The Hallmarks of Effective Compliance

What the Government Expects to Find in an Anti-Corruption Compliance Program

By Brian O'Bleness

Similar to Foreign Corrupt Practices Act enforcement generally, the federal government has expanded what it expects to find in an anti-corruption compliance program.

U.S.-connected companies operating internationally face significant legal risks from the U.S. Foreign Corrupt Practices Act (FCPA) if employees or agents bribe or promise to bribe the expansive class of people known as foreign officials. The U.S. Securities and Exchange Commission (SEC) and the U.S. Department of Justice (DOJ) reemphasize FCPA enforcement as a continuing priority by their clear and frequent actions and words. Here, I address what the government would expect to find if it reviewed your client's company FCPA compliance program.

Brief FCPA Background

In 1977, Congress passed the FCPA, making it illegal for U.S. companies, their employees, and their agents, in the United States or abroad, to pay or to offer to pay, anything of value, to any foreign government official or foreign political party for the purpose of obtaining or retaining business. Because it is a criminal statute, there must be corrupt intent.

One formulation of the crimes covered in the act is that a person or a company is guilty of violating the FCPA if the government can prove that:

1) a payment, offer, authorization, or promise to pay money or anything of value
2) was made to a foreign government official (including a party official or manager of a state-owned concern), or to any other person, knowing that the payment or promise will be passed on to a foreign official,
3) with a corrupt motive,
4) for the purpose of influencing any act or decision of that person, inducing such person to do or to omit any action in violation of his or her lawful duty, securing an improper advantage, or inducing such person to use his or her influence to affect an official act or decision, to assist in obtaining or retaining business for or with, or directing any business to, any person.

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In additional to the bribery elements, there are accounting provisions penalizing the lack of internal controls and books and records provisions for improperly recording bribes as other than bribes. The act has both criminal and civil penalties, and it applies to both public and private U.S. companies everywhere that they do business with and therefore, also to their business partners. The DOJ and the SEC have been very aggressive with every aspect of FCPA enforcement, from interpreting jurisdictional reach and finding intent, to defining gaining and retaining business. Many countries have similar laws or conventions even if they do not enforce them.

Since the early 2000s, FCPA enforcement has been increasing steadily and evolving. No theory goes out of style completely; however, some theories wax and wane over time. Because cases are seldom tried except by individual defendants, guidance about the FCPA is offered mostly by reviewing prosecution agreements, speeches by agency officials, the sentencing guidelines, and new in 2012, the joint guidance from the SEC and the DOJ.

That story line is the same for guidance to developing an FCPA compliance program. The polestar for many years was the U.S. Sentencing Guidelines. First, section 8B2.1 offered some guidance on what an "effective compliance and ethics program" required, including (1) creating policies, procedures, and controls; (2) exercising oversight; (3) due diligence; (4) training; (5) monitoring and auditing; (6) enforcement and discipline; and (7) appropriate response and future prevention. And these programmatic elements, if present, potentially offer sentencing credit if a company finds itself involved in a prosecution.

In November 2012, the SEC and the DOJ released the long-anticipated guidance specifically focused on the FCPA. *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (Nov. 2012). The resource guide offers 10 "hallmarks" of effective compliance programs that the agencies expect to see in programs today. As Andrew Ceresney, the SEC Enforcement Division director, said recently,

> [t]he best companies have adopted strong FCPA compliance programs that include compliance personnel, extensive policies and procedures, training, vendor reviews, due diligence on third-party agents, expense controls, escalation of red flags, and internal audits to review compliance. I encourage you to look to our Resource Guide on the FCPA that we jointly published with the DOJ, to see what some of the hallmarks of an effective compliance program are.

Andrew Ceresney, U.S. Securities & Exchange Comm'n, Director, Division of Enforcement, Remarks at the CBI Pharmaceutical Compliance Congress: FCPA, Disclosure, and Internal Controls Issues Arising in the Pharmaceutical Industry (Mar. 3, 2015), http://www.sec.gov/news/speech/2015-spch030315ajc.html (last visited May 11, 2015).

