INTERNAL CONTROLS AND ANTI-BRIBERY COMPLIANCE

STUART H. DEMING[†]

ABSTRACT

Legal regimes in much of the world now resemble the anti-bribery provisions of the Foreign Corrupt Practices Act. In a few countries, laws relating to record-keeping practices have been used to address foreign bribery. But particularly in the United States and the United Kingdom, reliance is increasingly being placed on legal regimes associated with an entity's internal controls as a means of deterring foreign bribery.

Internal controls provide a broader and more holistic means of addressing foreign bribery than a compliance program. Yet given their esoteric nature, internal controls pose a particular challenge for those providing legal advice. However, a common framework is beginning to emerge for identifying steps that should be taken to ensure that an entity has adequate internal controls with respect to foreign bribery.

Adequate internal controls must consider and address a number of overarching factors not limited to bribery and corruption risks. A series of systemic controls, procedural in nature and not limited to bribery and corruption, must also be implemented throughout an organization. But, in particular, internal controls must be focused on third parties where the risk of corruption or bribery is generally the greatest.

[†] Stuart H. Deming is a principal with Deming PLLC in Washington, D.C. and in Michigan where he represents clients in a range of foreign business and investigatory matters. He previously served with the U.S. Securities and Exchange Commission and in various capacities with the U.S. Department of Justice. He is the author of THE FOREIGN CORRUPT PRACTICES ACT AND THE NEW INTERNATIONAL NORMS (2d ed. 2010), and has served as a member of the Board of Editorial Advisors to the FOREIGN CORRUPT PRACTICES ACT REPORTER. For many years, he co-chaired the American Bar Association's ("ABA") National Institutes on the Foreign Corrupt Practices Act. He also founded and chaired the ABA's Task Force on International Standards for Corrupt Practices and continues to serve as a vice chair of its successor, the Anti-Corruption Committee. Mr. Deming received his B.A., M.B.A., and J.D. from the University of Michigan. He has also been licensed as a Certified Public Accountant in the State of Michigan.

I. INTRODUCTION

By its enactment of the Foreign Corrupt Practices Act ("FCPA") in 1977,[1] the United States became the first country to prohibit the bribery of foreign officials.[2] Prior to that time, no country had adopted legislation that prohibited the bribery of foreign officials. Indeed, the bribery of foreign officials was so much an accepted practice that it was recognized by taxing authorities in most of the world as a legitimate business expense. Through a series of rather dramatic developments over a number of years, that has all changed.

Today most developed countries have implemented and are beginning to enforce domestic legislation prohibiting the bribery of foreign officials. Virtually all other countries are parties to international conventions prohibiting improper offers, promises or payments to foreign officials.[3] Based upon the current state of

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[1] Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended at 15 U.S.C. §§ 78m, 78dd-1 to -3, 78ff (2012)) [hereinafter FCPA].

[2] As used throughout, the term "foreign official" is meant to include foreign public officials as the terminology is used in the FCPA, international anti-bribery conventions, and the related implementing legislation. Similarly, unless otherwise indicated, reference to "improper inducements" is intended to incorporate the concept of offer, promise, or payment of anything of value as is also applied in the FCPA, international anti-bribery conventions, *see infra* note 3, and the related implementing legislation. In addition, reference to "entity" is intended to apply to any form of legal entity, whether it be a company, firm, or some other variation of a legal entity. And finally, given the repeated reference to the law of the United States and the United Kingdom, spellings within quotations may vary and as well, for the very same reason, reference to "internal controls" or "internal control" may be used interchangeably in the text. The latter refer to the very same concept under the applicable law in both countries.

