Client Alert:

Strengthening Risk Assessments in Response to COVID-19

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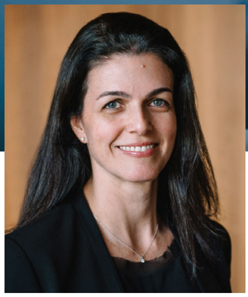

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Taking Accountability in Risk Assessments

As the world continues to battle coronavirus, risk assessments will continue to play a crucial role in companies' compliance programs. To protect from emerging and heightened risks and adhere to the Brazilian Clean Companies Act (BCCA) (Law no. 12.846/2013), which was implemented to hold companies accountable in improving compliance programs, Brazilian companies must ensure risks are adequately identified and addressed. While strong adherence to internal policies, procedures, and controls are always important, strengthening the risk assessment process is critical in understanding risks and taking actions to minimize risk exposure during and after the pandemic.

Emerging Risks in the COVID-19 Environment

The unprecedented circumstances of the global pandemic resulted in several prominent and emerging risks:

1 **Charitable Contributions:** With donations on the rise, seemingly philanthropic acts can increase corruption risks and open the door for potentially illegal funds to be disguised as charitable donations. It is important to know the ultimate donation receiver to reduce the possibility of bribery and corruption whether cash or non-cash payments. Due diligence should include

screening against government-maintained lists of restricted or prohibited parties, such as those published by the United States Departments of Commerce, State, and Treasury (Available here: U.S. Consolidated List); and the European Union (Available Here: E.U. Consolidated List).

2 Procurement: Due to the effects of COVID-19, companies were forced to significantly change their procurement processes. Supply chains were disrupted, and large-scale contracts were awarded under far less stringent procurement protocols as governments quickly freed up funds for emergency purchases, increasing opportunities for potential fraud and misconduct. The rush and seemingly looser contracting framework will not stop government agencies from eventually conducting reviews, audits, and investigations. Many of these activities may take suppliers who are new to government contracting by surprise.

- **Supply Chain Impacts—**Companies may feel stress on their supply chain during these trying times and seek alternate arrangements, elevating bribery risks in countries with already high levels of corruption. This could have implications for companies across industries, such as through contract rigging, especially if the government is involved.
- **New Procurement Channels—**As new suppliers are onboarded, typical due diligence procedures may be circumvented due to heightened pressure to fulfill customer orders or deadlines. Doing so leaves a company exposed to third-party risk as standard due diligence measures are flouted. Furthermore, those suppliers may be unvetted and unproven new vendors, whether a newly formed company or an existing company selling a new product. If a government contract has sourcing restrictions, limiting the acceptable countries of origin, getting products quickly to meet demand, could lead companies to use unacceptable, alternative sources.
- **Emergency Purchases—**Companies must be cautious to minimize undue risks from emergency purchases for immediate stakeholder benefits. Risk of financial loss is heightened as companies may overpay for scarce products or services . Governments are suddenly purchasing medical supplies and food products for their citizens, increasing bribery and corruption risk. For example, usual bidding requirements and fair-pricing approaches for contracts may not be followed as governments rush to equip their countries to fight the pandemic.
- **Product Delivery—**Companies may experience delays in obtaining products ordered, increasing risks at ports of entry. In addition, products delivered may be of poorer quality than products expected. Pressure to meet clear border requirements, meet tight timelines, and avoid contract-based delay penalties, can lead companies or third-party service providers to engage in questionable practices.

3 New Products & Services: Although companies must adapt to the evolving pandemic-related needs of clients and consumers by offering new products and services and working with new vendors, doing so can introduce new and unknown risks. New methods of sales and distribution (e.g., e-commerce), when rapidly introduced, can increase reputational risks, as there may not be appropriate controls in place to prevent mistakes in supply chain and distribution. Raw materials sourcing and problematic manufacturing practices could result in products that don't meet contract or regulatory standards, or even worse, violate applicable laws. Having stable, established diligence practices will help companies navigate these unchartered waters.

Steps to Update Risk Assessments

To account for emerging and heightened risks, companies should enhance their risk assessment process by taking these steps:

1 Re-evaluate risk assessment scope: Determine whether to conduct a company-wide risk assessment or focus on key risks specific to ongoing or changed conditions due to the pandemic.

2 Reassess Inherent Risks: Review a combination of existing external and internal sources (i.e., previous risk assessments, employee surveys, events, audit findings, expected changes in revenue sources) to understand changes in risks since the pandemic began. Thorough risk assessments consider perspectives of leadership and staff by facilitating brainstorming sessions. External interviews of stakeholders, advisers and third parties may assist in comprehending emerging industry risks.

- Assess the potential for fraud, bribery, corruption, and antitrust, but also consider industry-specific risks to identify and understand potential areas of misconduct.

3 Reassess the current control environment and COVID-related residual: Periodically assessing control effectiveness and considering new control gaps in the new COVID-19 environment is key. Companies must avoid over-reliance on existing controls, acceptance of current practices, and resistance from management and staff to develop awareness of control effectiveness.

4 Take action: Develop and update policies, processes, robust internal controls, and training for gaps identified during the assessment.

- Take further steps in the due diligence process by undertaking supplementary procedures, such as engaging in virtual due diligence conversations or conducting additional analysis to understand the possible impacts of engaging certain vendors (e.g., import/tariffs, added costs).
- Conduct training on updated or new processes, including reminders for employee conduct and compliance, and the consequences of any misconduct. Reinforcing a culture of compliance and integrity through trainings emphasizes the link between culture and conduct and serves as a backstop against misconduct, particularly for schemes and scenarios impossible to predict.
- Assess and enhance internal controls, add new controls where processes are updated, and document any changes to control processes. In assessing internal controls, both design and operating effectiveness should be tested. Design effectiveness refers to whether the control activities, if they operate as prescribed by persons possessing the authority and

competence, mitigate the risk. Operating effectiveness refers to whether the control activities operate as designed and whether personnel performing the processes and controls possess the authority, resources and competence to effectively perform the processes and controls.

Increase Focus on Risk Assessments

Scrutiny from Brazilian national authorities around potential misconduct arising in the ever-evolving COVID-19 climate calls for increased visibility into fluctuating risk profiles. Some Brazilian businesses are already ramping up implementation of compliance procedures (e.g., whistleblower hotlines) as their risk assessments reveal new, high-risk areas. Companies must proactively address new or heightened risks to protect from potential wrongdoing caused by the dynamic Brazilian work environment. Proper risk assessments are essential to updating risk profiles as the pandemic continues to impact the business environment.

About the Author

Patrícia Latorre, a Partner with StoneTurn, has 20 years of external audit and fraud investigations experience. Specifically, she is an external audit specialist in fraud risk assessment and prevention procedures.

Patrícia has also led and taken part in anti-corruption engagements pertaining to the Foreign Corrupt Practices Act ("FCPA") in Brazil, Spain, United Kingdom, Germany, Holland, Belgium, Portugal and Switzerland. She has worked with clients across various industries, including telecommunications, communications, entertainment and media.