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Managing FCPA Exposure: Are Your Books in Order?

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Introduction

Many associate the Foreign Corruption Practices Act (FCPA) with its provisions that prohibit the bribery of overseas public officials. While they enjoy a relatively lesser public profile, the FCPA provisions governing publicly traded companies' books and records practices and accounting controls warrant significant attention in any FCPA compliance program. In fact, enforcement actions related to FCPA books and records and accounting controls provisions are much more common than, and may also lead to, anti-bribery enforcement actions. Indeed, failure to maintain adequate books and records and accounting controls can facilitate bribery activity. Even without actual bribery, violation of the FCPA books and records and accounting controls provisions can prompt civil and criminal enforcement activity by the Department of Justice (DOJ) and Securities and Exchange Commission (SEC).

Background and Recent Developments

The FCPA essentially consists of two sets of provisions: the anti-bribery prohibitions and the books and records and accounting controls requirements. This writing focuses on the latter. However, because an understanding of the FCPA anti-bribery provisions is necessary to fully comprehend the purpose and intent of the books and records and accounting controls requirements, these provisions are also addressed.[1]

Because the FCPA is both a criminal and civil statute, both the DOJ and SEC have authority to enforce it.[2] The SEC only regulates "issuers," i.e., companies whose securities are listed in the United States, and has only civil enforcement authority. The DOJ is responsible for criminal investigations and prosecutions under the FCPA's anti-bribery and books and records and accounting controls provisions, as well as civil enforcement of the anti-bribery provisions against non-issuers.[3]

The FCPA sanctions against bribery are severe. Corporations and other business entities are subject to a fine of up to $2 million per criminal violation, and officers, directors, stockholders, employees and agents (including non-U.S. nationals) are subject to a fine up to $100,000 and imprisonment for up to five years.[4] Under the Alternative Fines Act, the actual fine may be up to twice the amount of the benefit that the defendant sought to obtain by making the corrupt payment. In addition, fines imposed upon individuals may not be paid by their employer or principal. A violation of the FCPA may also result in a civil and criminal forfeiture of assets. Any property, real or personal, that constitutes or is derived from proceeds traceable to a violation of the FCPA or a conspiracy to violate the FCPA may be forfeited.

Civil enforcement actions related to FCPA anti-bribery violations may result in penalties of up to $10,000 as well as additional fines not to exceed the greater of the disgorgement of the gross pecuniary gain resulting from the violation or a specified dollar limit of up to $500,000.[5]

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Likewise, considerable sanctions may result from violation of the FCPA's books and records and accounting controls provisions. Willful and knowing violations of these provisions can lead to up to $5 million in criminal fines and/or imprisonment for up to twenty years for individuals, and companies can be fined up to $25 million.[6]

FCPA enforcement actions in recent years have resulted in significant and high-profile awards and settlements. In 2008 Siemens AG paid a civil disgorgement of $350 million,[7] a criminal fine of $450 million,[8] and agreed to a corporate monitor in conjunction with its guilty plea to and civil settlement of FCPA books and records and related conspiracy violations. In 2009 Halliburton and its subsidiary, Kellogg Brown and Root LLC, agreed to pay $559 million to the U.S. to resolve criminal and civil charges of bribery of Nigerian officials during the construction of a gas plant.[9]

As if the stakes of FCPA compliance were not high enough, the recently passed Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) raised them even higher, at least for issuers. Section 922 of Dodd-Frank amends the Securities Exchange Act of 1934, which contains the FCPA, to implement whistleblower provisions and establish the whistleblower's bounty at no less than 10 and up to 30 percent of the total recovery. With such recoveries topping tens and even hundreds of millions of dollars, Dodd-Frank is sure to prompt an increase in FCPA enforcement via whistleblower reporting.

Section 922 of Dodd-Frank also authorizes the SEC to share whistleblower-provided information with other U.S. government agencies, including the DOJ, as well as foreign securities authorities and foreign law enforcement. This is particularly significant in the context of parallel proceedings, when an SEC subpoena or Wells notice leads to a referral of the matter to the DOJ for potential criminal enforcement.