[3] Among others, the Organization for Economic Co-operation and Development [hereinafter OECD], the Organization of American States [hereinafter OAS], the Council of Europe, the African Union, and the United Nations, and the World Bank adopted significant measures. A series of recommendations of the OECD ultimately led to the OECD's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions [hereinafter OECD Convention]. *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and Related Documents*, OECD, http://www.oecd.org/daf/briberyininternationalbusiness/anti-briberyconvention/38028044.pdf.. The OAS adopted the Inter-American Convention Against Corruption [hereinafter Inter-American Convention] in 1996. *Inter-American Convention Against Corruption*, OAS, http://www.oas.org/juridico/english/treaties/b-58.html. It entered into force on March 6, 1997. As of July 1, 2012, 33 countries had deposited their instruments of ratification or accession to the Inter-American Convention. *See id.* at http://www.oas.org/juridico/english/Sigs/b-58.html. The Council of Europe's Criminal Law Convention on Corruption [hereinafter CoE Criminal Law Convention] was adopted in 1998. *Criminal Law Convention on Corruption*, THE COUNCIL OF EUROPE, http://conventions.coe.int/Treaty/en/Treaties/Html/173.htm. The CoE Criminal Law Convention entered into force on July 1, 2002. *See id.* at http://conventions.coe.int/Treaty/Commun/ChercheSig.asp?NT=173&CM=8&DF=7/6/2009&CL=ENG. As of July 1, 2012, 41 countries had ratified the CoE Criminal Law Convention or acceded to it. *Id.* The African Union Convention on Preventing and Combating Corruption [hereinafter AU Convention] was adopted and opened for signature in July of 2003. *African Union Convention on Preventing and Combating Corruption*, AFRICAN UNION, http://www.au.int/en/sites/default/files/AFRICAN_UNION_CONVENTION_PREVENTING_COMBATING_CORRUPTION.pdf.

developments, it is only a matter of time before most of the world will have adopted domestic legislation prohibiting the bribery of foreign officials.

In addition, in a number of countries, domestic legislation relating to record-keeping practices of companies have been used as a basis for pursuing individuals and entities for engaging in questionable practices associated with the payment of bribes to foreign officials.[4] But particularly in the United States and the United

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It entered into force on August 5, 2006. *OAU/AU Treaties, Conventions, Protocols & Charters*, AFRICAN UNION, http://www.au.int/en/treaties. As of July 1, 2012, 31 countries had ratified the AU Convention. *List of Countries Which Have Signed, Ratified/Acceded to the African Convention on Preventing and Combating Corruption*, AFRICAN UNION, http://www.au.int/en/sites/default/files/corruption.pdf. The United Nations Convention against Corruption [hereinafter UN Convention] was adopted in October of 2002. G.A. Res. 58/4, U.N. GAOR, 58th Sess., U.N. Doc. A/RES/58/4 (Oct. 31, 2003). It entered into force on December 14, 2005. *United Nations Convention against Corruption*, UNITED NATIONS OFFICE ON DRUGS AND CRIME, http://www.unodc.org/unodc/en/treaties/CAC/ signatories.html. As of July 1, 2012, there are 160 parties to the UN Convention. *Id.*

[4] The FCPA's record-keeping provisions require an issuer to "make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." 15 U.S.C. § 78m(b)(2)(A) (2012). *See, e.g.*, United States v. Cantor, 2 FOREIGN CORRUPT PRAC. ACT REP. 2d (West) § 27:569 (S.D.N.Y. 2001), the former president of American Banknote Holographics, Inc. ("AGNH"), a wholly-owned subsidiary of American Bank Notes Corporation (ABN), an issuer, pled guilty to conspiring to inflate the reported financial condition of ABN and ABHN by falsifying books and records and by making false statements to auditors. Litigation Release No. 17068A, 75 SEC Docket 977 (July 18, 2001), *available at* http://www.sec.gov/litigation/litreleases/lr17068a.htm. The conspiracy to inflate ABN's and ABNH's financial condition arose from actions taken by ABN, ABNH's former patent, to artificially inflate ABNH's profits prior to ABNH's initial public offering. ABN caused ABNH to record revenue for sales that did not actually occur or that were incomplete at the time they were recorded, i.e., "bill and hold" sales. To ensure that these sales were included in ABN's and ABNH's financial reports, Cantor and others deceived ABN's and ABNH's independent auditors with false representations and fabricated corporate records. In terms of the conspiracy to violate the anti-bribery provisions of the FCPA, ABNH was informed by its foreign sales agent in Saudi Arabia that he needed additional funds to pay "consultancy fees" in connection with ABNH's bid to print holographs to be applied to Saudi currency. The SEC filed related complaints and administrative actions involving securities fraud and violations of the anti-bribery and accounting and record-keeping provisions of the FCPA with respect to Cantor, ABN, ABNH, and others. *Id.* In United States v. York Int'l Corp., 3 FOREIGN CORRUPT PRAC. ACT REP. 2d (West) § 30:108 (D.D.C. 2007), one of the counts of the Information associated with the deferred prosecution agreement charged York International Corp., an issuer, with record-keeping violations for the failure of two of its subsidiaries to keep accurate books and records. Payments were recorded as "commission" and "consultancy" payments when they were known to be unlawful kickbacks to the Iraqi government or when they were known to generate cash to pay kickbacks and bribes.

