Tips and practical guidance on conducting value-added anti-corruption audits

The Basic Program for a Third Party Audit
The Basic Assumptions

- A company has hundreds of sales agents, distributors, intermediaries in foreign markets
- The Company has already conducted due diligence on those third parties and has entered into contracts with them
- The Company is now looking to conduct audits and reviews on the anti-corruption compliance of these third parties

Practical Hints

Think about:
- How the Partners will react when the Vendor/Principal/Supplier (i.e. you) will now wish to conduct an audit
- How you will actually conduct the audit in the foreign country and what resources you will require
  - Resources that understand the local markets
  - Legal, Compliance, Audit, Accounting experience
  - Local language experience
- How you can engage the business into the process of the audits and get their ‘buy-in’
- How to scale the audit process so that you can conduct a reasonable number of the universe of partners each year
- Whether this is going to be perceived as a ‘witch-hunt’
Overall Process

- Notification Letters
- Internal Communication Matrix
- Partner Review Checklist
- Document Request List
- Business Interview Checklist
- Interview Questions
- Task Lists
- Meeting Schedules
- Risk Assessment Template
- Attribute Weightings
- Guide to Risk Weightings
- Draft Report Templates
- Remediation Guidelines
- Communication Plans
- Escalation Paths
- Report
- Risk Assessment
- Execution
- Planning

Country/Regional Timeframe

- Notification to Business
- Discuss objectives with country managers
- Conduct Risk Assessment with Channel
- Determine Focus Partners and Country
- Request data from Partner
- Assess country risks, macro compliance risks
- Collect and review sample data submitted
- Onsite Assessment at Partner
- Execution & Testing
- Interview, Review and Data Analysis
- Report Out internally
- Report Out to Partner

X represents the date of the on-site audit
X-8 means 8 weeks before onsite audit
Risk Assessment Phase

Objectives of Risk Assessment

- Conducted Annually in each Country
- Considers different types of risk
  - Financial
  - Non-Financial
  - Statutory
  - Compliance
- Purpose is to determine which Partners should engage in an Audit and what type of Audit should be conducted
- The objective of the Risk Assessment is to identify the distributors to be reviewed during the next financial year and plan the timing of the review.
- The Risk Assessment process should be initiated by the compliance manager and reviewed by the compliance director on an annual basis.
Example: Risk Assessment Process

1. Legal Completes non financial risk terms
2. Compliance Manager in Country
3. Interviews with Channel Team in Country
4. Discussion with Management for Approval
5. Short List of Potential Partners
6. Review of financial risk attributes
7. Country Audit Plan Prepared
8. Plan Approved
9. Audit Begins

Non-Financial Risk Assessments

- Product Type
- Time Since last Audit
- Contract Type
- Private vs. Public
- Country of Concern
- Export Control Restrictions
- Legal Risk
- Previous Issues
- Business Perception
- High % of Govt Business
- Sub-Tier Partners
Financial Risk Attributes

- Free Goods, Samples & Returns
- Direct Sales vs. Indirect Sales
- Stocking Levels
- Margin Analysis
- MDF Amounts
- Returned Goods
- Amount of Sales

Practice Hints

- Don’t confuse an ‘audit’ with an ‘investigation’
- The choice of who to audit may well take into account whether there have been issues in the past, however, this should not be the sole determining factor
- The concept of the audit in the Company has to be a forward looking ‘growth opportunity’ for the Partner.
  - Not an opportunity to find something wrong and terminate them
- There needs to be some value shown to the Partner
  - Give them a practical report which identifies gaps and gives some advice on how to fill those gaps
Planning Phase – Initial Steps

- Establish the Process Flow
- Notification
  - To Channel Team
  - To Country Management
  - To other Stakeholders
  - To the Partner
- Establish Communications Channel with Partner & Internal
- Confirming review dates and deadlines
- Partner Submission Checklist
Practical Tip

- Do your contracts allow you to audit in the first place?
- Ensure that the communication to the Partner is done by the business NOT by the audit team
  - Business focused
  - Not compliance focused messaging

