Ten Board Questions On Anticorruption Compliance

by Roman E. Darmer, Henry Klehm and Joshua S. Roseman

With a combination of stronger enforcement, tougher individual liability, and higher fines, violations under the U.S. Foreign Corrupt Practices Act (FCPA) are a top compliance issue for all major corporations. The board of directors is the ultimate fiduciary for such compliance. What does your board need to ask about company controls before it is too late?

The United States Department of Justice, the U.S. Securities and Exchange Commission, and non-U.S. governments and agencies have emphasized their continued commitments to pursuing both corporate and individual violators of the Foreign Corrupt Practices Act (FCPA). Given this ongoing emphasis, corporate board members have particularly important roles to play in overseeing compliance and anticorruption programs at the companies they serve.

In late November 2017, U.S. Deputy Attorney General Rod Rosenstein announced changes to how the Department of Justice (DOJ) will prosecute companies that violate the Foreign Corrupt Practices Act (FCPA). More specifically, he announced that companies will earn a presumption of declination, or possibly a 50 percent mitigation of penalties, if they self-disclose, cooperate, remediate, and disgorge profits.

Rosenstein also reaffirmed DOJ's commitment to prosecuting FCPA violations by the individuals involved in the misconduct. Similarly, Chairman Jay Clayton of the Securities and Exchange Commission (SEC) has also emphasized the SEC's ongoing commitment to holding individuals accountable. Internationally, non-U.S. governments are increasingly both cooperating with U.S. investigators and also extending their own local anticorruption laws against corporations and individuals alike.

The ever-increasing FCPA risk to individuals has led to at least one "noisy resignation" by a company director who believed that the company was not taking adequate steps to ensure compliance with the FCPA and other laws. The good news for companies and their directors, however, is that the enormous risks of corporate misconduct can be mitigated by an effective corporate compliance program.

This compliance program serves two important purposes. First, it decreases the opportunities for misconduct, and increases a company's ability to detect misconduct when it occurs.

Second, the existence of an effective compliance program is a factor that U.S. prosecutors consider in determining whether to bring charges and in negotiating plea agreements. It is also a mitigating factor for purposes of criminal sentencing under the U.S. government's Federal Sentencing Guidelines.

An effective compliance program requires that the board "exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program."

The board of directors has an important role to play in overseeing a company's anticorruption compliance program. The Sentencing Guidelines provide that an effective compliance program requires that the board be knowledgeable about its content and operation, and must "exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program."

The DOJ and SEC Resource Guide to the U.S. Foreign Corrupt Practices Act makes clear that "compliance begins with the board of directors and senior executives setting the proper tone for the rest of the company." Likewise, DOJ's Principles of Federal Prosecution of Business Organizations provide

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that prosecutors must consider whether the board exercises independent review of the company's compliance program and whether directors are provided with information sufficient to enable the exercise of independent judgment.

The FCPA prohibits companies from indemnifying directors for any fines that might be assessed for individual violations.

An inadequate or ineffective anticorruption compliance program also increases directors' exposure to shareholder derivative litigation. Notably, the FCPA prohibits companies from indemnifying directors for any fines that might be assessed for individual violations of the statute by directors, officers, and employees.

For all these reasons, directors are well-advised to diligently oversee anticorruption compliance at the companies. Following are 10 essential questions that every director should ask and be able to answer about company anticorruption compliance programs.

☐ ***1. Does the board, and senior management, set and communicate the proper "tone at the top?"*** The bedrock of an effective compliance program is the proper "tone at the top" set by the board and senior management. This means that the board and senior executives should clearly demonstrate a commitment to compliance that is in turn reinforced and implemented by middle managers and employees at all levels. A company's compliance culture will be judged by the following characteristics:

- Whether the organization explicitly encourages ethical conduct and compliance with the law.
- Whether management "buys in" to the requirement of ethical conduct and adheres scrupulously to ethical standards, creating an appropriate corporate culture.
- Whether management reinforces the company's culture of compliance by clearly and regularly communicating and enforcing compliance.

The board cannot, and should not, attempt to manage the corporation or directly supervise management in its implementation of a compliance program. The board must, however, set the proper "tone at the top" by, among other things, selecting ethical leaders and developing a supportive relationship with the chief compliance officer (CCO).

