Look before you leap
Managing risk in global investments
We are pleased to present the annual Look Before You Leap survey on how companies are using background/integrity checks to better manage the risks inherent in investments and new business relationships outside the United States. In addition, this year’s survey also addressed how companies are complying with the U.S. Foreign Corrupt Practices Act (FCPA) and the challenges they face.

This year’s survey shows us that companies appear to be increasingly focused on assessing and managing the risk in their international relationships, but many seem to be struggling to do so at a reasonable cost. To gain greater insight into whom they are doing business with, background checks are progressively becoming the norm — conducted at least some of the time by 89 percent of the survey participants — and will be viewed as expected baseline controls by the regulators in the next year.

Survey results also highlighted that companies that conduct background investigations, and do so effectively, may be able to avoid significant problems that may otherwise have gone undetected in the due diligence process. In fact, more than half of the survey respondents said their companies had renegotiated or cancelled a planned investment or business relationship outside the United States based on the findings of a background investigation.

The increased focus by management on these issues appears to have been spurred by a more aggressive regulatory environment. In this year’s survey, three-quarters of the survey participants said they had become more concerned about the potential for FCPA violations, with the greatest concern about their activities in emerging markets such as Russia, Africa, China, and the Middle East. The potential for significant regulatory risk, the need to install robust internal controls and conduct additional, effective due diligence were some of the key issues identified as a result of Deloitte’s1 recent investigative work for Siemens AG, which agreed in 2008 to pay fines totaling $1.6 billion to U.S. and German regulatory authorities due to anti-corruption violations.

In our practice each day, we see that companies with robust due diligence and strong internal controls are usually less likely to encounter unforeseen problems in their overseas business activities. We hope that this 2009 Look Before You Leap survey will help your company as it manages these complex issues.

Wendy Schmidt
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Deloitte Financial Advisory Services LLP

Joe Zier
Partner, Forensic & Dispute Services
Deloitte Financial Advisory Services LLP

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1 As used in this instance, Deloitte refers to Deloitte & Touche GmbH and the 35 member firms of Deloitte Touche Tohmatsu that participated in the Siemens AG investigation.
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Executive summary

This third edition of Deloitte’s Look Before You Leap survey focused on the use of background/integrity checks when considering a business relationship, investment, or acquisition outside the United States. In addition, it analyzed in detail the steps companies are taking when active in foreign markets to help comply with the U.S. Foreign Corrupt Practices Act (FCPA).

The survey found that investigating these issues has had a major impact on many company business plans. More than half of the 200 survey participants surveyed said that issues identified in background/integrity checks over the last three years had led their companies to renegotiate or cancel a planned business relationship, investment, or acquisition outside the United States. Similarly, 42 percent of the survey participants said their companies had cancelled or renegotiated a planned business transaction outside the United States over the last three years due to concerns over compliance with the FCPA.

And concerns over compliance with the FCPA appear to be increasing. Seventy-five percent of the survey participants surveyed said that over the last three years companies in their industry had become more concerned over the potential for FCPA violations, with the greatest concern about potential violations in emerging markets such as Russia, China, and the Middle East.

Despite the high level of concern about maintaining FCPA compliance, however, only about one-fifth or fewer survey participants said their companies conduct detailed investigations into a series of potential FCPA problem areas — such as whether certain compensation to third parties is appropriate or whether the target company has a system to identify anomalous transactions — before entering into a business relationship outside the United States.

In working with clients in many industries, Deloitte has found that companies can benefit from proactive programs that probe deeply into the backgrounds and past activities of potential partners to identify any allegations of bribery, corruption, criminal activity, or other inappropriate behavior. When conducting such due diligence, companies should consider looking at a variety of sources, including public records, local media, Internet searches, and interviews with people knowledgeable about the local market. Companies should also consider evaluating the effectiveness of any anti-corruption compliance programs in the local companies that they are seeking to acquire or do business with.

