

SARBANES-OXLEY & ACCOUNTING AND AUDITING ROUNDUP

Foreign Corrupt Practices Act.

A Practical Guide to Compliance and Auditing

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AGENDA

- Discussion of the risks – what, where, how
- FCPA Overview
- FCPA Enforcement
- FCPA Non-Compliance Costs
- Compliance Programs – Key Elements
- FCPA Fraud Risk Assessments
- Current Practices in Monitoring & Compliance
- Cases & Red Flags

What's the Risk? Where Is It? How Do You Know?

Inappropriate stock transfers

Skimming

Fictitious Sales

Tax Schemes

IP Theft

Payroll schemes

Scrap Theft

Misleading Revenue Bookings

Inappropriate Use of Customer Data

Concealed Liabilities

Employee Theft

Inventory Theft

Ghost Employees

Fraudulent Financial Reporting

Corruption

Kickbacks

Bribery

Conflicts of Interest

Fictitious Revenues

Fraudulent Invoicing

Misdirection of Funds

What is the FCPA?

The FCPA, or Foreign Corrupt Practices Act, was passed into law in 1977. It can be broken down into two parts – each a separate offense:

1. Anti-bribery Provisions
2. Accounting Requirements

Foreign Corrupt Practices Act: Anti-Bribery Provisions

- Violations of the FCPA Anti-Bribery Provisions occurs when:
 - A covered person commits an act in furtherance of:
 - Any offer, promise, gift or authorization of,
 - Giving of a thing of value,
 - To a foreign official,
 - Directly or indirectly,
 - To secure an improper advantage,
 - Unless it falls within an exception or a affirmative defense succeed.

Foreign Corrupt Practices Act: Exceptions and Affirmative Defenses

■ Facilitating Payments Exception

- Permits insubstantial payments merely to secure or expedite performance of a routine governmental action (“Grease payments”)
- Does not include any decision by a foreign official to award new business or to continue business with certain entities

■ Affirmative Defenses

- Payment was lawful under the written laws and regulations of the foreign country.
- Payments were made for reasonable and bona-fide expenses such as travel or lodging directly related to:
 - Promotion, demonstration, or explanation of products or services, or
 - Execution or performance of a contract with a foreign government or agent

Foreign Corrupt Practices Act: Accounting & Record-Keeping Provisions

- Requires Issuers to keep accurate books and records
 - Books and records must, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets
 - SEC impose a reasonableness standard rather than a materiality standard when enforcing this provision
 - Requirement extends not only to an issuer's financial records but also to its contracting policies and procedures

- Requires Issuers to devise and maintain an adequate system of internal accounting controls that:
 - Provide reasonable and cost effective safeguards against the unauthorized use or disposition of company assets
 - Provide reasonable assurance that financial records and accounts are sufficiently reliable for purpose of external reporting

FCPA Enforcement: Roles and Responsibilities

- DOJ is responsible for:
 - All criminal enforcement
 - Civil enforcement of the anti-bribery provisions with respect to domestic concerns, foreign companies and nationals
- SEC is responsible for:
 - Civil enforcement of the anti-bribery provisions with respect to issuers of certain types of securities
 - Enforcement of the accounting and record-keeping provisions of the U.S. securities laws



Foreign Corrupt Practices Act (FCPA)

- › [Statute](#)
- › [Legislative History](#)
- › [1998 Amendments](#)
- › [Opinion Procedure Releases \(1993 - 2007\)](#)
- › [Opinion Procedure Regulations](#)
- › [Review Procedure Releases \(1980 - 1992\)](#)
- › [Lay-Person's Guide to the FCPA Statute \(June 2001\)](#)
- › [International Agreements Relating to Bribery of Foreign Officials](#)
- › [Other FCPA & Anti-Corruption Sites](#)
- › [Recent Court Opinions](#)

http://www.usdoj.gov/criminal/fraud/fcpa/

How To Contact Us

Specific questions should be faxed to:

Department of Justice
Criminal Division, Fraud Section
Attention: FCPA Coordinator
Fax Number: (202) 514-7021

E-mail Address: FCPA.Fraud@usdoj.gov

SEARCH

FRAUD ALL DOJ

FRAUD SECTION

- FOREIGN CORRUPT PRACTICES ACT (FCPA)
 - Statute
 - Legislative History
 - 1998 Amendments
 - Opinion Procedure Releases
 - Opinion Procedure Regulations
 - Review Procedure Releases
 - Lay-Person's Guide to FCPA
 - Int'l Agreements Relating to Bribery of Foreign Officials
 - Other FCPA & Anti-Corrupt Sites
- IDENTITY THEFT
- INTERNET AND TELEMARKETING FRAUD
- PRESS ROOM
- CAREER OPPORTUNITIES
- CRIMINAL DIVISION HOME
- DOJ HOME

Who is subject to the FCPA?

