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Companies venturing abroad need to step up against a new raft of risks

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There is a pressing need for companies expanding into regional markets to develop formal processes to effectively identify and assess potential fraud risks, according to analysts.

These include due diligence to better understand foreign business partners and parties that will conduct business on their behalf.

“As long as people have material needs and wants, there will be fraud,” says KPMG Singapore partner Owen Hawkes.

“The challenge for companies is mitigating the risks fraud presents to an acceptable level, but they can never banish it altogether.”

Along with a concerted effort to understand the risks the organisation faces, Hawkes says it is necessary to put in place a holistic suite of measures to mitigate those risks, as well as an education and training program to ensure the board, management and staff are all actively guarding against fraud.

According to the recently-released Singapore Fraud Survey 2014 by KPMG and Singapore Management University (SMU), the quantum of losses suffered by companies due to fraud has jumped more than three-fold to about S$22 million, compared with just three years ago. The average cost of employee fraud is S$457,000.

The survey also found that internal parties are involved in 75 per cent of reported fraud, which is harder to detect and therefore very significant.

“Internal fraud is committed by what we call a ‘knowledgeable insider’, who knows internal controls procedures and how to circumvent them,” says SMU associate professor and CPA Australia Singapore divisional president, Themin Suwardy.

“The range of things they can commit is also much wider than the external fraudster.”

Notably, two-thirds of the study’s respondents felt that the risk of bribery and corruption was a key concern for Singapore companies conducting business in the region.

Half were concerned about the need to provide payments or gifts in order to win or retain business, compared to just 20 per cent in 2011 when a similar survey was conducted.

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More than a third of respondents were also concerned about foreign government officials and overseas-based third parties. In fact, more than four in 10 said they were very concerned about interacting with foreign governments, while 36 per cent expressed the same reservation about using third parties.

Clearly, companies need to better manage this by assessing the risks inherent in the environment in which they are intending to operate by conducting due diligence, and also understand the innate business practices of the relevant country.

"Otherwise, they risk being blind-sided by practices they may never have known existed," Hawkes warns.

Companies should also ensure their employees, management and business partners understand the expectations of the organisation, he adds.

The KPMG-SMU survey found that organisations are adopting a variety of approaches to mitigate cross-border risks.

Three-quarters of respondents said their employees were issued guidelines for reducing such risks, two-thirds said they have compliance programs in place, while six in 10 had conducted staff training.

Although good starting points, much more needs to be done to check on potential fraud when operating in foreign markets, Suwardy says.

"With cross-border activities, especially for the first time, the risks will be higher because you are dealing with more uncertainty," he explains. "You have new people – staff, suppliers, customers and other parties – and new regulations, perhaps different business practices and so forth, so it takes a while to set the right culture and tone."

Boards, management and employees all have a vital role in combating fraud.

"The board has to ensure a framework is in place to prevent, detect and respond to fraud and exercise oversight to ensure it is being operated effectively," Hawkes says.

"Management must dedicate sufficient time and resources to addressing the risks and engage with fraud issues at a sufficiently granular level when they arise."

Employees, he notes, have a huge advantage in assisting companies prevent and detect fraud.

"Because they are on the ground, they can see how business activities are undertaken, what risks arise, and how controls are operated in reality," Hawkes says. "Employees can feed back information on threats, control failures, and unusual or anomalous activities providing they are trained and empowered to do so."

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Unfortunately, fraud often occurs because of lack of effective working controls.

“It is not enough to [just] have control procedures in place,” Suwardy says. “It is important to make sure they cover your risk areas and are carried out effectively.”

“All company directors and managers need to have a healthy dose of professional scepticism. Of course, you need to trust your employees, but please verify [them].”

Avoid falling foul of fraud

When doing business abroad, companies need to undertake risk assessment procedures to understand and prepare for potential risks.

They should carry out due diligence to understand who they are working with and who will be conducting business on their behalf.

One approach is to develop formal processes for identifying and assessing potential risks in any new territory a company intends to enter.

These assessments typically involve reviewing factors such as:

- the risks inherent in new jurisdictions
- the nature of contractual relationships
- government relationships
- cultural norms and differences in the jurisdictions, as well as relevant laws and regulations
- reliance on agents

All processes should be reviewed periodically and during major changes to business operations.

In addition, in-country personnel should be educated on potential risks and how to manage them.

Source: KPMG and Singapore Management University

Melvin Yong is CPA Australia’s general manager – Singapore. The CPA Australia Singapore office is celebrating its 60th anniversary this year.