

Bribery, Corruption and Fraud in the Middle East

First Middle East
Bribery, Corruption and Fraud survey



Building a better
working world

Contents

Foreword	1
Executive summary	2
Bribery and corruption	3
Fraud	10
Conclusion	19
Contact information	22

Foreword

The past four years have not been easy ones for companies based in the Middle East.

The fallout from the global financial crisis, the Arab Spring and imposition of economic sanctions on countries in the region have all negatively impacted growth.

A silver lining has been the effect the crisis has had in encouraging organizations to examine risks presented by corruption.

Implementing a robust ethical and compliance culture will always place a company in a position of strength in both local and international markets.

In fact, the need to have an embedded corporate ethical and compliance culture has never been greater.

US authorities continue to make use of the Foreign Corrupt Practices Act (1977), which has resulted in a number of high profile prosecutions and financial settlements for companies regarding their conduct in the Middle East.

Likewise, the UK Bribery Act (2010) has extra-territorial reach. It has caused Middle East companies with UK operations to hurriedly review existing anti-corruption procedures, both internally and with regard to third parties whose services are utilized (e.g., agents). In this report, these third parties are referred to collectively as associates.

But the increased pressure on Middle East organizations comes not only from America and Europe.

A number of large companies in the region today demand suppliers operate robust ethics procedures, typically including: internal audit functions, whistle-blowing procedures, conflict of interest policies and anti-bribery/anti-corruption (ABAC) policies.

These companies also stipulate associates are audited by an independent body.

Companies based in the Middle East, then, are no longer immune from ethical and compliance issues. If they are to compete and succeed in the international marketplace, management must fully embrace anti-corruption initiatives.

The findings of the first Ernst & Young Middle East Bribery, Corruption and Fraud Survey demonstrate clearly the challenges facing decision-makers across all sectors in the Middle East.

In many cases, the results are startling.

Too often, organizations in the region confront fraud, bribery, and corruption only after the event and lack adequately robust controls to manage risks in these areas.

As a result, losses are often significant and reputational damage immense.

The purpose of this survey is to shed light on a topic that for too long has been pushed to one side and to provoke a debate to benefit the region's business community.

Middle East organizations can no longer wait for bribery to occur before taking action.

I would like to thank Dr. Janice Goldstraw-White and Professor Martin Gill of Perpetuity for their efforts in providing this valuable and insightful report.

Sincerely

Michael Adlem
Partner – Fraud Investigation & Dispute Services
Middle East & North Africa



ABAC legislation

The efficacy of existing legislation in the Middle East addressing bribery and corruption is the subject of much debate.

Interviewees were asked whether the company for which they worked had introduced ABAC compliance policies.

Sixty-four percent of respondents said they had.

It was noted that companies with anti-bribery policies often also had formal policies for dealing with other forms of corruption.

Of the respondents who said the company for which they worked had formal anti-corruption policies, 68% said the policies were effective in meeting legal requirements. Only 2% said they were ineffective.

Some respondents said that although their company had no formal policy, best practice was still standard procedure.

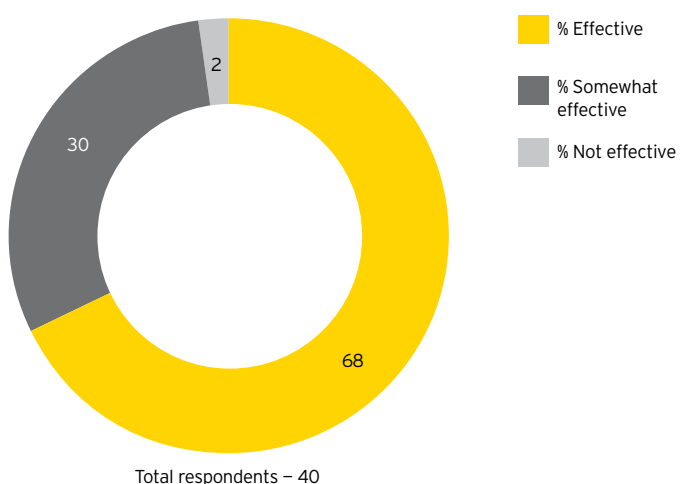
Several respondents referred to publications such as a corporate Code of Conduct, which they said covered corruption in general terms.

Others pointed out that some pieces of legislation were not applicable to their organization. For example, a company that does not have a British presence is not required to adhere to the UK Bribery Act.

Respondents from a number of recently formed organizations stated their employers were still developing anti-corruption policies.

Figure 2

Effectiveness of ABAC policies in meeting legal requirements



Some interviewees emphasized the difficulty of providing effective communication to staff and ensuring what was outlined as a requirement was practised in day-to-day activities:

'Although we give staff the handbook, we are never sure if they read it. It depends on the individual. We do not have a regular message to remind them.'

'The policies are effective in meeting legal requirements, but do people abide by them?'

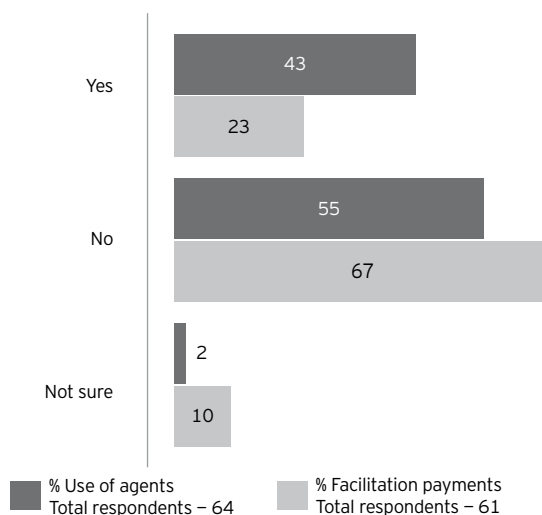
Facilitation payments

In the Middle East, bribes paid to agents to secure business or to speed up processes are often euphemistically referred to as 'facilitation' payments.