The resource guide makes the critical point that no "one-size-fits-all" compliance program exists. It is essential that a compliance program reflect the reality of the company developing and maintaining it, including its size, type of business, industry, and risk profile. The hallmarks are "meant to provide insight into the aspects of compliance programs that DOJ and SEC assess." The hallmarks are for the most part self-explanatory. And while the government included all 10 because all 10 are important, and the government expects to see all 10, like a trip to the zoo, I have my favorite animals, and you will sense that below. I present them in the order that they appear in the resource guide; however, from my perspective, life begins with assessing risk, as discussed below.

Hallmarks of an Effective Compliance Program

The hallmarks of an effective compliance program that the SEC and the DOJ expect to find in a an FCPA compliance program are (1) commitment from senior management and a clearly articulated policy against corruption; (2) code of conduct and compliance policies and procedures; (3) oversight, autonomy, and resources; (4) risk assessment; (5) training and continuing advice; (6) incentives and disciplinary measures; (7) third-party due diligence and payments; (8) confidential reporting and internal investigation; (9) continuous improvement, meaning periodic testing and review; and (10) when it comes to mergers and acquisitions, pre-acquisition due diligence and post-acquisition program integration.

Commitment from Senior Management and a Clearly Articulated Policy Against Corruption

The agencies believe that a program should begin at the top, be clearly stated, and disseminated throughout the organization.

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The common formulation for this is "tone from the top." If the top of an organization is not buying into a compliance program, the rest of the organization will not be buying into a compliance program; without support from the top, the compliance program will struggle, there will be a few champions from some department, and the FCPA will not take root and will not become the responsibility of the operating parts of the company.

Code of Conduct and Compliance Policies and Procedures

A code of conduct and compliance policies and procedures need to be clearly written, concise, and accessible to all employees. The clearer these are, the easier it is for employees to grasp the information and use it. And by the way, translate these into the local language. While having a written policy is important, unfortunately many companies stop here with the statement that a company has a written policy not to bribe. Not good enough. Even written materials need to be tailored to the organization, and they need to be thoughtful, but an FCPA program consists of much more than written policies.

Oversight, Autonomy, and Resources

A company must assign adequate personnel of adequate rank with adequate

resources to accomplish compliance. This is about commitment by an organization. Each of these hallmarks reflects the opening caveat that a compliance program must fit the size and the risk of an organization, but this hallmark, "oversight, autonomy, and resources," also means that a program must still have standing, access, appropriate people, and a budget to function.

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Risk Assessment

Here we are. Risk assessment is critical. It is an obligation of a company to assess its risk to make sure that it will have an appropriate compliance program. I would call this job number one. If a company does not understand the risk that it faces, there is no way to design a program that prevents, detects, and remediates that risk. Assessing risk also goes to the heart of the question of how to fit a compliance program to a company. Burdening a company with a compliance program that is too large, too complex, too cumbersome, too onerous, or too anything else will result in program failure. In addition, "off the shelf" programming does not necessarily address a company's risk. Thoughtful, up-front risk assessment will save effort and focus a program on real risk. In addition, risk should be reviewed periodically because companies change over time.

Training and Continuing Advice

Again, training and continually seeking advice is critical. Training disseminates and communicates a compliance program. The government agencies will use this as a proxy for program effectiveness. Having a program in the box does not do the business development person in Faraway Country any good if he or she hires an intermediary who is a pass through; instead, training that business development person on the FCPA and the elements of the company's compliance program is essential.

Incentives and Disciplinary Measures

The incentives and disciplinary measures hallmark involve carrots and sticks, and the federal guidance is clear that both incentives and disciplinary measures should be available all the way up and down an organizational chart. Disciplinary action should be meted out in an even-handed fashion; but positive reinforcement should exist in equal part.

Third-Party Due Diligence and Payments

Most recent corruption cases have involved a third-party that caused trouble for a company. Third parties create enormous continuing risk area for companies, so completing front-end due diligence on third-party agents is critical. A company cannot operate without a program for vetting agents, consultants, sales agents, business partners, tax representatives, customs brokers, labor negotiators, fixers, or whatever. If an agent has any type of interaction with any government official—and that definition is very broad—there is risk, and the due diligence obligation cannot be ignored. If the risk is higher, the diligence should be deeper. If there are red flags, those red flags should be considered and answered thoughtfully. If a government investigation involving an agent opens, the following conversation with a main federal lawyer will take place in some fashion: Did you do diligence on this service provider? Where is your file? Did you see these red flags? What did you do in response? Why did you use this agent in the face of these red flags?

