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Help Clients Avoid Corruption and Prosper Overseas

BY ROBERT TIE



In emerging markets where corruption is widespread – China is one – Western multinational corporations are particularly vulnerable to bribery, kickbacks, and other forms of fraud.

But a growing international consensus holds that corruption harms all companies – domestic and foreign. So, many governments are cracking down hard on businesses and individuals who commit fraud or even permit it

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– intentionally or not.

This article explains how to protect companies from both victimization and prosecution. CFEs, through education and advocacy, can help their multinational clients identify and engage trustworthy anti-fraud professionals in foreign markets. Likewise, they can help strengthen internal controls and reduce undetected corruption that, when exposed, attracts prosecutors and destroys shareholder value. The essential ingredient for achieving these objectives: a CFE's willingness to take a leadership role with clients.

WAKE-UP CALL

Sometimes danger lurks where businesspeople either don't expect it or underestimate its gravity.

For example, take the white-hot Chinese economy. At the end of June, it surpassed Japan's on a quarterly basis. Expectations are that the world's most populous nation will finish 2010 with a \$5-trillion-plus gross domestic product (GDP), in second place behind America's \$14-trillion economy.

While China's national numbers are impressive, figures for individuals tell another story. For 2009, per capita GDP in the U.S. was \$46,400; in the European Union, \$32,900; and in China, \$3,600.

So, when multinational companies do business in China, their Western employees – as foreigners – must find their way to profitability and compliance in an unfamiliar setting where most people earn a small fraction of average American and European salaries.

CFEs will recognize this situation as a likely nexus for the Fraud Triangle. Consider these examples:

1. Motive: Greed afflicts citizens and visitors in all nations.
2. Opportunity: Government officials and private sector managers – often with considerable authority and low wages – might abuse their power, especially over foreigners.
3. Rationalization: Resentment of wealthy "outsiders" can weaken otherwise honest citizens' ethical resistance to corruption.

Making matters worse, companies focused on business development in a lucrative new market occasionally fail to implement effective internal controls against corruption among their employees or the local advisors they sometimes engage too quickly. Each of these businesses desperately needs guidance from a skilled, trustworthy fraud fighter and carefully selected allied professionals.

UNDER-CONTROLLED

From C-suites to cubicles, news bulletins can provoke cold sweats. Given what's sometimes at stake – massive fines and lengthy imprisonment – it's easy to see why.

WASHINGTON, D.C., Dec. 15, 2008 – Siemens AG and three subsidiaries plead guilty to Foreign Corrupt Practices Act (FCPA) violations. Coordinated enforcement actions by DOJ, SEC and German authorities result in penalties of \$1.6 billion. ([U.S. Department of Justice press release](#))

WASHINGTON, D.C., Nov. 17, 2009 – “The prospect of significant prison sentences for individuals should make clear to every corporate executive, every board member, and every sales agent that we will seek to hold you personally accountable for FCPA violations.” (Lanny A. Breuer, Assistant Attorney General, Criminal Division, U.S. Department of Justice, at the 2009 National Forum on the Foreign Corrupt Practices Act)

SHANGHAI, March 29, 2010 – Four employees of the British-Australian mining giant Rio Tinto, including an Australian citizen, were found guilty of accepting millions of dollars in bribes and stealing commercial secrets. They were given sentences of seven to 14 years in prison, and were later dismissed by their employer. ([The New York Times](#))

Regardless, the corporate reaction to such developments often is ill-considered and inadequate. That’s why effective internal controls and thorough vetting of all employees and contractors should be companies’ top priorities overseas. CFEs who persuade management to adopt these best practices are serving their clients well.

“Western businesses in China are like pieces of meat attracting flies,” said Peter Humphrey, CFE, founder of risk management consultancy ChinaWhys and founding president of the ACFE’s Shanghai chapter. “A strong internal audit function is particularly essential here.”

Humphrey’s prior experience includes serving as China country manager for U.S. risk management firm Kroll and as head of China investigations at PricewaterhouseCoopers in Beijing.

FREQUENTLY UNANSWERED QUESTIONS

“Many important and difficult ambiguities confront the Western multinational corporation in China,” Humphrey said. “But there are no easy answers.”

In his view – based on 35 years’ experience in Asia, Eastern Europe, and the Balkan states – the culture gap between the West and China is the world’s biggest. He said corruption remains woven into China’s culture to an extent no longer true in most developed societies.

“China’s almost impenetrable language and culture make it harder for Westerners to resist and detect corruption in their business operations,” he said. “And here the fraud motivation is greater than elsewhere. China offers the potential for enormous profit – by any means.”

Humphrey, who earned a four-year degree in Sinology (the study of Chinese language, civilization and literature) from the University of Durham in England, said Western and Chinese members of his firm also are fully bilingual in English and Chinese. However, he said, “developing the ability to converse fluently and read Chinese business documents takes foreigners several years of intensive study.”

