

# FCPA Compliance: Auditing and Monitoring Third Parties

Minimizing Liability Risks When Using Sales Agents, Distributors and Other Intermediaries

TUESDAY, APRIL 10, 2018

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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# FCPA Compliance: Auditing and Monitoring Third Parties

April 10, 2018

Presented by Ed Fishman for Strafford  
Publications Webinar

[nossaman.com](http://nossaman.com)

MAKING IT HAPPEN.

# Overview of Presentation Topics

- Statutory Framework for Third Party Liability
- Recent Enforcement Actions Involving Third Parties
- Evolving Expectations for Auditing and Monitoring Third Parties
- Unique Risks Created by Different Third Parties
  - Sales and Marketing Agents
  - Distributors and Resellers
  - Freight Forwarders, Brokers and Logistics Companies
  - Consultants
  - Other Intermediaries

# Summary of FCPA

- U.S. Foreign Corrupt Practices Act (FCPA)
  - Prohibits corruptly giving “anything of value” to a “foreign government official” in order to obtain or retain business or any improper advantage
  - Third party intermediaries acting on behalf of a company can create FCPA liability if the company ignores “red flags” about their conduct
  - There is an exception for “facilitating payments”
  - There are affirmative defenses for “reasonable and bona fide” promotional expenses, payments required under a contract with a foreign government agency, and payments allowed under the written laws of a foreign country
  - Enforced by the DOJ and by the SEC

# Statutory Framework

- The FCPA prohibits a U.S. domestic concern or issuer from making corrupt payments both directly and indirectly through third party agents, distributors or other intermediaries
- The anti-bribery provision prohibits the offer or payment of “anything of value” to a third party while “knowing” that all or some of that payment will be offered or given by the third party to a “foreign official” for unauthorized purposes
- Knowledge can be established by:
  - Having actual knowledge that an improper payment will be made.
  - Having constructive knowledge that an improper payment may be made due to the existence of “red flags.”
  - Failing to conduct adequate due diligence or oversight of the third party, which may cause U.S. authorities to take the position that the knowledge element has been satisfied due to willful blindness/conscious disregard.



# Third Party Risk Profile

- One of the greatest FCPA risks facing companies today is from third party activity
- OECD estimates that approximately 75% of improper bribes are paid through third party intermediaries
- From a risk mitigation standpoint, it is imperative to obtain an understanding of the company's third party risk profile based on the different types of third parties that work with the company, the structure of the business/economic relationship with such third parties, the countries and industries in which those third parties conduct activities for or on behalf of the company, and the level of due diligence, oversight and monitoring of the activities of the third parties

# Recent Enforcement Actions

- Many of the largest FCPA settlements in history have involved violations caused by or orchestrated through the use of third parties:
  - Telia (2017): \$965 million
  - VimpelCom (2016): \$795 million
  - KBR/Halliburton (2009): \$579 million
- Almost all of the recent FCPA settlements have involved allegations relating to some level of third party involvement, either as the conduit to make improper payments or the conduit to receive improper payments on behalf of the government officials involved in the transaction

# Mitigating Third Party FCPA Risk

- Corporate liability often turns on the extent to which a company undertook commercially reasonable efforts to detect and prevent violations.
  - See, e.g., Federal Sentencing Guidelines, Ch. 8, Part B, Remedying Harm From Criminal Conduct, and Effective Compliance and Ethics Program
  - An effective compliance program includes due diligence to prevent and detect criminal conduct and taking reasonable steps to ensure the compliance program is followed, including monitoring and auditing to detect criminal conduct
- DOJ/SEC Resource Guide states that “companies should undertake some form of ongoing monitoring of third-party relationships. Where appropriate, this may include updating due diligence periodically, exercising audit rights, providing periodic training, and requesting annual compliance certifications by the third party.”

# Third Party Monitoring Expectations

- Deferred Prosecution Agreement with Keppel Offshore (DOJ 2017)
  - “anti-corruption policies and procedures shall apply...where necessary and appropriate, to outside parties acting on behalf of the Company, including but not limited to agents and intermediaries, consultants, representatives, distributors, teaming partners, contractors and suppliers, consortia and joint venture partners (collectively, “agents and business partners”)

# Third Party Monitoring Expectations

- “Where necessary and appropriate, the Company shall implement the following with respect to agents and business partners:
  - compliance training
  - compliance certifications
  - effective system for confidential reporting of violations and for providing advice/guidance
  - appropriate risk-based due diligence and **compliance requirements for retention and oversight, including right to audit books and records and right to terminate for violations”**

# Theories of Third Party Liability

- Direct participation in third party misconduct
- Express or implied authorization of third party misconduct (e.g. providing payment while aware or substantially certain that third party will pass along all/portion to foreign official)
- Knowledge of third party misconduct (e.g. awareness or substantial certainty that third party will engage in misconduct, including conscious avoidance)
- Direct liability for third party agent conduct if undertaken within scope of agency relationship and intended (in part) to benefit the principal

# Sales & Marketing Agents

- Commissioned sales agents have traditionally posed the highest third party risk under the FCPA due to their significant, often unsupervised interaction with potential customers on behalf of their principals
- U.S. enforcement authorities now expect U.S. companies to conduct some level of due diligence into the activities of their foreign sales agents and to implement certain internal controls designed to monitor the activity of sales agents in order to detect potential “red flags”
- Embraer (2017): Recent FCPA enforcement action involving third party sales agent with no experience in the relevant industry or region
- Lindsey Manufacturing (2011): Lindsey and two of its top executives were convicted of violating the FCPA after a five-week trial. The jury concluded that Lindsey’s sales representative in Mexico secured contracts for the company by passing a portion of his 30% commission to officials from Mexico’s state-owned electric utility.

