Diligent Procurement

What Due Diligence in the Bribery Act era means for Procurement Professionals

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In 1998, Rolls-Royce Motors was put up for sale. Given the iconic status of Rolls-Royce, the sale attracted a number of potential buyers, of which BMW appeared to be the leading contender. However, they were eventually outbid by the Volkswagen Group - and that, arguably, would have been the end of the story had it not been for the fact that Volkswagen’s initial flush of success rapidly faded when they realised - after the sale had been concluded - that the Intellectual Property (IP) assets did not include the rights to use the Rolls Royce trademark, including the name and logo; BMW owned those rights as a result of a previously-negotiated licence. As a consequence, Volkswagen had spent some-thing in excess of £400M and had success-fully acquired all the rights necessary to manufacture the car - but not the rights to brand it as a Rolls Royce.

Even if you think that the Volkswagen case was exceptional, it is clear that effective due diligence is critical to all aspects of procurement. However, as a recent Harvard Business Review article said, ‘Deal making is glamorous; due diligence is not’ - and, arguably, it is for this reason that such fundamentals were missed in the excitement of Volkswagen’s acquisition of Rolls-Royce. Although, ultimately, BMW and Volkswagen negotiated a solution which allowed Volkswagen temporary use of the Rolls-Royce name and logo, it was almost certainly not the contractual situation that Volkswagen wanted or envisaged.

In a smaller, but no less significant, case nearer to home that is still being investigated, a significant number of schools and pupils were recently affected when their ski holidays were cancelled at the last minute as a result of issues with the supplier. However, what is not clear from all the reports to date is who, if anyone, was responsible for under-taking due diligence on that supplier - and what, if anything, in practice was indeed undertaken.

Due diligence can be tedious, time-consuming and difficult and, clearly, not seen as ‘glamorous’; for these reasons, it can often be delayed, deferred, delegated or, in-deed, dismissed in the procurement process. However, whilst the Volkswagen case shows the potential consequences of ineffective due diligence, those consequences are now magnified significantly with the advent of the Bribery Act - which brings with it the specific requirement that a commercial organisation should apply due diligence procedures in order to mitigate identified bribery risks. Failing to do so, and failing to prevent bribery, brings with it the risk of fines and prison, not to mention potential debarment from public procurement contracts.

Bribery Act Due Diligence – General Central to the Bribery Act are six key Principles; due diligence is seen as so significant that it warrants its own principle, principle 4.

Under principle 4, the requirement is that a commercial organisation should have due diligence polices and procedures which cover the parties to a business relationship, including the organisation’s supply chain, agents and intermediaries, all forms of joint venture and similar relationships, and all markets in which the commercial organisation does business.

Clearly, organisations will need to know who they are doing business with if their due diligence, risk assessment and mitigation process is to be fully effective, although the formal guidance does recognise that “an organisation is likely only to exercise control over its relationship with its contractual counter-party.” The guidance, however, does go on to say that the anti-bribery ‘chain’ should be maintained by counterparties requesting that the next party in the chain adopt a similar, consistent, approach.
In addition to current due diligence activities, organisations will need to consider additional work to ensure that bribery risks associated with a particular business relationship - and commodity - are understood, such that appropriate decisions and preventative measures can be taken. This work would, for example, include location and jurisdictional issues, business type and commodity, together with the integrity of business partner organisations and individuals.

In summary, it is insufficient just to rely on current procurement practices, policies and due diligence as being ‘good enough’ for the Bribery Act era.

**Bribery Act Due Diligence - Specifics**

Under the Bribery Act, there is a full defence if an organisation can show that it has ‘adequate procedures’ in place to prevent bribery. The Bribery Act guidance goes on to say that the Government considers that (adequate) procedures put in place by commercial organisations wishing to prevent bribery being committed on their behalf should be ‘informed’ by six principles; as has been highlighted, principle 4 specifically focuses on due diligence.

It is envisaged that application of the principles will result in the range of procedures necessary to prevent bribery. However, the Government’s principles are not prescriptive, nor specific. They are intended to be ‘flexible and outcome focussed’ to allow for the variety of circumstances that commercial organisations operate in. Clearly, small organisations will face different challenges to those of large multi-national enterprises but, irrespective, the outcome should always be appropriate, robust and effective anti-bribery procedures - that are proportionate to risk.

