

# ***Foreign Corrupt Practices Act: The role of forensic accountants***



It's the day before a Fourth of July weekend and the General Counsel (GC) of a Securities Exchange Commission (SEC) registrant requests an urgent meeting with the Chief Compliance Officer (CCO) and the Vice President of Internal Audit (VP-IA).

The GC tells the stunned executives that a whistleblower has come forward with allegations that bribes, disguised as consulting fees, are being paid by the company's South Korean subsidiary. How, the GC asks, could this have happened, when the compliance and internal audit teams performed what appeared to be a thorough anti-corruption compliance audit in Seoul just last year?

What do you think happened? Let's analyze.

## **The Statute: Internal Control Provision of the Foreign Corrupt Practices Act (FCPA)**

The FCPA requires SEC registrants to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurance that transactions are recorded appropriately and in accordance with rules and regulations. It is important to note that a violation of the anti-bribery provision is not required in order to violate the internal control provision.

## **The FCPA Guide<sup>1</sup>: Review and test; prevent, detect, remediate**

The FCPA Guide further clarified that in order to comply with the internal control provision:

- An organization should take time to review and test its controls.
- A well constructed, thoughtfully implanted, and consistently enforced compliance and ethics program can help prevent and detect, remediate, and report misconduct, including FCPA.

## **Sarbanes Oxley Act (SOX) and FCPA: The interplay**

In light of the internal control provision of the FCPA, companies often seek refuge under SOX compliance. However, there is a significant difference between SOX and FCPA requirements. Section 404 of SOX requires SEC registrants to establish an adequate internal control structure and procedures for financial reporting to assist in detecting a material misstatement. Unlike the provisions of SOX, FCPA has no materiality threshold because there is no financial threshold for compliance with laws.<sup>2</sup>

To illustrate, a \$75,000 payment to a consultant in South Korea typically will not be material to an SEC registrant's financial statements and accordingly may not be the focus of a SOX audit. However, this payment may be very relevant from an FCPA compliance assessment perspective, since Mali is an emerging market with a high corruption perception index and the payment involves a consultant, which is a compliance-sensitive area.

In a nutshell, SOX compliance ≠ FCPA compliance.

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<sup>1</sup>U.S. DEP'T OF JUSTICE, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT (2012), available at <http://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf>.

<sup>2</sup>*Id.*

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## How can forensic accountants bridge the gap between SOX and FCPA?

Forensic accountants combine their accounting knowledge with investigative skills, using this unique combination in litigation support and investigative accounting settings. In contrast, SOX internal auditors are primarily tasked with testing the adequacy of financial controls over the financial reporting process. The risk of using internal auditors for FCPA compliance assessments is that unless they have forensic accounting or FCPA experience, they often lack certain skills that are very important in performing FCPA compliance assessments. Here are a few examples:

- Internal audit procedures often focus on testing internal controls by performing walkthroughs, but do not always perform transaction testing of compliance-sensitive accounts such as commission, discounts, gifts, and charitable contributions. Additionally, if controls are compromised through collusion, SOX walkthroughs may not reveal anomalies, whereas transaction testing likely will.
- SOX internal auditors may not always apply the same level of skepticism as forensic accountants. For example, a vendor invoice that matches the company's purchase order and service agreement may satisfy typical SOX documentation requirements. However, forensic accountants will likely look beyond such documents and inquire about the substance behind the transaction by asking for: (1) evidence of service provided; (2) due diligence, if any, performed on the service provider; (3) fair market value of the service; (4) timing of the payment (prepayment versus on completion of service); and the like.
- Data mining is another important aspect of FCPA compliance that may not be appropriately addressed by internal auditors who lack forensic credentials and FCPA experience. Performing appropriate data mining can reveal anomalies, including but not limited to: transactions with key words (e.g., India's *Diwali* festival or China's focus on relationships expressed as *Guanxi*), transactions under approval threshold, payments to vendors in tax havens, and vendors with sequential invoices.

### DOJ: FCPA calls for 'qualified auditors' with 'FCPA and anticorruption training'

The significance of involving forensic accountants with FCPA experience has not gone unnoticed; the Department of Justice (DOJ) alluded to this need in a recent deferred prosecution agreement, stated: "Each FCPA Audit shall include on-site visits by an audit team comprised of qualified auditors who have received FCPA and anticorruption training."

### Hindsight for the GC, CCO, and VP-IA

It's the day after the July Fourth holiday. After mulling it over, the business leaders realize — albeit too late — how the auditors last year failed to detect the bribery in the company's Korean subsidiary. While the internal audit team focused on wrapping up the SOX audit and performing high-level procedures such as control testing and walkthroughs, the compliance team spent its time conducting interviews and verifying FCPA policies and training. Somewhere in between, transactions such as the consulting fees were not detected — because no transaction testing was performed.

Since 'books don't lie,' the use of forensic accountants in performing FCPA compliance assessments is a regulatory expectation. Do you perform FCPA compliance assessments using forensic accountants with FCPA experience?

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