# Distributors & Resellers

- Distributors and resellers traditionally *perceived* as posing less risk than sales agents because they obtain title to the goods from the manufacturer or retailer, but FCPA risk involving distributors and resellers can be **significant** in situations where the manufacturer/retailer relies on the distributor to identify specific sales opportunities
- Teva Pharmaceutical (2016): Mexican subsidiary allegedly gave improper discounts to distributor to create cash margin for improper payments; Russian subsidiary allegedly sold products to distributor owned by Russian procurement official
- Smith & Nephew plc (2012): Medical device company allegedly sold products at full list price to Greek distributor and then paid discount to an off-shore shell company controlled by the distributor to create off-the-books funds to make corrupt payments
- Invision Technologies (2005): Invision executives were alleged to be aware of a “high probability” that its distributors/resellers in China and Thailand were bribing foreign officials to secure contracts for the sale of baggage screening equipment to public airports.



# Freight Forwarders, Brokers and 3PLs

- Freight forwarders, customs brokers and logistics providers can create FCPA risk for their customers due to their frequent interaction with foreign officials at customs clearance facilities and ports of entry.
- Weatherford (2013): Oil services provider allegedly used a freight forwarding company to funnel bribes to African foreign official for renewal of oil services contract by generating sham purchase orders and invoices for services that the freight forwarder never performed.
- Panalpina (2010): Panalpina was charged with aiding and abetting its customers' violations of the FCPA by acting as an agent of several U.S. issuers on behalf of whom it made allegedly corrupt payments to expedite products through the customs processes of several countries.
- Vetco Gray (2007): Employees of three Vetco Gray entities allegedly were aware that their customs agent continuously bribed Nigerian customs officials to gain preferential customs treatment and clearance for Vetco Gray products.

# Consultants

- Consultants are often used as the conduits for improper payments under the guise of sham consulting service contracts, and these companies working with consultants in high-risk markets should verify that the consultants are providing actual services and are being paid fair market value for those services
- Alstom (2014): French power company allegedly paid \$75 million to third party consultants to secure more than \$4 billion worth of projects in various countries while “knowing” that at least a portion of the consultant payments would be used to bribe foreign officials in those countries
- Diageo (2011): Diageo allegedly engaged a consulting firm to lobby the Thai government regarding various customs and tax disputes and through this arrangement approximately \$600,000 in corrupt payments were paid to a Thai official.
- Alcatel-Lucent (2010): Alcatel allegedly engaged numerous commissioned “consultants” in several countries, who paid for bribes, gifts, entertainment, and travel expenses of government officials to receive information and other business advantages on behalf of Alcatel, despite numerous “red flags” that these consultants were making corrupt payments.

# Other Intermediaries

- U.S. enforcement authorities will be suspicious if any transaction involves companies that do not appear to be engaged in any substantive activities (so-called “shell companies”), particularly if they are located in off-shore banking jurisdictions. These companies often are used to make corrupt payments and to keep the payments off the books and records of the issuers and their subsidiaries who are making the payments.
- Telia (2017): Swedish telecom company allegedly paid bribes to a shell company that members of its management knew was beneficially owned by a Uzbek government official
- Cinergy and Terra Telecommunications (2011): Cinergy and Terra executives allegedly used a series of shell companies to launder money to pay bribes to Haitian telecommunications officials for favorable contract terms.
- Comverse Technologies (2010): Executives at Comverse’s Israeli subsidiary allegedly directed its agent to establish a shell company through which Comverse, Comverse employees, and the agent transferred money to Greek government officials.

# QUESTIONS?

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# Planning Third Party Audit & Compliance Reviews

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# Audit Objectives & Scope of Work

- ▶ Strong compliance programs can deter and detect violations, but *no* compliance program can completely prevent violations from occurring
- ▶ Goal of periodic auditing is to evaluate and improve effectiveness of third party (“TP”) compliance and suitability of TP relationships and to send message to market that you take compliance seriously
  - ▶ It is expected by the U.S. enforcement authorities, helps establish an “adequate procedures” defense under the UK Bribery Act, and delivers value from a business perspective as well

# Set-Up Successful Audit

- ▶ Begins with a proper vetting and on-boarding process, culminating in strong compliance contract terms that include audit and termination rights
- ▶ Next: Develop a written TP audit protocol for internal transparency, understanding and consistent application
- ▶ Get business team buy-in—explain need and benefits, and solicit their support in TP communications and audit execution
- ▶ Understand legitimate fears/concerns of TPs
  - ▷ Scope; disruptive; access to proprietary business information
- ▶ Underscore that audit focus is limited to TP's performance of and compliance with *your contract*

# Audit Objectives & Scope of Work

- ▶ Audit firm needs local forensic accounting and ABAC expertise
- ▶ Audit firm engagement should be via legal counsel, with auditors working “at the direction of counsel,” all for privilege purposes
- ▶ Audit focus should be to confirm the TP’s business *bona fides*, assess its internal control environment, and evaluate its adherence to its contractual compliance obligations (*esp.* GT&E practices, marketing spend).
- ▶ Audit will require TP’s cooperation, with full access to relevant records and back-up documentation, plus interviews of key team members servicing your business



# Audit Play Book and Sequencing of Work Stream

## ▶ Sequencing of process is important:

- ▶ Outline objective and scope of audit
- ▶ Develop standard draft Work Plan
- ▶ Develop agenda and talking points for call with internal liaison to TP
- ▶ Gather readily available information via Internal Document Request List
- ▶ Develop agenda and discussion points for kick-off call with TP
- ▶ Customize Document Request List for TP; send after TP kick-off call
- ▶ Auditors commence on-site work, while legal counsel reviews other relevant written materials provided in response to Document Request List