To put due diligence in perspective, the guidance says that “The significance of the role of due diligence in bribery risk mitigation justifies its inclusion (here) as a principle in its own right.” Due diligence is included under the Bribery Act, for example, to ensure that organisations put in place procedures and proportionate measures designed to prevent ‘associated persons’ from bribing on their behalf.

Whilst the principle of due diligence is considered to be firmly established as a key element of good corporate governance, it is clearly envisaged that due diligence related to bribery prevention will often form part of a wider due diligence framework. Moreover, due diligence procedures are both a form of bribery risk assessment and a means of mitigating risk. As a simple example, if a commercial organisation identifies that there are risks associated with using a local third-party intermediary then due diligence undertaken on specific prospective third-parties could significantly mitigate those risks.

Clearly, due diligence procedures should be proportionate to the identified risk; the due diligence can be undertaken internally, by external consultants or by the increasing number of compliance-type organisations who are establishing the capability to undertake due diligence on behalf of organisations.

It must be noted that a person ‘associated’ with a commercial organisation includes any person performing services for a commercial organisation; the definition is - purposely - broad and can embrace a wide range of business relationships with the result that the appropriate level of due diligence will vary enormously depending on the risk, and potential risk, arising from a particular relationship. Clearly, any relationship involving the use of a third-party to establish a business in foreign markets is always going to bring with it the requirement for the
highest levels of due diligence in order to mitigate the risk of bribery. As an extension of this, any relationship - either existing or proposed - that dictates the use of local agents as a consequence of local law or convention will need to very carefully scrutinised, particularly with regard to the process ofextricating the organisation from that relationship once it is established. Clearly, the importance of thorough due diligence and risk mitigation prior to any business commitment are paramount in such circumstances. As the Volkswagen case showed, mergers and acquisitions are also relationships that particularly require effective due diligence

Due diligence will need to be undertaken on a risk-based approach which may, at the lowest extreme, mean that little or no due diligence is actually required. At the other extreme, however, significant due diligence will be required that could necessitate, for example, direct interrogative enquiries, indirect investigations or general research both at company and individual (‘associated person’) level. It cannot be stressed too much that this process should not be considered as a ‘one-off’ activity, typically prior to the start of a contractual relationship - but should be undertaken on a periodic or continuous basis, proportionate to the identified risks.

In general, more due diligence will be required on prospective and existing incorporated ‘associated persons’ (e.g. companies) than on individuals; this is because more ‘associated persons’ are likely to be involved in the performance of services by a company and the exact nature of their roles, relationsships and interfaces with other connected bodies may not immediately obvious. Accordingly, due diligence may involve direct requests for details of the background, expertise and experience of relevant individuals which will then need to be verified through research and reference checks.

A commercial organisation’s employees are presumed to be persons ‘associated’ with the commercial organisation for the purposes of the Bribery Act. As a consequence, organisations will need to consider what Bribery Act and due diligence-related requirements are incorporated into recruitment and HR procedures, in order to mitigate the potential risk of bribery associated with the post, or posts, in question - including both ‘active’ and ‘passive’ offences i.e. giving and receiving. Clearly, some functions and posts may be considered to be high risk, a classification which is likely to include procurement and related activities.

**Bribery Act risk assessment and due diligence**

The Bribery Act requires that a commercial organisation regularly and comprehensively assesses the nature and extent of the risks relating to bribery to which it is exposed; risk assessment and due diligence procedures are directly linked in that due diligence is both a form of bribery risk assessment and a means of mitigating risk.

Clearly, if an organisation is to have in place effective controls to prevent bribery then it is essential that the risks faced by that organisation are fully understood. This should be accomplished through a full and on-going risk assessment, supported by appropriate due diligence, although the procedure - and results - will vary widely across organisations. This risk assessment is clearly the foundation of understanding the corruption risks that a business can face and is the cornerstone of the company’s wider compliance and ethics programme. The risk factors, be-low, should be considered by all companies as part of their overall risk assessment procedure:

