The Next Great Fed Crackdown

The Foreign Corrupt Practices Act is experiencing a resurgence.

By Thomas R. Weirich, CPA, and Steven A. Harrast, CPA

Rooting out shady business deals is becoming big business these days.

The U.S. Department of Justice (DOJ) and the U.S. Securities & Exchange Commission (SEC) together have stepped up their investigations of violations of the Foreign Corrupt Practices Act of 1977 (FCPA). Not to be outdone, the U.K. has added the Bribery Act, with provisions similar to those of the FCPA. In addition, 38 countries have signed an agreement to criminalize bribery of foreign government officials.

With this resurgence in anti-corruption enforcement, corporate managers are looking to bolster internal controls to prevent costly and embarrassing violations. The purpose of this article is to present an overview of the FCPA provisions and the upward trend in enforcement through historical information and examples of recent cases. We'll conclude by identifying red flags that management should evaluate to enhance compliance with the Act.

Enforcement with a Capital "E"

Over the past two years, both the DOJ and the SEC have aggressively brought criminal actions, civil actions, or both against companies and individuals for violations of the FCPA. In 2010 alone, the federal government assessed fines and penalties exceeding $1.8 billion. As of August 1, 2011, the U.S. government had brought charges against 25 more companies or individuals, clearly signaling that the FCPA continues to be a major enforcement objective (enforcement reports are listed at www.fcpablog.com).

Take a look at some of these recent high-profile cases:

◆ During January 2009, the DOJ conducted a sting operation and coordinated arrests on two continents, including 21 arrests at a security products trade show in Las Vegas. The dealers thought they were paying a bribe to an intermediary of a foreign government who turned out to be a Federal Bureau of Investigation (FBI) agent. What happens in Vegas may *not* stay in Vegas!

◆ In 2010, Daimler and its subsidiaries agreed to pay $93.6 million in criminal fines and surrender $91.4 million in profits after being charged with paying illegal gratuities to government officials in at least 22 different countries to secure foreign contracts.

◆ In August 2010, the DOJ settled a probe of bribery at Hewlett-Packard (HP) in which the Justice Department alleged that HP executives paid bribes in Russia. HP agreed to pay $55 million to settle the case.

The first provision of the FCPA criminalizes the bribery of foreign *government* officials in order to obtain or retain business.

In 2009, the SEC announced the reorganization of its Enforcement Division to include a new unit to focus more proactively on FCPA violations. Congress followed up with the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was enacted July 21, 2010. The Dodd-Frank Act provides greater incentives for whistleblowers: When recoveries exceed $1 million, whistleblowers can receive between 10% and 30% based on information they provide. (Using the Daimler case as an example, this would have resulted in whistleblower payments between $18.5 million and $55.5 million.) According to testimony recorded before the bill was passed, whistleblowers are 13 times more effective in uncovering fraud than are external auditors and the SEC. (For more on the topic of whistleblowing, see "Can Ethics Education Impact Whistleblowing?" in the Summer 2011 issue of *Management Accounting Quarterly*, available at www.imanet.org under the "Resources & Publications" tab or at www.mamag.com.)

The increase in enforcement actions underscores every organization's responsibility to consider the possibility of FCPA violations and to establish an effective compliance program to prevent them. Once violations occur, corporations will be in a very difficult spot because disclosure of a potential FCPA violation to the external auditor would appear to trigger a Section 10A investigation, which requires the independent auditor to report the potentially illegal acts to management or the SEC (but may ultimately be preferable to a whistleblower action).

