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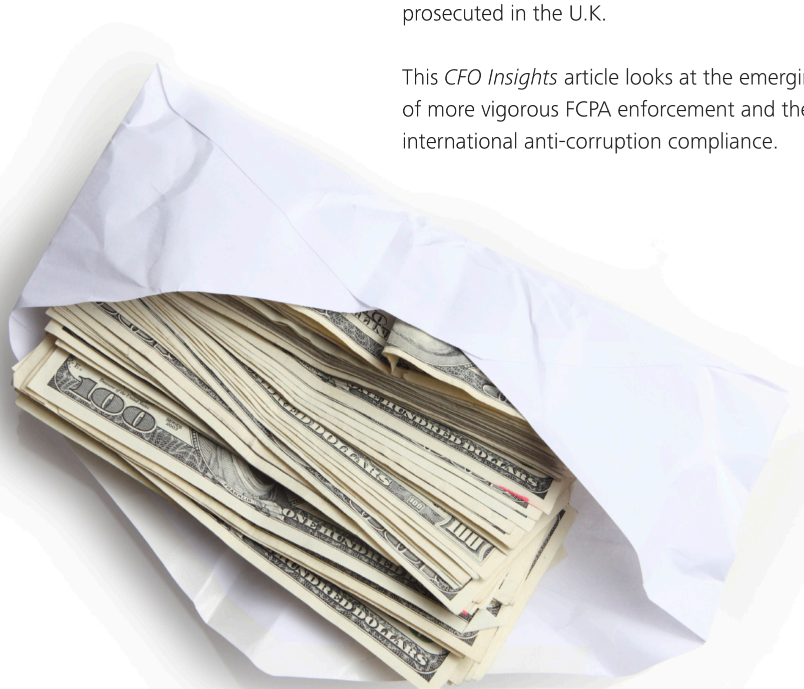
CFO insights:
Foreign Corrupt Practices Act: Some keys to avoiding violations

In 2004, the U.S. Department of Justice (DOJ) charged two individuals and collected $11 million in fines for Foreign Corrupt Practices Act (FCPA) violations.[1] In 2009 and 2010, the DOJ charged more than 50 individuals and collected nearly $2 billion in fines.[2] Using tactics similar to sting operations for federal drug busts and mob crackdowns, the DOJ is enforcing FCPA more vigorously—and making proactive FCPA compliance a critical consideration for Chief Financial Officers (CFOs).

The need is not just U.S.-based. The DOJ has made it known that it intends to align with many of the guidelines and principles embodied in the United Kingdom (UK) Bribery Act of 2010, which goes into effect this summer. That law expands the definition of corruption to encompass not only corruption of government officials, but also commercial corruption—corrupt activities between private entities or non-governmental entities. Under the U.K. Bribery Act, companies doing any form of business in the U.K. are subject to its provisions. Thus, any U.S. company with operations in the U.K. that might have engaged in commercial- or government-related corrupt activities—anywhere in the world, including the U.S.—could be prosecuted in the U.K.

This *CFO Insights* article looks at the emerging implications of more vigorous FCPA enforcement and the need for international anti-corruption compliance.



Corruption: Multiple Reasons for Prevention

Tighter anti-corruption statutes and enforcement practices combined with evolving business strategies make it crucial for CFOs to launch anti-corruption initiatives. In addition to protecting against reputational risk, other reasons for doing so include:

Increasing Penalties and Compliance Costs

Penalties for corruption-based transgressions are increasing. Specifically, the methods of calculating penalties are moving toward multiples based on disgorgement of profits gained from the underlying corrupt activities. For example, if an employee offers a $1 million bribe to get a $20 million contract with a 50% margin, the government might demand the company disgorge the $10 million profit on the contract and pay up to three times that amount in fines. In recent years, this has resulted in penalties in excess of a billion dollars in significant matters. And as a compelling source of funds for governments, such penalties may lead to more frequent and aggressive enforcement actions.

In addition to higher penalties, the costs of investigating and defending FCPA allegations are going up. It is not uncommon for investigation costs on even small matters to range from $1 million to $10 million and in large matters to potentially exceed $50 million. Furthermore, CFOs may have to establish reserves to address penalties as well as disclose the existence of investigations in periodic SEC filings. Both are problematic and may result in derivative problems, such as premature disclosure to the DOJ and third parties, shareholder civil actions, or even increased fines.

Globalization Strategies May Increase Risk

Today, many companies are looking for growth in emerging markets. But many such markets are also hot spots for potentially corrupt activity that may be part of the business culture, despite being locally illegal. In these situations, competitive or other pressures may motivate local employees to adopt practices inconsistent with the values and norms of the parent multi-national. Without increased transparency into local operations, extended oversight, and an awareness of how business is actually done, expansion into emerging markets can pose greater risks than most companies are willing to accept as part of their normal risk appetite.

Third Parties—Blindness is Not an Excuse

In many markets, both emerging and established, companies often use third parties to help establish operations, deal with local regulators for licenses, permits etc., or function as a sales channel. Such dealings mean that an increasing amount of corruption-related risk is now tied to third-party sales channels or other related activities. Under the law, however, if a third-party agent does something corrupt, it may adversely impact the principal company.