More frequent, higher-profile, and larger-value verdicts and settlements associated with FCPA enforcement in recent years and the additional enforcement tools provided by Dodd-Frank signal that, if anything, the DOJ and SEC will increase FCPA enforcement activities in the foreseeable future.

Anti-Bribery Provisions

The FCPA's anti-bribery provisions prohibit both U.S. and foreign public and private corporations, and "any officer, director, employee, or agent" of such entities, from offering, paying or authorizing the offer or payment of anything of value to a foreign government official, foreign political party, party official, candidate for foreign public office or to any official of a public international organization in order to obtain or retain business.[10] Broad interpretations of what constitutes "anything of value," who qualifies as a "foreign official," and whether an offer or payment is for the purpose of "obtaining or retaining business" translate to a wide range of activities that could potentially violate the FCPA's anti-bribery provisions.

One exception and two affirmative defenses exist to the FCPA anti-bribery provisions. Payments made to expedite or facilitate the performance of "routine governmental action," such as permit processing, mail delivery, and inspections, are exempted from the FCPA.[11] An affirmative defense to a FCPA bribery charge exists if "the payment, gift, offer, or promise of anything of value that was made, was lawful under the written laws and regulations of the foreign official's, political party's, party official's, or candidate's country."[12] It is also an affirmative defense if the "payment, gift, offer, or promise of anything of value" was a "reasonable and bona fide expenditure" such as travel and lodging expenses, incurred by or on behalf of a foreign official, party, party official, or candidate and was "directly related" to the "promotion, demonstration, or explanation of products or services" or "the execution or performance of a contract with a foreign government or agency thereof."[13]

Books and Records and Accounting Controls Provisions

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Unlike the anti-bribery provisions, the FCPA books and records and accounting controls provisions apply only to issuers. Such companies must "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."[14] Issuers must also devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management's general or specific authorization; and (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets.[15]

The FCPA does not specify what practices will satisfy the books and records and accounting controls requirements. Instead, the statute defines the "reasonable detail" requirement for books and records and the "reasonable assurances" to be provided by the issuer's accounting controls as "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."[16] The level of "prudence" is not further defined in the FCPA, but should be informed by the reporting requirements of the Sarbanes-Oxley Act of 2002 (SOX), under which corporate officers must certify the accuracy of financial statements and assess the adequacy of internal controls.[17]

SEC regulations further inform the level of reporting necessary to comply with the FCPA. SEC Rule 13b2-1 provides that "No person shall directly or indirectly, falsify or cause to be falsified, any book, record or account subject to section 13(b)(2)(A) of the Securities Exchange Act."[18] SEC Rule 13b2-2 prohibits directors and officers of issuers from making or causing to be made any materially false or misleading statements or material omissions in conjunction with any "audit, review or examination of the financial statements of the issuer required" by the SEC or any document or report required to be filed with the SEC.[19] The same rule also prohibits officers and directors of issuers from directly or indirectly taking "any action to coerce, manipulate, mislead, or fraudulently influence" the issuer's auditors into rendering materially misleading financial statements.

As demonstrated in the Halliburton case, the issuer is also responsible for the books and records and accounting controls of its majority-owned domestic and foreign subsidiaries.[20] Even when the issuer owns 50 percent or less of the subject company's voting stock, the FCPA requires the issuer to "proceed in good faith to use its influence, to the extent reasonable under the issuer's circumstances, to cause such domestic or foreign firm to devise and maintain a system of internal accounting controls" consistent with the FCPA.[21]

Willful and knowing violations of the FCPA books and records and accounting controls provisions can result in criminal fines of up to $5 million and imprisonment of up to 20 years for individuals, and corporations can be fined up to $25 million.[22]

Enforcement Actions

As noted above, books and records and accounting controls inquiries by the SEC are frequently the precursor to full-blown enforcement actions and, less often, parallel criminal proceedings by the DOJ. The SEC has authority to subpoena an issuer's records and testimony. In fact, because SEC regional offices now enjoy independent authority to issue formal orders of investigation (with their accompanying subpoena power), SEC subpoenas for documents and testimony are becoming more prolific and broader in scope.