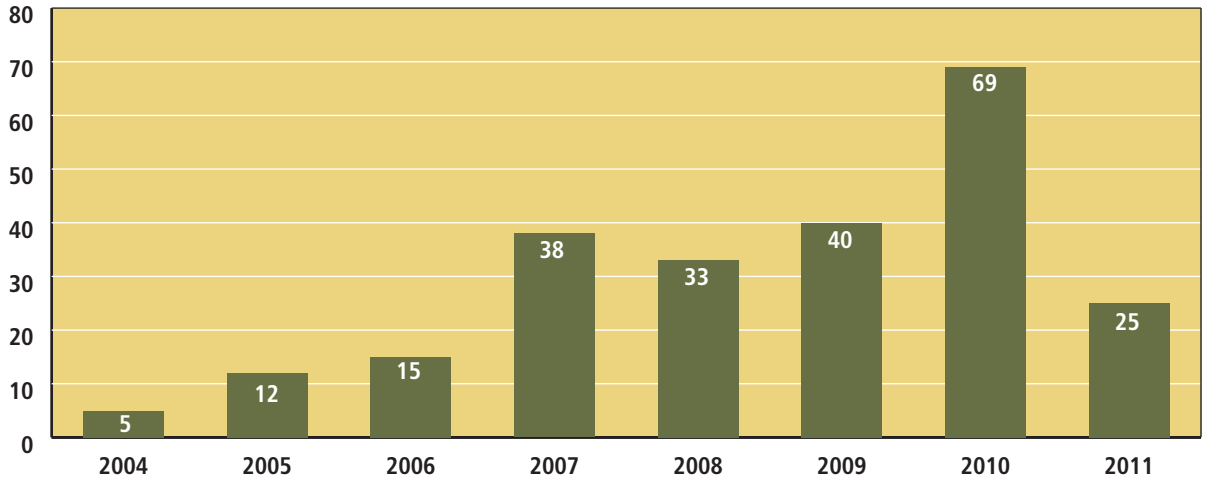
Clearly, avoiding illegal activities, including those prohibited under the FCPA, has become a corporate imperative. (Individuals who violate FCPA provisions are also subject to prison sentences and substantial fines.) Large multinational companies—and expanding smaller ones, too—need to understand recent enforcement actions and trends and also be familiar with measures to ensure compliance with the Act.

When Is a Bribe Truly a Bribe?

During the 1970s, there was increasing concern over the practices of U.S. companies doing business overseas. In an SEC investigation, more than 400 U.S. companies admitted to making questionable or illegal payments to foreign government officials, politicians, and political parties. The actions ranged from bribery of foreign officials to facilitating payments (or "grease payments") to ensure certain ministerial or clerical duties got done on time. As a result of this investigation, Congress enacted the FCPA of 1977. A strong business lobby, however, convinced Congress that U.S. companies operated at a disadvantage because many foreign companies routinely paid bribes, and some countries even permitted the deduction of a bribe as a business expense. Therefore, in 1988, Congress directed the administration to begin discussions in the Organisation for Economic Co-operation and Development (OECD) to help enact legislation similar to the FCPA among major U.S. trading partners. In 1997, the U.S. and 37 other countries signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which provides for international cooperation in criminalizing the bribery of foreign government officials.

Anti-Bribery Provisions. The first provision of the FCPA criminalizes the bribery of foreign *government* officials in order to obtain or retain business. In a typical violation scenario, a company with a U.S. connection (incorporated in the United States or having a U.S. presence) makes a payment to a foreign official, either directly

Figure 1: FCPA Actions in 2004 – 2011 (Through August 1, 2011)



or through an agent, with the purpose of securing business with the government customer or an enterprise controlled by the foreign government. Payments sometimes are disguised as commissions or other marketing expenses and channeled through entities where scrutiny is less likely. Or they're part of otherwise legitimate contractual payments. A *Wall Street Journal* article published last August reported that the United States is investigating a high-ranking Mexican official who received a Ferrari, a luxury yacht, and several million dollars in exchange for lucrative contracts for two U.S. companies. A Mexican citizen living in Houston, who allegedly set up a company in Mexico to serve as an intermediary between the Mexican official and the two companies, has been arrested in the case.

In the Las Vegas case mentioned earlier, security product dealers at a convention were given the impression that they were making a payment to an agent who would carry it to government officials in an African country, allegedly Gabon. But the agent was an FBI employee, and a number of dealers were arrested under the FCPA. This brings up an important point: The FCPA requires only *intent*, not actual malfeasance. Maximum penalties for culpable individuals for violating the anti-bribery provisions include a maximum criminal fine of $250,000 and five years in prison. A corporation found in violation can be fined upwards of $2 million.

To constitute a violation of the Act, five elements must be present:

1. An Entity Paying the Bribe. The FCPA covers payment made by citizens, nationals, or residents of the United States or a business entity that is organized in one of the states, territories, possessions, or commonwealths of the U.S. or has its principal place of business in the U.S. This includes issuers of securities registered in the U.S. who file reports with the SEC. Foreign corporations and nationals are also subject to the FCPA if the bribe takes place on U.S. soil.