A company can defend its position better when it has a file that documents third-party vetting, when the company has considered the red flags, and when the file has documented this consideration. There may be differences of opinion about what the business decision should have been given the information learned, but if the due diligence process is not undertaken, the government will not find what it expects to find in a company's compliance program. Risk-based due diligence and evaluation of payment arrangements are the two key elements to mitigating third-party agent risk.

Confidential Reporting and Internal Investigation

The resource guide suggests that a company should have a means of confidential and anonymous reporting that would involve a mechanism to follow up a report with an effective internal investigation by the company.

Continuous Improvement: Periodic Testing and Review

The government expects that a compliance program will be tested. It is only through operating a program, testing how it does operate, auditing the results, and improving the program that a program will continue to fit the company that uses it.

Mergers and Acquisitions: Pre-Acquisition Due Diligence and Post-Acquisition Program Integration

For acquisitive companies, having this hallmark is important. Offshore acquisition can be fraught with surprises. Programmatically, the work should be done up front to find out what a company will receive with an acquisition or merger, and as soon as the company owns it, the work of bringing the new part of the organization into the existing compliance program should begin.

Internal Controls for Anti-Corruption

In addition to the 10 hallmarks explained above, an FCPA compliance program should have internal controls to guard against corruption. To be up front though, precisely what internal controls for anti-corruption cover and their purpose is the subject of debate. Among financial professionals, internal controls typically have to do with protecting against events related to materiality. But because this article seeks to explain what the government expects to find in an FCPA compliance program, I discuss here the anti-corruption internal controls that the SEC will expect to find in an FCPA compliance program. Similar to every other aspect of FCPA enforcement in the last 10 years, the federal government has interpreted the FCPA in ways that expand what anti-corruption controls should cover, and the government expects to find those controls, but this is where we are today.

Anti-corruption controls are both financial and operating controls that pro-

vide system checks to help prevent rogue employees, or company agents, from passing a bag of company cash to a government official in an undetected fashion. And, to be clear, from the SEC's perspective, these controls should be designed in a way that small leaks of cash, or small amounts anything of value, should be preventable and detectable. The accounting controls must include basic things such as proper delegations of authority, appropriate supporting documentation for approval, documenting transactions accurately, regular monitoring and auditing, and training for financial personnel in fraud and anti-corruption. A company should have some other FCPA-specific internal controls as well.

New Vendor Add Process

In addition to the internal controls already mentioned, a company should adopt some internal controls around the new vendor add process both tied to accounting so that a vendor cannot be paid until the required information is obtained and tied to due diligence so that the vendor cannot be added until due diligence is completed.

Accounts Payable

A series of controls should be built into accounts payable to ensure that the types, amounts, and payees are legitimate and accurate.

Expenses

Controls around expense reimbursement should reflect the written policies for travel and entertainment, including amounts, approvals, and supporting documentation. If preapprovals are required for entertaining certain customers, those controls must be enforced.

Petty Cash

Petty cash is the source of trouble for a lot of companies, and the tighter the cash controls the better. In cash economies, petty cash is sometimes necessary and sometimes the amounts can be large. The larger the exposure, the more important cash controls are. There should be written policies regarding use, limits, approval, and supporting documentation. Because of the potential exposure, the supporting documentation may require some level of detail that should be described in the policy.

Ceresney recently summarized his thoughts on internal controls as follows:

> in cases we have brought, we see controls that were not carefully designed to match the business, or that were not updated as the business changed and grew. And we see that senior leadership was not asking the tough questions—and sometimes not even asking the easy questions. Senior management in some cases was just not engaged in any real discussion about the controls. As a result, employees did not properly focus on them and the firm and its shareholders are put at risk.

Ceresney, *supra*.

Trying not to wander too far afield on this topic, there is an initiative in the United States that has attempted to address internal controls and other related topics called "COSO," after the Committee of Sponsoring Organizations of the Treadway Commission. COSO members collaboratively have developed a framework for internal controls referenced or used by many organizations.

The government certainly expects to find internal controls that prevent corruption and a proper focus on those internal controls by employees and management.

Recent Enforcement Actions

The four enforcement actions discussed here can teach us all some lessons about compliance programs.