# Audit Play Book and Sequencing of Work Stream

- ▶ Auditors report findings / developments to inside and outside legal and compliance teams
- ▶ Review of initial audit findings and confer with Auditors
- ▶ Use analyses to outline questions/discussion points for interviews
- ▶ Schedule telephone interviews; include both auditors and outside counsel, as well as translation support if/as necessary
- ▶ Auditors and outside counsel collaborate in preparing joint report and adhering to agreed form, with specific recommendations included
- ▶ Debrief and address questions with in-house legal/compliance teams

# Audit Objectives & Scope of Work

- ▶ Auditing all third parties is not practical, so develop risk matrix to assess relative risk presented by each relationship and prioritize. Consider:
  - ▷ Geographic reputation for corruption risk
  - ▷ Nature of services being provided and compensation arrangements
  - ▷ Involvement in the business of any state-owned, -controlled or -affiliated organizations
  - ▷ Industry
  - ▷ Reputational and anecdotal information
  - ▷ Make reference to original intake diligence file
  - ▷ Use an objective numerical ranking system as well as experience-based, subjective judgments to prioritize

# Designing the Audit: Areas of Priority Focus

Keep audit process as simple, non-disruptive and cost-effective as possible (while still being thorough). The process has to be affordable and sustainable. Examples of priority areas of interest include:

- ▶ Updated information regarding any TP investigations, incidents or allegations involving bribery/corruption/fraud
- ▶ Review and test TP's Code of Conduct, GT&E policy (if any) and related protocols and procedures to assure compliance therewith
- ▶ Transaction testing regarding documentation for use of petty cash, gifts, travel, entertainment, general marketing, and any charitable or political contributions related to your business
- ▶ Examine any TP disbursements and the use of any other sub-contracted TPs supporting the business; if any, scrutinize their fees and services

# Final Steps

- ▶ Consider use of independent compliance committee to organize process, conduct risk assessment and be responsible for remediation

# Questions?



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George Martin is a partner of Faegre Baker Daniels, where he also serves on the Management Board. He Co-chairs FaegreBD's global anti-bribery/anti-corruption practice, with extensive experience in Asia, Eastern Europe, Latin America, the Middle East and Africa. He practiced law for 5 years in Eastern Europe and China. Mr. Martin's experience includes leading and conducting FCPA investigations worldwide, and providing M&A FCPA due diligence on cross-border transactions, day-to-day compliance counseling to multinational clients regarding their global operations and third party intermediary relationships, as well as related compliance policies and procedures. He also has extensive experience partnering with FaegreBD's white-collar team in appearing before the U.S. Department of Justice and Securities and Exchange Commission in connection with FCPA voluntary disclosures.

# **FCPA Compliance: Auditing and Monitoring Third Parties**

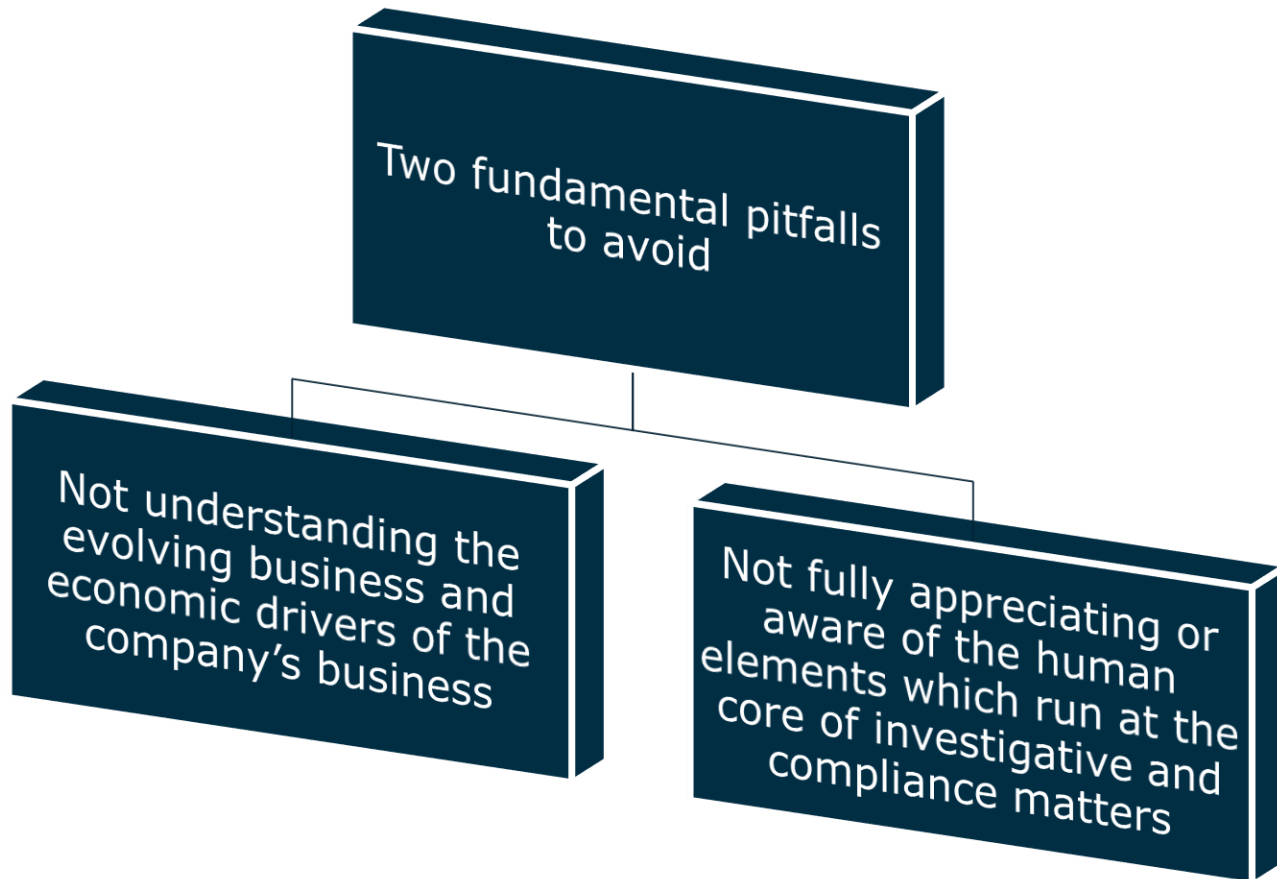
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# Avoid Missing the Elephant in the Room – First Take a Step Back and Think about the Situation