In addition, the Act includes a "knowledge standard" that assumes that securities issuers and domestic entities should be aware of possible violations related to their international business associates, including consultants, joint-venture partners, distributors, subcontractors, and suppliers. Various DOJ cases have concluded that a corporation violated the FCPA because a reasonable person would have realized the existence of violations and the offender consciously chose not to ask about them.

2. Intent of the Bribe. The entity making the bribe must have a corrupt intent, such as to induce a foreign government official to misuse his or her position. As mentioned earlier, the FCPA doesn't require that the act take place, only that the intent was corrupt.

3. Payment of the Bribe. The FCPA prohibits paying, offering, or promising to pay anything of value—not just money—to obtain or retain business. Payments to facilitate routine government actions (facilitating payments or "grease payments"), such as obtaining permits, licenses, utilities, phone service, police protection, transportation, and inspections, are generally exceptions to—and are therefore excluded from—the Act.

4. Recipient of the Bribe. Though foreign government officials are clearly within the FCPA's scope, it's less clear whether officials of state-owned enterprises, members of the royal family, or a member of a legislative body would be considered a foreign government official. But the DOJ has an opinion process for determining whether an individual would be considered a foreign official.

5. Business Purpose Test. The Act prohibits any payment that may help an entity obtain or retain business. The DOJ interprets "obtaining or retaining business" very broadly in that the term includes more than the mere award or renewal of a contract.

Accounting Provisions. The second provision of the FCPA requires that companies establish and maintain books and records that reflect their transactions accurately and fairly. Specifically, the accounting requirement attempts to prevent three types of improprieties:

- Failure of the company to record illegal transactions,
- Falsification of records that help to conceal illegal transactions, or
- Creation of records and documents that quantitatively are accurate but nevertheless may mislead by failing to identify the substantive aspects of the transaction.

How seriously do the feds take these mandates? An individual knowingly circumventing or failing to implement the accounting provisions not only can be criminally fined up to $5 million and be sentenced to 20 years in prison, but he or she would also be barred from serving as an officer or director of a public company. In short, a conviction under the Act would be a career killer.

Putting the Hammer Down: Recent FCPA Violations

As Figure 1 shows, the DOJ and SEC have seen a fairly steady rise in FCPA actions. The DOJ alone reported that 34 cases were filed in 2010. As of August 1, 2011, the SEC had taken action on 20 FCPA cases, and the DOJ reported filing five cases.

Let's look at some examples.

1. UTStarcom subsidiary violates FCPA by providing trips to popular tourist destinations in exchange for telecom contracts. (DOJ Justice News, December 31, 2009, and SEC Litigation Release No. 21357)

UTStarcom, a Delaware corporation headquartered in Alameda, Calif., and listed on the Nasdaq (UTSI), is a global telecommunications company that designs, manufactures, and sells network equipment and handsets. UTStarcom has historically focused on doing business in Asian markets, with a particular emphasis on China, through its wholly owned subsidiary, UTStarcom China (UTS-China).

UTS-China arranged and paid for employees of Chinese, state-owned telecommunications companies to travel to popular tourist destinations in the United States, including Hawaii, Las Vegas, and New York City. The trips were purportedly for individuals to participate in training at UTStarcom facilities. In fact, according to a DOJ press release, UTStarcom had no facilities in those locations and conducted no training. UTS-China then falsely recorded these trips as "training" expenses, but their true purpose was to obtain and retain lucrative telecommunications contracts.

Under its agreement with the DOJ, UTStarcom was required to pay a $1.5 million penalty, implement rigorous internal controls, and cooperate fully with the Department. The agreement recognizes UTStarcom's voluntary disclosure, its thorough self-investigation of the underlying conduct, and its remedial efforts to prevent future violations. As a result, the DOJ will not prosecute UTStarcom or its subsidiaries, provided that the company satisfies its ongoing obligations under the agreement.

2. Technip violates FCPA with bribes to Nigerian government officials. (SEC Litigation Release No. 21578, June 10, 2010)

Technip, a global engineering, construction, and services company based in Paris, France, settled with the SEC in June 2010 for multiple violations of the FCPA. The company had become a U.S. securities issuer, and thus subject to the FCPA, in August 2001.

