

**Countering Fraud for a Competitive Advantage
London Stock Exchange 17 November 2018****Chairman's notes**

The Natural Resources Forum breakfast roundtable on countering fraud took place at the London Stock Exchange on 17 November 2018. In the presence of and with the contributions of counter-fraud specialists, academics, lawyers and those whose companies have been defrauded, we discussed what fraud and corruption is, how it can be mitigated, and lessons learned.

This document summarises the key points made by the speakers in their presentations and in discussion; our meetings are conducted under the Chatham House Rule, so the notes do not ascribe individual speakers to comments.

I trust you find the notes useful.

Fraud and corruption are endemic

All organisations experience fraud: "The probability of fraud is 1"

It is a cost but it's hidden: some 3-7% is lost to fraud, though note the cost is far more than 4% - change of rating can take you from 8xEBITDA to 4xEBITDA

Fraud by definition avoids controls.

Fraudsters are not born – but take advantage of an opportunity

Whereas in corruption there is the "corrupter pathogen" – someone determined to corrupt others

Don't be fooled – it's very close to home - for example, Danske Bank EUR180bn through Estonian institution.

Why is mining prone to regular scandals?: Much of world's natural resources found in places which have lower levels of behaviour than the UK. The sector is all about hope and potential – what is a reserve? What is the geology? These all lead to subjective interpretations. An inherent problem is a hope for something bigger.

Countries with high risk of corruption has unsophisticated systems and controls

Mining particularly is in a situation where flag bearers in the sector regularly get into trouble.

Mitigations can be put in place

Mitigation can be highly valuable: one example: Serious competitive advantage – reducing losses by 40% Y1 to 60% in 4 years.

Fraud detection is a sign of good company health.

Fraud loss measurement:

- Measure it.
- Don't focus on the detected levels
- You can't arrest your way out of this.
- Create the ethical culture.

Key to dealing with fraud is to understand why people do it

Three elements of the fraud triangle – opportunity/pressure/rationalisation

Strategy – reduce opportunities, look at system, focus on the people

Monitor red flags

Create an effective culture

Need to understand the difference between “sharp business practice” and fraud

Build effective policies: Policies are most often set up at the head office level – should be created bottom up. Build policies around the companies and their issues.

Need a sense of proportionality. For “low grade” fraud and corruption, consider – do you need to self-report? What systems did you have? How were they circumvented?

Remediation? How to move forward? – these things will inform your decision to self-report

Understand the political climate: “Ultimately jurisdiction can trump anything”. Political agenda informs investment climate and sometimes fraud can be used as a tool of government – allegations of fraud used to challenge ownership of companies.

Build policies understanding the local environment: Head office/in country operators – major difference in the experience. To unearth fraud you need to get in country.

Lessons learned

The Board

Don't take what you're told by executive management for granted. Defrauders will cover up.

Investors will have a sense of the company.

Look at the culture – is there complete and open access? (siloed businesses allow the top much more control)

Spend more time with management and staff – but this must not be a formal process.

Spend time with investors – don't rely on what you're being told.

Checks and balances are put in place by management and everyone knows what they are (so they can be evaded)

Internal audit should be via the Chairman of the Audit Committee. External audit provides false confidence.



You need to be present – get the smell test – “something is happening but we don’t know what it is.”

Whistleblowing process must be independent and go to the Senior NED.

Learn from history: powerful individuals can lead companies astray. Culture at the top is very important. To unearth the fraud you need to get in country.

Need powerful non-exec directors

General Lessons

Extractive industries are people businesses– people develop reputations, but reputation is not a guarantee.

Focus on deterring the board at the outset.

Related parties, esp in EU – counterparties, fellow directors &c – both formal and in country – this is a high percentage of your fraud.

Need a clear answer to a simple but important question – if you don’t get one, you have a problem.

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