March 4, 2015

SEC Recommends "Localized" FCPA Controls For Foreign Subsidiaries

The internal controls fostered by the SEC to safeguard against corrupt payments advocate that Foreign Subsidiaries implement policies, procedures, and training translated in the local foreign language.

In December 2014, the U.S. Securities and Exchange Commission (SEC) charged a Massachusetts-based global manufacturer of scientific instruments with violating the U.S. Foreign Corrupt Practices Act (FCPA) by providing nonbusiness-related travel and improper payments to various Chinese government officials in an effort to win business.

The SEC investigation found that the respondent lacked sufficient internal controls to prevent and detect approximately $230,000 in improper payments made by its China-based offices that falsely recorded the payments in books and records as legitimate business and marketing expenses. The payments enabled the respondent to realize approximately $1.7 million in profits from sales contracts with state-owned entities (SOEs) in China whose officials received the improper payments.

Lax internal controls allowed employees in the respondent's China offices to enter into sham "collaboration agreements" to direct money to foreign officials and send officials on sightseeing trips around the world.

The SEC focused on the books and records and internal controls provisions of the FCPA. Employees of the China offices of four respondent subsidiaries (the China Offices) made unlawful payments of approximately $230,938 to Chinese government officials who were employed by SOEs in China that were the respondent's customers. These payments were made to obtain or retain business from the SOEs for the China Offices. Specifically, all of the China Offices provided nonbusiness-related travel to Chinese government officials, and one China Office also paid Chinese government officials under "collaboration agreements" for which there was no legitimate business purpose.

The payments to the Chinese government officials were recorded as legitimate business and marketing expenses in the China Offices' books and records, when, in fact, the payments were improper and designed to personally benefit the officials. The China Offices' books and records were consolidated into the respondent's books and records, thereby causing those books and records to be inaccurate. The respondent failed to devise and maintain an adequate system of internal accounting controls sufficient to prevent and detect the improper payments that occurred over several years.

The SEC stated that the respondent failed to implement an adequate internal controls system to address the potential FCPA problems posed by its ownership of the China Offices, which sold their products primarily to SOEs. One of the missing internal controls was the failure to use and train employees in their own language.

For example, the respondent did not translate its training presentations on FCPA, ethics, or compliance issues into local languages, including Mandarin. And, although the respondent implemented an FCPA policy, it failed to translate that policy into Mandarin and relied mainly on its China-based managers to ensure that employees understood the potential FCPA implications of doing business with SOEs. Also, although the respondent periodically distributed its Code of Conduct (which contains its gifts and entertainment policies) and employee handbook to employees worldwide, it again failed to translate these documents into local languages, including Chinese. Likewise, the respondent's toll-free employee hotline, which employees were to use to report complaints anonymously, was not provided in Mandarin.

The respondent also failed to adequately monitor and supervise the senior executives at its China Offices to ensure that they enforced the appropriate anticorruption policies or kept accurate records that concerned payments to Chinese government officials. The China Offices had no independent compliance staff or an internal audit function that had authority to intervene into management decisions and, if appropriate, take remedial actions.

The respondent additionally failed to tailor its preapproval processes for circumstances in China and instead allowed the China Offices' approval for items such as nonemployee travel and changes to contracts. As a result, senior employees of the China Offices had unsupervised control over the compliance process. These Chinese employees in turn abused their privileges and approved suspect payments to Chinese government officials for nonbusiness-related travel and for purported collaboration agreements.

The FCPA, enacted in 1977, added section 13(b)(2)(A) to the Securities Exchange Act (Exchange Act) to require companies to make and keep books, records, and accounts that, in reasonable detail, accurately and fairly reflect the transactions and disposition of companies' assets.[1]

The FCPA also added section 13(b)(2)(B) to the Exchange Act to require reporting companies to, among other things, devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that the companies' transactions are (i) executed in accordance with management's general or specific authorization and (ii) 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.[2]

In settling the case with the SEC, the respondent took the following steps to improve its FCPA compliance: (1) instituting a preapproval processes for nonemployee travel; (2) establishing a new internal audit function and hiring a new director of internal audit charged with overseeing the respondent's global compliance program, including FCPA compliance; (3) adopting an amended FCPA policy translated into local languages; (4) implementing an enhanced FCPA training program, which includes training programs in local languages as well as mandatory online employee training programs regarding ethics and FCPA compliance; (5) enhancing due diligence procedures for third parties; and (6) implementing a new global whistleblower hotline.

Finally, the respondent also agreed to pay $1,714,852 in disgorgement, $310,117 in prejudgment interest, and a $375,000 penalty.

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1. 15U.S.C. § 78m(b)(2)(A).
2. 15 U.S.C. § 78m(b)(2)(B).

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