In addition to SEC subpoenas, SOX compliance has prompted increased FCPA activity. Specifically, compliance with SOX requirements that corporate officers certify the accuracy of an issuer's SEC filings and evaluate internal controls can reveal the kind of "slush fund" spending and accounting associated with FCPA offenses. Increased corporate discoveries necessarily lead to increased self-reporting of potential FCPA violations and commensurate enforcement actions.

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When the results of an SEC subpoena or a self-disclosure signal compliance issues, the SEC may issue a notice, known as a Wells notice, indicating that the SEC staff is recommending the commencement of an enforcement action. The recipient of such a notice may be afforded an opportunity to respond and attempt to dissuade the SEC from bringing an enforcement action. Doing so places the Wells notice recipient before the decision-makers at the SEC, but at the costs of tipping its hand regarding its defense and creating a discoverable record with potential evidentiary admissions. Accordingly, a recipient of a Wells notice must determine whether its interests are best served by responding or, instead, holding its cards and focusing on its defense in an enforcement action.

Particularly in light of the statutory authority to do so under Dodd-Frank, the SEC may inform the DOJ of the results of its investigation. This may result in the DOJ issuing a target letter, presenting the matter to a grand jury, the commencement of a parallel criminal proceeding and its attendant fines, penalties, forfeiture, imprisonment of individuals, and potential debarment from governmental contracting upon conviction or a guilty plea.

Conclusion

In sum, decentralized SEC subpoena authority, SOX-driven self-disclosures, heightened FCPA enforcement, broader application of the FCPA's provisions, significant financial incentives for whistleblowers, statutory mandates to share investigation results with the DOJ, and skyrocketing judgments and commensurate costs of settlement all drive unprecedented levels of FCPA enforcement activity by the SEC and DOJ. More often than not, FCPA enforcement at least begins with books and records and accounting controls issues.

As a result, companies and individuals with FCPA obligations are well-advised to assess whether their FCPA compliance programs are sufficiently robust to detect and prevent violations.

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[1] The United States Department of Justice provides excellent guidance and instruction to assist the practitioner understand and comply with the Foreign Corrupt Practices Act. *See* generally the United States Attorney's Manual (USAM, 9-47-100 et seq.) and the Criminal Resources Manual (USAM, Title 9, CRM §§ 1017-1019).
[2] The guidance given to prosecutors by the Justice Department is contained in the Principles of Federal Prosecution of Business Organizations, USAM, Chapter 9-28.000.
[3] As discussed below, the FCPA books and records provisions apply only to issuers.
[4] 15 U.S.C. §§ 78dd-2(g), 78dd-3(e). *See also* USAM. Title 9, CRM, § 1019, p.1.
[5] 15 U.S.C. §§ 78dd-2(g), 78ff(c). *See also* USAM. Title 9, CRM, § 1019, p.1.
[6] 15 U.S.C. § 78ff(a).
[7] Final judgment, *SEC v. Siemens Aktiengesellschaft*, No. 08-cv-2167 (D.D.C. Dec. 18, 2008).
[8] Judgment, *United States v.Siemens Aktiengesellschaft*, No. 08-cr-367 (D.D.C. Jan. 6, 2009).
[9] Judgment, *United States v. Kellogg, Brown, & Root, LLC*, No. 09-cr-71 (S.D. Tex. Feb. 12, 2009); Judgment,*SEC v. Halliburton Company and KBR, Inc.*, No. 09-cv-399 (S.D. Tex. Feb. 17, 2009).
[10] 15 U.S.C. §§ 78dd-1, 78dd-2, 78dd-3.
[11] 15 U.S.C. § 78dd-1(b).
[12] 15 U.S.C. § 78dd-1(c)(1).
[13] 15 U.S.C. § 78dd-1(c)(2). *See alsoSee also* USAM. Title 9, CRM, § 1018, p.3.
[14] 15 U.S.C. § 78m(b)(2)(A).
[15] 15 U.S.C. § 78m(b)(2)(B).
[16] 15 U.S.C. § 78m(b)(7).
[17] 15 U.S.C. § 7241.
[18] 17 C.F.R. § 240.13b2-1.
[19] 17 C.F.R. § 240.13b2-2.
[20] 15 U.S.C. § 78m(b)(6).
[21] 15 U.S.C. § 78m(b)(6).
[22] 15 U.S.C. § 78ff(a).

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