Companies that fail to take these steps may run the risk of violating the FCPA and other laws, and could potentially be subject to significant penalties. In addition, the discovery of inappropriate or illegal behavior on the part of foreign business partners can lead a company to suffer significant damage to its corporate reputation. As U.S. companies continue to expand around the world, especially in emerging markets, putting in place effective procedures designed to help identify and address potential problems with business partners and acquisition targets — both with FCPA compliance and with business integrity generally — can be a key contributor to long-term success.
Deloitte Financial Advisory Services LLP contracted Bayer Consulting to conduct this Look Before You Leap survey to help assess how companies are managing investigative due diligence in acquisitions, investments, and business relationships outside the United States.

The survey was conducted online between May 28 and October 3, 2008. It was completed by 216 senior professionals involved with acquisitions, investments, and business relationships outside the United States for their companies. The responses were aggregated for the purpose of analysis, and individual responses have been kept strictly confidential. The survey participants came from companies representing a range of industries and sizes. (See Exhibit 1 and Exhibit 2.)

**Exhibit 1**
*Industry*

- Financial services: 26%
- Other: 20%
- Media: 3%
- Life sciences: 4%
- Retail: 6%
- Energy & resources: 12%
- Technology: 7%
- Manufacturing: 25%

**Exhibit 2**
*Annual Revenues*

- Less than $100 million: 27%
- $100 million - <$1 billion: 25%
- $1 billion+: 48%
More than half of the survey participants said their companies had cancelled or renegotiated planned transactions outside the United States due to issues identified in background/integrity investigations.

There was widespread use of background/integrity investigations before business transactions outside the United States by the companies participating in the survey. Fully 89 percent of the survey participants said their companies conducted background/integrity checks of relevant parties at least some of the time before entering into a business relationship, merger, or acquisition outside the United States, while 69 percent said they always or frequently conducted such investigations.

For many of the participants, these investigations have been a critical input into business decisions. Fifty-nine percent of the survey participants said that information identified in a background/integrity check had led their companies to renegotiate a planned transaction outside the United States over the last three years, while 55 percent said such information had led them to cancel one.

The most common issues that led companies to change their foreign business plans were a lack of transparency or unusual payment structures in contracts, cited as a reason by 61 percent of survey participants, and the existence of unusual business relationships between executives at the target company and government officials or third parties, cited by 48 percent of survey participants. (See Exhibit 3.) However, several other issues also caused companies to cancel or renegotiate transactions, including the use of agents, consultants, distributors, or other third parties to obtain or facilitate business (38 percent of participants) and the discovery that the entity was involved in a criminal or administrative violation from a governmental agency (33 percent of participants).

**Exhibit 3**

Issues identified in background/integrity investigations that led company to cancel or renegotiate potential transactions outside the United States

*Base = Survey participants at companies that cancelled or renegotiated*
Background/integrity checks investigate a wide range of potential problems.

Survey participants were asked about the extent to which their background/integrity checks investigated a list of potential problem areas. (See Exhibit 4.) More than 70 percent of the survey participants said that eight of the 10 issues received either a very detailed or somewhat detailed investigations at their companies. The issues that most often received a very detailed investigation during background/integrity checks were the existence of criminal or administrative violations (49 percent of participants), evidence of fraud or money laundering schemes (49 percent of participants), and excessive or questionable payments to or on behalf of government officials, consultants, or other third parties (42 percent of participants).

Exhibit 4
Level of investigation into issues in background/integrity investigations

- Criminal/administrative violations: 49% very detailed, 34% somewhat detailed = 84%
- Fraud/money laundering: 49% very detailed, 31% somewhat detailed = 79%
- Lack of transparency in contracts: 36% very detailed, 43% somewhat detailed = 79%
- Subject to fines: 38% very detailed, 38% somewhat detailed = 77%
- Unusual relationships with third parties: 35% very detailed, 39% somewhat detailed = 75%
- Use of third parties to obtain business: 34% very detailed, 40% somewhat detailed = 74%
- Excessive payments to third parties or government: 42% very detailed, 30% somewhat detailed = 72%
- Extent of sales in high-risk countries: 27% very detailed, 44% somewhat detailed = 71%
- Appearance of agents on watchlists: 33% very detailed, 31% somewhat detailed = 64%
- Large political/charitable contributions: 26% very detailed, 30% somewhat detailed = 56%

Very detailed
Somewhat detailed
Compliance with the Foreign Corrupt Practices Act

One of the key concerns when entering into a business relationship, making an investment, or conducting an acquisition outside the United States is compliance with the Foreign Corrupt Practices Act (FCPA), which prohibits U.S. companies and their subsidiaries, as well as their officers, directors, employees, and agents, from bribing “foreign officials” in order to secure business or some other improper advantage. It also requires all SEC-registered companies to maintain internal accounting controls and to keep books and records that accurately reflect all transactions. In addition to requiring appropriate record-keeping for all transactions and dispositions of assets, the FCPA also stipulates the required levels of due diligence about individuals and entities doing business with the company.