The practice is common in the region.

Figure 3

Use of agents and facilitation payments



Many respondents were unsure whether facilitation payments constituted bribery.

'Actually, [I use it] as a tool for preventing corruption, because by using agents I have shuffled the problem away to someone else. I do not perceive that I have been corrupt if they have been corrupt on my behalf. If he gets me business for half a million, then how he does it is not my business. I don't encourage it, indeed I discourage it, but in reality I will not know. It is pragmatic.'

Of the respondents who admitted making facilitation payments, 29% recognised such payments were illegal. Seventy-one percent said they were not illegal.

An interviewee said:

'We pay agents a fixed percentage, which we apply rigidly as a matter of public policy. It is a percentage to brokers. This is normal business. Some agents might be in breach, but I am clear I am not involved ... Legally speaking there is a barrier between us and them. That is how things work in this part of the world.'

'One interviewee said his organization had made payments to government officials 'or nothing would go anywhere.'

ABAC risk-assessments

Organizations intending to safeguard against accusations of bribery and corruption should carry out regular and frequent ABAC risk assessments on clients, suppliers and associates.

A company may be liable for the actions of others acting on its behalf.

Asked if the organization for which they worked carried out these checks, 38% of respondents said they did, 49% said they did not and 13% said they did not know.

Reasons cited for not carrying out regular checks included:

- ▶ A policy of conducting risk-assessments only at the beginning of a project or when signing a new client
- ▶ Lack of understanding of the law
- ▶ Failure to recognise the imperative to make ABAC assessments distinct from existing risk assessments

Seventy-five percent of respondents who said the organization for which they worked conducted regular ABAC risk assessments on associates said they considered the practice to be effective.

One respondent said:

'We have gone into a lot of detail on this. We have gone through jurisdictions on this. We have policies in place where entertainment requires prior approval. With gifts, we record them in a register. The process was beefed up here.'

However, 21% of interviewees said regular ABAC risk assessments were only somewhat effective and 4% said they were not effective at all:

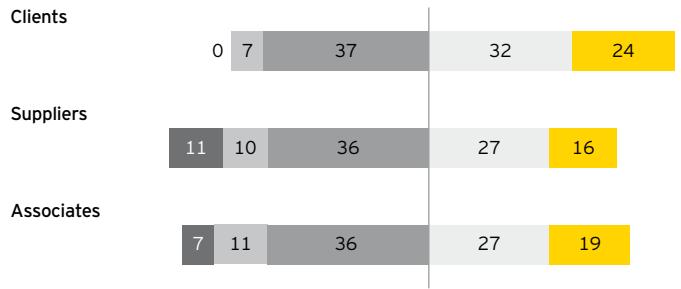
'These risk assessments are only somewhat effective because I'm not sure you can know fully, unless you check every single way of working. Sometimes it is difficult to tell what is a bribe or not.'

Respondents were asked how often checks were made on clients, suppliers and associates.

More than a third of those interviewed said the organization for which they worked never conducted any checks.

Figure 4

ABAC risk-assessments



Total respondents – 62

■ % Always
 ■ % Never
■ % Sometimes
 ■ % Not sure
 ■ % Not applicable

Some respondents said that although the organization for which they worked did not carry out frequent risk assessments, assessments were made on an annual basis.

Others said that where there was a good relationship with the client it was less likely that a risk assessment would be undertaken.

A number of interviewees said checks had become more frequent since the UK Bribery Act had been implemented:

'Always for new suppliers now, since the Act, we have conducted them for major existing clients.'



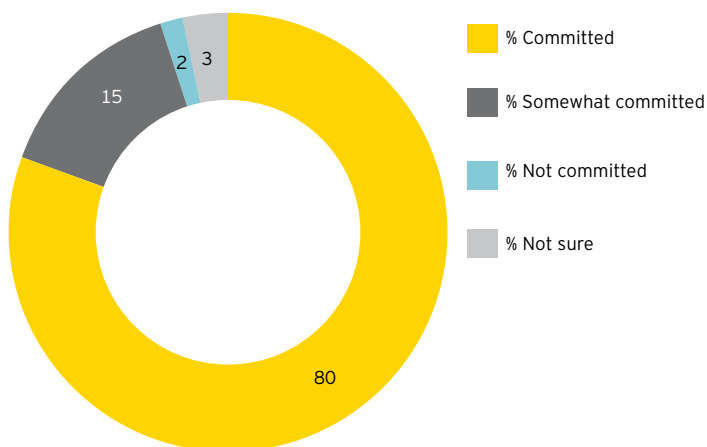
Management of ABAC in organizations

It is essential that management takes the lead in ensuring corporate bribery and corruption is eradicated.

Eighty percent of respondents said the management of the organization for which they worked was committed to tackling bribery and corruption.

Figure 5

Leadership commitment to tackling bribery and corruption



Total respondents – 62

Surveyed senior managers voiced determination to tackle corruption:

'[It is] not a problem and we are ensuring it is not going to become a problem.'

'The rigor with which we went to in revising our policy and new procedures ... there was a lot of messaging from the top.'

'[It is] important for reputation ... The board will act very aggressively to tackle bribery and corruption.'

Ignorance of the law and naivety regarding the consequences of not stamping out bribery and corruption were often given as reasons as to why management of some companies seemed only 'somewhat committed' to fighting fraud.

Comments included:

'I would have expected to see more in terms of circulars. On the back of our payslips we have messages about whistle-blowing but I would have expected to see more on corruption.'

'Not totally committed because they are not totally aware of all types of bribery and corruption.'

Interviewees were asked if the organization for which they worked had a dedicated ABAC and Compliance Officer and if so, whether they believed the role was effective.

