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# Practical Scenarios – Supply Chain Third Party Audits

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## The Nature of the Problem

- 90% of all foreign bribery criminal prosecutions under the FCPA in 2013 involved third parties. That aspect of FCPA enforcement has not changed. Consider:
  - If employees of multi-national corporations (MNCs) or U.S. companies are inclined to engage in corrupt activity, they are much more likely now to use third parties.
  - Why? Unintended consequences of robust compliance programs. Employees of MNCs are much more likely now to know and fear the consequences of a compliance investigation. They may also understand that the use of a third party is prohibited, but often think that corrupt activity is harder to detect if it is conducted by a third party.
  - Also, controls and reporting requirements over third parties are generally not as robust as controls and reporting requirements of employees of MNCs and their subsidiaries.
- A major problem in various SE Asian countries? Why?
  - Family and social obligations. *Grenchai* can compromise transparency.
  - Local justice systems.
  - Demand & supply of government officers. Official salaries. And the list goes on.

# Ranking Compliance Risk of a Third Party

- No simple cookie cutter approach
- Intermediaries Generally
  - Sales: agents vs. distributors, but GE/InVision case.
  - Price charged vs. market price.
  - Family and connections to government.
- Suppliers
  - Competence and ability? Is the supplier *really* the supplier?
  - Country risk? MNC v local supplier?
  - Who recommended the supplier? Someone affiliated with the government or a state owned enterprise (SOE)?
  - High Risk Supplier or Non-Project Specific Supplier?
- Preventative Measures: conduct due diligence of third party and document all aspects of due diligence

# Drafting the Compliance Provision

## Compliance Provisions.

**Importance:** Proper records required to comply with books and records provision of FCPA.

## Key Issues

- Books & records must comply with GAAP/IFRS **and** meets books & records provision of FCPA.
- All business with the third party must go through the contracting company. Gaps can sometimes occur because non-compliant activity goes through non-contracting affiliated company.
- Clear requirements.
- Right to audit. Press back by third parties on this now more common
- Dispute resolution. In some jurisdictions, international arbitration may be preferred

# Who Conducts the Audit?

- **Smaller matters** can be handled internally, but difficult at the outset to determine if a matter really is small (or could escalate) and privilege could be waived.
- **Outside Counsel:**
  - Privilege. Once an investigation starts, all reports should be privileged.
  - Trade-Off off between local expertise (more below) vs. experience with regulators. Also, local work permit rules.
  - Local language skills are not given importance they deserves
  - Familiarity with local culture, common forms of local corruption and high risk agencies and SOEs (not all agencies and SOEs in countries identified as risky by CPI, etc., are equally risky) not given importance they deserve.

# Conducting the Audit – Part 1

- **Due Diligence:** Presumably the third party was subject to a due diligence before the audit was conducted (but, in reality, this is often not the case).
- **The basics**
  - Conduct audits periodically. Good compliance practice and reduces the risk that a third party will be tipped off that there is a genuine concern.
  - Get the documents first. But in practice, not everything (and sometimes nothing) is produced before the audit. Press hard for documents.
  - Review and analyze documents. For example, check prices and costs against market values, check for unusual patterns, identify gaps, identify players (anyone associated with the government or an SOE?)
  - Document everything contemporaneously. Time stamp reports.
  - If a third party, no need for an “Upjohn Warning”, but make sure third party’s employees understand that the auditing counsel is not their counsel

# Conducting the Audit – Part 2

- Some selected specifics:
  - Select a time period, but don't be wedded to that time period. Make sure third party understands the time period is not fixed.
  - Typically start with randomly selected transactions. Focus on suspicious transactions *after* a few randomly selected transactions. The randomly selected transactions can be used as a baseline against which to measure any suspicious transactions.
  - I prefer on-site interviews and reviews. Otherwise, too many convenient excuses for why a document is not available.
  - Sometimes necessary to interview employees simultaneously but separately.
  - Request documents again after interview if needed. They are often needed.
  - Self protection. Compliance officers and local or international lawyers are not law enforcement officials. They can and sometimes are exposed to local risk.

# Concluding the Audit

- Prepare a factual report as quickly as possible after the audit while memories are still fresh.
- Keep copies of every document supplied if possible. If not, summarize as best you can.
- High Level Report and Detailed Background Report
  - After interviews completed and documents reviewed (as best as possible), prepare a high level report. Busy executives may not have the time to review 15 witness interviews. Tie it all together in the high level report. Distinguish between (a) facts; (b) memories; and (c) theories.
  - Detailed Reports: After each interview and document review, a summary should be prepared. Every report should include the facts and the lawyer's impressions of the facts (for privilege and attorney-work product purposes).

# Conclusion and Q & A

While reasonable efforts have been made to ensure the accuracy of the proceeding slides and this presentation, neither constitutes legal advice. For legal advice, please contact qualified counsel.