

## Regulatory Complexity and Enhanced Enforcement Leads to Compliance Challenges

The continued adoption of new or proposed regulations, clarifications of existing requirements, increased regulatory enforcement and the advent of new fraud monitoring tools and techniques has prompted leading companies to take a fresh look at the effectiveness of governance and compliance programs.<sup>1</sup>

Current regulatory highlights include enforcement of standbys like the Foreign Corrupt Practices Act (FCPA), newly formed agencies like the Consumer Financial Protection Bureau (CFPB), which grew out of the mortgage crisis to focus on consumer protection, and a sweeping array of rules which fall under the umbrella of the Dodd-Frank Act of 2010<sup>2</sup> which reach beyond financial stability. In addition, new sanctions against Iran and Syria have prompted expanded disclosure requirements<sup>3</sup> while European competition and anti-cartel regulators have been remarkably active. In the 90 days preceding the November 2012 presidential election, one analysis showed over 6,000 regulations and notices were posted, an average of 68 per day.<sup>4</sup> While this discussion focuses on U.S. trends, analogous activity in other countries is also impacting global organizations.

Similarly, continued public intolerance of corruption and mispending of federal funds in all forms have made scrutiny of potential fraud, waste, and abuse a mantra of the U.S. federal regulatory and law enforcement community. Whether an entity is a direct recipient of federal funding, a federal contractor, a U.S. company doing business in a newly regulated industry, or in a high-risk jurisdiction, leading companies are reevaluating governance and compliance efforts to keep up with the pace of regulatory change and enforcement as well as the rise of shareholder activism.



### Questions Executives and Board members should consider to assess the adequacy of compliance programs:

1. Are Board agendas and risk programs focused on communicating tone at the top and recalibrating oversight programs for evolving regulatory risk areas?
2. Has the effectiveness of compliance/Internal Audit, ethics and conflict of interests programs been evaluated in light of regulatory trends? Examples might include disclosure requirements pertaining to conflict minerals, or transactions with Iran or Syria, healthcare mandates, data privacy or foreign corruption concerns.
3. Does the company have the right skills, budgets and reporting process in light of the new enforcement environment?
4. Does the company systematically assess and remediate the root cause of compliance concerns identified?
5. Does the company use evolving technology tools to effectively identify red flags and analyze data?

<sup>1</sup> "Preparing for Increased Regulatory Oversight and Enhanced Enforcement," KPMG LLP, October 2009

<sup>2</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act

<sup>3</sup> Defining Issues, No. 12-59, KPMG LLP, December 2012

<sup>4</sup> <http://www.openforum.com/articles/reforming-federal-regulations-key-to-economic-growth/>

## Resource Guide to the U.S. Foreign Corrupt Practices Act (FCPA) includes provisions such as:

- Who and what is covered by the anti-bribery and accounting provisions
- Effective acquisition, due diligence and post-transaction integration techniques
- Definitions such as who is a foreign official, what are appropriate gifts or facilitating payments
- Hallmarks of effective compliance programs.



### The FCPA

FCPA enforcement has increased in frequency, size of fines and penalties and the effort required by companies to comply with its more than 35-year-old provisions.<sup>5</sup> This, along with a confluence of best practices in guidance published outside the U.S.<sup>6</sup> led to the recent joint release of *A Resource Guide to the U.S. Foreign Corrupt Practices Act* by the

U.S. Department of Justice (DOJ) and U.S. Securities and Exchange Commission (SEC).<sup>7</sup> The Guide contains detailed information about the DOJ and SEC positions on key provisions, including features of an effective corporate compliance program. Additionally, ten criteria are noted in the section called “Hallmarks of Effective Compliance Programs”<sup>8</sup> referencing additional publications from multiple organizations as evidence of “an emerging international consensus on compliance best practices.”<sup>9</sup>

The Guide also includes hypothetical examples that illustrate FCPA provisions and practical suggestions for reducing FCPA risk and is an example of a regulatory update that has prompted some companies to reevaluate their existing FCPA compliance programs.

### Conflict Minerals and Sanction Updates

Supply chain transparency is another regulatory trend to watch. Traditional compliance programs and underlying technology tools historically have not been designed to focus on supply-chain disclosure requirements. Examples requiring this focus include the Conflict Minerals rule<sup>10</sup> which requires disclosure of the use of specific minerals from certain parts of the globe; and the Iran Threat Reduction and Syria Human Rights Act of 2012<sup>11</sup> which requires SEC registrants to disclose certain types of transactions with these regimes.



Organizations have realized that they need to plan well ahead of effective compliance dates in order to modify their compliance processes. Even leading companies are challenged to establish the data aggregation processes necessary to identify and monitor these types of disclosures on an ongoing basis.