The CCO should be empowered with appropriate resources, independence, and board access. The board can also model ethical behavior by appropriately addressing and remedying misconduct when it learns of it.

On a more practical level, the board should encourage management to develop and communicate clearly written codes of ethics and robust anticorruption policies. Require regular training on applicable policies, and reinforce expectations of ethical behavior by all employees, in clear and understandable ways.

In addition, management must be held responsible for developing procedures to ensure timely and thorough investigation of alleged misconduct by any employee, regardless of level, and appropriate consequences where warranted by the facts. Finally, directors can incentivize management to shape a culture of compliance by establishing it as a metric by which management will be evaluated and compensated.

Directors should understand the company's primary corruption risk areas, and satisfy themselves that management has accounted for those risks.

☐ ***2. Do we effectively assess our risk?*** The DOJ and SEC and have repeatedly made clear that "one-size-fits-all compliance programs are generally ill-conceived and ineffective." Consequently, the government has no formula for what a compliance program should look like. An effective compliance program will be tailored to address the unique risks that the company faces in its operations.

A sound risk assessment will consider a number of factors, including the company's size, nature, and structure of its business; type and location of operations; whether it relies on third parties; interaction with government officials; the company's history in the market; and other considerations.

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mary corruption risk areas, and satisfy themselves that management has accounted for those risks in the compliance program. Require that management periodically revisit the issue, particularly after any substantial change in business model, geographic market, or acquisition.

☐ ***3. Do we have effective standards, policies and procedures to address our risks?*** The fundamental building blocks of an effective anticorruption compliance program are a code of conduct along with written anticorruption policies and procedures to guide management, employees, and third parties. Equally important, according to the FCPA Resource Guide, is whether they are "clear, concise and accessible to all employees and to those conducting business on the company's behalf."

One important feature is that the policy identifies the name, title, and personal contact information of the CCO or other personnel who can answer questions about the policy or provide guidance. An effective anticorruption policy will also highlight and explain applicable laws, including the FCPA, the UK Bribery Act, and/or relevant local anticorruption laws in all jurisdictions where the company does business.

A comprehensive policy should also provide an explanation of key terms as well as specific guidance as to permissible behavior in the company's business environment. This includes facilitating payments, giving and receiving gifts, travel and entertainment limits, and political and charitable contributions.

A robust anticorruption policy need not and cannot identify every scenario that employees or agents may encounter. However, policies should be reviewed, updated, and supplemented on a regular basis to keep up with the many ways in which bribes have been paid.

An effective anticorruption policy will also account for the fact that even when a bribe cannot be proven, the company can still violate the FCPA by mischaracterizing payments in its financial records, or not maintaining internal controls that provide reasonable assurances of the reliability of financial reporting.

A company must create and implement policies, processes, and internal controls specifically aimed at preventing and detecting corrupt payments. Because the FCPA does not have a materiality threshold, a company's existing Sarbanes-Oxley controls may not always be sufficient by themselves.

The only way for a company to achieve interconnection between anticorruption policies and practices is through continuous communication, training, and reinforcement.

☐ ***4. Do we adequately communicate and train on anticorruption policies and processes?*** While written codes of ethics and anticorruption policies are a necessary measure in the prevention of bribery, they will not achieve their objective unless they are properly implemented. DOJ guidelines expressly state that in determining whether to bring charges, prosecutors should "attempt to determine whether a corporation's compliance program is merely a 'paper program' or whether it was implemented in an effective manner."

This means that companies must ensure that their codes and anticorruption policies are made available and actually read by the employees who are meant to be guided by them. In determining whether a compliance program is "paper" or "real," the DOJ and SEC will evaluate how anticorruption policies and procedures are actually incorporated into a company's operations.

The only way for a company to achieve that interconnection between policies and practices is through continuous communication, training, and reinforcement. As a former DOJ compliance counsel has observed, "I always asked compliance people to point to employees in the company who have read through the standards or policies they were showing me. I don't think I've ever met anybody who could actually answer that question."

Current versions of key compliance program documents should be readily available on a company intranet or portal, and translated into local languages for foreign units. All new employees should be required to certify that they have read these documents upon joining the company, and periodically thereafter if the compliance program changes in a material way.