According to the SEC, between at least 1995 and 2004, senior executives at Technip and other members of a four-company joint venture cooked up a scheme to bribe Nigerian government officials to obtain multibillion-dollar contracts to build liquefied natural gas (LNG) production facilities. The complaint alleged that, from the inception of the joint venture, Technip and its partners paid bribes to help obtain the LNG contracts. The joint-venture partners formed a "cultural committee," composed of senior sales executives at each company, to consider how to carry out the bribery scheme. To conceal the illicit payments, a shell company controlled by a U.K. solicitor and a Japanese trading company entered into phony contracts that served as conduits for the bribes. Payments to these two agents topped $180 million.

The SEC also alleged that Technip's internal controls failed to detect or prevent the bribery and that the company falsified its records to cover up the scheme. Although Technip was aware that what it was doing was against the law, it didn't implement adequate controls to ensure compliance with the FCPA. Instead, its due diligence was a "perfunctory exercise" so that the company could show some documentation in its files. Technip was ordered to disgorge $98 million in ill-gotten profits derived from the scheme, plus prejudgment interest. It

also agreed to pay a criminal penalty of $240 million.

3. Manager violates FCPA by paying government officials to gain access to tobacco processing facilities. (DOJ Justice News, August 4, 2010)

A former foreign manager for a Virginia-based tobacco company pleaded guilty in August 2010 for his role in a conspiracy to bribe officials of the Republic of Kyrgyzstan. The employee plead guilty to one count of conspiracy to violate the FCPA and received three years' probation and a $5,000 fine.

The manager admitted to conspiring to make payments totaling more than $3 million to government officials in Kyrgyzstan from 1996 through 2004 to obtain export licenses and gain access to government-owned tobacco-processing facilities. According to court documents, the payments were based on the number of kilograms of Kyrgyz tobacco his employer purchased and processed for export. In addition, the DOJ says the manager admitted that he made cash payments to local government officials, known as Akims, to obtain permission to purchase tobacco from local growers and to the Kyrgyz Tax Inspection Police to influence their decisions and avoid lengthy tax inspections and penalties.

4. The Department of Justice charges Tyson Foods with bribery. (DOJ Case 11-CR-037-RWR)

On February 10, 2011, the DOJ filed charges against Tyson Foods and its wholly owned subsidiary, Tyson of Mexico (TdM). The DOJ reported that the Government of Mexico administers an inspection, "Tipo Inspección Federal," for meat-processing facilities. The inspection program at each facility is supervised by an onsite veterinarian who's a government employee paid by the state to ensure that all exports conform to Mexican health and safety laws. The DOJ charged that, in order to export meat products from Mexico, Tyson and TdM paid the veterinarians to obtain or retain business for TdM. The DOJ also alleged that the payments to the veterinarians were falsely classified in Tyson's books and records as "professional fees." Tyson Foods agreed to pay a $4 million criminal penalty to resolve the investigation. It also reached an agreement with the SEC to pay $1.2 million in disgorgement of profits, including prejudgment interest.

Anti-Corruption Goes Global

Anti-corruption legislation has also spread to the U.K. On April 8, 2010, the U.K. Bribery Act was created that says a company can now be prosecuted for failure to prevent bribery. The new law makes internal controls more important for domestic U.K. companies, as well as foreign companies doing business in the U.K., and requires them to document compliance with anti-bribery controls.

The recent *Global Enforcement Report 2011*, published by Trace International, a nonprofit membership association that assists companies with anti-bribery compliance, provides additional statistics in the identification and tracking of international anti-bribery enforcement trends. The report highlights that most countries have criminalized the payment of bribes to government officials by signing international conventions such as the OECD Convention. Yet only 24 countries have pursued enforcement of their foreign bribery laws. The two major industries involved in the largest number of enforcement activities are extractive industries (mining companies, for instance) and the aerospace/defense/security industries. Additionally, South Korea, Italy, and Nigeria lead enforcement activity worldwide in terms of dealing with their own government officials. Overall, the largest number of enforcement activities involves Iraq, Nigeria, and China.

Some Red Flags

With the recent tightening of enforcement of the FCPA and the unprecedented increase in cases in the last two years, the prevention and detection of illegal acts should be at the top of every corporate agenda. The DOJ has provided the following red flags that might indicate potential violations:

Transaction-specific red flags

1. An agent refuses to agree in writing to abide by the FCPA.
2. A foreign partner refuses to agree to certain controls in a joint venture.
3. A sales agent has ties to a government official.
4. A foreign partner is owned by a key government official.
5. A U.S. company hears "rumors" that a silent partner in a transaction is a high-ranking government official.
6. An agent requires his or her identity not be disclosed.
7. An agent makes an odd request, such as to backdate certain invoices.
8. The foreign partner can't contribute anything to the joint venture except influence.