Only 37% of respondents said their organization had an ABAC Officer, although 83% of those respondents said they considered the work of the Officer to be effective:

'We have a Compliance Officer and she keeps things up to date and sends out global examples.'

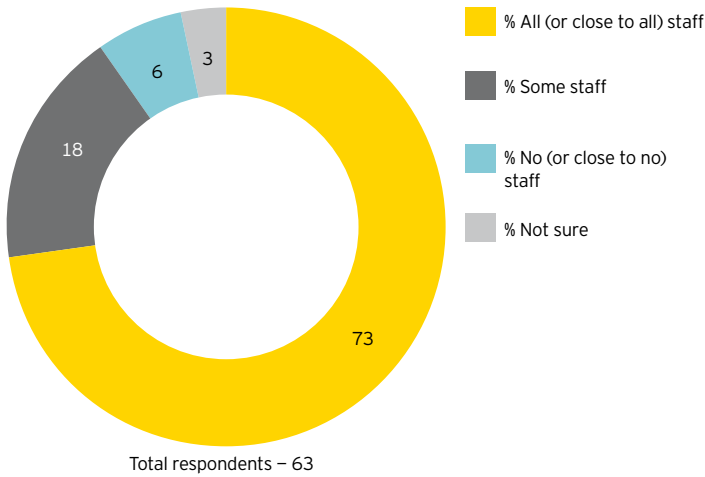
Reasons cited for not having an ABAC Officer included:

- ▶ Company was newly formed
- ▶ ABAC functions were already undertaken by departments such as Finance, Legal or Risk
- ▶ The role was not a statutory requirement
- ▶ The company was too small
- ▶ The company had never encountered fraud

Asked how widely the organization for which they worked communicated the need to be vigilant for corruption, almost three quarters of respondents said corporate ABAC messages went to all, or nearly all staff.

Figure 6

Communication of ABAC messages



Interviewees said ABAC communication was generally undertaken through emails or intranet messages, with organizations often requiring employees to sign statements confirming they had read ABAC policies.

Some respondents said they felt more work could be done to align ABAC messaging with employees’ personal objectives.

A respondent who worked for an international company said ABAC communications could be ineffective because they were sent out in only one language.

Asked when the company for which they worked last reviewed its approach to ABAC compliance procedures, respondents’ answers appeared to vary depending on whether organizations were bound by the UK Bribery Act.

Fifty percent of respondents said their organization had reviewed procedures in the last twelve months. Twenty-five percent said a review had not taken place for more than a year.

Knowledge of ABAC legislation

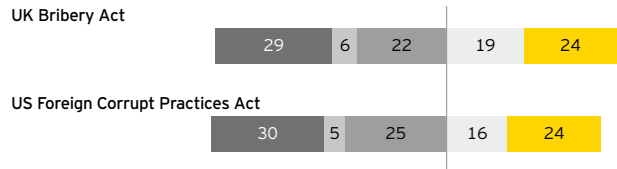
It is important that employees of all firms are aware of ABAC and global best practice.

Interviewees were asked if they agreed with the assertion that they had good knowledge of the UK Bribery Act and the US Foreign Corrupt Practices Act.

Nearly a quarter of respondents agreed.

Figure 7

Knowledge of UK Bribery Act and US Foreign Corrupt Practices Act



Total respondents – 63

■ % Strongly agree/agree ■ % Disagree/strongly disagree
■ % Neither agree/disagree ■ % Not sure
■ % Not applicable

Typically, interviewees with a good knowledge of UK legislation also had good knowledge of US legislation.



Asked if they had to be more careful dealing with UK companies since the UK Bribery Act was introduced, a quarter of respondents said they did:

'The new rules will put me off trading with the UK, sure, to some extent, and especially in the USA, this [legislation] makes it difficult to do business with them.'

ABAC requirements in practice

More than one in five respondents believed ABAC legislation would affect business adversely.

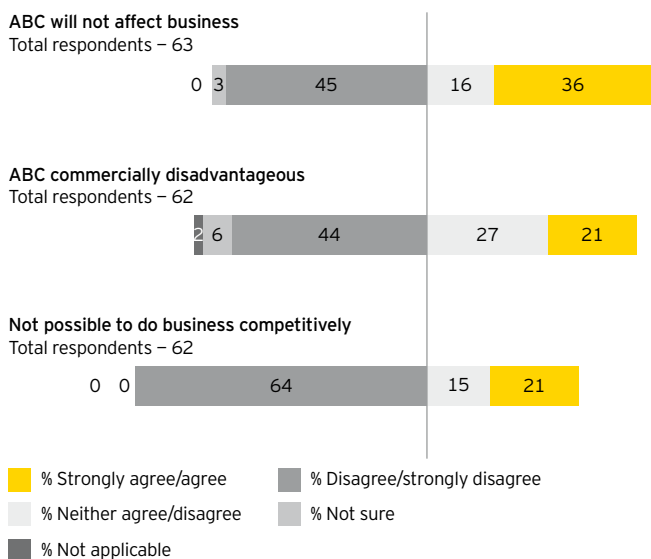
Some respondents felt the legislation would prevent Middle East organizations from competing effectively, both domestically and internationally:

'The anti-bribery/anti-corruption requirements are commercially disadvantageous in certain parts of Africa and the Middle East. They add challenges for companies when they try to compete with Japan, China or India. It depends on the product. If our company were convicted for bribery and corruption offences it would be more concerned with its reputation than profits.'

Forty-four percent of those surveyed said they did not think that ABAC legislation would be disadvantageous to business.

Figure 8

The effect of ABAC regulations on business activities



One in five respondents agreed with the assertion: it is not possible to do business competitively in the Middle East without engaging in bribery and corruption.

Sixty-four percent of respondents said business could be conducted in the Middle East without paying bribes.