As shown by some recent settlements, regulators can act against the principal company even if the latter does not have direct involvement in the corrupt activity but benefits from that activity. This is based on the premise that third parties rarely act without someone's—generally a local on-the-ground salesperson—knowledge. And in this age of texting and e-mail traffic, it is very likely that some evidence will be uncovered that a company employee or manager knew or suspected that a particular contract was won through corrupt activity, such as the payment of bribes. Little wonder that regulators are now aggressively using "willful blindness" and "should reasonably have known or expected" legal arguments as part of their prosecutions.

In addition, there is increasing awareness around countries, cultures, or business activities that might have a higher degree of corruption-related risk, making it more difficult for companies to allege that they reasonably had no knowledge. A case in point is successor liability FCPA risk arising from merger and acquisition activity. These activities typically deserve a higher degree of surgically targeted due diligence on third parties and service providers being inherited to help mitigate the risk of the company could be subsequently being charged with something that they were not involved in nor knew about.

Addressing Corruption Risks

Many companies balance their risk appetite with the costs of compliance on a regular basis. However, in setting up anti-corruption initiatives, CFOs should consider the following actions and tools and not rely solely on the fear of getting caught as the only deterrent.

Internal Controls and Employee Training May Not Be Enough

Companies cannot rely only on typical internal processes and controls to detect and prevent corrupt activity. After all, when people try to undertake illegal activities such as paying bribes, they usually try to hide that activity. They may use false documents, "slice and dice" transactions, third parties to keep "slush" funds, etc. Internal controls, however, are based upon the fundamental premise of the underlying integrity of documentation and an effective approval process throughout. If this assumption proves to be inaccurate, the inappropriate activities will not be detected by normal internal controls. The next time you sign 302 certification, ask yourself these questions: Are you relying on appropriate and effective internal controls to prevent and detect corrupt activities? Or are you waiting for the problem to manifest itself, suspecting that it is likely there? The latter is a reactionary approach that is unfortunately too common.

Similarly, anti-corruption training programs, while useful in informing employees about personal and organizational consequences of corruption, are not enough to prevent it. Not only does anti-corruption training have to be "sticky" for the general employee population, but it has to reach that small group that might circumvent company policies. Thus, you should consider more effective monitoring and "business reality" based approvals of transactions and third parties on a regular basis.

Surveillance and Third-Party Knowledge Are Important

Beyond internal-process controls, additional monitoring may be necessary. Greater automated surveillance of e-mails, data, and transactions increases the likelihood of identifying problems that can be investigated more thoroughly and/or prevented at an early stage (see recent CFO Insights article, Whistleblowing after Dodd-Frank: New Risks, New Responses). Visible, focused surveillance and investigative programs can also signal a company's commitment to its anti-corruption efforts.

Assessing Third-Party Risk Is Crucial

Finally, it is important to conduct effective and appropriate risk assessments and due diligence on third parties acting on behalf of the company. But since most large companies deal with hundreds and thousands of third parties around the world, it is difficult to perform a uniform level of due diligence or even to pick the right parties to address on a sample basis. Differentiated risk-based assessment levels and solutions based on local contexts and cultures can help your finance, internal audit, and compliance staffs undertake more targeted reviews of those third-party risks. As always, CFOs will have to decide how to allocate scarce employee and investment compliance resources.

Unfortunately, for any multi-national, it is extremely likely that some form of corrupt activity on behalf of the company is already occurring. Moreover, the probability of regulators finding out about that activity before the company is increasing, especially given the number of vehicles regulators use to uncover these activities, such as whistleblowers or direct research. In the event you discover a corruption-related problem, work with your General Counsel to choose the best response. This may involve Board involvement, early voluntary disclosure to regulators, regulatory filing disclosure, and external audit investigations, even though substance may not yet have been established to the concern.

If an issue is disclosed and settled, however, regulators increasingly prefer to appoint a monitor to oversee a company's remedial compliance activities. A monitor, generally an external attorney, checks whether the company has appropriate and effective anti-corruption processes and controls throughout its organization. While the monitor reports to the government, the company bears the costs, which can easily total millions of dollars a year. No company enjoys having a monitor and the government looking over its shoulder; it is far more effective to implement proactive risk mitigation and remediation processes and install anti-corruption focused surveillance and compliance processes to prevent yourself from having to be monitored in the first place.

Continuing changes in law enforcement practices and increased regulation around global compliance make it imperative for CFOs to ensure compliance with FCPA and similar anti-corruption laws. Proactive attention and investment by CFOs on effective methods to prevent corrupt activity is not only prudent, but cost-effective.

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Endnotes

[1] U.S. Department of Justice, Assistant Attorney General Lanny Breuer speech at the 24th National Conference on the Foreign Corrupt Practices Act, National Harbor, MD, November 16, 2010, http://www.justice.gov/criminal/pr/speeches/2010/crm-speech-101116.html.

[2] U.S. Department of Justice, Assistant Attorney General Lanny Breuer speech at the 24th National Conference on the Foreign Corrupt Practices Act, National Harbor, MD, November 16, 2010, http://www.justice.gov/criminal/pr/speeches/2010/crm-speech-101116.html.