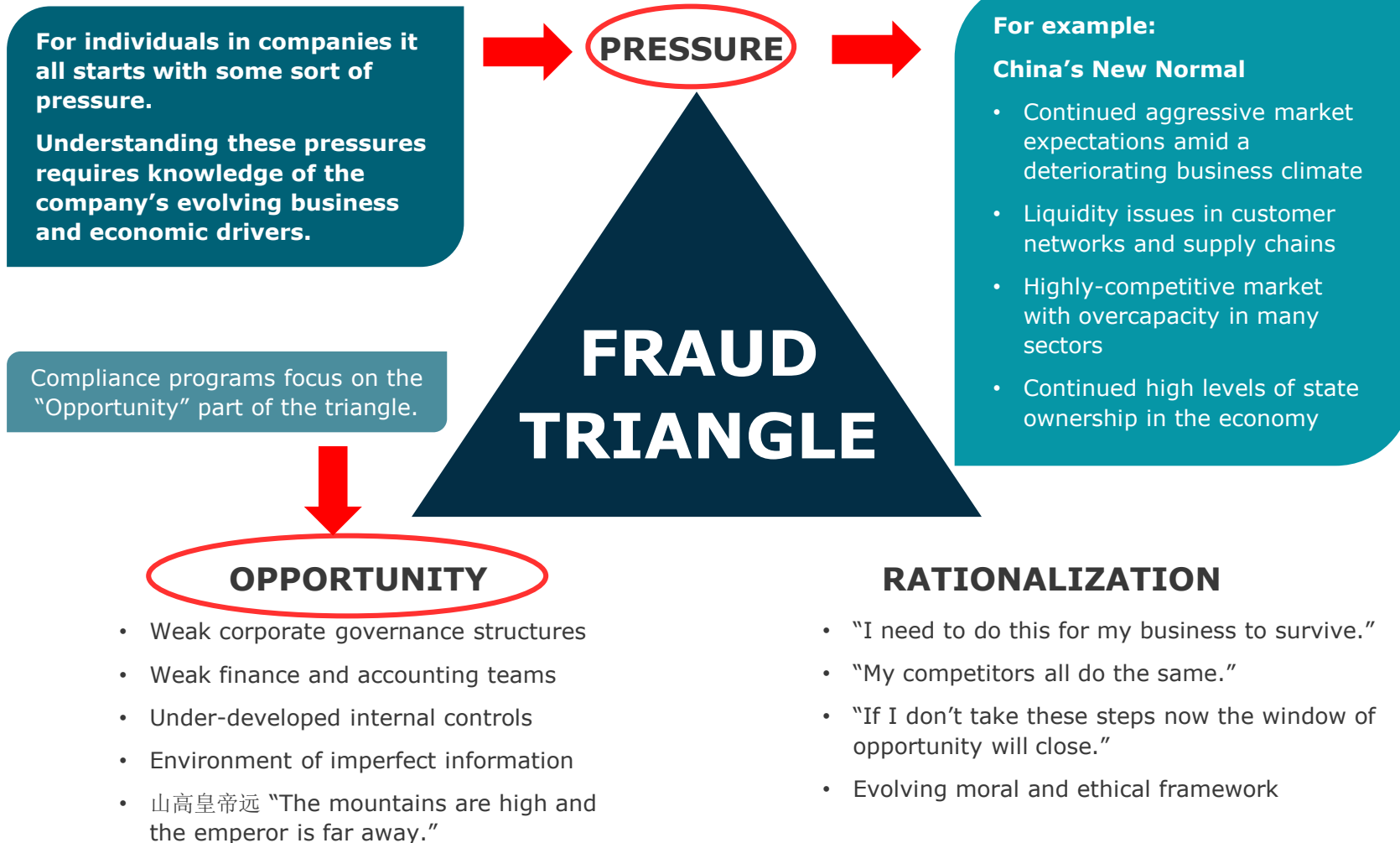
Before jumping into any testing, first take a step back and look at the bigger picture to avoid missing the elephant in the room. There are two common pitfalls if one does not first take a step back and look thoughtfully at the situation.





# Understanding an Entity's Business Starts with Knowing its Particular Pressure Points

The Fraud Triangle provides a conceptual framework to understand the underlying elements that come together to create an environment conducive to produce fraud and corruption.