Pursuant to the UK's Companies Act 1985, "every company" shall keep accounting records that disclose "with reasonable accuracy" the financial position of the company, and enable the directors to ensure that any balance sheet and profit and loss account comply with the requirements under the Act as to their form and content and otherwise. In particular, company records must contain "entries from day to day of all sums of money received and expended by the company, and the matters in respect of which the receipt and expenditure takes place, and a record of the assets and liabilities of the company." Companies Act, 1985, c. 6, § 221 (U.K.). In the resolution of the UK's Serious Fraud Office's investigation of BAE Systems

Kingdom, increased reliance is being placed on legal regimes associated with an entity's internal controls as a means for deterring improper inducements to foreign officials.

II. INTERNAL CONTROLS

Internal controls and compliance programs are similar but yet different from one another. From a conceptual standpoint, internal controls are more systemic and encompassing in nature.[5] They apply across an entire entity and address a range of considerations not solely limited to legal compliance issues.[6] In contrast, a compliance program is a critical component of internal controls.[7]

Internal controls provide a flexible and more holistic means of addressing anti-bribery compliance issues. Whether under applicable law of the United States or the United Kingdom, proof of an improper inducement is not required in order to

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PLC, the plea entered was to a violation of section 221 of the Companies Act for aiding and abetting the offence "contrary to section 221(5) of the Companies Act 1985 by the officers of British Aerospace Defence Systems Limited." Regina v. BAE Systems PLC, Charge, Statement of Offence (Dec. 20, 2010), *available at* http://www.sfo.gov.uk/media/133543/bae%20opening%20statement%2020.12.10.pdf.

[5] Internal control has been defined as "a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of reporting.
- Compliance with applicable laws and regulations."

COMMITTEE OF SPONSORING ORGANIZATIONS OF THE TREADWAY COMMISSION [hereinafter COSO], INTERNAL CONTROL–INTEGRATED FRAMEWORK, EXPOSURE DRAFT, ¶ 11 (2011). The foregoing definition "emphasizes" that internal control is:

- A *process* consisting of ongoing tasks and activities. It is a means to an end, not an end in itself.
- *Effected by people.* It is not merely about policy manuals, systems, and forms, but about people at every level of an organization that impact internal control.
- Able to *provide reasonable assurance*, not absolute assurance, to an entity's senior management and board.
- *Geared to the achievement of objectives* in one or more separate but overlapping categories.
- *Adaptable to the entity structure.*

Id. ¶ 12 (emphasis in original).

[6] The components of internal control, including the control environment, risk assessment, control activities, information and communication, and monitoring activities, *id.*, ¶ 31, "are relevant to the entire entity, and to the entity level subsidiaries, division, or any of its individual operating units, functions, or other subsets of the entity." *Id.* ¶ 32.

[7] *Id.* ¶ 14; U.S. DEP'T OF JUSTICE AND SEC. & EXCH. COMM'N, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* at 40 (Nov. 2012) [hereinafter FCPA Guidance].

establish a violation of the requirement that certain entities implement adequate internal controls. Esoteric, typically subjective in nature, internal controls are seldom the basis for a criminal prosecution. In a criminal context, because of their esoteric nature, internal controls violations are difficult to prove.

In a civil context, strict liability is effectively imposed. No proof of intent is required. The internal control provisions are always applied after the fact. The prospect of strict liability is particularly daunting in the absence of clear and well-defined standards for determining the adequacy of internal controls. From a regulatory standpoint, no definitive checklist or bright-line standards exist. So much is dependent upon the particular factual situation. What may be effective in one setting may not be effective in other settings.

Despite their esoteric nature, legislation in the United States and the United Kingdom mandating adequate internal controls in certain situations have led to the issuance of regulations and guidance that are of assistance in laying out the contours of what constitute adequate internal controls. The guidance associated with determining the adequacy of internal controls is increasingly being supplemented by what may be learned from settlements reached with regulatory authorities.

