

Foreign Corrupt Practices Act: Dormant No More

The Foreign Corrupt Practices Act (FCPA) prohibits U.S. businesses from bribing foreign officials and requires public companies to, among other things, maintain accurate books and records. Although the FCPA has been around for more than 20 years, regulatory oversight and enforcement action have intensified as a result of public outcries against corporate excess and corruption. Businesses with an international presence have come under increasing scrutiny, not only because of the FCPA, but due in large part to the auditing and disclosure requirements stemming from the Sarbanes-Oxley Act of 2002 (SOA). By strengthening the accuracy and effectiveness of financial reporting, SOA has caused management to identify potential violations of the FCPA that might otherwise have gone under the radar. International enforcement has likewise increased, as more foreign governments have joined the Anti-Bribery Convention ratified in 1999 by the Organization for Economic Cooperation and Development (OECD). Now accounting irregularities, accusations of bribery and FCPA violations receive widespread coverage by the news media.

As the U.S. Securities and Exchange Commission (SEC) and United States Department of Justice (DOJ) step up their efforts against business corruption on foreign soil, the list of corporate casualties is mounting – and includes some of the biggest and brightest in the business world. Halliburton, Chevron and UPS are under investigation. Monsanto, Tyco International and defense contractor Titan Corporation have all paid fines ranging from \$1.5 million to more than \$50 million. The DOJ has proposed fines as high as \$640 million for DaimlerChrysler. Even with these large penalties making the news, more and more firms are self-reporting potential matters to the SEC, citing possible viola-

tions of the FCPA by their employees, officers and agents.

Why do major corporations agree to pay such large sums, and why do they seem so eager to report accounting errors and other failings to the SEC? Because it may be the least expensive alternative. Simple accounting irregularities can result in fines of up to \$25 million and other statutory provisions, such as the Alternate Fines Act, can double penalties. In addition to fines and disgorgement of profits, sanctions can include bans on contracts with state and federal authorities, cancellation of government contracts, imposition of additional reporting requirements and compliance monitors, or even imprisonment. Beyond that, failure to have sufficient internal controls to prevent, deter, and detect fraud – including likely violations of the FCPA – may result in a material weakness within an organization's system of internal control, impacting its financial statements as well as providing grounds for additional penalties and/or shareholder lawsuits. With a regulatory settlement, the costs, delays and uncertainties of prosecution are eliminated, and unpleasant media scrutiny is minimized.

At first glance, the prohibitions on bribery and the requirement to keep “reasonably detailed” financial records seem to be simple common sense: U.S. companies may not bribe any foreign official in order to obtain or continue doing business. Nor can U.S. companies employ foreign agents to do the dirty work of bribery for them. But common sense alone will not protect a company from the harsh penalties of the FCPA.

Understanding the requirements and prohibitions of the FCPA is essential to any organization that strives to succeed in today's global market. As outsourcing increases and more businesses seek the

rewards of a global presence, the risk of running afoul of the FCPA likewise grows. Careless accounting practices or inadequate financial controls may subject a company to sanctions, even if it has not engaged in bribery. Worse, a company can inherit liability from an organization when it acquires a business that had previously engaged in illegal conduct. Even if organizations have FCPA programs and policies in place, but do not provide adequate training or communication to employees or agents regarding expectations of ethical behavior, they may find themselves in violation. This is especially true where the “tone at the top” espouses corporate compliance but “management mentality” provides incentives or pressures to “get things done.”

Red Flags

Most businesses do not engage in international operations or sales with the intent of committing bribery. Instead, inadequate training and monitoring of international sales forces, consultants, subcontractors or partners creates an environment where borderline activities or outright corruption can occur regularly, yet remain hidden. When doing business in countries where many organizations are government-owned or operated, the ability to recognize who is a government official also can become complicated.

To avoid inadvertent violations of the FCPA, an enterprise must make sure that its personnel and agents aren't simply informed about the accounting and anti-bribery provisions; it must obtain their commitment to abide by those provisions and to immediately report any potential violations.

Some violations are frighteningly banal. For example, expenses that are deliberately mischaracterized on employee requests for reimbursement constitute a

violation of the record-keeping provisions and are sufficient to impose penalties. Even if the mischaracterization seems trivial or has no net fiscal effect, it is a violation. Most of the prosecutions brought by the SEC have been under these accounting provisions rather than the anti-bribery laws. Properly characterizing travel, entertainment and hotel expenses is essential, as is maintaining accurate, detailed financial records of transactions.