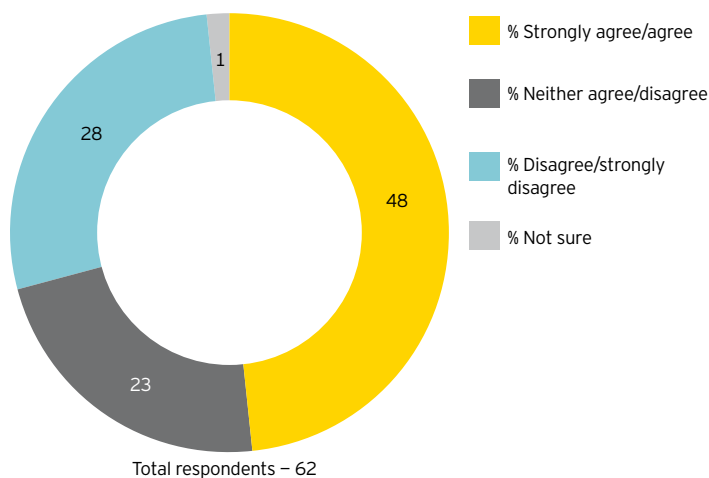
Implementing ABAC legislation

More than a third of respondents said they thought ABAC legislation would have no impact on the way in which business was conducted in the Middle East.

However, 45% of people surveyed said they thought new ABAC laws would affect business.

Figure 9

ABAC legislation effectiveness



Asked if changes to the law would be effective in preventing bribery and corruption in future, 28% of respondents said they would not.

'The anti-bribery/anti-corruption requirements will deter bribery and corruption, but not permanently solve the problem.'

Forty-eight percent of interviewees said the new laws would be effective.

Asked if being convicted for bribery or other corruption offences would seriously affect the profits of the organization for which they worked, 29% of respondents said it would not.

Fifty percent said a conviction for bribery and corruption would affect profits seriously.

Summary

Bribery and corruption remains an everyday occurrence in the Middle East, despite efforts by governments to eradicate it.

Perceptions of bribery and corruption, both in terms of what constitutes bribery and corruption and acceptance of it, will be hard to change.

Organizations in the Middle East vary enormously in their approaches to combating bribery and corruption, whether in their own corporate environment or in the corporate environments of those with whom they associate.

While some companies have taken large strides towards proactively fighting bribery and corruption, others lag, and some organizations accept bribery and corruption as a necessary part of business.

That two-thirds of interviewees felt bribery and corruption is a problem in the Middle East is striking: indicative of both its frequency and its harmful effects.

The ingrained perception seems to be that bribery and corruption are a necessary part of being competitive and winning or retaining business in the region.

Agents or go-betweens not only exacerbate the problem, but also enable organizations to feel removed from the acts of bribery and corruption.

So-called 'facilitation' payments are rife, and in many cases executives do not realise making them is a form of bribery.

Management, although mostly committed to behaving legally, is not always cognizant of the law, or is naïve about the consequences of bribery and corruption.

Improvements can be made to organizations in the Middle East's efforts to communicate ABAC messaging.

Most startling were the following findings:

- ▶ One-fifth of respondents felt it was not possible to conduct business in the Middle East without engaging in bribery or other forms of corruption
- ▶ One-fifth of respondents felt ABAC legislation would be disadvantageous to business
- ▶ One-third of respondents felt ABAC legislation would be ineffective
- ▶ Less than one-quarter of the respondents had good knowledge of the UK Bribery Act and US Foreign and Corrupt Practices Act

These findings underline the enormity of the challenge facing Middle East lawmakers.



Fraud

The problem

When asked to consider the implications of internal and external fraud separately, similar findings emerged.

More than two-thirds of respondents agreed that both internal and external fraud were a major problem in the Middle East:

'External fraud is an issue, but inside jobs are a major issue.'

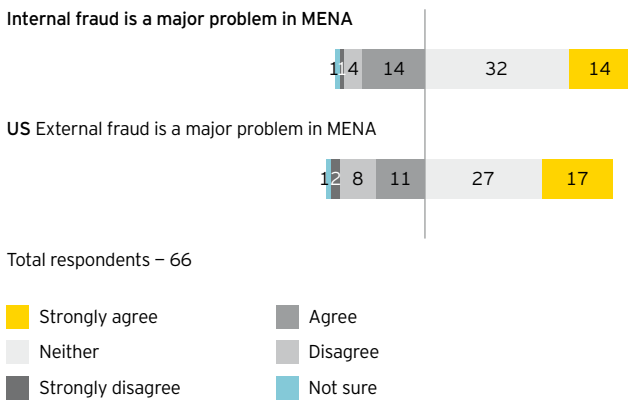
However, asked if external fraud presented a challenge to the company for which they worked, less than 40% of respondents said it did, and almost a third said it did not.

Several respondents indicated they believed internal and external fraud in the Middle East was no more prevalent than in other regions:

'Internal frauds are a major problem, but no higher here than in Europe. Some regions are bad though, such as Southeast Asia and North Africa.'

Figure 10

Comparison of perception of external and internal fraud in the Middle East



Fraud trends

More than half of respondents identified trends in recent fraud offences in the Middle East.

The increased technological complexity or sophistication of fraud was the most frequently cited trend:

'It [fraud] is becoming more complex. Early fraud was generally simple, committed by poor, uneducated people. Now it is high-tech, [committed by] high management, educated and wealthy people from different entities.'

Several respondents said use of the internet made organizations such as banks more vulnerable to fraud, eclipsing traditional concerns about dishonest staff.

Other noted trends included increased involvement in corruption by senior management, markedly improved quality of counterfeit materials and increased frequency of credit card fraud.

Several interviewees pointed out the Middle East was vulnerable to credit card fraud because it had yet to implement 'chip and pin' technology widely.

It was generally felt that the effects of the global financial crisis in the region had led to more frauds being discovered, many of which had been going on for years:

'All people talk about in the last four to five years is fraud, the increase in incidence and amount. Possibly since the downturn more fraud has been revealed. Before, no one cared.'