From the perspective of legal practitioners, in-house counsel to corporations, and others providing advice relative on anti-bribery compliance issues, the seemingly nebulous concepts associated with internal controls pose a particular challenge. Nonetheless, an examination of the regulatory framework, guidance, and settlements reached in the United States and the United Kingdom provide a framework for identifying specific steps that can and should be taken to ensure that an entity has adequate internal controls with respect to foreign bribery.

III. FOREIGN CORRUPT PRACTICES ACT

One of the problems disclosed by the revelations of the Watergate era in the United States was the accounting and record-keeping practices that made improper payments possible. "Congress believed that almost all such bribery was covered up in the corporation's books, and that to require proper accounting methods and internal accounting controls would discourage corporations from engaging in illegal payments. Congress recognized that both investors and the corporation itself would benefit from accurate bookkeeping."[8]

To address these practices, the FCPA placed new and significant obligations on issuers to maintain records that accurately reflect transactions and dispositions of assets and to maintain systems of internal accounting controls. Known as the "accounting and record-keeping" provisions, these provisions constitute the second and less well-known mechanism within the FCPA to deter improper inducements to foreign officials. But they constitute a more potent mechanism with implications far greater than simply deterring improper inducements to foreign officials.[9]

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[8] Lewis v Sporck, 612 F. Supp. 1333 (N.D. Cal 1985) (citing S. REP. 95-114, (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098).

[9] "Congress recognized at the time of the FCPA's consideration that the accounting provisions would have an effect extending beyond 'questionable payments' made in connection with foreign business." Stuart H. Deming, *The Potent and Broad-Ranging Implications of the Accounting and Record-Keeping Provisions of the Foreign Corrupt Practices Act,* 96 J. CRIM. L. & CRIMINOLOGY 465, 469 (2006) (citing GARY LYNCH, ENFORCEMENT OF THE ACCOUNTING PROVISIONS OF THE FOREIGN CORRUPT PRACTICES ACT OF 1977, at 1 (1983), *reprinted in* 2 FCPA REP. 260.001 (2d ed. 2009)).

Unlike the anti-bribery provisions, the accounting and record-keeping provisions are not limited to improper inducements to foreign officials. They "apply to all aspects of an issuer's practices relating to the preparation of the financial statements of an entity subject to their terms."[10] The accounting and record-keeping provisions directly affect the worldwide operations of all issuers, including their majority-owned foreign subsidiaries and their officers, directors, employees, shareholders, and agents acting on behalf of an issuer.[11] They essentially create an affirmative duty on the part of issuers and officers, directors, employees, agents, and stockholders acting on behalf of an issuer.

A. Scope and Jurisdiction

The scope of the accounting and record-keeping provisions is more limited than that of the anti-bribery provisions. Specifically, these provisions apply only to issuers of securities. Issuers are defined by Section 3 of the Securities Exchange Act of 1934 ("Exchange Act") as entities required to register under Section 12 or file reports under Section 15(d) or which have filed a registration statement that has not yet become effective under the Securities Act of 1933.[12]

1. Issuers

In general, publicly-held entities with securities traded on a national exchange in the Untied States are issuers. Issuers can include foreign entities, including a foreign entity with American Depository Receipts ("ADR"),[13] that are registered pursuant to

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[10] *Id.*, at 468.

> Although one of the major substantive provisions of the FCPA is to require corporate disclosure of assets as a deterrent to foreign bribes, the more significant addition of the FCPA is the accounting controls or "books and records" provision, which gives the SEC authority over the entire financial management and reporting requirements of publicly-held United States corporations.

Sec. & Exch. Comm'n v. World-Wide Coin Inv., Ltd., 567 F. Supp. 724, 746 (N.D. Ga. 1983).

[11] *See also* Arthur F. Matthews, *Defending SEC and DOJ FCPA Investigations and Conducting Related Corporate Internal Investigations: The Triton Energy/Indonesia SEC Consent Decree Settlements,* 18 NW. J. INT'L L. & BUS. 303, 349 (1998) (citing KATHLEEN F. BRICKEY, CORPORATE CRIMINAL LIABILITY § 9:20, at 279 (1992)).

[12] 15 U.S.C. §§ 77a-77c, 780(d), 781 (2012).