Management may have difficulty in recognizing the indicators that point to the more serious violations of the FCPA anti-bribery provisions that can lead to criminal liability. To assist in reviewing records and data for such indicators, the DOJ has recommended looking for “red flags” or circumstances that should alert managers to potential FCPA violations, especially when negotiating a new business relationship or engaging the services of a foreign consultant.

Managers responsible for foreign branches or foreign consultants who insist on unusually high commissions, demand additional payments during critical negotiations or who request atypical financial arrangements may indicate that funds are intended to pay bribes to obtain government approval of necessary licenses or contracts. An apparent lack of qualifications or resources on the part of a joint venturer may be indicative of an enterprise that relies on bribes or “favors” to obtain government contracts. Unusual payment patterns or a lack of transparent accounting methods and records is particularly worrisome.

The presence of “red flags” does not prove that a proposed consultant or partner is “corrupt,” nor does it mean that their services cannot be accepted. But it does suggest that further attention should be paid to background checks and any agreement should be carefully drafted to ensure FCPA compliance.

Even the most commendable corporate behavior can cause problems if not undertaken with care. Donations to legitimate charitable organizations are prohibited when the donation is made at the request of a governmental official or political candidate. Such donations are considered to be the equivalent of indirect payments to the official. If donations

are not consistent with the corporation’s historical patterns of planned giving, they may face additional scrutiny by auditors. Unfortunately, the desire to be a good corporate citizen can become complicated.

Vulnerable Industries and Activities

Some industries and activities are more vulnerable to FCPA violations than others. Defense and aerospace industries, for example, typically contract directly with national governments. Sometimes their personnel and agents are placed in environments where they can be pressured into improper acts. Heavily regulated industries such as telecommunications, construction, oil and energy interact regularly with governmental entities and face similar pressures. Foreign sales and marketing agents are at the aggressive front lines of business, and are particularly vulnerable to performance pressures and the influence of routine local practices that are prohibited by the FCPA.

A corporation may be liable not just for the acts of its employees, officers and agents; it can inherit the pre-existing liability of any business it acquires or forms a partnership with. Consequently, due diligence investigations for proposed mergers and acquisitions must be exhaustive. It was during a due diligence review of Titan Corporation by its proposed acquirer, Lockheed Martin, that substantial FCPA violations were found, which scuttled the deal. Titan eventually entered guilty pleas and paid hefty penalties.

Pitfalls and Opportunities

The extent of risk that a business will face and the type of compliance program it needs to implement depends on the nature and extent of its foreign activities. Country-specific risk assessments must be made. Proper training must be given to all who will interact with government officials or related third parties. Those who approve contracts, make hiring decisions or maintain financial records must be thoroughly educated in the accounting requirements imposed by the FCPA.

Education is not enough, however. An effective compliance program typically includes regular internal auditing and monitoring activities, as well as the use

of an ethics hotline that allows field representatives to discuss situations before they make problematic decisions. When contemplating mergers and acquisitions, in order to avoid some of the dangers of inherited liability, a U.S. firm may seek an opinion letter from the DOJ regarding any questionable practices discovered during due diligence. Implement a “know your agent” rule within your organization. All existing agents should be identified and periodically evaluated to ensure an ongoing business need. Potential agents should be properly vetted by corporate management prior to conducting business on behalf of the company in local overseas markets, and the use of sub-agents expressly reviewed and approved in writing before they are activated in the field.

Although FCPA compliance programs may be considered costly or burdensome, adherence with the accounting provisions can provide a business with the tools to better monitor its finances and deter other types of wrongdoing, from expense account abuses to embezzlement. It also provides a work environment that encourages ethical behavior at all levels and support for managers who may feel pressured to wink at “minor” infractions. With care and diligence, the provisions of the FCPA can be used as an incentive to strengthen an organization’s economic and ethical bottom lines.

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Sources:

The FCPA is codified in Title 15 of the U.S. Code. Accounting requirements are covered primarily by Sec.78m, while the anti-bribery provisions are in Sec.78dd-1 and following.

Foreign Corrupt Practices Act: Antibribery Provisions, U.S. Department of Justice, <http://www.usdoj.gov/criminal/fraud/fcpa/dojdocb.htm>.

The procedures for obtaining an FCPA Opinion from the Department of Justice are found in Title 28, Part 80 of the Code of Federal Regulations, <http://www.usdoj.gov/criminal/fraud/fcpa/opinproc.htm>.