- Expertise availability necessary to undertake the risk assessment
- Risk data including internal and external audit reports, investigations, location/jurisdictional data (such as that from Transparency International) and complaints
• Key internal bribery risks including deficiencies in employee knowledge of a company’s business profile and understanding of associated bribery and corruption risks; employee training or skill sets; and the company’s organisation and/or compensation structure
• Lack of clarity in company policies on gifts, hospitality and entertainment; travel expenses; the use of agents, consultants and other intermediaries; political and charitable contributions; due diligence procedures relating to business partners including acquisitions, joint ventures and other relationships; and contracts and bids
• Country risk including (a) perceived high levels of corruption; (b) factors such as absence of anti-bribery legislation and implementation and a perceived lack of capacity of the government, media, local business community and civil society to effectively promote transparent procurement and investment policies; and (c) a culture which does not punish those who seeks bribes or make other extortion attempts
• Transaction risk including charitable or political contributions, the obtaining of licenses and permits, public procurement, high value projects or complex projects involving multiple contractors, intermediaries and/or agents
• Partnership risk including those involving foreign business partners located in higher-risk jurisdictions, associations with prominent public office holders, insufficient knowledge or transparency of third party processes and controls
• Commodity risk associated with the commodity or commodity-type being purchased, for example, relative to the geographic location, source and related factors
• Relativity risk is the risk associated with a contract that may be very substantial financially, strategically important or both to a supplier but is relatively small, commoditised and largely inconsequential to the purchaser, which can then result in insufficient controls and, potentially, an environment for bribery

Once an appropriate risk assessment has been undertaken in line with the issues high-lighted above and supported by appropriate due diligence, an organisation will then need to develop, implement and maintain effective anti-bribery procedures and policies.

It must be recognised that the UK Government is clear that a static risk assessment - and due diligence - is insufficient, such that as a business evolves, or external circumstances change, a company will need to en-sure that it is devoting sufficient resources to the assessment and mitigation of bribery and corruption risks. One good example would the small- or medium-sized company that enters a new market in a geography where it has not done business before; in using new intermediaries and agents, the company clearly may not be able to simply rely on anti-bribery policies designed for well-understood domestic purposes.

**Procurement due diligence**

‘Due diligence’ is an umbrella term which represents a number of activities that should be undertaken certainly prior to entering a contractual agreement. As has been shown earlier, it is vital that due diligence is per-formed in an effective and timely way but, just as important, whatever due diligence pro-cess is established in procurement, it must both work well and be utilised, and utilised in a way that can proved. Clearly, this will demand regular monitoring and feedback so that the process, safeguards and controls can themselves be changed and improved.

However, it should be recognised that due diligence can also be undertaken on special contractual issues if it is warranted, including, for example, human rights; placing a contract at a good price may come back to haunt an organisation and cause considerable reputational...
damage if fundamental supply chain issues such as human rights and labour practices are not taken into consideration from the outset.

Due diligence is a formal phase of contract negotiation whereby both (or all) parties undertake a process to test and verify their understanding of the potential contract and the commitments to be entered into. Clearly, this will often include verification of financial information, staff information, deliverables, previous contracts, assets, property and a host of other data.

Effective due diligence will enable the parties involved to conclude a contract with a full understanding of the basis on which the contract is to be let and a full awareness of the deliverables, timescales, costs, risks and other contractual commitments. Conversely, failure to undertake due diligence may result in a failure to conclude a contract, failure during the life of the contract and/or unforeseen consequences such as reputational damage. Effective due diligence hinges on a defined, agreed and communicated due diligence process, one that is adopted and used in accordance with agreed requirements, such as contract value, complexity or risk.

Clearly, the detailed issues to be considered for a particular contract will vary but, nonetheless, the generic issues will be constant for a given type of contract - for products, services, outsourcing and so on. As a consequence, it is crucially important that as a part of their overall due diligence process, organisations develop contract type-specific due diligence checklists - where checks are then excluded only by positive decision, and not by default for reasons of ease or expediency.