### Healthcare Fraud

In addition to the traditional areas of enforcement, the rollout of healthcare reform is continuing to impact the need for governance and compliance enhancements that impact skills, budgets and organizational structures. The Department of Health and Human Services authority<sup>12</sup> now exposes companies to potentially significant civil and criminal penalties<sup>13</sup> for violation of data privacy and security rules governing the protection of Protected Health Information (PHI) such as self-funded health plans, medical malpractice information, medical insurance claims or benefit plans.<sup>14</sup>

<sup>5</sup> FCPA Digest Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act; Shearman & Sterling LLP; January 2013

<sup>6</sup> U.K. Ministry of Justice (The Bribery Act 2010 Guidance, Ministry of Justice), the Organisation of Economic Cooperation and Development (“Good Practice Guidelines on Internal Controls, Ethics, and Compliance,” OECD, Adopted 18 February 2010), the World Bank (“Debarment with Conditional Release & Integrity Compliance,” [worldbank.org](http://worldbank.org)), and others (Wolfsberg Anti-Corruption Guidance, The Wolfsberg Group, 2011)

<sup>7</sup> A Resource Guide to the U.S. Foreign Corrupt Practices Act by the U.S. Department of Justice (DOJ) and U.S. Securities and Exchange Commission (SEC), November 14, 2012

<sup>8</sup> Ibid; pages 57 – 63

<sup>9</sup> Ibid; page 63

<sup>10</sup> “Implications of the Conflict Minerals Rule - Lessons Learned,” KPMG LLP August 2012  
Conflict Minerals final rule, SEC

<sup>11</sup> H.R. 1905: Iran Threat Reduction and Syria Human Rights Act of 2012, August 3, 2012

<sup>12</sup> Under the Health Information Technology for Economic and Clinical Health (HITECH) Act, an amendment to the Health Insurance Portability and Accountability Act (HIPAA). [http://healthit.hhs.gov/portal/server.pt/community/healthit\\_hhs\\_gov\\_regulations\\_and\\_guidance/1496](http://healthit.hhs.gov/portal/server.pt/community/healthit_hhs_gov_regulations_and_guidance/1496)

<sup>13</sup> Recoveries this year topped \$3 billion for the first time, approximately \$2 billion of which were related to false claims for drugs and medical devices. – “Justice Department Recovers Nearly \$5 Billion in False Claims Act Cases in Fiscal Year 2012,” USDOJ, December 4, 2012

<sup>14</sup> “OCR Privacy Brief: Summary of the HIPAA Privacy Rule,” U.S. Department of Health and Human Services, rev. May 2003

"With government taking a more proactive enforcement posture that goes beyond blatantly fraudulent enterprises and includes looking for potential healthcare fraud and abuse in otherwise legitimate companies, having a comprehensive compliance program in place is critical," said John Liddy, partner Manatt, Phelps & Phillips, LLP.<sup>15</sup>

### Focus on Consumer Protection

The executive and legislative branches of government have also stated their intention to influence consumer protection directly through the CFPB and its effects are just starting to impact the compliance programs of a variety of financial businesses. As an example, in 2012, the CFPB, in conjunction with other regulators, entered into several multimillion dollar settlements with credit card issuers.<sup>16</sup> In addition to monitoring banks, the CFPB also has authority over credit unions, mortgage companies, payday and educational lenders, and credit reporting companies requiring a wide array of impacted organizations to overhaul their compliance programs.

The SEC Annual Report on the Dodd-Frank Whistleblower Program for the fiscal year ending September 30, 2012 indicates that 3001 tips were received with the most common complaints related to corporate disclosures and financials (18.2%), offering fraud (15.5%), and manipulation (15.2%).<sup>17</sup>

### Updating Compliance and Other Risk Programs

As leading organizations face financial pressures in an unpredictable economy, transaction activity increases, faster

reporting deadlines are instituted with more complex new mandates, and companies need to analyze vast amounts of unstructured data, they are recognizing the need to update or automate traditional oversight processes, by focusing on a few key areas:

- The revaluation of the budgets, training, communication protocols, design and operational effectiveness of corporate compliance programs and controls. As an example, many proactive organizations are also considering updated tools to explore root causes of historical or recurring compliance lapses.
- Understanding fraud and misconduct risks that can undermine business objectives in new initiatives such as growth in emerging markets or new products and services. As an example, there have been many FCPA cases involving third-party intermediaries especially in new markets which is prompting many companies to relook at on-boarding and background check processes around such intermediaries as part of the oversight overhaul.<sup>18</sup>
- In enterprise risk programs, consider the exposure to higher risk initiatives, new sanctions, and litigation that may arise from violations of law or stakeholder expectations on a global basis.
- Reconsideration of Management and Board committee roles and responsibilities to align with the regulatory regimes applicable to the company. For example, some Audit Committees are becoming overwhelmed and alternatives such as compliance or risk committees are starting to become more frequent.<sup>19</sup>

