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EXPERT ANALYSIS

Long Time Coming: The SEC's Increased Use Of the Internal Control Provision of the FCPA

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Probably the most striking recent trend in enforcement of the Foreign Corrupt Practices Act is the increase in charges of internal control violations by both the Justice Department and the Securities and Exchange Commission. Although lawyers in the trenches in battles with the SEC and the Department of Justice have seen this development coming for a while, it has only recently caught the attention of commentators.

As a result, the attention to internal controls has left some companies scrambling to respond and others wondering why it took the government so long to push this provision of the statute.

The increased focus on internal controls is the product of two concurrent developments.

First, years of government attention to compliance programs, with their emphasis on training and reporting, produced scores of companies with passable compliance programs but continued FCPA problems. Training and reporting processes have proven to be insufficient to stem the tide of violations. Compliance programs are useful, but the government wants more.

Second, proving a violation of bribery provisions of the FCPA is difficult. It often requires proof of events in foreign countries in which the U.S. government has limited ability to obtain the cooperation of witnesses and the production of documents. By contrast, internal controls charges are more focused on processes in the United States, about which evidence is far more easily obtained.

Beneath the surface of these developments is a disconnect about what the internal controls provisions actually require. The government — and especially the SEC — has settled on an interpretation of the internal controls provision that is at odds with the understanding of many in-house finance professionals about what internal controls are intended to address.

Ask corporate finance professionals about internal controls at their companies and you will likely get an answer about processes designed to protect the company's assets at a level that would materially impact the company's financial statements. Ask your friendly neighborhood SEC investigator about internal controls and you will instead get inquiries about the exponentially smaller level of amounts of money that would be enough to influence a low-paid public official in a poor third-world country.

Not only is the SEC looking at controls on a more microscopic level, but its predilection to pursue internal controls charges sometimes seems based on an interpretation of the FCPA that borders on strict liability. Circumstantial evidence of a bribery violation — such as evidence that some money may have left the company without proper authorization or accounting records — translates for the SEC into proof that the company's controls were inadequate.

Statutory elements of reasonableness and *scienter* get short shrift in a world in which the SEC aggressively pushes internal controls charges, and the vast majority of companies remain predisposed to settle.

While it is too soon to tell whether the SEC's aggressive interpretations of the internal controls provisions of the FCPA will withstand judicial scrutiny, it is not too soon to see the benefits to companies in careful attention to their internal controls at the microscopic level sought by the SEC.

For example, controls carefully designed to implement anti-bribery policies by ensuring that no payments can leave the company until due diligence into a vendor and accurate receipts for goods and services have been reviewed and approved by an appropriate manager can help companies in at least two ways. They have the potential both to reduce violations, and if a violation nonetheless occurs, to provide an additional basis to convince the government that the company should be given a break because it was and is interested in preventing violations.

Whatever verdict is reached on whether the FCPA requires them, building in such controls as companies improve and automate their financial systems will likely prove to be helpful in ensuring compliance and, in the long run, a good business practice.

Statutory elements of reasonableness and scienter get short shrift in a world in which the SEC aggressively pushes internal controls charges.



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