

cær

Centre for Australian Ethical Research



“Just how business is done?”

**A review of Australian business' approach to
Bribery and Corruption**

Publication Date: 8 March 2006
Report Number 1, 2006

Contents

1.	Executive Summary	3
2.	Bribery vs Facilitation Payments	3
3.	Australian Law	4
4.	US and UK Law: A comparison	5
5.	Why bother with a Code of Conduct?	6
6.	Bribery and Facilitation Payments	6
7.	The influence of the ASX	9
8.	Code of Conduct Systems	10
9.	Conclusion	11
10.	Recommendations	11
11.	Notes	13

Executive Summary

This background briefing examines the approach taken by Australian companies in restricting bribery and corruption.

Comparisons between Australian, US and UK law illustrate that the sanctions in place in the US and UK are more severe for companies and individuals engaging in bribery than those in Australia.

The recent AWB scandal has brought home to Australian investors the reality that bribery and corruption pose genuine financial risks to a company's operations.

Approximately half of the companies on the S&P/ASX 100 have policies prohibiting bribery and less than one quarter have policies on regulating facilitation payments. This does not compare favourably with the percentage of companies prohibiting bribery in comparable markets overseas. Of the top 100 companies by market capitalisation in the UK, 92% have explicitly prohibited giving and receiving bribes. In Europe the figure is 91% and in the US it is 80%.

It is interesting to note that the Australian companies at the highest risk from bribery and corruption, through

exposure to susceptible sectors or countries, have the lowest level of disclosure on this issue.

Even fewer companies augment their policy with an adequate system to encourage a culture of compliance with anti-corruption policies. Out of the S&P/ASX 100, 18 companies have a policy prohibiting bribery and an appropriate system. Only 5 companies have a policy prohibiting facilitation payments supported by an adequate system.

The ASX may have a role to play in increasing the number of companies that address the issue directly. Companies are far more likely to include ethics elements suggested by the ASX than those that are not. The ASX does not currently suggest corruption as an issue for inclusion in business ethics codes.

Corruption can have uncertain consequences for investors that stem from the additional types of risk corruption introduces. Investors have a role to play in encouraging companies to prohibit bribery and corruption by including this type of risk in investment decisions.

Bribery vs Facilitation Payments

The OECD Working Group on Bribery released a report on Australia's application of international bribery conventions on the second day of the Cole inquiry into the actions of AWB in the oil-for-food scandal. The report detailed Phase 2 evaluations of Australia's moves to incorporate the

Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendations on Combating Bribery in International Business Transactions into domestic policy. The report made a number of recommendations and highlighted a number of inconsistencies

in the way Australia approaches enforcing anti-corruption mandates.

The term 'corruption' often becomes a catch-all phrase for a range of legal, illegal and unethical business practices. The distinction between bribery and facilitation payments is one area that has recently received a lot of media attention in light of both the OECD report and the Cole inquiry. Australian criminal and tax laws distinguish between the two practices both in-kind and by degrees.

A bribe is defined as a favour or gift offered or given with the intention of influencing behaviour or opinions of the recipient. 'Active' bribery is the action of giving a bribe while 'passive' bribery is receiving the payment.

The OECD identifies facilitation payments by the circumstances in

which they are made. A payment is a facilitation payment, and not a bribe, where it is paid to government employees to speed up an administrative process where the outcome is already pre-determined.

The difference lies, in the simplest terms, in the decision-making power of the recipient. A payment to hurry along a visa application that is certain to be granted is a facilitation payment. The outcome of whether the visa is granted or not is determined by regulation, and a payment to alter a decision in this respect would be a bribe. A payment to a government employee before a tender process has been concluded is a bribe as the recipient may consider the payment when deciding on awarding the contract.

Australian Law

Bribery is a crime under the Commonwealth Criminal Code Act 1995. Australian nationals engaging in bribery of foreign government officials can receive fines of up to AUD 66,000 and ten year jail terms. Australian companies face fines of up to AUD 330,000 if convicted of bribing foreign officials. Australian companies and individuals may be convicted of bribery whether the act is committed from within Australia or from overseas.

There are two defences to the charge of bribery. The first is if the payments made are not illegal in the recipient's country. The other defence is that of facilitation payments.

