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Audit Committees and the Foreign Corrupt Practices Act

By Homer E. Moyer, Jr.

Issues relating to the provisions of Foreign Corrupt Practices Act (FCPA) are demanding more and more attention from the audit committees of corporate boards. Payments to or enrichment of foreign government officials, which may violate the FCPA, present issues that simultaneously raise the prospect of an unauthorized dissipation of corporate assets, inaccurate books and records entries, and a failure of internal financial controls.

As a result, many corporate audit committees have recognized that when a possible FCPA issue surfaces, they need to be informed, and possibly directly involved. And audit committees have increasingly asked themselves the question, "What must we do to discharge our responsibilities in today's regulatory environment?" At least part of the answer is having an understanding of the dynamics of FCPA enforcement, which continue to evolve at a remarkable pace. Among the questions that audit committees need to address in effectively dealing with possible FCPA issues are the following.

1. Do we have an effective FCPA compliance program in place? FCPA enforcement officials now expect companies involved in international business to understand the FCPA and have a compliance program in place. Although the program may be a part of a larger set of ethics or business conduct policies, it can no longer ride the coattails of a general ethics program. A review of recent FCPA cases reflects not only that the "best practices" bar continues to rise, but more importantly, that the absence of an FCPA compliance program is treated as a substantial negative factor in imposing penalties and settlement terms.

Director Summary: Audit committees need to be aware of the provisions in, and increased enforcement of, the Foreign Corrupt Practices Act (FCPA), which proscribes payments to foreign government officials. Be prepared by formulating a plan for FCPA compliance, and disclosure of violations, should they occur.

2. Do we need our own FCPA counsel? Although audit committees sometimes consult with or retain separate counsel to advise them on FCPA issues, doing so is a necessity only in certain situations. The audit committee may well want to assure itself, however, that the company has access to FCPA expertise and experience, from either in-house or outside counsel. Expertise that includes both substantive FCPA expertise and experience with enforcement agencies is desirable.

3. What is the best response to a violation? When an internal report of a possible violation is inconclusive or incomplete, as is often the case, it is essential that the company take immediate action to investigate further and make at least an initial assessment of the apparent likelihood and seriousness of a violation. If one is discovered, the company must act decisively to stop any ongoing violations. Not only may a slow response result in additional violations, but dealing with a violation immediately is often the first test of a company's good faith. Depending on the circumstances, corrective action or discipline may also be appropriate; if so, a failure to act may be viewed as a failure by the company. And the discovery of any violation should prompt a follow-up inquiry as to why and how the violation occurred and what modifications or enhancements to the company's FCPA compliance program would reduce the risk of a recurrence.

4. Should we disclose to enforcement officials, and how quickly? As a result of Sarbanes-Oxley requirements and strong agency encouragement to disclose voluntarily and promptly, the pressure for doing so is stronger than ever. For these and other reasons, in some situations a "voluntary disclosure" is the clear choice, even if possibly a misnomer. For example, if a company is obliged to disclose a matter in its Form 10-Q or 10-K, then the issue of self-reporting to enforcement agencies becomes an obvious necessity. Moreover, a company or

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its audit committee may elect to disclose in any event—because disclosure by the press or a whistleblower is likely, because the company wants to resolve the matter, or because corporate philosophy so dictates.

Although immediate disclosure may reduce the risk that an audit committee could later be criticized, it may not be in the company's best interests and may be premature, particularly if the report proves to be based on incorrect facts, a misunderstanding of the law, or ulterior motives. Many companies view initial investigation and assessment as an essential prior step. At the same time, speed in making the initial review and any disclosure is more important than ever. Today, enforcement officials will likely view a disclosure following an initial investigation of several months as tardy; delay also increases the chances that enforcement agencies will otherwise learn of the matter, which will diminish the credit the company may receive for stepping forward.

A possible compromise step is a "placeholder" disclosure by which a company advises agencies that it has received a report of a possible violation and the company is now investigating the report and will report back. Such notice preserves the company's early disclosure position, but creates some risk that if the issue proves inconsequential, the government's interest may already have been piqued, which could lead to further government involvement.

5. What are the company's downside risks? In the last two years, there has been an increase in the number of enforcement actions, rising penalties, and active cooperation between the Department of Justice and the SEC. Less apparent is the increased level of cooperation among enforcement officials in different countries. Investigations in France, Switzerland, Lesotho, and Argentina, for example, have led to investigations in the United States, and more of the same can be expected.

Recent cases have seen not only the highest financial penalties in a decade ($28.5 million for Titan; $16 million for ABB), but settlements in recent cases have required disgorgement of profits, deferred prosecution agreements, criminal prosecutions of corporate executives, and elaborate remedial compliance measures. Moreover, the resolution of FCPA issues prior to the completion of a pending merger has in some cases involved intense internal investigations costing well into the tens of millions of dollars. And as before, an indictment or settlement also risks collateral penalties of loss of export privileges or government-backed insurance or loans.

6. Might our company be required to retain a "compliance monitor"? Seven of the last eight FCPA settlements have required the company involved to retain an independent compliance advisor for a period of up to three years. Retained and paid by the company, monitors develop and implement their work plans in close consultation with enforcement agencies. Required consultants provide the government (and the company's audit committee) with post-settlement oversight and a continuing source of information on the company's behavior. At the same time, they can impose considerable additional costs on the company, both in terms of committing or diverting company resources to satisfy the monitor's requirements and in fees and costs, which in some cases may exceed the fine paid for the violation.

7. What preventive measures can audit committees employ before the fact?

- Assure that audit committee members are educated on the administration and enforcement of the FCPA and periodically updated on new cases and on the subtle and not-so-subtle developments revealed in recent enforcement actions.
- Take steps to assure that the company's internal audit unit has been trained in the FCPA.
- Insist that your company's FCPA compliance program be updated on a regular basis.
- Monitor how the company responds to possible violations, often a better indicator of a company's compliance culture than the company's written program.
- Conduct dry runs of possible FCPA violations, walking through the steps that the company would take to respond quickly and decisively to information suggesting a possible violation.

The extent to which audit committees share responsibility and accountability with management has obviously expanded since Sarbanes-Oxley. With this broadened responsibility and the increased prominence that the FCPA continues to claim, boards of directors, and audit committee members in particular, need more than ever before to be conversant with the FCPA, current on its recent developments, and prepared to deal decisively with issues as they arise. ■

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