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Third-party due diligence: Compliance management applied to supply chains

» The objective of a third party's due diligence process is to track its history of illicit practices.

» Due diligence of third parties and business partners is in the scope of major global anti-corruption laws.

» Companies have dedicated much effort and resources on due diligence research to improve risk management.

» Automated solutions can reduce the volume of manual activities and enhance the security and traceability of data and records.

» Restructure the due diligence process to optimize activities, spare resources, and promote greater agility.

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A third party's due diligence, sometimes known as a background check, has been the topic of many discussions in the scope of compliance programs. With the objective of tracking the history of occurrences of illicit practices by third parties, this process has been noted as effective in protecting contracting companies and their leaders in cases where fraud and corruption exist.

Melo

Due diligence of third parties and business partners is in the scope of major global anti-corruption laws. According to the Brazilian Anticorruption Law (Nº 12.846/2013), individuals and legal entities can be held accountable for acts of corruption and fraud committed by third parties that benefit them or the contracting company. In this context, decree number 8.420/2015 includes evaluation parameters such as the effectiveness of compliance programs, the existence and application of appropriate due diligence for contracting, and—depending on the case—the supervision of third parties.

In legal terms, the company is responsible for third-party conduct if it benefits from any illicit act carried out by that party, be they a supplier, a business partner, a recipient of donations, or others. Providing the company's code of conduct to partners is a good practice, but it is not enough. It is necessary to know the third party, especially its background and its interface areas in developing business activities.

Applying risk management in prioritizing activities and resources

Companies should have dedicated professionals to research third-party public data and the media to look for potential signs of risk. Manually tracking third-party data in the company's records can be arduous labor due to the volume of potential business partners. In an attempt to reduce the volume of due diligence research, many companies set a limit on

their third-party database in order to prioritize the execution of the due diligence research. The classification of third parties and business transactions as "red flags" is a practical and functional solution.

Red flags can represent corruption and fraud risk for related parties. Some examples of potential red flags are payments-in-kind, non-standard financial exchanges, and higher-than-normal supplier remuneration. Similarly, a red flag is also applicable to a third-party business transaction when it is—or already was—a target of an investigation or process related to corruption, is on a public black list, or was recommended by a public agent.

Diligence activities, besides demanding important resources from a company (human or financial), add another step to contracting, which can slow down the process. And formalizing data and traceability for decision-making has made the compliance professional's job more difficult.

Automation enables greater agility in decision-making, gives more reliability to the process, and allows cost reduction.

Automation solutions for due diligence process

One solution is to structure the diligence process and introduce automation of some activities and operational tools.

By defining rules and guidelines and mapping the process flow of the organization, it is possible to standardize the criteria to identify red flags and classify the risks for third-party and business transactions. Risk assessments can direct and prioritize efforts according to the risk level of the entity, and it can define how deep the diligence research must be (e.g., public media research, on-site visits, audits).

Technology can automate processes like the identification of red flags, carry out public media research via bots, handle the flow of approvals, and send alerts. Besides reducing the volume of manual labor and enhancing the security and traceability of data and records, automation enables greater agility in decision-making, gives more reliability to the process, and allows cost reduction.

Conclusion

As the popular saying goes, "Sometimes it is necessary to take a step back in the path you believe is correct to be able to take two steps forward in the path you are sure is correct." Many companies already have a third-party diligence process; however, they dedicate excessive resources to it. Analysis on third parties and their business operations can better direct the due diligence process, making it possible to mitigate situations that represent the greatest risk to the company. Furthermore, it can optimize the diligence process, saving resources and promoting greater agility.

It is better to act in prevention than endure the harm to the company. In this sense, the due diligence process is an essential part of a compliance program that aims to protect the company and its leaders. ✳

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