Although not exhaustive, Table 1 shows a typical top-level due diligence checklist which would then be supplemented by contract-and sector-specific parameters. It should be noted that due diligence needs to be up-to-date - a lot can change in three months - and reflect the roles, responsibilities and requirements of all parties in a contractual relationship:

<table>
<thead>
<tr>
<th>Table 1: Procurement due diligence - typical checklist</th>
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<tbody>
<tr>
<td>1. Legal and contractual status (e.g. does the organisation have the legal capacity and required rights)</td>
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<td>2. Business status and information</td>
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<td>3. Financial status and performance including banking and third-party guarantees and insurance</td>
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<td>4. Staff and staffing information and references, including TUPE</td>
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<td>5. Operational agreements including strategy alignment, Service Level Agreements and policy/procedural alignment</td>
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<td>6. Property, assets and related contracts including Intellectual Property (IP)</td>
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<td>7. Other issues including consultation, Trade Unions and Public Relations</td>
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<td>8. Existing contracts and contractual performance</td>
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<td>9. Judicial and regulatory issues/findings</td>
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<td>10. Approvals, standards and documentation</td>
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<td>11. Exit strategies and contingency/transition plans</td>
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<td>12. Human Rights and other specialist requirements</td>
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There are now available a wide range of tools, techniques and companies—often Internet-based—that can assist an organisation in undertaking due diligence on a prospective contractual partner in order to discharge the requirements identified in the checklist. Some of these tools are shown in Table 2 and include:

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<th>Table 2: Due diligence - tools and techniques</th>
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Due diligence: the challenge - and actions - for procurement professionals

As the Volkswagen example shows, failure to undertake effective due diligence can have significant consequences. However, whilst the principle of due diligence has long been established as a key element of good corporate governance, the critical challenge today for procurement professionals is to ensure that timely, demonstrable and appropriate due diligence is carried out effectively and consistently.

Whereas, arguably, a due diligence failure in the past might lead only to commercial consequences, however significant, now the consequences could be far greater, potentially also involving substantial fines and imprisonment under the Bribery Act. Moreover, one of the penalties also available to the authorities is that of debarment from public procurement contracts, whilst monies obtained by a company as a consequence of a corruptly-obtained contract could also fall under the Proceeds of Crime Act.

It is recognised that the formal Bribery Act guidance confirmed that an “organisation may be liable for failing to prevent a person from bribing on its behalf but only if that person performs services for you in business. It is very unlikely, therefore, that you will be liable for the actions of someone who simply supplies goods to you.” However, the potential bribery risks associated with a third-party agent undertaking negotiations with foreign public officials may well be assessed as very significant, with the result that far more extensive due diligence procedures are required in order to mitigate the risk for this particular ‘associated person’. Crucially, whilst the Bribery Act only came into force on 1st July and the formal guidance recognises the difficulties of retrospective application, nonetheless the procedures will need to be applied to existing associated persons and contracts over time. Additionally, one of the major challenges in this area for procurement professionals, and others, is extending these policies and processes to subsidiaries, business partners and third-party service suppliers. ©CIPS 2013
through public anti-bribery and corruption terms and conditions incorporated into each contract, together with common or shared Codes of Conduct.

Procurement professionals will, without question, have a critical role in ensuring that their organisation can fully and demonstrably satisfy the requirements the Bribery Act, by establishing genuinely ‘adequate procedures’. Central to this will clearly be a need for effective due diligence and, even for those organisations who believe that they already operate such a process, this will need to be demandingly verified - as a key element of their organisation’s overall ‘corporate shield’.

Clearly, the crucial challenge for procurement professionals is to recognise the new demands that the Bribery Act places on the due diligence process - and to act now to ensure that their organisation can meet those demands, both in spirit and letter.

**Key References & Tools:**

A key reference source of anti-bribery and corruption, and Bribery Act, information is the Government-sponsored Business Anti-Corruption Portal which can be found at: [business-anti-corruption](#).

The Portal is managed by the Global Advice Network ([.globaladvice](#)) on behalf of a number of governments and includes a wide range of UK and international information, including country profiles and anti-corruption tools together with integrity system documents that can be downloaded and tailored by an organisation to meet their specific circumstances and needs.

The Portal also includes a free Public Procurement due diligence tool together with guidance, procedure and risk assessment documents. These can be readily applied, and tailored, to a wide range of procurement situations, not just public procurement.

The Global Advice Network also has an anti-bribery and corruption e-learning package specifically aimed at procurement officers and the procurement function, including associated Internal Audit activities.

**Links & Sources:**

UK Bribery Act
[justice.gov](#)

Business Anti-Corruption Portal
[business-anti-corruption](#)

Global Advice Network
[.globaladvice](#)

Foresight Valuation Group
[foresightvaluation](#)

Harvard Business Review
[hbr](#)

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.bis.gov.

Wakefield Council
.wakefield.gov.