# Understanding Key Drivers – Economic, Business, and Regulatory

Grasp the “Revenue” and “Regulatory” elements of the entity’s operations

## Example: Top Challenges for Multinationals in China

1. Competition with Chinese companies in China
2. Cost increases
3. Licensing
4. Overcapacity
5. Transparency
6. Uneven enforcement or implementation of Chinese laws
7. Human resources
8. Intellectual property rights enforcement
9. Foreign investment restrictions
10. National treatment

These operational issues all point to greater downward pressure on margins and increased pressure for fraud and compliance challenges.

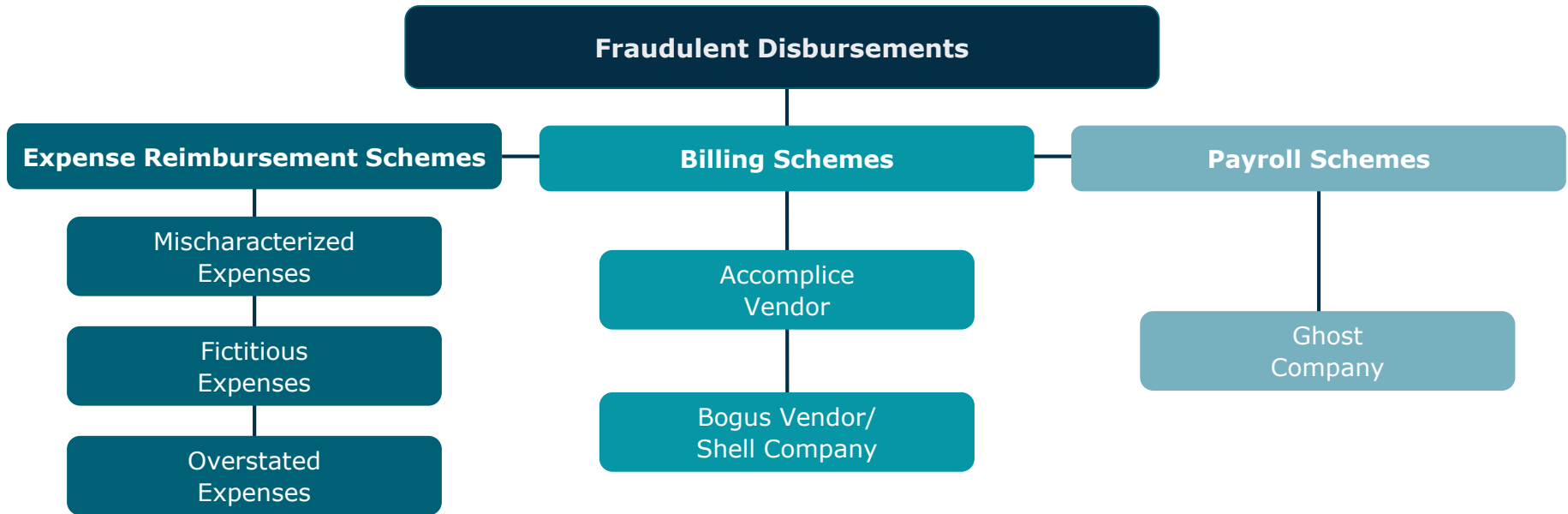
The above example applies to China; every global location will have different priority issues.

The two main over-arching operational risk categories in terms of anti-corruption compliance are **Revenue** and **Regulatory** and these are reflected in these operational issues.

Third parties are used for one of these two over-arching areas.

By understanding the latest developments and trends in each location’s business this conceptual framework can help prioritize elements for an effective testing plan.

# Common Corruption-Related Fraud Schemes - A Shift Over Time to More Use of Third Parties



*However, note that with the increased awareness of corruption issues around the world, there has been a general evolution corruption-related schemes:*

From higher volume / lower dollar value schemes  
(like excessive meals, gifts, and travel)...

**...to lower volume/higher dollar value schemes  
with more creative, hidden approaches  
(with an emphasis on the use of 3<sup>rd</sup> parties)**

# Common Red Flags with Third Parties

## Basic Nuts and Bolts – Obvious Issues

- Reputation for paying or receiving bribes
- A history of corruption in the country or industry
- No physical address for its business operations
- True ownership of the business unknown or opaque
- Will not sign an anti-corruption certification that no corrupt payments will be made
- Refuses to include – or abide by - an audit clause and/or anti-corruption compliance clause

## More Subtle Red Flags

- Apparent lack of qualifications or resources to perform services provided
- Third party was recommended by a government official
- Unusual payment patterns or financial arrangements
- Questionable and excessive commissions and expenses for which there is no reasonable, rational and explainable accounting

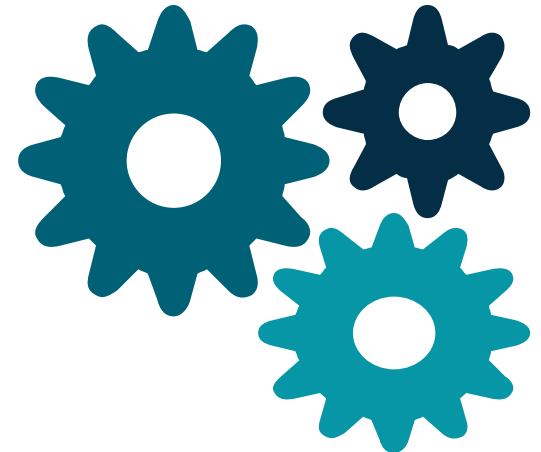
# Common Testing Mistakes

## Under-Testing Key Areas While Over-Testing Less Relevant Ones

- Testing low-risk third parties and missing the higher risk ones
- Taking a set amount of random samples across the general ledger (e.g., random 10% of transactions across all GL accounts)
- Over-reliance on specific threshold amounts
- Taking an automated, cookie-cutter approach to the testing process
- Not understanding the key drivers of the entity's business

## Psychological biases influencing the testing process

- Need a flexible approach
- Take an objective look at the drivers of the entity's business



# Missing the Elephant in the Room – Part Two

The Human Element...“The Secret of Steel”

Not fully appreciating or aware of the human elements which run at the core of compliance and investigative matters



## Key Problems Include:

- Compliance processes left on autopilot
- Over-reliance on technology tools as a cure-all
- **Psychological bias in investigations and compliance matters...**

# Psychological bias in investigations and compliance matters

## Types of bias

### **Bias – Three common types:**

#### **Stereotypes**

A stereotype is an exaggerated belief, image, or distorted truth about a category of people or an individual member of that category. A stereotype can be either positive or negative.