[13] As part of the United Nations Food for Oil investigations, ADRs were used as a basis for jurisdiction to prosecute foreign entities for kickbacks to Iraqi officials. For example, in December of 2008, Fiat S.p.A. (Fiat), an Italian multinational company with ADRs listed in the United States, as part of a deferred prosecution agreement with the Justice Department, agreed to pay a $7 million penalty for illegal kickbacks paid to officials of the former Iraqi government by three of its subsidiaries. *See* Press Release, U.S. Dep't of Justice, Fiat Agrees to $7 Million Fine in Connection with Payment of $4.4 Million in Kickbacks by Three Subsidiaries Under the U.N. Oil for Food Program (Dec. 22, 2009), *available at* http://www.justice.gov/opa/pr/2008/December/08-crm-1140.html. In the respective informations filed against two of the wholly-owned subsidiaries, Iveco S.p.A. and CNH Italia S.p.A., *id.*, each foreign subsidiary was charged with one count of conspiracy to commit wire fraud and to violate the record-keeping provisions for making improper payments to Iraqi officials. 15 U.S.C. § 78m(b)(2)(A) (2012); 18 U.S.C. §§ 371, 1343 (2012). Employees and

Section 12 or required to file reports pursuant to Section 15(d) of the Exchange Act. ADRs represent an ownership interest in the securities of a foreign private issuer that are deposited,[14] usually outside of the United States, with a financial institution as a depository.[15]

The scope of the entities that may be considered issuers includes:

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agents of the subsidiaries made improper payments to the former Iraqi government in order to obtain contracts with Iraqi ministries to provide industrial pumps, gears, and other equipment. Kickback payments were inaccurately recorded as "commissions" and "service fees" for its agents. In addition, as part of Fiat's resolution with the SEC, the complaint filed in Sec. & Exch. Comm'n v. Fiat S.p.A. (2008) (No. 1:08-cv-02211), *available at* http://www.sec.gov/litigation/complaints/2008/comp20835.pdf, alleged violations of both the internal controls and record-keeping provisions. 15 U.S.C. §§ 78m(b)(2)(A)-(B).

[14] "ADRs represent an ownership interest in the securities of a foreign private issuer that are deposited, usually outside of the United States, with a financial institution as the depository." Deming, *supra* note 9, at 473.

> ADRs are negotiable certificates issued by a U.S. bank or trust company. Mark Saunders, *American Depositary Receipts: An Introduction to U.S. Capital Markets for Foreign Companies,* 17 FORDHAM INT'L L. J. 48, 49 (1993). Unless an exemption is available, ADRs must be registered under the Securities Act before they may be publicly distributed within the United States. 15 U.S.C. § 77(b)(1). "[T]he public offering of ADRs is no different than the public offering of ordinary shares in many respects, from a legal point of view." Frode Jensen III, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From a Legal Perspective,* 17 FORDHAM INT'L L. J. S25, S29 (1994). The legislative history of U.S. securities laws reflects an intent to treat foreign private issuers the same as domestic issuers. Saunders, *supra*, at 59 (citing R. Adee, *Offerings by Foreign Private Issuers, in* SECURITIES UNDERWRITING-PRACTICIONER'S GUIDE 413, 428 (K. Bialkin et al. eds. PLI 1985)). "[T]he more voluntary steps a foreign company has taken to enter U.S. capital markets, the degree of regulation and amount of disclosure more closely approaches the regulation of domestic registrants." *Id.* at 60 (quoting Integrated Disclosure System for Foreign Private Issuers, Securities Act Release No. 6360 [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,054, at 84,651 (Dec. 2, 1981)).

Id., at 473 n. 50.

[15] "ADRs may be either sponsored or unsponsored." Pinker v Roche Holdings Ltd., 292 F.3d 361, 367 (3d Cir. 2002).

> An unsponsored ADR is established with little or no involvement of the issuer of the underlying security. A sponsored ADR, in contrast, is established with the active participation of the issuer of the underlying security. [B. Hertz, *American Depository Receipts,* 600 P.L.I./Comm. 237, 239 (1992).] An issuer who sponsors an ADR enters into an agreement with the depositary bank and the ADR owners. *Id.* at 243. The agreement establishes the terms of the ADRs and the rights and obligations of the parties, such as the ADR holders' voting rights.