Relevant anticorruption training must also occur throughout the organization, including periodic training and certification for all directors, officers, relevant employees, and where appropriate, agents and business partners. The determination of "relevant" employees depends on the unique characteristics of a company's work force. Effective training materials will typically cover the company's code of ethics and policies and procedures, as well as applicable laws, and should give practical advice for the company's business model.

The training should, however, be tailored and focused to the audience. For example, the training of sales personnel may focus on gifts and entertainment, whereas the training of accounting personnel may focus more on spotting red flags on invoices for payment.

The training should also be clear in explaining the company compliance personnel who can be contacted if an employee encounters a questionable situation. The delivery method of the training (web based, in person, written handouts, or some combination) will also depend on the risk assessment done at the outset of designing the compliance program.

☐ ***5. Do we conduct due diligence on third parties?*** The use of third parties, including agents, consultants, and distributors, creates a heightened anticorruption risk for companies, as they can often act with less transparency than company employees. Thus, companies should consider how they use third parties and conduct appropriate due diligence based on industry, country of operation, size and nature of the functions, transactions, and historical relationships. That due diligence process should begin before the company engages a third-party agent and may consist of one or more steps based on relevant risk factors.

First, the company should understand the corporate profile of the proposed third party, including its ownership structure, top personnel, qualifications and associations, and relationships with current or former foreign officials. Consider requiring a potential third-party agents to complete a comprehensive questionnaire before entering into a relationship.

Second, the company should consider the precise role that the third party will fill and the contract terms that will govern the relationship. In many cases, such contracts require proof of compliance with all relevant anticorruption laws and grant audit and training rights to the company.

Third, the company must inform third parties of the company's compliance program, including its code of ethics and anticorruption policies. Provide access to those policies, and make clear your commitment to ethical and lawful business practices.

Finally, even after a third party is approved, the company should monitor the relationship. Update the diligence periodically, exercise audit rights where appropriate, seek compliance certifications, and provide periodic training.

Financial and nonfinancial recognition can drive compliant behavior.

☐ ***6. What incentives do we provide for compliance?*** In evaluating a company's compliance program, prosecutors will determine whether the program is enforced consistently throughout the company. According to the FCPA Resource Guide, a "compliance program should apply from the boardroom to the supply room—no one should be beyond its reach."

In order to create a culture of compliance, management must therefore take appropriate remedial action whenever it discovers deviations. Among this will include documenting violations, as well as any remedial measures taken in response, including counseling, retraining, and other disciplinary action.

On the flip side, positive incentives can also drive compliant behavior. These can include financial and nonfinancial recognition, including personnel evaluations and promotions, and rewards for improving the company's compliance program, and ethics and compliance leadership. Consider providing financial incentives to employees who report unethical behavior or improper conduct, particularly now that whistleblower laws offer such incentives to employees who report illegal or improper conduct to the SEC that results in enforcement action.

☐ ***7. How do we monitor and audit to detect improper conduct?*** Misconduct can occur despite the existence of an otherwise effective compliance program. Therefore, only regular monitoring and auditing can ensure that a program is effective.

"Monitoring" refers to activities or processes that are embedded into the business to create close to real-time prevention and detection of wrongdoing. Some examples may include compliance personnel attending business strategy meetings, conducting surveys of employees, or visiting work sites. Other more complex examples may include using data analytics to spot potential red flags in sales or payment data, or surveilling employee email.

Compliance "auditing" is different in that "audits" are typically backward looking, and not integrated within regular business processes. In its most robust form, an anticorruption audit tests for adherence to company policies and procedures, as well as financial transactions for potential corruption red flags.

Anticorruption compliance audits are typically conducted by internal audit personnel as part of an annual audit plan. There may be times, however, where circumstances warrant special anticorruption audits outside the normal plan. Those cases are often quasi-investigative in nature, and companies would be well advised to consult with lawyers about conducting the audit in a manner that will protect any privilege that may exist.

Boards should ensure that internal audit includes anticorruption auditing, if appropriate. They should further take steps to satisfy themselves that the CCO or other management raise with the audit committee any material findings stemming from anticorruption audits.