This means, for the most part, CFEs with no Chinese language skills could neither conduct interviews nor review documentation during fraud examinations in China. But multinational companies urgently need other, non-language skills that many CFEs have and could all develop.

“Strong analytical skills and leadership ability are the most important qualifications for Western CFEs working

on fraud cases in China,” Humphrey said. “To be effective, all internal audit teams need management’s full and highly visible support. That’s doubly true here because of the culture of corruption.”

So CFEs who fully understand their clients’ business model and markets will steadily move closer to senior executives. And these practitioners will have greater influence over corporate strategy and tactics including building and leading a competent internal audit team.

EDUCATE, ADVOCATE, LEAD

One of the best ways to help clients cope with fraud in foreign markets is to educate them on how to engage effective local internal and external auditors.

“Two types of audit prevail at multinational companies doing business in China,” Humphrey said. “Neither is effective.”

In one, the company’s head office or regional center sends in an expatriate internal auditor who can’t speak or read Chinese.

The other type of audit is done by inexperienced external auditors unfamiliar with manufacturing operations – the mainstay of Chinese industry – and with risk-based auditing techniques, which examine not just the financials, but also the environment in which the client operates.

“Such auditors seldom conduct interviews and don’t notice red flags such as low-wage client staff with Rolex watches and Ferraris in the parking lot,” Humphrey said.

CFEs therefore should recommend that their clients find and engage auditors with skills that correspond with actual risks, not merely those within an unqualified auditor’s comfort zone.

But it’s not easy finding qualified auditors whose integrity is relatively certain.

CFEs therefore could recommend that management innovate when hiring internal auditors. For example, training current non-audit staff in a new role could be more effective than hiring relatively unknown people from other companies.

“It’s worth trying to staff your internal audit department with trusted employees you already have,” Humphrey said. “You can teach auditing skills, but you can’t give someone integrity.”

Of course, clients can’t halt business operations while they build an internal audit staff from within. Neither can they do without experienced senior auditors. To fill such positions safely and as quickly as full due diligence permits, clients can hire a local risk management consultancy to conduct an extensive background check on any candidate for employment.

The CFE, representing the client’s home office or regional center, can evaluate local consultants’ suitability and act as a liaison and coordinator once the client has engaged a firm.

DIG DEEP

As a CFE himself, Humphrey knows the importance of a thorough investigation.

“A major problem we frequently encounter is that the client was impatient to hire someone and didn't do any more than a superficial reference check with a headhunter,” he said. “Of course, that didn't reveal much, and some of those companies ended up with fraudsters on the payroll. Then they came to me.”

In China, there is no national pool of data on the population. So Humphrey works from locality to locality, individual source to individual source.

“When doing a background check in the U.S., you might spend 50 to 70 percent of your time doing desktop work and 20 to 30 percent doing human inquiries,” he said. “In China it could be up to 80 to 90 percent human-source inquiries and 10 percent desktop research with open-domain sources.”

But, difficult as it is, such research is essential. For example, some clients have told Humphrey their most important criterion in hiring the company's China country manager was to select a candidate who is Chinese. Other factors – though critical – were virtually ignored by these companies.

“But without a thorough background check, what do they really know about that person?” Humphrey asked. “Perhaps he worked in New York, and they interviewed him there. But that meeting, a cursory reference check, and a long résumé don't add up to real due diligence.”

Performing such checks properly is one of the services Humphrey's firm offers, as do others in China. He and his bilingual colleagues use a combination of three investigative methods.

The first level is desktop research of open-source information, especially from Chinese-language sources, in public and commercial databases, chat rooms, bulletin boards, and alumni association websites.

The second level focuses on sources such as household population registers, company registers, and educational records. Westerners might see no difference between first- and second-level sources.

“That's because second-level information is openly available in the U.S., but might not be public in China,” Humphrey said. For example, China's population registers aren't public records; access to them is restricted by local authorities. Good contacts are essential to obtain this kind of data, and Humphrey has developed them over his long career.

The third level of research consists of human-source inquiries. After identifying the people who should know something about the candidate, Humphrey approaches them discreetly, using fronts, such as posing as a headhunter. To the extent possible, he avoids alerting the candidate to the precise details of his inquiries.

“You can't rush these things, which can be troubling to employers in a hurry,” he said. “They often see this as a mere final formality in the hiring process. If they say they need a report in a few days, I tell them we're unable to help them. It could take several weeks to produce a thorough reading on a person.”

Humphrey applies the same investigative rigor to background checks on his clients' potential business partners.

“Due diligence goes beyond the balance sheet,” he said. “It’s just as important to uncover nonfinancial intelligence as it is to stare at the numbers.”

OPPORTUNITY KNOCKS

CFEs can provide real value to their multinational clients by identifying qualified overseas investigators and auditors and recommending best practices to reduce risk and optimize career development of trusted employees.

No one is better qualified than a CFE to lead the way to safer business practices abroad. Practice expansion opportunities have never been greater.

Robert Tie is a New York business writer.

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