**Best Practices During an FCPA Enforcement Action: The Armor Holdings NPA**

As reported by the FCPA Blog, the Wall Street Journal and numerous others, on July 13, 2011, Armor Holdings Inc., entered into a Non-Prosecution Agreement (NPA) with the Department of Justice (DOJ) to pay a $10.29 million penalty to resolve violations of the Foreign Corrupt Practices Act (FCPA). Contemporaneously, Armor Holdings settled a civil enforcement action brought against the company by the Securities and Exchange Commission (SEC) and agreed to pay a total of $5,690,744 in disgorgement, prejudgment interest and civil penalties in order to resolve the SEC action. These fines and penalties were in conjunction with Armor Holdings series of contracts with the United Nations (UN) for supply of body armor for use in Iraq.

An interesting side note is that the British company BAE Systems, Inc., acquired Armor Holdings but we note that it was in 2007, after the conduct in question took place. Nevertheless, this case has significant implications for the compliance practitioner. We will give some detail to the books and records scheme used by the company to disguise its bribes and then detail some of the factors listed by the DOJ in its Press Release (the NPA is not available as of the posting of this blog). These factors listed by the DOJ clearly show that a sustained, committed effort to cooperate with the DOJ and SEC in the investigation, coupled with a robust remediation program going forward can significantly help a company overcome what may appear to be clear facts which would seem to warrant a criminal penalty, in addition to a civil action.

***Distributor Net Accounting***

a. The Scheme

Armor Holdings made sales through certain unnamed third party intermediaries. The contracts were awarded from 2001 through 2006. The accounting basis of the scheme was an accounting system described as “Distributor Net” which was worked by the company to disguise more than $4.3 MM in commissions paid to these third party intermediaries. These third party intermediaries never received title to the goods in question. Under such a sales system, according to US Generally Accepted Accounting Principles (GAAP), Armor Holdings should have recorded the sale to the UN at the full or "gross" sales price - with a separate display of any commission expense for amounts paid to an intermediary.

However, Armor Holdings would send the customer a "gross" invoice, including the sales price of goods sold, plus commission, while internally recording sales at a "net" amount that did not include the commission due to the third party sales intermediary. Thus, amounts received from the customer would be greater than the amount booked internally for a sale, resulting in a credit balance in the customer's account receivable. Armor Holdings would then transfer the "overpayment" through a series of non-commission accounts before ultimately disbursing it to the third party sales intermediary. These payments to sales intermediaries under the scheme were never recorded as a commission expense on the books and records of the company.

b. Notice to the Company

As early as March 2001, the company's outside auditor "emailed comments to certain senior officers, indicating that the "distributor net" practice understated accrued liabilities and accounts receivable; and that the company should record a receivable for the gross amount due, together with an accrual for commissions." In September, 2005, the comptroller of "another Armor Holdings subsidiary who had refused to implement "distributor net" at his division advised senior officials at AHP and Armor Holdings of his concern that such accounting was "blown out of the water" by GAAP." The SEC Complaint noted that even with the admonitions Armor Holdings engaged in "at least 92 transactions from 2001 through June 2007 - resulting in approximately $4,371,278 of undisclosed commissions on the books and records of Armor Holdings, and rendering those books and records inaccurate."

***Non-Prosecution Agreement***

As noted above, Armor Holdings was able to negotiate an NPA for these accounting sins. Although the NPA is not currently available, the DOJ did list several factors, in its Press Release announcing the settlement, which led to the NPA. These factors included:

- Armor Holdings complete voluntary disclosure of the conduct.
- Armor Holdings internal investigation and cooperation with the DOJ and the SEC.
- That the conduct took place prior to the acquisition of Armor by BAE.
- Armor Holdings extensive remedial efforts undertaken before and after its acquisition by BAE.
- Armor Holdings implemented BAE's due diligence protocols and review processes.
- Armor Holdings applied all of BAE's compliance policies and internal controls to each of its businesses.
- Armor Holdings had engaged in extensive remediation and improvement of its compliance systems and internal controls.

Armor Holdings also agreed to "enhanced compliance undertakings" in the NPA but we will have to wait until the NPA is released to see what those may be. While the DOJ Press Release noted that Armor Holdings would not be required to retain a corporate monitor, the company had agreed to report to the department on implementation of its remediation and enhanced compliance efforts every six months for the duration of the agreement. Lastly the NPA requires that Armor Holdings continue to implement rigorous internal controls and that it cooperate fully with the department.

The clear import of this NPA is that a company can come back from the edge of the abyss through thorough and sustained cooperation with the DOJ. Armor Holdings had 92 separate instances of disguising bribes yet was able to obtain a NPA. The lesson learned is clear: self-disclose, clean house, remediate and implement a *best practices* compliance program and your company may well be able to extricate itself without landing on the "***Top Ten of All Time FCPA Settlement List***".

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