- **U.S. nationals and residents and U.S. companies;**
- **Officers, directors, employees, agents, or stockholders of U.S. companies**



Keep In Mind!

A U.S. company, through the actions of its foreign subsidiary, can violate the FCPA.

Source: Foreign Corrupt Practices Act, Gonzalez Rolon Valdespino & Rodriguez, LLC, 2003.

What Does FCPA Non-Compliance Cost You?

■ Criminal

- Companies fined \$2 million per violation
- Individuals fined \$100,000 per violation and/or five (5) years in prison.
- Fines may be higher under *Alternative Fines Act*
 - Up to twice the benefit sought by the action
- Company cannot pay fines on employees' behalf

■ Civil

- \$10,000 per violation for companies and individuals
- In SEC enforcement action, court may impose an additional fine not to exceed the greater of:
 - gross amount of the pecuniary gain; or
 - specified dollar limitation based on the egregiousness of the violation
 - \$5,000 to \$100,000 for a “natural person”
 - \$50,000 to \$500,000 for any other person.
- Attorney General or SEC may exercise civil injunctive and subpoena power

Source: Lay-Person's Guide to FCPA – US Department of Justice

What Does FCPA Non-Compliance Cost You?

(cont'd)

■ Other Governmental Action

- FCPA violator may become ineligible for:
 - Doing business with government
 - Export licenses
 - Conducting securities business
 - CFTC or OPIC agency programs
- Unlawful payments to foreign government officials not tax deductible as business expense

■ Private Cause of Action

- **Treble damages under RICO statute**
- **Actions under other federal or state laws**

Source: Lay-Person's Guide to FCPA – US Department of Justice

Key Components: FCPA Compliance Program

- **Help-line** for questions and guidance
- **Whistleblower program**, i.e., confidential means of reporting concerns or problems
- **Accountability and responsibility** for program assigned to a member of **senior management**
- **Code of ethics/conduct**
 - Current
 - Simple English - easily understood
 - Effectively communicated, disseminated and reinforced
- Specific **FCPA or other anti-bribery policies**
- Protocols and procedures to ensure compliance with code of ethics/conduct or other related policies
 - **Reporting mechanisms**
 - **Training: employees, agents and JV partners**
 - **Certification by employees and agents**
 - **Monitoring implementation and controls**
- **Risk assessment** considerations
 - FCPA risk incorporated into company's risk and control evaluation activities
- **Training and awareness programs**
 - Active and periodic communication with employees, business partners
- **Knowledgeable and active oversight by Board**
- Effective and heightened **due diligence**
 - In-depth background checks of employees, new business partners (alliance, JV's, etc.)
 - Updated background checks of existing employees, business partners
 - FCPA clauses included in new vendor contracts, as well as renewals
 - Vendor right-to-audit clauses
- On-going **monitoring and auditing activities**
- **Disciplinary, prosecution and recovery guidelines**
- **Self-reporting** to government agencies / law enforcement

What Is a “Fraud Risk Assessment?”

Traditional View	<ul style="list-style-type: none">■ Identification and prioritization of key fraud risk at the entity and process level■ Inherent and net / managed / residual ratings based upon significance and likelihood (or “probability”)■ Scenario based, “top-down” approach
Marketplace Interpretation	<ul style="list-style-type: none">■ Assessment of anti-fraud program and controls■ Identification of key fraud risk and controls focused on internal control over financial reporting■ “Labeling” risk / controls after completion of risk and control matrices
Common Challenges	<ul style="list-style-type: none">■ Fraud not defined, causing lack of focus and direction■ Fraud risk not “explicitly” considered■ Decentralized activity with inconsistent approach across organization