Stereotypes are often created or reinforced by mass media, but they are also passed on (perhaps unintentionally) by parents and family members, teachers, religious leaders, and other respected individuals.

#### **Prejudice**

A prejudice is an opinion, prejudgment, or attitude about a category of people or individual members of that category. Prejudice is often thought of as a negative feeling toward members of a group, but prejudices can be positive, too.

Implicit prejudice, the type that the holder is not consciously aware of, is everywhere in the workplace. When an investigative or compliance professional begins an assignment and meets the CFO, who is a gray haired and older than the investigative professional, what sort of expectations might the investigative professional form? Would those expectations differ if the CFO was much younger?

#### **Discrimination**

Discrimination is behavior that treats people unequally as a result of their group memberships. Discrimination often starts out as a stereotype or a prejudice.

If professionals are not aware of their stereotypes and prejudices, or if they are but do not properly address them, these can affect workplace actions and can lead compliance and investigative work plans off-track.

Source: Association of Certified Fraud Examiners, "Overcoming Bias in Investigations and Audits"

# Psychological bias in investigations and compliance matters

Potential harmful impacts if bias goes unchecked

## ***Compliance Matters***

Harmful effects of bias include:

- The reviewer/auditor gives insufficient consideration to the risk of fraud/corruption in the planning stages of the audit because she/he has had positive past experiences with the local entity's personnel and third parties.
- The reviewer/auditor accepts management's explanations and representations without sufficient corroboration.
- Reviewers/auditors fail to recognize red flags...thereby missing the elephants in the room
- Failure to catch potential issues up front leading to risk of bigger disasters down the road

## ***Investigations***

Bias can have any of the following effects on an investigation as well:

- The real perpetrator gets away.
- The wrong person is punished and that person's reputation is unfairly tarnished.
- The reputation of and trust in the investigative function is damaged.
- Workforce morale is weakened.
- The organization faces negative publicity.
- A terminated employee represents a potential financial liability.



# Psychological bias in investigations and compliance matters

## Examples of potential impact

### *Example 1*

#### ***Bias in Performing Analyses and Reliability of Management/Employees Explanations***

Bias is particularly harmful with respect to over-reliance on explanations from management or not adequately following through on certain explanations. Bias can impair an examiner's ability to apply professional skepticism to the responses from management and others in connection with analytical procedures.

### *Example 2*

#### ***Bias in Planning Compliance Audits/Reviews***

Building on the preceding bias, internal investigative and compliance professionals plan their audit procedures based on a risk assessment. Part of this assessment involves identifying fraud risks and assessing their likelihood and significance. Repeated exposure to certain personnel in environments without significant frauds or ethical breaches in the past, can lull an examiner into a false confidence that fraud risks are minimal. And if the examiner does not identify significant risks during the assessment, the resulting audit/review plan will exclude key relevant risk profile elements.

### *Example 3*

#### ***Bias in Performing Procedures***

Examiners make judgments all the time while performing audit procedures. What constitutes an exception in a test? It is a simple question, but anyone who has conducted transaction testing understands that the answer is not always so simple.

Testing procedures use significant judgment and professional skepticism for decisions about which test results require follow up or explanation and which do not. These judgments and an examiner's professional skepticism are shaped, in part, by the implicit biases brought into the workplace.

Source: Association of Certified Fraud Examiners, "Overcoming Bias in Investigations and Audits"

# Psychological bias in investigations and compliance matters

## Characteristics to help overcome potential bias

**Able to Suspend Judgment** This characteristic was described all the way back in Statement on Auditing Standards No. 1 as an essential element of professional skepticism. Investigators and auditors should wait to form judgments until they have obtained and considered sufficient evidence.

**Informed** Good skeptics gather information and are not satisfied until they have reviewed and understood all of the relevant data, including any facts that might conflict with their existing hypothesis.

**Ethical** Good skeptics seek the truth and are not easily influenced or swayed. They do not waver in abiding by standards of ethics and integrity.

**Curious** Good skeptics are not doubtful of everything they are told, but they do have a natural curiosity and questioning minds. They do not blindly accept everything they are told as being correct and complete.

Good skeptics have a natural desire to search for knowledge.

**Self-Confident** Good skeptics are not easily deterred by the latest piece of information or attempted persuasion from management. Rather, they take in all relevant information and process it before reaching a conclusion.

**Persistent** Good skeptics seek the truth by gathering and considering all information—even if the information is extremely difficult to obtain and the individuals who own the information are opposed to providing it. Good skeptics do not give up easily.

**Perceptive** Good skeptics are:

- Constantly alert for red flags or new information
- Able to connect information from multiple sources
- Able to identify patterns in behavior and information

**Effective Communicator** Good skeptics are effective communicators, not only in expressing themselves, but also in serving as active listeners, observing and taking in all information being provided by an interviewee. Good skeptics are also good at asking questions without coming across as adversarial.