Id. "ADRs that are traded on American securities exchanges must abide by the Exchange Act's periodic reporting requirements." *Id.* (citing B. Hertz, *supra*, at 288-89). "ADRs that are not traded on exchanges . . . are not subject to the Exchange Act's reporting requirements, but under SEC Rule 12g3-2(b) the issuer must furnish such annual reports, shareholder communications, and other materials that are required to be prepared pursuant to regulations in its home country." *Id.* (citing B. Hertz, *supra*, at 289-90 (citing C.F.R. § 240.12g3-2(b)).

- Entities, whether foreign or domestic, with securities listed on a national securities exchange in the United States,[16] which includes the National Association of Securities Dealers Automated Quotation System (NASDAQ).[17] This can also include foreign entities with ADRs listed on a national securities exchange.[18]
- Unless otherwise exempt, entities, whether foreign or domestic, that are issuers of securities with $10 million or more in assets at the end of their most recent fiscal year with any class of securities held of record by 500 or more persons worldwide, including 300 or more in the United States.[19]
- For the fiscal year in which the registration statement for a class of securities under the Securities Act of 1933 becomes effective or is required to be updated,[20] entities with a class of securities held of record by more than 300 persons.[21]

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[16] 15 U.S.C. § 78(d) (20012); 17 C.F.R. § 240.12h-3(c) (2012).

[17] Exchange Act Release No. 34-54240, 88 SEC Docket 1686 (July 31, 2006), *available at* http://www.sec.gov/rules/other/2006/34-54240.pdf.

[18] Pinker v. Roche Holdings Ltd., *supra* note 15 (citing Bruce L. Hertz, *American Depository Receipts,* 600 PLI/Comm. 237, 239 (1992)).

[19] "When read in conjunction with Exchange Act Rules 12g-1 (17 CFR 240.12g-1) and 12g3-2(a) (17 CFR 240.12g3-2(a)), Exchange Act Section 12(g) requires an issuer to file an Exchange Act registration statement regarding a class of securities within 120 days of the last day of its fiscal year if, on that date, the number of its record holders is 500 or greater, the number of its U.S. resident holders is 300 or more, and the issuer's total assets exceed $10 million." Exchange Act Release No. 34-58465 94 SEC Docket 69 n.11 (Sept. 5, 2008), *available at* http://www.sec.gov/rules/final/2008/34-58465.pdf. Many foreign private issuers are not aware of the need for an exemption in the United States. This can occur even without an intention to reach U.S. investors. A compilation of foreign private issuers registered and reporting with the SEC is available at http://www.sec.gov/divisions/corpfin/internatl/companies.shtml.

In some circumstances, an exemption from this registration requirement may be available to a foreign private issuer, 15 U.S.C. § 78(g)(3) (2012); 17 C.F.R. § 240.12g3-2(b) (2012). On October 10, 2008, the SEC amended 17 C.F.R. § 12g3-2(b) to exempt foreign private issuers whose securities are listed on markets in their home countries and not listed on a national securities exchange in the United States if they publish certain financial and business information in English on their web sites. Exchange Act Release No. 34-58465, *supra.* The SEC provided for a three-year transition period since there may be some foreign private issuers that will lose that exemption under the amended provisions of 17 C.F.R. § 240.12g3-2(b) (2012).

[20] 15 U.S.C. § 780(d) (2012); 17 C.F.R. § 240.12h-3(c) (2012).

[21] 15 U.S.C. § 780(d) (2012); 17 C.F.R. § 240.12h-3(a) (2012).

- Banks and savings associations and that are insured in accordance with the Federal Deposit Insurance Act.[22]

2. Subsidiaries

The accounting and record-keeping provisions also apply directly to the operations of majority-owned foreign subsidiaries of an issuer.[23] However, the accounting and record-keeping provisions are not necessarily applicable to domestic or foreign entities if the issuer holds an interest of 50 percent or less in the foreign entity.[24] When an issuer holds an interest of 50 percent or less in the foreign entity, the issuer remains obliged to "proceed in good faith to use its influence to the extent reasonable under the circumstances to cause [the subsidiary] to devise and maintain a system of internal accounting controls" consistent with the requirements of the accounting and record-keeping provisions.[25] In such circumstances, an issuer will be "conclusively presumed" to have fulfilled its statutory obligations when it can demonstrate its good-faith efforts to influence its subsidiary.[26]