Concerns over FCPA compliance
Companies are increasingly concerned over the potential for FCPA violations.
Three-quarters of the survey participants surveyed said that companies in their industry had become more concerned over the last three years about the potential for FCPA violations, with roughly one-third saying that these concerns had increased significantly. (See Exhibit 5.) The concerns about FCPA compliance are even greater among larger companies. Fully half of the survey participants at companies with annual revenues of $1 billion or more believed that the concern in their industry about potential FCPA violations had increased significantly, while 82 percent said that it had increased at least somewhat.

Exhibit 5
Increased concern over last three years about potential FCPA violations
Views of respondents about concern among companies in their industry overall

<table>
<thead>
<tr>
<th>Category</th>
<th>Increased significantly</th>
<th>Increased somewhat</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>36%</td>
<td>39%</td>
<td>75%</td>
</tr>
<tr>
<td>$1 billion +</td>
<td>50%</td>
<td>32%</td>
<td>82%</td>
</tr>
<tr>
<td>Less than $1 billion</td>
<td>23%</td>
<td>45%</td>
<td>68%</td>
</tr>
</tbody>
</table>

Increased significantly | Increased somewhat
Greatest concern about FCPA compliance is related to emerging markets.

With many emerging markets having become associated with corrupt business practices, survey participants are most concerned about the potential for violations of the FCPA when doing business in these locations. When asked how concerned their companies were about the potential for FCPA violations when doing business in specific markets, survey participants were most likely to report their companies were extremely concerned about FCPA violations in Russia/CIS (i.e., the former members of the Soviet Union) (70 percent), Africa (69 percent), China (60 percent), and the Middle East (59 percent). (See Exhibit 6.) Substantial percentages of survey participants also reported concerns about Latin America, Southeast Asia, and India.

Bribery schemes are one of the sources of FCPA risk. When asked about the types of bribery schemes observed most often in foreign business environments, the schemes that were most often ranked as either first or second in frequency were subcontractors that don’t add value (48 percent), inappropriate training and travel expenses (46 percent), and the use of third-party foreign payers (45 percent). Roughly one-quarter of survey participants cited intermediary price inflation and the creation of slush funds.

### Exhibit 6
Concern about potential for FCPA violations in specific locations percent

<table>
<thead>
<tr>
<th>Region</th>
<th>Percent extremely concerned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia/CIS</td>
<td>70%</td>
</tr>
<tr>
<td>Africa</td>
<td>69%</td>
</tr>
<tr>
<td>China</td>
<td>60%</td>
</tr>
<tr>
<td>Middle East</td>
<td>59%</td>
</tr>
<tr>
<td>Latin America</td>
<td>40%</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td>39%</td>
</tr>
<tr>
<td>India</td>
<td>39%</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>24%</td>
</tr>
<tr>
<td>South Korea</td>
<td>24%</td>
</tr>
<tr>
<td>Western Europe</td>
<td>7%</td>
</tr>
<tr>
<td>Japan</td>
<td>6%</td>
</tr>
</tbody>
</table>
FCPA concerns often lead companies to renegotiate or cancel planned foreign transactions. Forty-two percent of survey participants reported that concerns over FCPA compliance had led their companies to either renegotiate or pull out of a planned business relationship, merger, or acquisition outside the United States over the last three years.

Survey participants cited a long list of FCPA concerns that had contributed to these decisions. Leading the list of FCPA concerns that led to changed business plans was the appropriateness of compensation paid to international agents, consultants, and third parties, which was cited by 55 percent of survey participants. (See Exhibit 7.) However, several other issues were named by roughly one-third of survey participants as motivating their areas of concern that led to their decision, including the existence and effectiveness of FCPA due diligence/screening procedures and the existence of compliance representations from employers, agents, and other business partners.