'It took the collapse of Dubai to expose the level of fraud. There was too much money around before which hid it.'
'We are seeing a lot of examples where people previously cooked the books and overstated their accounting figures and this is coming to light now after the bubble burst.'

A quarter of respondents said they felt adverse economic conditions might make companies reduce spending on measures to prevent fraud, thereby putting them at increased risk.

Identifying, quantifying and recovering fraud losses

Participants in the survey were asked from which types of fraud they felt most at risk.

The most common answer was misuse of credit cards, but other responses included: procurement and contractor fraud, misappropriation of assets, identity theft, cybercrime, financial mis-reporting and money laundering.

Respondents were asked if they felt all the frauds committed against the organization for which they worked were detected. Almost a half said they did believe all frauds were detected.

However, many respondents said they were not as sure:

'We get about 10-12 frauds a year, I would like to hope we know about all of them, but in reality I think we know about 90-95% of them.'

'We would like to think we identify most frauds, but you can never identify all of them.'

'Given the nature of our business, fraud would be discovered somewhere in the cycle. It depends on timing though when it would be discovered.'

The majority of respondents said they thought victims of fraud were likely to recover a small amount.

However, in cases where legal action was involved and insurance against fraud had been taken, respondents felt a much larger amount would be recovered.

Victimization from fraud

Organizations in the Middle East are often reluctant to publicly admit detecting fraud for fear that doing so would adversely affect their reputation.

Consequently, many do not report it.

Ninety percent of respondents said an organization in the Middle East that had experienced fraud would suffer reputational damage as a result:

'Reputational damage is a major problem in this part of the world. If you hear a company has detected fraud, most people will avoid them. People will remove money from their banks and ... people go elsewhere. Everyone starts to talk, making it difficult for companies to declare they have detected fraud.'

'People in the Middle East don't really understand reputational damages. They have a misguided perception that covering them up is the way forward.'

'They [the board] understand but are neglectful to acknowledge them publicly. It's a taboo.'

Respondents said a cultural imperative in the Middle East to save face was a factor in preventing organizations, particularly family-run organizations, from reporting fraud.

Some interviewees said boards of family run organizations might be reluctant to invite authorities to investigate what they considered to be a private family matter:

'In the Middle East, saving face is very important especially in your family ... you would lose everything if you were convicted of fraud, so frauds are generally frowned upon.'

'We try to deal with cases internally as we do not like to air our dirty linen in public, though we do take some cases to court and amend controls. However, the Middle East is a small place and such things become very public. This is very sensitive. We are usually advised to tackle it internally and minimise the exposure to the media.'

Some interviewees pointed out large, often family-owned, conglomerates might experience difficulty in applying rigid anti-fraud policies to differing branches of the business:

'We are very aware of fraud as we have gone through a lot of issues in the last three years, but we are ineffective at putting in systems. Group entities that are owned by families have each entity seen as a company in their own right, not as a group. It is also very costly as well. What is at risk in one country might be very different in another as they may be very disparate.'



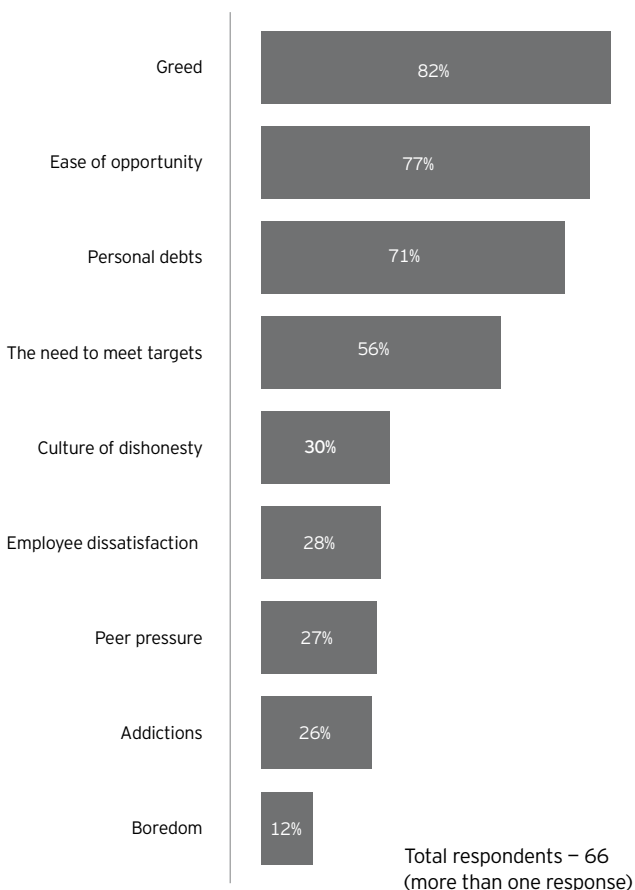
Why do they do it?

Understanding motivations for fraud is useful for implementing effective preventive measures.

Interviewees were asked what they thought were the common motivations for fraud in the Middle East. The results are shown below.

Figure 11

Perceived motives for fraud



Some respondents stated a cultural association in the Middle East of perceived wealth with power and status could lead individuals to incur unserviceable debt, heightening the temptation to commit fraud:

'The UAE is a consumer-oriented society where the average man wants to earn lots of money and buy things out of the mall. They rack up huge debts then they leave the region and the debts get written-off when not paid.'

Pressure to hit targets set by employers was cited as a motivation for committing fraud by several respondents. Examples given included manipulating performance figures, overstating income and understating costs:

'We have had two cases relating to targets recently ... they were not about the money, just targets.'

Several respondents said addiction to drugs, and the consequent need to pay for drugs, could be a motivation for fraud.