Directors should develop a supportive relationship with the CCO, who should be encouraged to "speak truth to power" in the C-suite and in the boardroom.

☐ ***8. Does the compliance officer have adequate "clout," resources, and independence?*** The Sentencing Guidelines require that a "high-level person" within the organization be assigned responsibility for the compliance program, and that such person periodically (at least annually) report to the board. That person, usually the CCO, must also have "adequate autonomy" from management, as well as sufficient resources to ensure that the compliance program is implemented effectively.

Depending on the size and complexity of an organization, the CCO may delegate day-to-day administration and oversight to others. Whatever the organizational structure, the DOJ and SEC will look beyond the organizational charts to satisfy themselves that, in practice, there is a real compliance function headed by a CCO with real clout and resources to perform his job.

Directors should develop a supportive relationship with the CCO. That means that in addition to access to the board, directors should foster an environment where the CCO is encouraged to speak frankly and privately with the board. The CCO should be encouraged to "speak truth to power" in the C-suite and in the boardroom. The board empowers the CCO with the clout, credibility, and independence needed to do the job when it gives the CCO a "seat at the table" in the boardroom.

☐ ***9. When we discover a problem, do we ensure that an independent, thorough and timely investigation is done?*** A company must investigate and remediate misconduct when it learns of it. That means that a company must have an effective mechanism for employees to report potential misconduct. Once it learns of such allegations, a company must investigate in a timely and thorough fashion. Whether a formal policy or not, companies should ensure that investigators are both qualified and sufficiently independent from the subjects of the investigation.

For the board's part, directors should satisfy themselves that management brings to their attention all potentially material allegations. At a minimum, the board should learn of allegation related to accounting, internal accounting controls, or auditing matters. Such allegations, and particularly those directed at senior management, may prompt the board to launch its own investigation with the help of outside counsel that is independent from management.

Regardless of who investigates, the board should satisfy itself that the company has sufficiently remediated any wrongdoing.

In the event of serious wrongdoing, the board may need to consider whether to self-report the misconduct to the authorities. This decision can have a material financial and reputational impact on the company.

In November 2017, DOJ adopted a new FCPA corporate enforcement policy that added new incentives to encourage companies to self-disclose FCPA violations. The revised enforcement policy creates a presumption of declination for companies if they self-disclose, fully cooperate with the DOJ's investigation, remediate, and disgorge any ill-gotten profits.

To be eligible for such cooperation credit, DOJ and SEC will require a company to completely disclose all relevant facts about all individuals involved, regardless of their position, status or seniority, and provide to the DOJ all facts relating to that misconduct.

Does your compliance program work? Management needs to be "self-critical" of all business processes and procedures.

☐ ***10. How do we review the effectiveness of our compliance program?*** The essential question for any anticorruption compliance program is "does it work?" This can be a difficult question to answer, but it can be done by measuring and evaluating quantitative and qualitative data.

For example, a company can readily measure how many employees received anticorruption training, how many hotline reports it received, how many third-party intermediaries were the subject of diligence, how many transactions were scrutinized based on compliance concerns, or how many audits of its compliance program have occurred.

However, an important part of answering the effectiveness question is not susceptible to quantitative analysis. A company should also consider how it engages with its employees on this issue.

Senior management should include references to the company's commitment to ethics and a culture of compliance in written communications with employees and at "town hall" type meetings. Surveys or focus groups of personnel can reveal important perceptions of the workplace environment, and whether a shared culture of compliance and commitment to ethical business conduct exists.

Directors should periodically receive analyses measuring the effectiveness of the company's compliance program, and ask hard questions about the program's effectiveness. As a former DOJ compliance officer has noted, a sign that a company has a good compliance program is that it has a "self-critical" approach to compliance.

While there is no set checklist for evaluation, in the end directors should satisfy themselves that management remains "self-critical" of its compliance program, and that processes and procedures evolve with the underlying business.

Given continued aggressive prosecution of FCPA in the United States and enactment of stringent anticorruption laws in other countries, anticorruption compliance should be a top priority for every global company.

By asking these essential 10 questions in the boardroom, directors can ensure that their companies implement an effective program that will withstand government scrutiny should a potential violation be discovered. ■