Exhibit 7  
FCPA concerns that led company to renegotiate or cancel planned transaction outside the United States  
Base=Survey participants at companies that have cancelled or renegotiated transactions over last three years due to FCPA concerns

- Inappropriate compensation to third parties: 55%
- Effectiveness of FCPA due diligence: 38%
- Existence of compliance representations from third parties: 38%
- Testing of expense accounts: 36%
- System to identify red flags: 36%
- System to block false documentation: 34%
- Restrictions on charitable/political contributions: 26%
- System at target to identify anomalous transactions: 22%
- Effectiveness of ethics/FCPA training: 16%
- Target has FCPA monitoring system: 12%

Note: Percentages total to more than 100 percent since survey participants could make multiple selections.
Companies have increased their FCPA compliance activities.
As a result of these concerns, companies appear to have increased their activity in several areas to help maintain FCPA compliance. (See Exhibit 8.) Among the areas of increased focus are due diligence on a target entity’s relationships with agents, consultants, and third-party vendors and service providers, and internal controls focused on mitigating the risk of payments to third parties to obtain or retain governmental business.

Exhibit 8
Increase in activity over last three years to ensure FCPA compliance

<table>
<thead>
<tr>
<th>Activity</th>
<th>Significantly increased</th>
<th>Somewhat increased</th>
</tr>
</thead>
<tbody>
<tr>
<td>Due diligence on relationships with third parties</td>
<td>40%</td>
<td>39%</td>
</tr>
<tr>
<td>Mitigating risk of payments to buy influence</td>
<td>45%</td>
<td>28%</td>
</tr>
<tr>
<td>Training regarding cultural attitudes</td>
<td>40%</td>
<td>29%</td>
</tr>
<tr>
<td>Focused due diligence before transactions</td>
<td>33%</td>
<td>33%</td>
</tr>
<tr>
<td>Internal FCPA risk assessments</td>
<td>33%</td>
<td>32%</td>
</tr>
<tr>
<td>Guidance to internal audit</td>
<td>27%</td>
<td>38%</td>
</tr>
</tbody>
</table>

Companies employ a wide range of FCPA compliance techniques.
Survey participants reported that their companies use a wide range of techniques to help maintain FCPA compliance. (See Exhibit 9.) Leading the list was having clearly articulated corporate policies and procedures against violations of FCPA and anti-bribery laws, cited by almost three-quarters of survey participants. Other methods used by many companies were appropriate financial and accounting procedures designed to establish an effective system of internal controls; having one or more corporate officials with responsibility for overseeing FCPA compliance; and a formal reporting system, such as a “help line” to report suspected violations.

Larger companies appeared to be much more likely to use such methods. For example, 73 percent of survey participants at companies with $1 billion or more in annual revenues said they had a formal reporting system for FCPA and 63 percent said they had appropriate disciplinary procedures to address violations or suspected violations, compared to 37 percent and 33 percent, respectively, among those at smaller companies.

Surprisingly, only about one-quarter of survey participants said their companies required annual certifications of compliance by third parties, and a similar percentage said they conducted independent audits by outside counsel and auditors at least every three years to help them in their assessment of the effectiveness of the company’s compliance code, including its anti-corruption provisions.

Instead of conducting independent audits by outside counsel and auditors, 60 percent of survey participants said their companies conducted internal audits by company employees focused on the effectiveness of FCPA risk
mitigation processes and controls. Other approaches used to test the effectiveness of FCPA controls were having outside counsel interview employees and third parties (29 percent of participants), and conducting surveys and testing of third parties on their FCPA knowledge and compliance (17 percent of participants). However, one-quarter of survey participants said their companies did not test the effectiveness of their FCPA controls, including 16 percent of survey participants at companies with $1 billion or more in revenues.

Further, there appears to be limited use of software to test for anomalies or red flags with respect to FCPA risk mitigation and controls. Only 30 percent of survey participants reported using such data analytic programs to identify potential FCPA problems, with just 4 percent saying they used them extensively.

Most companies provide training to employees on FCPA issues.

A key element in any FCPA compliance program is training employees on the issues involved and how to handle them. Sixty-three percent of survey participants said their companies provided FCPA training to its employees annually or more frequently, with 87 percent of survey participants at companies with $1 billion or more in annual revenues reporting that training is provided this often.