It is difficult for employers to control or influence individuals' financial motivations for committing fraud. However, company policies and procedures can control factors such as ease of opportunity, employee dissatisfaction and boredom.

Respondents said fraud often occurs when individuals are placed in the way of temptation:

'Fraud is to do with people having too much opportunity and autonomy to commit it easily. In the last twelve years I have not seen any other types of fraud.'

Although an organization can never eliminate all opportunities for potential fraud, many interviewees said anti-fraud procedures were effective in reducing incidence:

'We work with tight controls: a manual, internal audit, compliance and the regulation of visiting branches, which makes the environment very tight and little opportunity to commit fraud.'

Employee dissatisfaction can take many forms. One respondent gave the following example:

'We ask them why they commit fraud after 20 years of service and they say they were passed over for promotion or did not get on.'

Another respondent indicated personal financial difficulty was less likely to be a motivation for fraud in the Middle East than it might be elsewhere:

'Employee dissatisfaction is not common here as we are a well-paid country and well taken care of.'

Other factors cited for motivating fraud included cultural dishonesty within an organization and peer pressure, either to commit fraud or to appear more successful.

Fraud investigations

Respondents were asked to rate the effectiveness of internal or external fraud investigators' efforts to identify fraud.

Fifty-eight percent of respondents said they believed internal fraud investigators were effective, while 12% said they were not.



By comparison, 32% of respondents thought external fraud investigators were effective and 5% said they were not effective.

Several respondents indicated they believed external fraud investigators were hindered by poor knowledge of the manner in which an organization conducted business.

Figure 12

Perception of the effectiveness of internal and external fraud investigators



The importance of regulation

Regulation is an important factor in changing cultural attitudes to fraud.

Interviewees suggested regulators in the Middle East were often not taken seriously:

'Regulators [are] not effective, [I] don't see any evidence it [fraud] is rooted out and punished. It is accepted ... [it] comes with the territory.'

'Reports are sent to the regulator but they just want a progress report. They need to get their act together. Law enforcement is better but it is very low profile here.'

Forty-six percent of respondents said they believed regulators in the Middle East were ineffective and less than a third thought they were effective.

There was, however, some indication regulators were becoming more effective:

'Regulators weren't effective in tackling fraud but now they are. People's perceptions in the West are that the Middle East doesn't have any legislation, but we have codes and decrees which are used and people have been convicted ... regarding fraud. We are an emerging market, pressed to show transparency and to demonstrate that we take action over such acts.'

The participants in the survey represented many commercial sectors. Many praised financial sector regulation:

'The Central Bank is very sensitive and on top of things. Documentation, action on audits, visits. They are very aware and focused.'

The criticism most commonly levelled at regulators was that they were not sufficiently proactive and were overly focused on recording incidents of fraud or issuing directives:

'I say the regulators are not effective because if a fraud is found there is no real requirement to inform the regulators unless it threatens the very existence of the business. There have been some massive frauds in banks recently, but the regulators did not control the damage and were not proactive enough.'

'Regulators think it [fraud] is a company problem, not theirs, and this makes things difficult.'

Some interviewees pointed out the need for an internationally coordinated regulatory response to fraud, as the problem was perceived to have become increasingly global in nature:

'[We] need good international regulations in place to tackle global fraud.'

Having the right policies in place

Anti-fraud policies designed to remain effective as an organization evolves are vital to combating fraud.

Interviewees were asked if the organization for which they worked had formal anti-fraud policies and procedures enshrined in printed company regulations.

Fifty-two percent of respondents said they did not, 44% said they did and five percent said they were unsure.

Some respondents said that although they did not have company policies specific to fraud, they were still bound by professional codes:



'Strategy is based upon the Solicitors Regulation Authority (SRA) Code of Conduct and Accounting Rules. We do not have a separate policy entitled 'fraud'. We are regulated and governed by SRA and the code details what would be undertaken and what checks and balances are needed.'

Some respondents noted their employers were not required to have such documentation and others pointed out they worked for companies that were too newly formed to have anti-fraud policies in place:

'We have an ethics hotline and we encourage staff to report using that. We are developing an anti-fraud strategy and we will be implementing training for staff.'

'We are a newly established organization as of 2005. Currently the Fraud Policy is in draft and has been sent to the Audit Committee awaiting approval by the board before the end of the year.'

'We have a Code of Business Conduct which talks a little bit about fraud. We also have a draft Fraud Policy that is not approved yet. It is very general though, we need to detail procedures more.'

Seventy-five percent of participants who said they were employed by organizations at which there was a specific anti-fraud policy in place said the policy was effective. The remaining 25% said it was somewhat effective.

However, one respondent noted it was difficult to measure the efficacy of anti-fraud policies:

'It is generally difficult to measure the success of a policy or strategy and qualify this, because we only know about reported and followed up fraud.'

Respondents said the organizations for which they worked received feedback on their fraud strategies in different ways, for example via training events and fraud hotlines.

Fraud strategies were generally viewed as helpful in giving direction to staff, in outlining key responsibilities and expectations, and providing frameworks to guide policy development:

'I believe what we have is effective. In my ten years here I have not come across much fraud. We follow the procedures laid down.'

'We have a policy in place with a definition of what fraud is, some level of awareness amongst staff of what fraud is; it is built into the operational risk framework. But being a large organization there is always room for improvement and fraud is evolving.'





'We have a compliance program with three pillars: prevention, detection and response. We also have a help desk in each pillar to answer questions we can't. This is run by a third party.'

Respondents who described the anti-fraud strategies of the organization for which they worked as somewhat effective said the policies were either lacking in sophistication or did not provide cover for all of the organization's activities:

'We do not have anything special but standard operating procedures cover fraud. This is from a preventative point of view. We do not detail what to do if a fraud occurs.'

'We have a code of conduct and other personnel documents but not a specific strategy. We are only a small company, but harder as you grow ... Generally we have good procedures, behaviours and controls in place, and the focus is on the preventive side of fraud.'