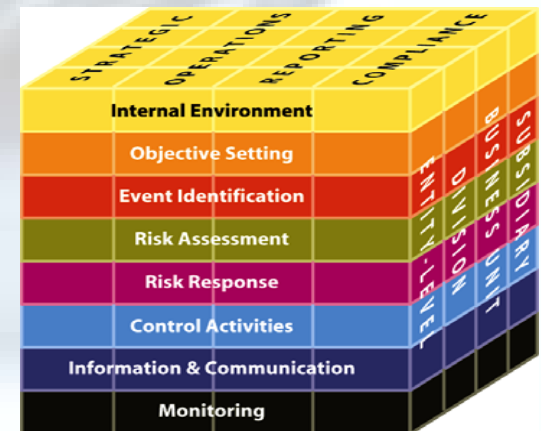
COSO-ERM:

Assessment of Fraud Risk Principle

Attributes of fraud risk assessment include:

- Integral part of risk assessment
- Incentives and pressure
- Considers risk factors
- Considers high-risk areas
- Audit committee oversight

COSO-ERM



Fraud Risk In Context of COSO-ERM

Considers risks in all areas – not just financial reporting

- Organizational culture and ethics
- Determine your organization's fraud risk appetite and tolerance
- Understand fraud risk management objectives
 - SOA compliance
 - IA planning and testing
 - Process improvement
- Identify events that could result in fraud risk
- Sustainable process to assess / measure risk to fraud and misconduct



Critical Considerations for Fraud Risk Assessments: The Top 10 List

1. Objective(s)
2. Definition of fraud
3. Scope
4. Privilege
5. Resources
6. Scenario-based approach
 - Identification of fraud risk
 - Measurement of fraud risk
 - Prioritization of fraud risk
7. Testing of controls
8. Monitoring
9. Documentation of methodology and results
10. Action (not reaction!) plan

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Common Fraud Scenarios: FCPA Risk Assessment

Common Fraud Scenario	FCPA Risk Scheme	Risk type	Key Corresponding Risks
Bribery – FCPA violation.	Slush fund ("account or cash stash") enables "off-books" payments (i.e., kick-back or bribe) that are made by employees or agents to foreign officials in exchange for business.	Misappropriation of Assets	Misuse of existing corporate accounts by Company personnel (i.e., suspense accounts, dormant accounts, etc.) to hide kick-backs or bribes to foreign officials.
		Fraudulent Financial Reporting	Off-the-books corporate bank account established and maintained for purposes of directing payments to foreign officials.
		Misappropriation of Assets	Unrecorded cash receipts and disbursements used to fund cash payments to foreign official or related third-party.
		Misappropriation of Assets	Improper disposal of assets other than cash used to fund slush account (i.e., scrap, inventory, tools, etc.).

Common Fraud Scenarios: (cont'd)

FCPA Risk Assessment

Common Fraud Scenario	FCPA Risk Scheme	Risk type	Key Corresponding Risks
Bribery – FCPA violation.	Employee or agent provides payment(s) to non-agent third parties that inappropriately benefit foreign official or related-third party.	Expenditure or liability incurred for illegal/improper purpose	<p>Excessive fees applied to goods, services, permits, customs, duties or taxes in order to fund kick-back or bribes to foreign officials or related-third parties.</p> <p>Events or sponsorships are used to disguise or funnel funds to foreign officials and/or family members (i.e., training, banquets, fundraisers, conferences, etc.).</p> <p>Facilitated and/or grease payments made by company employees and/or agents that are not in compliance with corporate policy.</p> <p>Inappropriate cash payments made to community liaisons, villagers, farmers, etc. on behalf of foreign official to enable business continuity.</p>

Common Fraud Scenarios: (cont'd)

FCPA Risk Assessment

Common Fraud Scenario	FCPA Risk Scheme	Risk type	Key Corresponding Risks
Bribery – FCPA violation.	Books and records are inappropriately modified in order to conceal bribes and kick-backs to foreign officials and/or related third parties.	Fraudulent Financial Reporting	Fictitious expenses recorded to account for bribes and kick-backs as well as facilitated and grease payments.
			Adjusting entries are made to conceal diverted assets to foreign official or related third party.
	Company personnel or agents provide time, goods and services to either a charitable organization or bogus charity that is owned, operated or influenced by foreign official as a bribe or kick-back.	Expenditure or liability incurred for illegal/improper purpose	Inappropriate expenditure of time, goods and services are either disguised through, or written-off, the Company's books and records as charitable contributions.
		Fraudulent financial reporting	Due diligence is not performed on charitable organizations with which the Company is affiliated.