**Well-Rested** Get sufficient sleep (lack of sleep has a dramatic adverse effect on individuals' ability to challenge their existing beliefs).

Source: Association of Certified Fraud Examiners, "Overcoming Bias in Investigations and Audits"

# Hypothetical Example: Basic Steps for the Follow-on Testing/Audit Process

## 1. Develop an appropriate risk profile

- Base the profile on the entity's latest trends and developments in the business
- Identify the "Revenue" and "Regulatory" drivers

## 2. Identify key individuals

- Which employees serve in roles which are higher risk "Revenue" and "Regulatory" related roles?
- Which ones have proposed and/or approved third parties for these areas?

## 3. Examine key accounts (GL detail)

- How are transactions with third parties booked?
- Which accounts are used by the local sub/entity?

## 4. Identify high-risk transactions

- Again, based on those pertaining to "Revenue" and "Regulatory" key areas
- Government and state-owned enterprise clients
- License and inspections

## 5. Examine related third party activities

- Payments – nature and of supporting documentation
- New additions – especially related to key individuals and priority areas
- "Nuts & Bolts" review: i.e. Have they signed anti-corruption certifications? Is there a compliance clause?

**Compliance audits/testing requires a focused and risk-based approach**

# Hypothetical Example: Developing a Risk Profile

## Developing a Risk Profile – Key Concepts

### Understand the local entity's business

- What are the main revenue sources?
- Who are its clients?
- Which clients are government entities and/or state-owned?
- How does the company go to market?
- What is the regulatory environment that applies to the business? What particular licenses are required?
- Which functions are handled at the corporate level and which ones at the local/subsidiary level?
- Who is responsible at the company for all these functions above?

Based on the answers to these questions, write a description of the company's risk profile. Then, develop testing procedures based on this risk profile.

## Hypothetical Example: Identifying Key Accounts

The chart on the right shows an example of expense-related accounts.

Every company varies in terms of the exact items on their chart of accounts. Redundancies are common.

Also, be aware that the local entity may be using non-standard definitions and relevant transactions may be booked in various accounts.

This is especially the case for post-M&A environments and situations where there has been significant turnover in the finance and accounting staff.

Account #	Account Description
5501111	Advertising
5501119	Business Development
5502132	Client Gifts
5501133	Client Maintenance
5501172	Consulting Fees
5501130	Entertainment (General & Administrative)
5502130	Entertainment (Sales & Marketing)
5501113	Exhibitions
5501117	Gifts
5501173	Human Resources & Consulting Fees
5501185	Legal
5501151	Office Expenses
5501115	Other Marketing Expenses
5501112	Promotional Samples
5501116	Public Relations
5501131	Sales Promotion
5502174	Training
5501121	Transportation
5501120	Travel (General & Administrative)
5502120	Travel (Sales & Marketing)

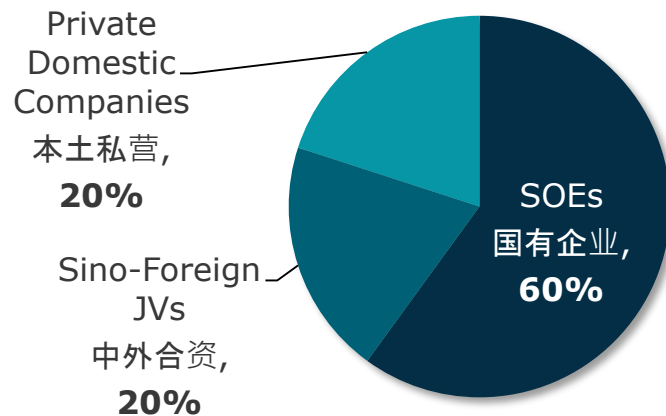
# Hypothetical Example: Background Facts

## Core Products: High Tech Components



- B2B company that sells high tech industrial components to many SOE customers
- Sales made through a direct sales force as well as agent and distributor networks
  - Separate sales teams for SOE and private company sales
  - Sales managers assigned by geography for North and South Regions
  - A network of agents overlap regions and customer types, designed to cover smaller-volume customers

## Customer Base 客户类型



## Sales Regions 销售区



## Hypothetical Example: Background Facts (cont.)

### **Over the last six months, the company experienced the following key activities:**

1. Acquired 2 new major SOE clients (both in North Region)
2. Received a large new order from an existing SOE customer (South Region)
3. Inspection by the tax bureau
4. For the annual sales plan, interviews yielded the information that a contract approval request has been submitted by requested by the market research manager on behalf of the VP of sales; the consultant offers to provide specific procurement plan information on SOE clients
5. The company added 3 new agents:
  - **Raymond Chen Shell Company** 陈大文皮包公司
  - **Brighter Future Consulting** 未来更好顾问公司
  - **Sino Prosperous Consulting Company** 中国顺景顾问有限公司

*(All agent contracts must be approved by the VP of Sales and the President / CEO)*

# Hypothetical Example: Org Chart

President & CEO  
总统 & 总裁

Identify key individuals  
辨识重要人物

VP Sales  
营销副总经理

VP Operations  
经营副总经理

VP Finance  
财务副总经理

VP Legal  
法律副总经理

SOE Sales  
国营销售

Private Co. Sales  
私人企业销售

Market Rsch  
市场调查

Customer Svc  
顾客服务

Logistics Mgr  
物流经理

Accounting  
会计

Licensing  
许可

Sales Mgr - North  
经理 - 北地区

Sales Mgr - North  
经理 - 北地区

Production  
生产

Info Mgmt  
信息管理

Compliance  
合规

Sales Mgr - South  
经理 - 南地区

Sales Mgr - South  
经理 - 南地区

Quality Control  
质量管理

Tax Mgr  
税务经理

R&D  
研究与开发

Administration  
行政管理

Purchasing  
采购



# Hypothetical Example: Chart of Accounts

Examine key accounts  
检查关键账目

Account No. 科目编号	Account Name 科目名称
57611002	Consultants 顾问费
57621000	Professional Services 专业咨询费
57621001	Outsourcing Fees 外包费用
57621002	Inspection Fees 检验费
57621003	Gifts 礼品
57621004	Business Travel 差旅费
57621005	Government Relations 政府费用
57621006	Product Examination 产品检测费
57691000	Fines and Penalties 商罚款
57811000	New Product Development 开发新产品费用