Blowing the whistle

Interviewees were asked to evaluate both the effectiveness of corporate codes of conduct and corporate instructions to 'whistle-blow' when instances of fraud were detected.

Figure 13

Effectiveness of code of conduct/ethics and whistle-blowing policies



Sixty-nine percent of respondents said they thought corporate codes of conduct or ethics codes were effective deterrents against fraud.

Sixty-one percent said promotion of a corporate culture of whistle-blowing was effective.

However, a minority of interviewees was critical of code of conduct manuals:

'The code of conduct is an overarching policy, therefore, itself does not make a huge difference ... not 'super-effective'.'

'A code of conduct is useless – I've not read one or know anyone who has except the person who wrote it. It's accepted normal behaviour that you don't steal from your employer, if you don't know that then there's something wrong with you.'

One respondent highlighted the difference in attitudes towards codes of conduct in the private and public sectors:

'We have a Compliance Department – Protection Department – big Legal Department in headquarters. Code of conduct is one area we need to get to look to. In the public sector, you have to fill in annual monitoring about personal relationships etc. The private sector doesn't tend to cover itself in glory. It is more interested in making money.'

Participants also emphasized the challenges of implementing effective whistle-blowing policies:

'We have posters to raise awareness and encourage staff to use the hotline, but use is low. I think staff fear that if they report something there will be repercussions for them, which they are scared of.'

'Employees are scared to notify concerns to a higher authority. Everyone wants to take care of their job and not risk their job.'

'We don't have a whistle-blowing policy, but the culture here does not encourage whistle-blowing as an acceptable prevention. People feel there is the risk of retaliation and they may end up getting hurt if it does not go the way they think.'



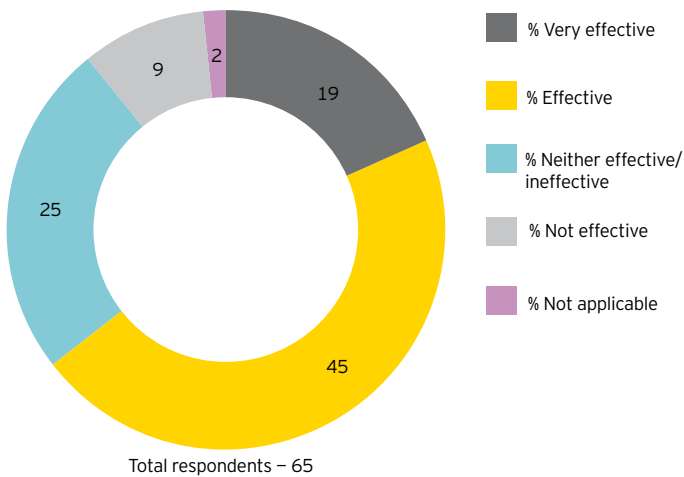
The control environment

Good internal controls to reduce opportunities to commit fraud and deter those who might be tempted are very important in any organization.

Nearly two-thirds of respondents considered the controls in their place of work either effective or very effective. Over a third were less impressed.

Figure 14

Effectiveness of internal fraud controls

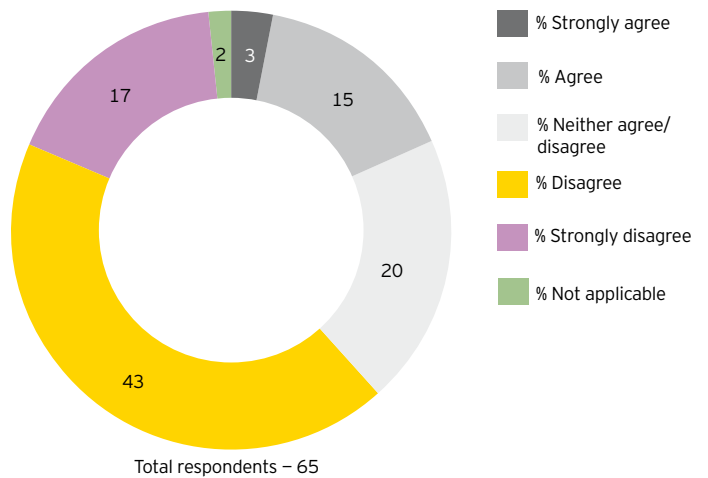


Asked for their thoughts on the statement 'our compliance function lacks rigor', 60% of respondents disagreed.

By contrast, 18% of respondents agreed.

Figure 15

Robustness of the compliance function





Setting the tone at the top

Good internal control systems must be accompanied by strong anti-fraud messaging from management.

When asked if they believed the members of the board of the organization for which they worked understood fraud risks well, 69% of respondents said they did.

Twenty-five percent said the board 'somewhat understood', and 6% felt they did not understand.

Several respondents said boards demonstrated their understanding of fraud risks by issuing directives and circulars relating to fraud:

'They do understand the problem and they have regular meetings with feedback on fraud. They tell me to bring things to their notice immediately and take positive action.'

'In my experience of the board members, especially the ones I interact with at meetings, do understand. They do ask questions about fraud and we have meetings in between [board meetings] as well.'

'We have an Audit Committee in place that discusses reports, plus the Internal Risk Management Committee. Part of the board meeting is dedicated to discussions on changes in the market, competitors and recent frauds in our organization and within our industry.'

'I believe they understand because the board comprises of people who are experienced in the banking field and have a good understanding of fraud risks.'

A minority were circumspect; indicating they felt the board of the organization for which they worked did not fully understand fraud risks:

'Most of them [board members] don't have experience in managing large operations therefore do not understand the opportunities for fraud and the importance of having procedures in place for minimizing fraud.'

'You know there is a certain culture in the Middle East, with no awareness of fraud protection and risks, so the board understands only somewhat. Policies and procedures need to be applied, but this is not seen as a major issue.'