There are discrepancies within Australian law as to what defines a

facilitation payment and whether such payments are legal. The Criminal Code defines facilitation payments by stating that the payment must be:

- of a nominal value;
- paid to a foreign official for the sole or predominant purpose of expediting a minor routine action; and
- documented as soon as possible.

The documentation must satisfy the reporting requirements also set out within the Criminal Code.

The Income Tax Assessment Act (1936) (ITA) also sets out a definition of facilitation payments. Until 1999 the ITA Act permitted companies to claim costs incurred generating an assessable income, including illegal activities such

as bribery, as a tax deduction. The ITA Act was amended so companies could only claim facilitation payments, and not bribes, as deductions as part of ratifying the 1997 convention. The definition of facilitation payments in the ITA Act does not include a reference to the minor nature of the payments. As the ITA Act does not refer to the size of a payment, and the Criminal Code does not define 'minor', it is unclear at what size a facilitation payment ceases being legal and becomes a bribe.

The Export Finance and Insurance Company uses a working definition of

'minor' as a commission payment of less than 10% of the value of the full contract. The agency, however, views payments between 5-10% as warranting investigation. This definition is not binding and has not been adopted by the ATO. Most Australian states add to the ambiguity at a federal level by identifying facilitation payments as illegal. The OECD identified the inconsistent and vague way in which Australian law treats facilitation payments as a hole in the system for administering anti-corruption legislation.

US and UK Law: A comparison

The Foreign Corrupt Practices Act is the predominant legislation governing bribery in the US. US nationals may receive fines of up to USD 100,000 and up to five years imprisonment if convicted of bribing foreign officials. Corporations face fines of USD 2 million if convicted of the charge. Punitive actions against corporations may also include the withdrawal of export approvals and exclusion from government contracts. US law also has provisions to increase the maximum fines available if the bribe has resulted in a loss or gain. The fine, in this case, may be twice the amount of the loss or gain incurred.

The same 2 defences against allegations of bribery exist in the US. A payment is not a bribe if it is legal in the recipient's country. A facilitation payment is also not considered to be a bribe. The US, like Australia, does not set out an upper limit for facilitation payments. Unlike Australia, the US does not make reference to 'small' or 'minor'

when defining facilitation payments, and the OECD identifies this as a flaw. Facilitation payments are tax deductible in the US.

The UK, unlike Australia and the US, does not recognise facilitation payments as a legal action and has not put forward a definition. In practice, as the OECD notes, it is unlikely that the UK would prosecute individuals or companies making small facilitation payments to officials in areas where this is usual practice.

A summary conviction in the UK may result in fines up to GBP 5,000 and six months imprisonment. An indictment for bribery may result in prison terms of up to seven years and unlimited fines.

While Australia is perceived to be less susceptible to corruption in Transparency International's 2005 Corrupt Perceptions Index, the possible penalties in both the UK and the US are harsher than those available under Australian law.

Why bother with a Code of Conduct?

Companies, as well as nation states, have an interest in inhibiting corruption.

Corrupt practices heavily impact on the business environments in areas where it is the norm. Ineffective competition and instability discourage investment in these environments. Controlling assets based on contracts or licences that require illicit payments to secure, or dependence on revenue streams based on these contracts, contributes additional layers of risk for the companies involved. Corruption damages the reputation of companies and industries and impacts on a company's informal 'licence to operate'. As a result, companies have a vested interest in alleviating corruption.

Companies with investments and operations in susceptible areas and industries do not have a clear cut-off between legal and illegal behaviour under Australian law. Many within the Australian media have called for companies to 'just say no' to any act that may be construed as corrupt in response to the Cole inquiry and the OECD report.

The response of some companies has been to participate in industry-wide

initiatives. The Extractive Industries Transparency Initiative (EITI) is one example where signatories commit to greater disclosure of payments made to foreign officials. The initiative is designed to improve the outcomes of resource-rich developing nations by requiring signatory governments to gather and disclose information regarding payments. Signatory companies agree to supply data on payments made to participating countries but the EITI does not require supporting companies to make additional or public disclosures.

Company policy is another avenue available to business to prohibit or regulate payments made to foreign officials. It is an attempt at self regulation on a company level. While company policy is not legally binding, it is an indication that directors have considered its components seriously. Company policy reinforced by a stringent system to enforce compliance is an effective first step in managing issues such as bribery and corruption. Australian investors should consider this issue when reviewing the companies in their portfolios.