Payment red flags

1. Payment of a commission is substantially above the going rate for an individual empowered to act for another (agency work).

2. Payment is made through convoluted means.
3. There's a pattern of overinvoicing.
4. Requests ask that checks be made to "bearer" or "cash."
5. Requests are made for unusual bonuses or extraordinary payments.
6. Requests are made for unusual upfront payments.
7. The values ascribed to assets contributed by the joint venture's foreign partner are excessive.

In order to assess risks and control exposures to potential violations of the FCPA, the board of directors/audit committee should ask these questions:

1. Have employees, and particularly managers, of foreign subsidiaries involved in sales been trained in their FCPA obligations?
2. Does documentation exist indicating that all foreign subsidiaries, agents, and business partners have been clearly informed of their obligation to comply with the FCPA?
3. Is there an internal program in place to periodically recertify that foreign subsidiaries, foreign partners, and agents understand that they need to comply with the Act?
4. Have investigations been performed to determine whether foreign subsidiaries, agents, and business partners had any previous FCPA compliance issues?
5. Are company managers aware of how the DOJ ascertains the propriety of a foreign transaction?
6. Has the DOJ opinion process been used to garner an opinion on a particular transaction? If so, what was the outcome?
7. What evidence is there that these controls are actually in place and are functioning?

Clearly, policies and training are best at mitigating against fraudulent payments. The absence of proper controls can lead to a stiff reprimand, such as in the 2008 enforcement action against Westinghouse Air Brake Technologies Corporation. The SEC criticized the company because it "did not have an FCPA policy or provide training or education to any of its employees, agents, or subsidiaries."

Compliance with the FCPA and, now, the U.K. Bribery Act is challenging many companies that compete for foreign contracts. Both the SEC and the DOJ have several pending enforcement cases, and many companies are finding out the hard way that illegal payments to secure business with foreign governments won't be tolerated. In many cases, a U.S. corporation discovers too late that a foreign subsidiary has been making illegal payments. To combat this, it must be clear throughout the company, especially in foreign countries, that FCPA violations can't—and won't—be permitted or overlooked. Internal auditors, including management accountants and other financial professionals, periodically will need to review foreign contract payments, payments to foreign agents, and any payments made for foreign marketing that might be diverted to a foreign government. Audit committees can assist by requiring management to fulfill their duties in preventing FCPA violations and by monitoring potential FCPA issues reported through company hotlines established for this purpose. External auditors, too, should review details of transactions involving payments to foreign entities to ensure that supporting documentation is complete.

Though management pushback or override is always a risk, every organization should have a published policy requiring the appropriate recording of payments to foreign entities and prohibiting payments, either directly or indirectly, to foreign government officials, including employees of state-owned enterprises. Any questions about the propriety of a possible payment to a foreign government official should be cleared with legal counsel and the DOJ opinion process before going forward. The DOJ allows a company to request a statement of the department's enforcement intentions regarding any proposed business transaction.

Because the DOJ and SEC undoubtedly will continue to aggressively make enforcement a priority, companies subject to the provisions of the FCPA must be very knowledgeable about them. Thus companies will need to completely understand their exposure and potential risk so that they can adequately design, implement, and monitor an effective compliance program. In this new, tougher environment, strong internal controls—including monitoring by internal auditors, external auditors, and audit committees—are essential. If a violation does occur, full disclosure and complete cooperation with the authorities might result in a nonprosecution agreement. Everyone needs a wake-up call now and then, and the DOJ and SEC are sending out a clear message that corporate corruption won't be tolerated. **SF**

Thomas R. Weirich, CPA, Ph.D., is a professor of accounting at Central Michigan University in Mount Pleasant, Mich., and a member of IMA's Saginaw Valley Chapter. You can reach Tom at (989) 774-3314 or weiri1tr@cmich.edu.

Steven A. Harrast, CPA, Ph.D., is an associate professor of accounting at Central Michigan University in Mount Pleasant, Mich. You can reach him at (989) 774-6574 or steven.harrast@cmich.edu.