'Sometimes, because of techniques and sophistication, board members do not fully understand. The conman is always ahead of you. We have an Operational and Group Risk Department from a few years ago but they are short-staffed, I am not sure they have identified comprehensive risks in the bank. They are more reactive than proactive.'

'The board is evolving and developing. It is mainly family members, all at different stages of development. Young people come on to the board with little experience.'

Eighty percent of respondents said the board of the organization for which they worked received corporate fraud reports on a monthly, bi-monthly or quarterly basis.

Responses indicated financial sector organizations, particularly banks, were most likely to be informed on a regular basis of fraudulent activity.

Boards of some organizations seemed willing to turn a blind eye to fraud:

'There is no mechanism for reporting and we have no policy. It is not required. It is a cultural thing in the Middle East, fraud gives you a bad reputation and the board feels discomfort.'

'Fraud is raised when applicable but they never ask for regular reports.'

'They have no interest at all, just how much cash we have.'

When asked to comment on the statement that 'strong ethical behaviour is good for business', 98% of respondents agreed.

Eighty-four percent of respondents said the board of the organization for which they worked promoted ethical behaviour. Three percent said they did not.

Dealing with employee fraud

All organizations face the possibility of fraudulent activity by their own staff.

Organizations can take proactive steps to deter internal fraud through measures such as effective pre-employment screening or raising fraud awareness amongst current employees.

Asked if the pre-employment screening technique of the organization for which they worked was effective, only 45% said it was. Twenty-nine percent said it was not effective.

Asked if they felt they had been made sufficiently aware of fraud risks when joining the organization for which they worked, 59% of respondents said the issue was covered during an induction course.

Twenty-eight percent said fraud awareness was not covered at an induction course and 11% said the organization for which they worked did not provide employee induction courses.



Many respondents who said they had been made aware of fraud risks when joining a company pointed out the level of detail with which the subject was covered was sparse:

'Employee inductions are conducted by Human Resources. They do not include fraud issues.'

'HR talks about it, also the Code of Ethics. Each employee has to sign to record they have read it.'

Fifty-three percent of respondents said they received ongoing fraud awareness training in their place of employment, while 42% said they did not:

'There are three stages to our training: first at induction, second, for departmental managers and third, operation at each level, with varying degrees of conversations about fraud, depending on level. [Fraud training is] more in-depth the higher they are up the chain.'

'Audit does various presentations throughout the year ... to supervisory management, for example 'know your employee' for them to get to know their workers better.'

'I run half-day workshops on fraud awareness, covering three main areas: theoretical, applications to business and workshops with case studies. 200 people have attended this year so far.'

'It is a continuous exercise, in terms of awareness. We deliver training in different forms.'

Where training did exist it ranged from short in-house seminars and on-the-job training, through to compulsory e-learning program for staff.

It was noted that banks were particularly good at providing on-going training to staff.

Auditors and fraud

A way to ensure fraudulent activity does not go undetected in organizations is to implement fraud transaction analysis systems. These systems typically look for anomalies such as ghost employees, duplicate claims, favoured vendors and suspicious payments.

Forty-four percent of respondents said fraud transaction analysis systems were effective in detecting fraud. Many respondents had no knowledge of these systems.

Asked about the effectiveness of audit teams in detecting fraud, 62% of respondents said internal audit was effective. Several respondents pointed out the scope of external auditors was limited in comparison to internal auditors, reducing their ability to be effective in detecting fraud in the overall structure of an organization:

'The scope of external audit is very narrow compared with Internal Audit. They only do random sampling; procedures not effective to find fraud, but geared to sign-off accounts.'

'In their contracts, audit disclosures state that they are not testing for fraud and cannot guarantee to find it. [Fraud is] generally found through whistle-blowing. Audits do not normally go to this level of detail.'

Conclusion

Fraud is a concern in the Middle East and corporate policies and procedures to prevent it are largely inadequate.

Two-thirds of respondents agreed that fraud in the Middle East represents a major problem, yet only a half of respondents said they worked for an organization that had a formal anti-fraud policy.

Often, the survey showed, existing formal anti-fraud policies are designed to be effective after fraud has been detected, rather than proactively acting as a deterrent.

Although, in general terms, the survey showed corporate management structures in the Middle East are committed to fighting fraud, respondents also indicated management of many organizations had yet to embrace the need to address fraud risk.

Responses showed many boards are reluctant to confront fraud for fear of reputational damage.

When it is confronted, the wish of management of many organizations, particularly family-run organizations, is often to deal with it internally and secretly.

Respondents also emphasized boards of many Middle East organizations are not fully aware of internal opportunities for fraud, while many accept corruption as a necessary part of business activity.

Fraud in the Middle East has markedly increased in complexity in recent years. Sophisticated and counterfeit scams are now common.

The economic downturn has revealed many ongoing frauds in the region. Effectively pulling away the covers; exposing fraudulent and corrupt practices that were previously difficult to detect, or for which there was little appetite to detect.

The most common motives for committing fraud in the Middle East are greed, ease of opportunity and personal debt.

With the exception of financial sector regulators, regulators are viewed with much scepticism in the region. In the main, they are believed to be ineffective in preventing fraud, instead merely recording it after the event.

Lawmakers in the Middle East face the considerable challenge of altering what can be an ingrained cultural perception of corruption as acceptable and beneficial to business.

To address this challenge, transparency must be strongly promoted while, simultaneously, governments must communicate the message that societies and economies thrive better where corruption is absent.

If the Middle East is to be successful in tackling widespread corruption, as it must be to attract increased foreign direct investment, it will need to replace traditional practices with international ones.

There is a lag in the Middle East between the increasing sophistication of fraud and corporate management's ability to deal with fraud.

Boards of many organizations in the region are committed to combating fraud, and progressive work is taking place to engage employees and implement effective controls.

But there is much still to be done.

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