply its anticorruption policy and: (1) terminate the review or engagement; or (2) request further information; or (3) accept the third party.

**Check out the NAVEX Third Party Risk Toolkit to [access](#) the tools and data you need to clearly demonstrate the top third-party risk considerations to your board.**

The list on the following page can be used as a starting point to help identify the most common third-party red flags, or risk indicators. Next to each red flag we have provided some suggested responses and best practices an organization can use to address these issues. As always, these situations and solutions are for demonstration purposes only. In practice, an organization’s response requires input from the organization’s Ethics and Compliance, Legal, Risk and other appropriate or designated internal and external business partners and resources.

**Table 2: Third-Party Corruption Red Flags and Suggested Responses**

Category	Red Flag/Corruption Risk Indicator	Risk Concern	Response(s)
Geographic / Industry	Is the third-party engagement being executed in a location where bribery or fraud is a high risk?	Engagements in high risk locations may warrant additional due diligence on the third party prior to engagement.	Check <a href="#">NAVEX Corruption Risk Country Profiles</a> for the ratings of specific regions or countries.
Geographic / Industry	Is the engagement in an industry with a history of bribery, corruption, and investigations?	Certain industries, e.g., mining, real estate, oil and gas and pharmaceuticals have higher incidences of fraud and corruption and may require greater due diligence	OECD, TI and other industry surveys have identified high risk industries. Engagement for these industries may warrant enhanced due diligence
Compensation or Transactional	Request for payments in cash or cash equivalents.	Cash or cash equivalents can be a source of bribes or kickbacks which are more difficult to trace.	Limit or eliminate cash payments by requiring all payments to be made only after submission of invoices, receipts and proof of reasonable payments. This requirement should be clearly spelled out in the contractual arrangements and your ABC policy.

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Compensation or Transactional	Payment of unusually high commissions or fees.	Commissions or fees which are extreme or vary greatly from reasonable compensation for similar services may indicate an arrangement which is not at arms-length or bona fide. Higher than normal commissions may suggest that the excess could be used to pay bribes.	In writing, clearly specify the services to be provided and the compensation structure. Variations by more than 10-20% may warrant written documentation of the special or unusual circumstances.
Business Qualifications	Related to or recommended by a foreign official.	The recommendation may be cover or pretense for higher fees or a case where approvals are greenlit solely based on the agreement to hire and pay this recommended third party. Bribes may also find their way into the coffers of these same foreign officials who provided the "recommendation"	Ensure that the bid process is fair and above board and only highly qualified third parties are considered and reasonably compensated. Contractual arrangements should be standard and in writing.
Business Qualifications	Incomplete questionnaires, refusal to provide reasonable information or discovery of information inconsistent with information previously provided.	The due diligence process is designed to elicit appropriate information for making an informed decision about the qualification, fitness, experience and financial stability of the third party. If they refuse to provide complete information it could portend a hidden risk, lax operational resources or an unwillingness to follow organization policy.	Do not ignore incomplete information or "assume the best". This is a risky strategy and will be very difficult to defend in the event that the reason for non-compliance with the information request was more sinister. If the failure is due to a lack of experience, it may only take some guidance or coaching to help them understand the importance of the information to the selection process.
Reputational	No demonstrable third-party compliance program or training on anti-bribery and corruption.	Selecting third parties that can produce evidence of an anti-bribery compliance program demonstrates a level of awareness and some commitment to compliance.	The engaging company could provide access to its own anti-bribery training or require proof of training from a reputable source prior to activating the engagement.
Reputational	Adverse information, e.g. on a government watch list, or adverse media reports on the entity, principals or beneficial owners.	Due diligence should include a search for negative information about past practices from available public sources. Automation or third-party providers may assist in this search.	All red flags are not equal and evidence of this kind of reputational issue should receive significant scrutiny and be well documented.

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Category	Red Flag/Corruption Risk Indicator	Risk Concern	Response(s)
Reputational	Gifts, entertainment or travel.	Evidence of lavish or unreasonable gifts, entertainment, travel or expenditures not reasonably related to a business purpose may be construed to be an attempt to bribe officials or corrupt the process.	A clear policy on what is acceptable (and in what circumstances) should be communicated to employees and third parties. Implement a review and pre-approval process as well as regular monitoring and auditing of books and records for anomalies.
Questionable or Improper Transactions	Requests for charitable donations to charities sponsored by foreign government officials or relatives.	An actual or perceived bribe could result from a charitable donation to a charity sponsored by a foreign government official or a close relative.	A clear policy on what is acceptable and in what circumstances. Implement a review and pre-approval process.
Structure or Relationships	Principals or beneficial owners are "politically exposed parties" (PEP), foreign government officials or their relatives	Extra care should be taken when the third party contains or benefits foreign government officials or their relations.	In addition to due diligence on the third-party entity, these engagements require a detailed disclosure and examination of information about owners, principals and beneficial owners.
Structure or Relationships	Shell company or newly formed entity with little or no organizational structure or past experience.	This could be an indication of a hastily created entity and not a legitimate contender for the engagement. This may raise concerns that the services to be provided for compensation are illusory.	For newly created entities, make sure that they contain qualified, experienced personnel and that the entity is legitimately and appropriately staffed and resourced to be able to provide goods and services expected in the transaction.
Inaccurate or Incomplete Books and Records	Payments without invoices or complete receipts.	The FCPA and many other regulations provide for a separate charge if books and records are incomplete or inaccurate, e.g., a bribe is listed as a "commission" or "miscellaneous permit fees".	This is often an overlooked element of an effective antibribery program. The intent of this requirement is probably designed to make sure that organizations are vigilant about reviewing and monitoring payments for suspicious activity. This charge may be a gateway to further fines and penalties.