

## The critical path forward:

Three methods to measure the effectiveness of an anti-bribery and corruption program



### TODAY'S REALITY:

- There is no “one-size-fits all” when it comes to anti-bribery and corruption compliance programs, and regulators are raising the bar for what makes such programs effective.
- Resolutions to recent FCPA investigations by U.S. regulators demonstrate that credit is given for ample demonstration of program effectiveness, while harsh penalties result if effectiveness is lacking.
- Companies that implement enhanced procedures to assess high-risk processes and controls may save on compliance costs over time.

While most companies have anti-bribery and corruption (ABC) compliance programs in place to meet the requirements of the Foreign Corrupt Practices Act (FCPA)<sup>1</sup>, many recognize an evolving need to take further steps to reduce the likelihood of an FCPA violation. A more robust ABC program can demonstrate a company's good faith in regulatory compliance and potentially influence authorities to mitigate fines and penalties if a violation does occur.

<sup>1</sup> A soon-to-be-released KPMG survey found almost 80 percent of more than 650 companies surveyed had a written ABC policy.

As these programs mature, and in light of new, tighter regulations and the recent focus of government enforcement actions, organizations are looking for ways to improve the effectiveness of their ABC compliance programs. While not limited to the following, we believe that companies evaluating their programs should pay considerable attention to the following three components:

1. Evaluating process-level financial controls
2. Risk assessments at select foreign locations
3. Third-party intermediary on-boarding procedures

## LESSONS LEARNED

Morgan Stanley underwent a government inquiry into potential FCPA violations. Upon completion of these inquiries, both the DOJ and the SEC declined to charge Morgan Stanley. The DOJ's published rationale<sup>2</sup> for the declination explicitly included the government's recognition of Morgan Stanley's effective ABC compliance program and the details of its policies and procedures, training, auditing and monitoring, and other elements of its ABC compliance program.

### Process-level financial controls

Given the heightened global government enforcement activity in recent years, most companies already have written ABC policies and procedures in place.<sup>3</sup> However, some of these policies are becoming outdated. ABC compliance program assessments have historically focused on higher-level or entity-level controls and policy awareness across the organization. Now, as these programs have matured, there is a growing emphasis on evaluating the effectiveness of process-level controls — in particular, the ABC-related financial controls.

This shift is occurring to address regulators' heightened expectations that companies' ABC programs be dynamic and continuously improving. Compliance program assessments

now include more risk-based targeted testing. They test for the effectiveness of select ABC-related controls, such as preapprovals for certain types of entertainment expenses or gifts, petty cash, or the vetting and approval of higher-risk third parties who interact with government or government officials on behalf of the company.

These assessments are generally most effective if supplemented with forensic data analysis and risk-based transaction testing with a large enough sample population. Ultimately, as companies' ABC programs mature, we expect to see more in-depth, targeted testing of a smaller number of higher-risk processes rather than limited testing across a broader spectrum of processes.

### Foreign entity risk assessments

As companies seek to enhance their process-level control testing, they are discovering that performing risk assessments at their foreign entities in high-risk jurisdictions is an effective way to identify those processes that need to be tested further and in greater detail. The on-the-ground knowledge gained during these assessments allows companies to design efficient test procedures. These risk assessments are also effective in determining if the ABC policy and procedures are addressing the most likely corruption risks facing the business in these countries.

Organizations are naturally sensitive to ABC compliance costs, and these additional risk assessments may increase related expenses, so any risk assessment-related efforts need to effectively balance cost and reward, particularly as

companies continue to expand into foreign jurisdictions. An initial effort to identify and prioritize higher-risk areas for more in-depth targeted monitoring and assessments can shed light on how effective the ABC-related controls are operating overall.

We have seen more and more companies rotating the assessment of their foreign operations by targeting a specific number to review each year. These risk reviews can also serve as the basis for scoping considerations related to monitoring and assessment procedures.

<sup>2</sup> U.S. Department of Justice, *Former Morgan Stanley Director Pleads Guilty for Role in Evading Internal Controls Required by FCPA*, April 25, 2012.

<sup>3</sup> A soon to be released KPMG survey found almost 80% of over 650 company's surveyed had a written ABC policy.

## Third-party on-boarding processes

Third-party intermediaries (TPIs) are the preferred avenue through which companies pay bribes.<sup>4</sup>

A recent report issued by the OECD analyzed 427 foreign bribery cases (263 against individuals and 164 against entities) that have been concluded since 1999. In 75 percent of these cases, the bribery payments were made through intermediaries. In 41 percent of the cases, these intermediaries were agents, distributors, and brokers. In another 35 percent, the intermediaries were corporate entities, such as foreign subsidiaries, entities serving as offshore tax shelters or local consulting firms.