Bribery and Facilitation Payments

Although Australia has been identified by Transparency International (TI) as the country second least likely to be involved in corruption globally, companies listed on the S&P/ASX 100 have considerable interests in industries and countries with a more challenging reputation. As Table 1 shows, 41% of the S&P/ASX 100 are involved in high risk sectors such as mining, gas and oil exploration and production and property

development. A total of 20% of the S&P/ASX 100 are involved in TI's high risk countries¹. A total of 11% of the S&P/ASX 100 have interests in both at-risk countries and operate in at-risk sectors. Half of the companies in the S&P/ASX 100 are involved in either a high risk sector or a high risk country.

¹ Transparency International Website: <http://www.transparency.org/policy_and_research/surveys_indices/cpi/2005>

Table 1. Involvement of Australian Companies in At-Risk Areas

	Involved in at-risk sector	Involved in at-risk country	Involved in both at-risk areas	Total
S&P/ASX 100 Companies	41	20	11	50

A total of 51 of companies listed on the S&P/ASX 100 have explicitly prohibited their employees from giving and receiving bribes. An additional 10% of companies have prohibited receiving bribes but do not refer to giving bribes while a further 2% of companies explicitly prohibit giving bribes but do not mention receiving bribes.

Figure 1. Percentage of top 100 companies from Australia, UK, US and Europe which prohibit both the giving and receiving of bribes.

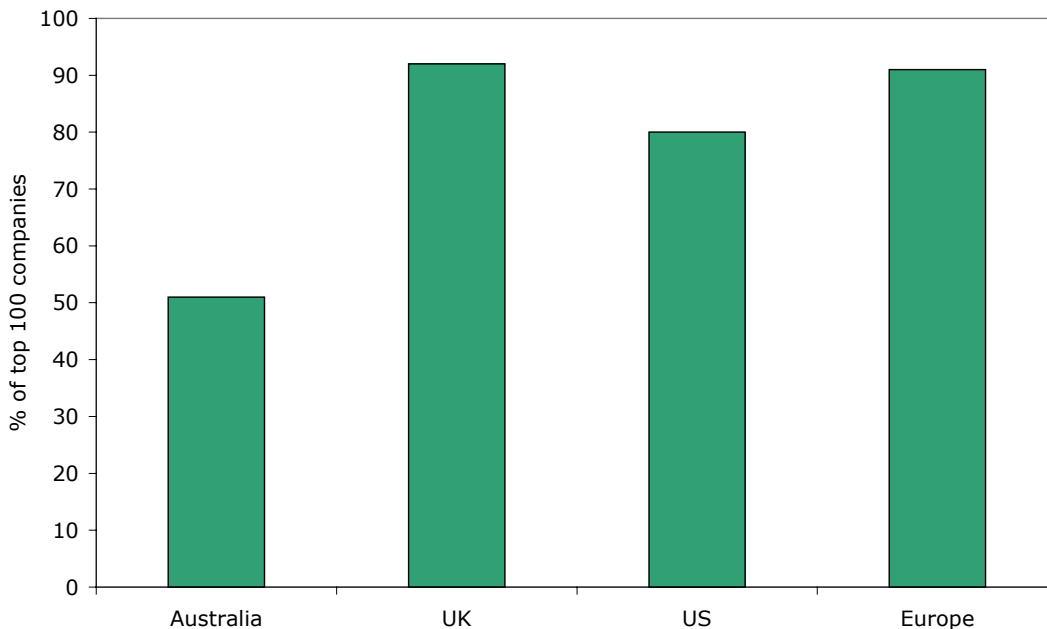


Figure 1 highlights that the rate of Australian companies prohibiting bribery does not compare well with US, UK and European companies. A total of 92% of the top 100 UK companies (by market capitalisation) have policies prohibiting giving and receiving bribes. European companies are not far behind with

91% of the top 100 adopting policies. Substantially more of the top 100 companies in the US have anti-bribery codes than the S&P/ASX100 with 80% prohibiting bribery.²

² International data sourced from CAER's UK partners Ethical Investment Research Services (EIRIS)

Table 2. Prohibition of Bribery by Companies in At-Risk Areas

	Involved in at-risk sector	Involved in at-risk country	Involved in either at-risk area	Not involved in at-risk area	Overall
Number of companies prohibiting bribery	20	13	25	26	51

Table 2 identifies companies with interests in at-risk areas that also prohibit bribery. Of 41 companies on the S&P/ASX100 involved in high risk sectors, 20 explicitly prohibit employees from engaging in bribery and corruption. Thirteen of the 20 companies with subsidiaries in high risk countries have explicit policies on bribery. Exactly half of the companies with an interest in either a high risk country or sector have policies prohibiting bribery.