FCPA Risk Monitoring: What We're Seeing in the Marketplace

- Follow-up on non-compliance with certification / affirmation of Code and related training
- FCPA compliance audits
- Extended “in-country” internal audit procedures
- Quarterly review of payments
 - Agents
 - Vendors
- Enforcement of “vendor-right-to-audit” clause

FCPA Compliance – Proactive & Reactive

PROACTIVE

- Due diligence on foreign mergers & acquisitions
- FCPA risk assessment
- Monitoring of FCPA risk via proactive data analysis

REACTIVE

- Voluntary disclosure of potential violations to DOJ and SEC
- Seek guidance from external counsel
- Internal investigation of potential violations

Lessons from Past Cases

- Understand the context in which you do business locally
 - Compliance programs that are successful in the U.S. may experience challenges in foreign subsidiaries
- Internal control should be proactive, not reactive
 - Devise and maintain internal control
- Due diligence and oversight of agents
- Due diligence on potential business partners
- Reinforce compliance efforts in high-risk countries
- Business culture – set tone at the top about what is acceptable and what is not
- Competition – highly competitive market creates incentives for bribery – be alert for these situations
- Accounting controls – document payments accurately

From the Headlines...

SEC SUES ABB LTD IN FOREIGN BRIBERY CASE

Source: SEC

SEC Files Settled Books and Records and Internal Controls Charges Against El Paso Corporation For Improper Payments to Iraq Under the U.N. Oil for Food Program - - Company Agrees to Pay \$7.7 Million

Source: SEC

Chiquita Brands International, Inc. Consents to Civil Penalty and SEC Cease-and-Desist Order Based on Apparent Bribes Made by Colombian Subsidiary

Source: Wilmer, Cutler & Pickering

**SEC SETTLES CHARGES
AGAINST INVISON
TECHNOLOGIES FOR \$1.1
MILLION FOR VIOLATIONS OF
THE FOREIGN CORRUPT
PRACTICES ACT**

Source: SEC

**U.S. Civilian Translator
Sentenced for Offering
Bribes to Iraqi and U.S.
Officials while Working in
Adnon Palace in Baghdad**

Source: DOJ

Case Study: Dow Chemical

- **An estimated \$200,000 in improper payments were made by a fifth-tier foreign subsidiary in Mumbai, India to Indian government officials from 1996 – 2001.**
- **Dow consented to \$325,000 in civil penalties without admitting or denying the allegations made by the SEC.**
- **The payments were inaccurately reflected in Dow's books and records, and the system of internal controls failed to prevent the payments.**

Source: SEC

Case Study: Baker Hughes Service International

- **APRIL 26, 2007**
- **Pleaded guilty to violating the FCPA Act**
- **Violations of anti-bribery provisions, conspiracy to violate the FCPA Act, aiding and abetting the falsification of the books and records**
- **Pay criminal fine of \$11 million**
- **Adopt a comprehensive anti-bribery compliance program**
- **Reached a separate settlement with the SEC - will pay \$10 million in civil penalties and \$24 million dollars in disgorgement of profits**
- **Total of \$44 million in fines is the largest monetary sanction ever imposed in an FCPA case**

Source: Houston Business Journal

Case Study: York International / Johnson Controls

• **OCTOBER 1, 2007**

Findings

- York was acquired by Johnson Controls in 2005
- From 2003 – 2004 paid 13 bribes totaling \$550k to UAE officials
- From 2000 – 2003 paid kickbacks totaling \$650k for “after sales service fees” to Iraqi controlled accounts in connection with sale of goods under the Oil for Food Program
- 2001 – 2006 York made illicit payments of \$7.5 M in “consultancy payments” to secure 774 contracts in the Middle East, China, India and Nigeria

Ordered to disgorge	\$ 8.9 M Profits
	1.1 M Pre-judgment interest
	2.0 M Fines
TOTAL	<u>\$12.0 M</u>

FCPA Risk Monitoring: Red Flags

- Rumors regarding unethical or suspicious conduct by an employee, marketing representative, consultant or other business partners
- Unnecessary third parties or multiple intermediaries
- Request for payment to a third party rather than the consultant
- Requests for payment in a third country
- Business in a country with bribery problems
- Requests for payment in cash
- Requests for excessive commissions or other payments
- Political contribution
- Requests for reimbursement of expenses that are poorly documented
- Incomplete or inaccurate information in required disclosure
- Refusal to certify compliance

Speaker Contact Information

Know Risk. Know Reward.™

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Independent Risk Consulting

Business Risk

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Internal Audit

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