Goodyear

In this enforcement action, "Goodyear failed to prevent or detect more than $3.2 million in bribes during a four-year period due to inadequate FCPA compliance controls at its subsidiaries in sub-Saharan Africa." Press Release, U.S. Securities and Exchange Comm'n, SEC Charges Goodyear with FCPA Violations (Feb. 24, 2015), http://www.sec.gov/news/pressrelease/2015-38.html. (last visited May 11, 2015). Goodyear employees paid cash bribes to police, city council officials, and others and then recorded the bribes as legitimate business expenses. The DOJ did not file charges under the anti-bribery provisions of the FCPA in the case. So this was a books and records, internal controls case. But it was a compliance program case, which involved $3.2 million in bribes (not a small amount, true), over 4 years in Goodyear's African subsidiaries consolidated in Goodyear's books. Goodyear paid $16 million to settle the SEC action. This is the most recent case covered here, so the opening sentence of the press release provides us with guidance on the SEC stance at present on what it expects to find in a company's compliance program. Goodyear's compliance program failed to "prevent and detect" the cash bribes to police and local officials in offshore subsidiaries. So, whatever elements are necessary to get that job done, the SEC expects to find those elements.

Weatherford International

In November 2013, the oilfield services company Weatherford International was charged with violating the FCPA by offer bribes and providing improper travel and entertainment for foreign officials in the Middle East and Africa to win business. The bribes included kickbacks in Iraq to obtain United Nations oil-for-food contracts. There also were commercial transactions with Cuba, Iran, Syria, and the Sudan that violated U.S. sanctions and export control laws. According to the SEC, Weatherford failed to establish an effective system of internal accounting controls to monitor risks of improper payments and to prevent or to detect misconduct. Weatherford paid more than $250 million to settle the SEC and the DOJ' charges.

In discussing the case last year, Assistant Attorney General Leslie Caldwell said,

> In this day and age—more than a decade after the Sarbanes-Oxley Act—we come across very few companies that do not have any compliance program.… Before 2008, the company had little more than a weak paper compliance program. The subsidiaries admitted that the company did not have a dedicated compliance officer or compliance personnel, did not conduct anti-corruption training, and did not have an effective system for investigating employee reporting of ethics and compliance violations.

Leslie R. Caldwell, Assistant Attorney General, U.S. Dept. Justice, Criminal Division, Remarks at the 22nd Annual Ethics and Compliance Conference (Oct. 1, 2014), http://www.justice.gov/opa/speech/remarks-assistant-attorney-general-criminal-division-leslie-r-caldwell-22nd-annual-ethics (last visited May 11, 2015).

Layne Christensen

In October 2014, SEC settled with Layne Christensen for a modest fine and disgorgement of $3.9 million in profits related to various improper payments in Africa. The DOJ declined prosecution in the case. After conducting its own investigation and cooperating with the government, Layne made changes to its program described by the SEC, which provide insight into important programmatic elements.

> Layne Christensen also took affirmative steps to strengthen its internal compliance policies, procedures, and controls. Layne Christensen issued a standalone anti-bribery policy and procedures, improved its accounting policies relating to cash disbursements, implemented an integrated accounting system worldwide, revamped its anti-corruption training, and conducted extensive due diligence of third parties with which it does business. In addition, Layne Christensen hired a dedicated chief compliance officer and three full-time compliance personnel and retained a consulting firm to conduct an assessment of its anti corruption program and make recommendations.

In the Matter of Layne Christensen Company, SEC Release No. 73437, Cease & Desist Order (Oct. 24, 2014), at 11.

Smith & Wesson

Last fall, Smith & Wesson consented to an SEC order in which no specific bribes were alleged. Instead, "Smith & Wesson failed to devise and maintain sufficient internal controls with respect to its international sales operations. While the company had a basic corporate policy prohibiting the payment of bribes, it failed to implement a reasonable system of controls to effectuate that policy." The SEC press release went on to state that "[t]his is a wake-up call for small and medium-size businesses that want to enter into high-risk markets and expand their international sales. When a company makes the strategic decision to sell its products overseas, it must ensure that the right internal controls are in place and operating." Controls that match and keep track of the business and the risks are necessary. The DOJ declined prosecution in the case.

Conclusion

The resource guide, speeches by agency officials, and the paper trails associated with recent prosecutions provide the best source of understanding the details of what the government expects to see in FCPA compliance programs. Scrutiny seems to be closer than ever with the bar rising. It may be time for a periodic review of the risk faced by your client's company. FD