

## Foreign Corrupt Practices Act (FCPA): Books & Records, Third Parties & the Compliance Risks They Create

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## **The Less Discussed Prong of the FCPA: Books & Records and Internal Controls**

- Only Applies to Public Companies, but....
- More Proceedings Under this Prong of the FCPA than Under the FCPA's Anti-Bribery Provisions
- Primarily Enforced by U.S. Securities & Exchange Commission
- Often used when all Elements of a Bribery Case cannot be Established.

## 1. Books & Records

- What's Required?
  - Every “issuer” must “make and keep books, records and accounts, which in reasonable detail, accurately and fairly reflect the transactions and disposition of assets”
- No materiality requirement
- Inadvertent mistakes do not violate the books & records provisions.
  - Practical Issue: Convincing the enforcement agencies that a mistake was inadvertent when what appears to be a bribe was lurking behind that “mistake”.

## 2. Internal Controls - Accountability

- Transaction Authorized.
- Transaction Recorded to Permit Preparation of Financial Statement in Accordance with GAAP and maintain Accountability for Assets
- Access to Assets Only Permitted with Management's General or Specific Authorization.
- Recorded Accountability for Assets is Compared with Existing Assets and Appropriate Action Taken When There is a Discrepancy. Testing,

Internal Controls Requirement Will Always be Applied in Hindsight

## A Few Observations

- Broad Reach – Not Just Bribery of Foreign Officials
- Inaccurate Records - Not Just Falsified Records
- Commercial Bribery. Commercial Bribery not criminalized by anti-bribery provisions of FCPA, but commercial bribery may violate accounting provisions.
- In 2002, before the dramatic increase in FCPA anti-bribery cases, Searle Civil Justice Institute estimated 1,200 “non-FCPA FCPA cases”

## Third Party Intermediaries

- Who are they?
  - Agents
  - Consultants
  - Distributors
- Under the Anti-Bribery Provisions of the FCPA, an Expansive “Knowing Standard” applies.
- Under the Accounting Provisions, need to accurately reflect purpose of payment and have internal controls.

## Mead Johnson Nutrition Company

- US\$12 million FCPA Action Against Mead Johnson.
  - SEC: Violated FCPA's accounting and internal control records because of:
    - Alleged Violation by a Foreign Subsidiary
    - Distributor Allowances (third party)
    - Had an Internal Control System
    - But Still Allegedly had Violations
    - So failure to “devise and maintain an *adequate* system of controls” is a violation. But U.S. law doesn't have an “adequate procedures” provision?

## Compliance – Third Parties

- Due Diligence Over Third Party Intermediaries
  - Local Check on Reputation
  - Determine Ownership & Control
  - Does it have its own compliance system?
  - How long in business?
  - Names and background of senior personnel
  - Shareholders – 10% +
  - Any ties to government?
  - Document every step of due diligence.
  - Document relationship



## Documenting Relationships with Third Parties

- Clear description of services. Is it market value?
- Time Frames
- Representations & Warranties
- Audit Rights
- Termination Rights
- Applicable Law and Effective Dispute Resolution.

## Final Thoughts

- Have a Robust Compliance Systems. Even though U.S. law does not expressly refer to “adequate procedures”, have them.
- Have Board and Senior Management take an role in Compliance System.
- Test your Compliance System. Test it globally and test it locally.
- Be Prepared to Enforce your Compliance System. Be Prepared to Audit your third Party Agents, Consultants, Wholesalers and other Intermediaries.

## Thank you

*While reasonable efforts have been made to ensure the preceding slides are accurate, this presentation does not constitute legal advice.*

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