<sup>15</sup> "White Collar Defense Partner Discusses Increased Fraud Enforcement in the Healthcare Sector," manatt.com, November 12, 2010

<sup>16</sup> "Controversial New Regulator Begins with Aggressive Enforcement Settlement against Financial Services Company," The Bureau of National Affairs, Inc. 2012

<sup>17</sup> U.S. Securities and Exchange Commission Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2012

<sup>18</sup> "Third-Party Intermediaries: Managing Global Corruption Risk: The Editor interviews Marc Miller, Partner, KPMG Forensic, New York," September 24, 2012

<sup>19</sup> "The Board's Role in Compliance and Risk Management: Lessons from Recent Decisions Revisiting 'Caremark' and its Progeny," Bloomberg Law, November 5, 2012

## Results of KPMG's Fall 2012 Audit Committee Roundtables

More than 1500 directors and governance professionals identified the following as the top two risks that posed the greatest threat to international operations:

Complexity of managing the extended organization

**63 %**

Legal/regulatory compliance including FCPA and other anti-bribery laws

**53%**

*"The goal is to get compliance right without getting buried in it."*  
— ACI Attendee/Board Member

<http://www.kpmginstitutes.com/aci/insights/active/protecting-corporate-assets-and-the-brand.aspx>

## The Risk of Ignoring the Warning Signs

According to the KPMG publication "Who is the typical fraudster," the percentage of investigative matters preceded by a "red flag" was approximately 56%; however, organizations acted on only 6% of those early warning signs. Matters involving the exploitation of weak internal controls were approximately 74% in 2011, up from the 49% KPMG observed in previous years. Fraudulent activities, involving multiple transactions, particularly in financial reporting matters, occurred 96% of the time in our 2011 analysis.

<http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Pages/typical-fraudster.aspx>



- Timely updates of compliance programs as regulations or enforcement clarifications evolve. For example, amendments to the U.S. Sentencing Guidelines for Organizations, effective in November 2010,<sup>20</sup> highlighted the role of the Chief Compliance Officer (CCO) and emphasized that direct reporting to the Board ("governing authority") is important. As a result, many companies have created direct reporting lines from the CCO to the Board, much as they did with their internal audit departments, in an effort to receive the maximum benefit of this change to the sentencing guidelines.
- Plan for the appropriate lead time necessary to modify oversight to comply with supply chain or other disclosure requirements such as those required by the Conflict Minerals rule or the Iran Threat reduction and Syria Human Rights Act of 2012.
- Ensure that the right technology and resources are available to incorporate effective data analytics into compliance programs. Analytic tools can efficiently analyze large sources of unstructured data including non numerical data which becomes increasingly important as emails, customer service or trading recordings and social media activity can provide valuable insights. These automated tools are also being used by regulators and many are quickly developing tools to crunch large amounts of data.<sup>21</sup>

Meeting the call for a well-established compliance program requires more than an annual check-the-box mindset. It requires tailoring each element of the program to address the most pressing and evolving risks facing the business in an effective manner, with updated data management tools and techniques and influencing the tone and culture that dictate how business gets done. Moreover, it entails foreseeing a time when questions may be asked challenging the quality and effectiveness of compliance efforts – with significant stakes riding on the provided answers.<sup>22</sup>

<sup>20</sup> 2010 Federal Sentencing Guidelines Manual: Chapter Eight - Sentencing of Organizations," ussc.gov, effective November 1, 2010

<sup>21</sup> e-Book on Big Data: The Risks and Rewards Locked in Vast Oceans of Data, KPMG LLP and ComplianceWeek, October 23, 2012

<sup>22</sup> <http://www.kpmg.com/us/en/services/advisory/risk-and-compliance/financial-risk-management/Pages/default.aspx>

## Compliance programs impact misconduct

Based on 3,500 responses to KPMG's "Integrity Survey – 2013": 56% of employees surveyed characterized the misconduct they had observed as serious, up from 46% in 2009. However, employees who work in companies with formal ethics and compliance programs reported fewer observations of misconduct, less toxic pressure to hit performance targets, and higher levels of confidence in management's commitment to integrity.

<http://www.kpmg.com/US/en/services/Advisory/risk-and-compliance/forensic/Pages/Default.aspx>

## KPMG's 2012 global study of General Counsels – Compliance in the face of increased regulation and enforcement is a priority:

- Enhanced oversight programs to address compliance risk were the priority for 37% of respondents.
- Nearly 80% said that they were expecting an increase in the number of general regulatory disputes they are called upon to address in the next five years. 60% anticipated a rise in disputes over competition and antitrust matters, a major area of activity for the U.S. authorities.
- Looking to the future, 53% of respondents expressed concern of strong risk related to data security and the way data protection rules are being applied and interpreted by the regulators.

<http://www.kpmg.com/global/en/issuesandinsights/articlespublications/pages/general-counsel-survey-2012.aspx>

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