Given that only half of the companies that are most exposed to risk in the area of bribery and corruption have public policies addressing the issue, there is a clear risk here for Australian investors.

The rate of companies incorporating facilitation payment controls into

company policies is substantially lower than companies addressing bribery. Only 24% of companies listed on the S&P/ASX 100 have sought to control the way in which facilitation payments are made by adding restrictions into their codes of conduct, and only 15% prohibit facilitation payments altogether.

Interestingly, it is the companies with interests in at-risk areas that tend not to prohibit facilitation payments, as shown in Table 3. One company out of the 41 in high risk sectors, and 3 out of the 20 in high risk countries, have prohibited facilitation payments. Only 3 companies out of the 50 with interests in either high risk area have policies prohibiting facilitation payments.

Table. 3 Involvement in At-Risk Areas

	Involved in at-risk sector	Involved in at-risk country	Involved in either at-risk area	Not involved in at-risk area	Overall
Number of companies prohibiting facilitation payments	1	3	3	12	15

The influence of the ASX

The ASX's Principles of Good Governance and Best Practice Recommendations have been very successful in encouraging companies to adopt public statements of ethics. All companies on the S&P/ASX 100 have followed this recommendation. Of these companies, 90% have made the policies publicly available, and 89% explicitly

state that the policy applies to all subsidiaries.

Companies are far more likely to include the business ethics aspects suggested by the ASX than others. The ASX mentions 'conflicts of interest' and 'obeying laws and regulations', for example, and almost all companies include these.