Predict arguments about:
- Access to confidential material
- Privacy issues and removing sensitive data
- Language issues and understanding data
- Inconsistency in accounting practices in local markets

- Expect that the recording of transactions might not be to the level to that which you expected

Planning Phase – Data Collection & Review

- Collect internal Financial Information
  - List of sales to the distributor
  - List of returns/credits to the distributor
  - List of free goods to the distributor
  - List of disbursements/payments to the distributor
  - Margin analysis by product to the distributor

- Understanding the Partner through the Pre-Review Partner Checklist and the Business Interview Checklist.

- Completed Partner Pre-Review Checklist by the Partner

- Documents received from the Partner (based on the Document Request List)

- Completed Internal Business Checklist by the In-country Business Unit Head/Sales employee in charge of the Partner
Practical Tip

- Partners will be very reluctant to provide certain information, including:
  - Customers, end users
  - End user pricing
  - Internal margins
- To the extent you need this information, make it easy to provide and with some element of confidentiality protection

Planning Phase – Analysis & Checking

- Low Risk Partner
  - Cleaning and performing analytics on the financial information received from the Partner
  - Preparing the Off-site Partner Checklist which will be performed through a teleconference.
- Medium & High Risk Partners
  - Cleaning and performing analytics on the financial information received from the distributor
  - Preparing the On-site Partner Checklist which will be needed on-site.
  - Selecting the samples required for review which will only be provided to the Partner on-site.
  - Ensuring that the meeting scheduler is sent and agreed with the Partner
  - Arranging for resources to conduct the audit
Execution Phase

On Site Analysis

- Development of a Partner Audit Checklist

- Interview Schedule & Checklists
  - Standard checklist of Questions

- Documentation testing
  - Standard testing and review

- Compliance Testing on Financial results
Execution Phase On-Site

On-Site Analysis

Kick-Off Meeting
- CEO Discussion
- CFO Discussion
- Outline of Process with Exec Committee

Document & Financial Testing
- Financial Testing
- Document Analysis
- Factory/Store Tour
- Follow-up interviews

Review & Close
- Initial Findings
- Recommendations
- Next Steps
Practical Tips

- Always start the audit with a business review
- Allow the partner to talk through their business, their controls and their focus on compliance
- Always have your business counterpart with you during the meeting
  - Don't just have the compliance people and the partner’s finance/compliance people in the room
- The Partner is likely to be very worried about the audit
  - Be sensitive to that issue
  - Open and Honesty will be key in building that relationship

Understanding the corporate structure of the Partner is key

- Perhaps conduct some fresh DD before hand to try and identify the corporate structure, side companies, affiliates etc.

Payees

- Money being paid out is a clear focus; when presented with payees, you may need to conduct offsite DD on each of the payees to detect whether they are legitimate

Sub-Distributors

- Keep a close eye on sub-distributors
Reporting Phase

Practical Tips

- **Overall Approach**
  - Reports should be shared with the Partner, not just for internal use
  - Partners should be informed regularly throughout the process and advised of any issues or delays
  - Reports should be ‘useful’ to the Partner
    - Give guidance on best practices
    - Includes tips for them to improve their practices
Practical Tips

- **The Last Day of the Audit**
  - Partners will want to know on the last day how things have gone during the audit.
  - You will need to diplomatically give them the guidance that ‘they will need to wait for the report’.
  - It is easy to fall into the trap of offering guidance or an indication on the result during the final meeting.

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Report Out

- Draft Prepared
- Draft Shown
- Final Report
  - Audit Team
  - Channel Mgmt
  - Country Mgmt
  - Finance, Legal input
  - Audit Committee
  - Partner
Reporting Phase

- **Finding's Developed**
  - Team produces findings
  - Agrees recommendations

- **Draft Review Report**
  - Distributed to Internal team via teleconference
  - Adjustments & Review

- **Final Report issued to Partner**
  - Recommendations
  - Steps for Improvement
  - Dates for Follow-up

End