## LESSONS LEARNED

In July 2014, the SEC issued a cease-and-desist order<sup>5</sup> issued to Smith & Wesson. According to the SEC's complaint and related public information, the company obtained a relatively small benefit (\$107,852) from the alleged bribes and at the time of the inquiry, the company's international sales only represented approximately 10 percent of total sales. Nevertheless, while the DOJ declined to pursue a criminal FCPA case, the SEC imposed a \$2 million civil sanction. Noteworthy is that while the company was charged for violating Section 13(b)(2)(A) of the Exchange Act for inaccurately recording the payments in its books and records, the company was also charged with violating Section 13(b)(2)(B) for a broader shortcoming which was unusual compared to previous matters:

"Smith & Wesson failed to devise and maintain sufficient internal controls with respect to its international sales operations. While the company had a basic corporate policy prohibiting the payment of bribes, it failed to implement a reasonable system of controls to effectuate that policy. For example, Smith & Wesson failed to devise adequate policies and procedures with regard to commission payments, the use of samples for test and evaluation, gifts, and commission advances. Further, Smith & Wesson's FCPA policies and procedures, and its FCPA-related training and supervision were inadequate. ... As a result of the conduct described above, Smith & Wesson violated Section 13(b)(2)(B)..."<sup>6</sup>

To address these risks, some companies have implemented procedures for the on-boarding of third parties, including risk-ranking each third-party relationship (e.g. agents, business partners, clients), and developing the appropriate level of due diligence screening and reporting based on that ranking. However, we have seen that many organizations have yet to develop formal third-party on-boarding processes. So, while this avenue for corruption is well known, many still have work to do to establish controls to help mitigate third-party corruption risks.

## What companies can do

Despite the heightened awareness of ABC issues and the number of companies with compliance programs in place, organizations continue to be penalized for their inability to demonstrate program effectiveness. Companies can take a number of steps to evaluate the strength of their ABC compliance program and whether they need to address additional risk concerns:

- Consider the maturity of the ABC compliance program
- Determine the extent to which the compliance program is implemented across various businesses
- Evaluate whether it has a current risk assessment related to ABC concerns

These considerations are important in determining whether a company is ready to begin in-depth targeted testing of high-risk processes. The lessons learned from enforcement activity and authoritative guidance are that:

1. A government investigation will focus on process-level, in particular ABC-related financial controls, as it examines payment controls weaknesses and the adequacy of the books and records.
2. Foreign-entity-level risk assessments may be necessary to understand the higher-risk processes to allow organizations to design audit and test procedures to effectively evaluate relevant process-level financial controls.
3. Third parties continue to be the main avenue to pay bribes. Robust measures to screen third parties cannot eliminate the potential that agents may pay bribes, but such procedures may better support evidence that the actions were by rogue representatives.

<sup>4</sup> OECD (2014), *OECD Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials*, OECD Publishing.

<sup>5</sup> U.S. Securities and Exchange Commission, Release No. 2014-148, *SEC Charges Smith & Wesson With FCPA Violations*, July 28, 2014.

<sup>6</sup> U.S. Securities & Exchange Commission, Securities Exchange Act of 1934 Release No. 72678, *In the Matter of Smith & Wesson Holding Corp.* (July 28, 2014).

Contact Person

**Nicholas Cameron,**  
Head of Forensics  
T: +971-44248992  
E: nicholascameron@kpmg.com

Author	Contact us					
<b>Peter Osmanski</b> 312-665-3690 posmanski@kpmg.com	<b>Northeast</b> <b>Marc Miller</b> 212-872-6916 marcmiller@kpmg.com	<b>Southeast</b> <b>Phillip Ostwalt</b> 404-222-3327 postwalt@kpmg.com	<b>Midwest</b> <b>Rocco de Grasse</b> 312-665-1296 rdegrasse@kpmg.com	<b>Midatlantic</b> <b>Pamela Parizek</b> 202-533-5362 pparizek@kpmg.com	<b>Southwest</b> <b>Michael Schwartz</b> 713-319-2258 mschwartz@kpmg.com	<b>West</b> <b>Guido van Drunen</b> 206-913-4208 gvandrunen@kpmg.com

[kpmg.com/us/forensic](https://kpmg.com/us/forensic)