Figure 2. Inclusion of Ethics Aspects in S&P/ASX 100 Codes of Conduct

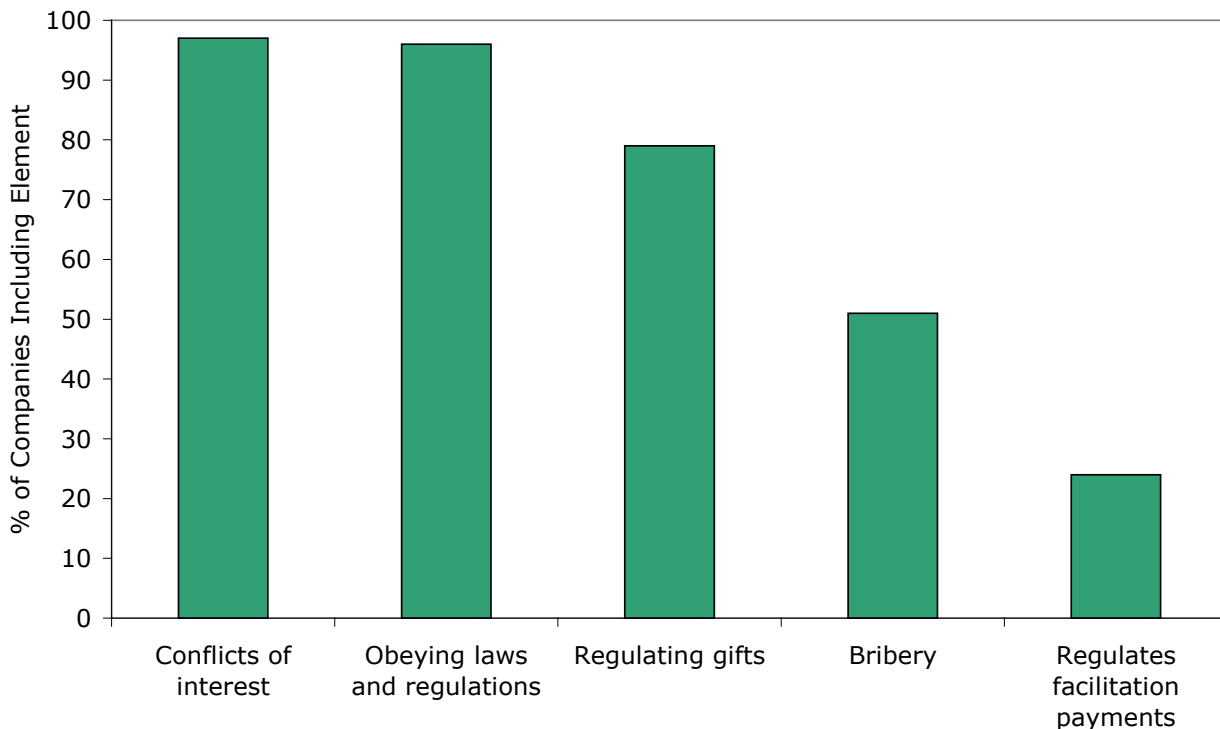


Figure 2 above notes that the aspects of business ethics mentioned in the ASX governance principles are present in most company codes of conduct. The ASX recommends that companies address conflicts of interest and obeying laws and regulations in this manner. Almost all (97%) companies mentioned conflicts of interest while 96% of companies have incorporated a reference to obeying laws and regulations. Giving and receiving gifts, not mentioned by the ASX, is incorporated into substantially fewer

(79%) codes of conducts. As stated earlier, the inclusion for bribery is lower still at 51% and facilitation payments are mentioned in only 24% of codes.

From this information it is very clear that the ASX's Corporate Governance Council recommendations have had a strong influence on corporate disclosure in this area. There is a potential here for investors through the ASX to provide positive influence to improve company disclosure on issues relating to bribery and corruption.

Code of Conduct Systems

There are vast differences in the way companies approach enforcing a culture of compliance with their codes of conduct.

Sixty eight percent of companies supply evidence of providing their employees with training on the code of conduct. This ranges from including aspects of the code in a new employee’s induction to comprehensive workshops for all employees. Seventy percent outline information to stakeholders and the public regarding the systems in place for monitoring compliance with the code. Only 18% of companies report publicly on breaches of the code and the sanctions that were applied.

Where companies have a clear system in place for enforcing their code of conduct, 90% of companies have in place systems to protect whistleblowers to encourage employees to report breaches, while 64% of companies indicate that a regular review of the code takes place.

CAER evaluated the enforcement systems of the S&P/ASX 100 based on this criteria. Policies seeking to inhibit bribery and facilitation payments require a system of implementation in order to be effective.