Many functions receive FCPA training. Roughly 80 percent or more of survey participants said their companies provided FCPA training to its senior corporate management (89 percent of participants), senior business unit management (89 percent of participants), legal department (87 percent of participants), sales and marketing employees (85 percent of participants), finance (84 percent of participants), and operations (78 percent of participants).

Exhibit 9
Activities to ensure FCPA compliance

<table>
<thead>
<tr>
<th>Activity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clear corporate policies</td>
<td>72%</td>
</tr>
<tr>
<td>Appropriate financial and accounting procedures</td>
<td>60%</td>
</tr>
<tr>
<td>Officials responsible for FCPA compliance</td>
<td>56%</td>
</tr>
<tr>
<td>Formal reporting system</td>
<td>54%</td>
</tr>
<tr>
<td>Due diligence before retaining third parties</td>
<td>51%</td>
</tr>
<tr>
<td>Disciplinary procedures</td>
<td>48%</td>
</tr>
<tr>
<td>Procedures to assess reputation of potential partners</td>
<td>48%</td>
</tr>
<tr>
<td>Active involvement of audit committee</td>
<td>43%</td>
</tr>
<tr>
<td>Contract provisions in contracts with third parties</td>
<td>43%</td>
</tr>
<tr>
<td>Regular training for stakeholders</td>
<td>40%</td>
</tr>
<tr>
<td>Oversight after third parties are retained</td>
<td>36%</td>
</tr>
<tr>
<td>Independent audits at least every three years</td>
<td>27%</td>
</tr>
<tr>
<td>Annual certifications of compliance by third parties</td>
<td>26%</td>
</tr>
<tr>
<td>Procedures to ensure appropriate delegation of authority</td>
<td>25%</td>
</tr>
<tr>
<td>Committee of senior officials to review transactions</td>
<td>21%</td>
</tr>
</tbody>
</table>
Few companies conduct detailed investigations of potential FCPA problem areas. Surprisingly few companies conduct detailed investigations of potential problem areas. (See Exhibit 10.) Only roughly one fifth or fewer of the survey participants said their companies conducted a very detailed investigation of potential problems areas before making an investment or acquisition, or entering into a business relationship outside the United States. Further, only about one half of the survey participants said their companies conducted at least a somewhat detailed investigation of potential problem areas.

Exhibit 10
Level of detail of FCPA investigation before entering into business relationship or acquisition outside the United States
About Deloitte FAS

Business Intelligence Services
The Business Intelligence Services (BIS) practice of Deloitte Financial Advisory Services LLP (“Deloitte FAS”) is an industry leader in investigative due diligence. We have access to multidisciplinary BIS professionals around the world through the network of Deloitte Touche Tohmatsu member firms and their affiliates (“DTT Member Firms”). BIS professionals are trained investigators with extensive experience in pre-transaction investigation of the reputation and integrity of companies and their executives. The skilled investigators of Deloitte FAS and the DTT Member Firms are experienced at combining extensive online and public record research with information obtained from a worldwide network of industry and other knowledgeable sources. We provide in-depth reporting that is tailored to our clients’ specific requirements and arrived at through high professional standards and ethics. In today’s business world, knowledge truly is power and can often make the difference between deal success and failure. We help our clients get the information they need to make informed investment decisions — and we can generally do it more efficiently and cost effectively than most organizations can achieve using internal resources.

FCPA Consulting
Deloitte FAS’ FCPA Consulting practice helps organizations navigate FCPA risk and respond to potential violations. Utilizing the network of the DTT Member Firms including their forensic resources in the United States, Canada, Europe, Russia, Africa, Latin America and Asia, we have worked on a variety of FCPA engagements including investigations, acquisition due diligence and compliance program implementation and assessments in over fifty countries for some of the world’s leading companies. We collect and analyze accounting data and other hard copy and electronic documents, including e-mail, to help identify the "red flags" of potential FCPA violations and gaps in companies’ anti-corruption controls. We have also developed a secure and powerful web-enabled tool, FCPA Analytics, which helps simplifies the collection and analysis of large volumes of accounting data necessary to help identify the potential "red flags" of potentially corrupt activity.