Be sure to talk with the local finance and accounting team to understand how they actually record transactions, as actual practice may vary from company policy and may not always have been consistent over time, especially if the department has seen a lot of turnover in personnel. (For example, agent fees may be recorded in 57611001 Consultants and/or 57621000 Professional Services.)

## Hypothetical Example: Additions to Vendor Master List in Last Six Months

Examine third party activities  
检查第三方活动

Company 公司	Department 部门	Internal Contact 内部联络人	Latest Amount Paid 最后付款数
Real Metal Company 坚实金属公司	Purchasing 采购	Rainbow Zhou 周彩虹	¥34,955.00
CHINA PPT INV 中国置业投资	Administration 行政管理	Leo Liu 刘力	¥29,000.00
Raymond Chen Shell Company 陈大文皮包公司	Marketing 营销	LIN Na 林娜	¥200,000.00
CCT LAND 中建置地	Administration 行政管理	Leo Liu 刘力	¥2,195.00
Brighter Future Consulting 未来更好顾问公司	Sales 销售	LU Yuping 陆雨平	¥40,000.00
Sino Prosperous Consulting Company 中国顺景顾问有限公司	Logistics 物流	SONG Hua 宋华	¥90,000.00

The three new agents show up on the vendor master list. The vendor master list additions also match the contracts log. You check and they all have duly approved contracts with anti-corruptions terms and conditions, and they all have anti-corruption certifications on record, as per company policy.

**However, in the general ledger review you noted another payment to a consulting firm - Fusion Consulting – which DOES NOT appear on either the vendor master list or the contracts log.**

# Hypothetical Example: General Ledger Detail

Identify high-risk transactions  
 辨识高风险交易

Date 输入日期	Account No. 科目编号	Account Name 科目名称	Description 摘要	Amount 金额
6/1/2015	57621004	Business Travel 差旅费	SONG Hua Apr Expense 宋华4月报销	¥5,301.54
6/1/2015	57621004	Business Travel 差旅费	WANG Xiaoyun Apr Expense 王小云4月报销	¥2,992.00
6/1/2015	57621004	Business Travel 差旅费	LU Yuping Apr Expense 陆雨平4月报销	¥10,567.00
6/1/2015	57621004	Business Travel 差旅费	LIN Na Apr Expense 林娜4月报销	¥21,347.81
6/1/2015	57611002	Consultants 顾问费	EH0259 Hardness Testing EH0259 硬度测试	¥75,000.00
6/1/2015	57611002	Consultants 顾问费	ZHOU Ran May Mill Consulting Fee 周冉5月厂子顾问费	¥2,000.00
6/1/2015	57621000	Professional Services 专业咨询费	Fusion Consulting Technical Service Fee 飞讯技术服务费	¥100,000.00
6/1/2015	57621002	Inspection Fees 检验费	5.14 Materials Import Inspection 5.14 原料井口检验	¥3,000.00

## Hypothetical Example: Key Observations and Follow-up Recommendations

- Three third party agents were hired in high-risk sales roles; nevertheless,
  - All had duly-approved contracts with terms and conditions required by company policy,
  - All had completed due diligence files approved by the compliance officer, and
  - There were no disbursements outside of contract terms.
- **However**, one payment to a third party not on the vendor master list (“Fusion Consulting”), in addition there was no contract with the vendor or due diligence file. This payment occurred in a regional branch office by newly-hired employees.
- As a follow-up:
  - Make sure newly-hired employees are trained on the company’s anti-corruption compliance policies, in all locations.
  - The finance department also needs to be trained to not process payments to vendors without a duly approved contract, anti-compliance certification, and approved due diligence file.

## For further questions, see contact information below:



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Brent helps companies and their stakeholders across Asia in the areas of internal investigations and remediation, anti-corruption compliance matters, mergers and acquisitions, dispute consulting, operational improvement, and interim management roles.

As a Certified Fraud Examiner, Brent has provided investigative and dispute consulting services in internal investigations, fraud prevention initiatives, commercial disputes involving mediation, arbitration, and civil litigation, as well as criminal prosecution. Brent also has testified in court as an expert witness in fraud-related matters. Brent has over twenty years of China business experience and is fluent in Mandarin Chinese.

### Relevant experience

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- Assisted an U.S. multinational client in an investigation into fraudulent transactions at a newly-acquired subsidiary. Project included the tracing of assets between the company and the founder/CEO's other business ventures.
- Led an internal investigation into whistleblower allegations pertaining to inappropriate behavior and asset misappropriation on the part of a country General Manager in Asia.
- Engaged by U.S. corporate parent counsel to investigate questionable third parties and alleged diversion of company funds for potential corruption and self-dealing/embezzlement issues.
- Testified in court as an expert witness in fraud-related matters.
- Guided companies through antifraud- and anticorruption-related matters involving due diligence, assessment of existing compliance infrastructure, and development and implementation of effective compliance programs across Asia.
- Served in interim management and monitoring roles, including compliance officer.