Figure 3. Codes of Ethics Systems for the S&P/ASX 100

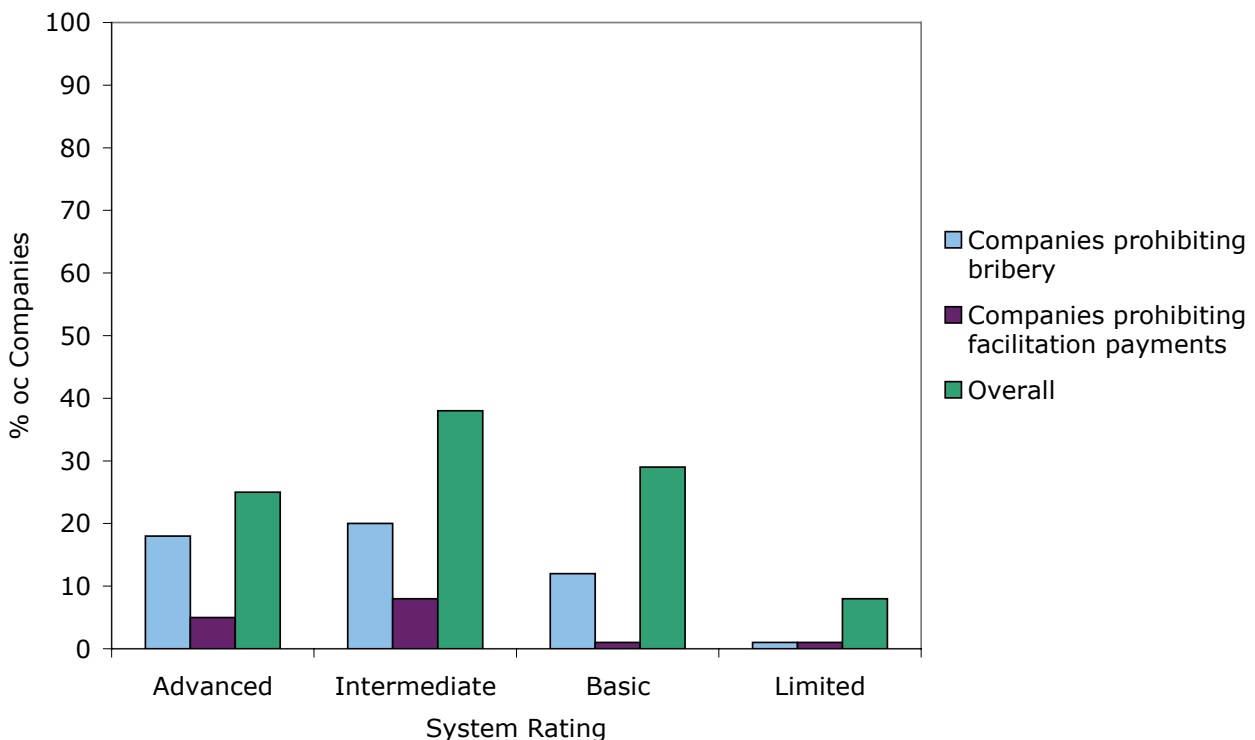


Figure 3 illustrates that 18 of the 51 companies that prohibit bribes have an advanced system for establishing a culture of compliance. Twenty companies with an anti-bribery policy have an intermediate system, 12 have a basic system and one has a limited system.

A similar case is also shown for companies that have explicitly prohibited facilitation payments. Of the 15 companies to do so, 5 have an advanced system for compliance, 8 have an intermediate program, one has a basic system and one has a limited system.

Conclusion

A detailed examination of code of conduct policies among companies listed on the S&P/ASX 100 shows us that approximately half prohibit bribery. This figure is considerably less than that seen in comparable markets in other parts of the world. The AWB scandal has clearly demonstrated that bribery poses a genuine investment risk to companies operating in areas where this is a problem. Australian investors should consider working more closely on this issue with the companies they invest in, to promote better business practice and reduce investment risk.

Companies, especially those in at-risk areas, are far less likely to prohibit facilitation payments. Given that industry and key regulators are unable to come up with a clear distinction

between facilitation payments and bribes, it is difficult to fault companies on this issue.

For those companies that do approach either practice, fewer still have systems in place to effectively apply the policies. Eighteen companies have a policy that prohibits bribery that is backed by a system to enforce it. Five companies have prohibited facilitation payments and are able to effectively enforce the mandate. It is not enough to simply have a public policy on bribery – it is essential that employees are given clear guidance on the implementation of that policy. Companies should be establishing systems to monitor, review and carry out policy procedures in day to day business operations through a clearly defined process.

Recommendations

1. Investors work with Australian companies to improve the way in which bribery and corruption risk is managed:

The statistics indicate there are gaps in the way Australian companies are tackling bribery and corruption. Companies seeking to effectively self-regulate their activities need two

components, in addition to the policy, in order to be effective:

- a system of enforcement that includes communication strategies, senior responsibility, review, and appropriate sanctions for breaches; and
- universal application of the code to all subsidiaries, joint ventures and

agents in order to capture those incorporated in at-risk countries and at-risk sectors.

Without these factors the existence of a policy lacks meaning and is ineffective.

2. The Australian Stock Exchange incorporate bribery and facilitation payments into their Principles of Good Governance and Best Practice Recommendations:

There is clear evidence that companies are adopting the recommendations of the ASX when developing codes of conduct. CAER suggests that companies could be doing more by incorporating bribery and corruption issues into these codes of conduct, enforcing these policies and applying them to all of their subsidiaries. The ASX has a demonstrated track record of protecting investors' interests, and by adopting additional criteria in their best practice recommendations, may lead to a greater consideration of these issues by Australian companies.

3. Regulators and industry work to develop a clear operating procedure for handling facilitation payments:

There is absolutely no doubt that many Australian companies are currently involved in the payment of facilitation fees to foreign government officials. Most people would assume that such payments are generally of a minor nature and intended purely to speed up the administrative process in overseas operations.

When does a facilitation payment become a bribe? Which companies are taking this risk? There is currently a lack of clarity for Australian companies trying to answer the first question, and a lack

of public information for investors trying to answer the second question.

CAER recommends that a cross-party forum be established involving the finance community, government and industry representatives to consider this situation in some detail. An ideal outcome would be a system that:

- allows a company to determine clearly whether a payment is a bribe or a facilitation payment;
- facilitates transparent disclosure of these facilitation payments in a non-critical manner to enable a company to be above reproach in its activities; and
- active promotion of good governance in countries where Australian companies are operating. Better government administration in places where Australian companies are doing business would be a positive for investors, for companies and for the countries in which Australian companies are operating.

The AWB scandal has highlighted the potential impact of bribery and corruption on investors and companies on a global scale. Investors, therefore, have a role in inhibiting bribery and corruption by considering the additional risk associated with these issues when making decisions about where to direct their finances.

Press Contact:
Duncan Paterson,
CEO

02 6201 1900
dpaterson@caer.org.au

Report Author:
Julie Walters,
Corporate Ethics Researcher

Notes:

Transparency International

www.transparency.org

Transparency International (TI) is a not-for-profit organization committed to combating corruption internationally. The 2005 Corrupt Perceptions Index lists the following as the 10 countries perceived to be most corrupt:

Chad; Bangladesh; Turkmenistan; Myanmar; Haiti; Nigeria; Equatorial Guinea; Cote d'Ivoire; Angola; Tajikistan.

The 2005 Index lists the following as the 10 countries perceived to be least corrupt:

Iceland; Finland; New Zealand; Denmark; Singapore; Sweden; Switzerland; Norway; Australia; Austria.

Australia ranks as the country ninth least perceived to be corrupt.

TI's Bribe Payer Index (2002) outlined the industries perceived to be most likely to be targeted to pay a bribe to government officials. These are as follows:

Public works/construction; arms and defence; oil and gas; real estate/property; telecoms; power generation/transmission.

Michael Ahrens, TI Australia on 02 9389 5930; or mca@zeta.org.au

OECD Working Group on Bribery

www.oecd.org/topic/0,2686,en_2649_37447_1_1_1_1_37447,00.html

The OECD Working Group on Bribery recommended Australia should increase the penalties for corporations found guilty of bribery to include exclusion from government contracts and public procurement and export credits and credit guarantees. The Group recommended increasing communication between state and federal police and increased effectiveness of the ATO in detecting bribery when doing audits. The group has also expressed concern over the tax deductible status of facilitation payments.

The report also calls for greater whistleblowing protection for public servants posted overseas. It is also recommended that Australia increase encouragement for public servants posted overseas to report incidents if they are aware of them.

Australian Stock Exchange Listing Guidelines

www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=364&companyid=ASX

The ASX Principles of Good Governance and Best Practice Recommendations Principle 3: Promote Ethical and Responsible Decision-Making. Recommendation 3.1 encourages companies to establish a code of conduct. The guidelines do not specify the content beyond this although it does suggest that companies include reference to conflicts of interest, corporate opportunities, confidentiality, fair dealing, company assets, laws and regulations, and reporting of unethical behaviour.

CAER

www.caer.org.au

The Centre for Australian Ethical Research (CAER) is an independent, not-for-profit research organization. CAER was established in 2000 to provide independent social and environmental data on companies operating in Australia and the Asia-Pacific region.

CAER collects data on approximately 180 socially responsible investment (SRI) issues for the S&P/ASX 300 and major New Zealand companies. CAER data is based on publicly available information gathered from company and government websites and company Annual Reports. CAER contacts companies directly twice per year, and conducts an annual survey of companies covering all of the SRI criteria addressed. Companies are also provided with the opportunity to review and respond to the information CAER holds twice per year.

EIRIS

www.eiris.org

Ethical Investment Research Services (EIRIS), established in 1983, provides the independent research into corporate social, environmental and ethical performance that is needed by investors to make informed and responsible investment decisions. EIRIS is one of the leading analysts of corporate social, environmental and ethical performance with research partners in six countries. EIRIS clients include ABN Amro Bank, ATP, Credit Suisse Asset Management, Fortis Investment Management, Gartmore Investment Managers, Government and Local Authority pension funds, Merrill Lynch, and Shroders Investment Management Ltd. In addition, the FTSE4Good index relies on EIRIS research. EIRIS does not promote any one particular view on ethical or socially responsible issues. EIRIS's unique analytical software tool, Ethical Portfolio Manager, allows institutional investors to develop and implement socially responsible investment policies whether based on an engagement, screening or preference/best-in-class approach. For further information about EIRIS' services for fund managers, pension funds and charities, including Convention Watch and EPM contact:

Lisa Hayes on +44 20 7840 5727; or Lisa.Hayles@eiris.org