In determining whether good-faith efforts are exercised, the relevant circumstances "include the relative degree of the issuer's ownership of the domestic or foreign [entity] and the laws and practices governing the business operations of the country in which such [entity] is located."[27] The degree of effective control can be expected to bear directly on the evaluation of whether an issuer's efforts are sufficient to demonstrate good faith on its part.[28] An issuer's duty to influence a subsidiary's behavior increases directly with the degree to which it can exercise control over the subsidiary.[29]

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[22] 15 U.S.C. § 78l(i)(2012). The civil enforcement jurisdiction relative to the accounting and record-keeping provisions is delegated to the respective U.S. banking regulators with jurisdiction over the particular bank or savings association. *Id.* Criminal enforcement jurisdiction remains unchanged and resides with the Justice Department.

[23] Matthews, *supra* note 11.

[24] 15 U.S.C. § 78m(b)(6) (2012).

[25] *Id.*

[26] *Id.*, § 78o(d).

[27] *Id.*, § 78m(b)(6).

[28] Deming, *supra* note 9, at 474 (citing from the House Conference Report associated with the 1988 amendments to the FCPA, Omnibus Trade and Competitiveness Act of 1988 [hereinafter OTCA CONF. REP.], Pub. L. No. 100-418, 102 Stat. 1415-1425, in explaining the addition of § 13(b)(6) to the Exchange Act). The OTCA CONF. REP. explained,

> [I]t is unrealistic to expect a minority owner to exert a disproportionate degree of influence over the accounting practices of a subsidiary. The amount of influence which an issuer may exercise necessarily varies from case to case. While the relative degree of ownership is obviously one factor, other factors may also be important in determining whether an issuer has demonstrated good-faith efforts to use its influence.

H.R. REP. NO. 576, at 917 (1988), *reprinted in* 1988 U.S.C.C.A.N. 1547.

[29] The SEC has taken action where an issuer has less than 50 percent control in terms of ownership. In Sec. & Exch. Comm'n v. BellSouth Corp., BellSouth consented to the entry of judgment for violating the FCPA's record-keeping and internal controls provisions. Sec. & Exch. Comm'n v. BellSouth Corp., Litig. Release No. 17,310, 2002 WL 47178 (Jan. 15,

3. Individuals

Depending upon the circumstances, individuals can be directly subject to the terms of the accounting and record-keeping provisions. In general, while acting within the scope of their employment or duties on behalf of an issuer, individuals, and, in particular, officers, directors, employees, stockholders, and agents of an issuer, can be subject to the terms of the accounting and record-keeping provisions. The scope of the accounting and record-keeping provisions also extends to individuals who, while acting within the scope of their employment or responsibilities, are officers, directors, employees, or agents of a foreign subsidiary where the issuer has an interest greater than 50 percent.

In addition, individuals and entities not otherwise subject to the accounting and record-keeping provisions can become subject to their terms to the extent that they may be accomplices to a violation of the accounting and record-keeping provisions.[30] For example, a supplier to an issuer who knowingly provides or facilitates the making of a false invoice to conceal the true nature of the underlying transaction, and thereby circumvent the internal controls, could be subject to prosecution for violating the accounting and record-keeping provisions.

B. The Internal Accounting Controls Provisions

The purpose of an accounting control system is to ensure that entities adopt accepted methods of recording economic events, protecting assets, and conforming transactions to management's authorization.[31] To enhance corporate accountability

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2000), *available at* http://www.sec.gov/litigation/ litreleases/lr17310.htm.. In the accompanying administrative proceeding, *in re* BellSouth Corp,, Exchange Act Release No. 45,279 (Jan 15. 2002), *available at* http://www.sec.gov/litigation/admin/34-45279.htm., BellSouth was found to have violated the internal control provisions. BellSouth's Nicaraguan subsidiary, Telefonia Celular de Nicaragua, S.A. (Telefonia), improperly recorded payments to the wife of a Nicaraguan legislator who chaired a committee with oversight over the legislation that would enable BellSouth to acquire a majority interest in Telefonia. Initially, BellSouth purchased a 49 percent interest in Telefonia with an option to purchase another 40 percent interest. However, Nicaraguan law prohibited foreign ownership of 50 percent or greater interest in telecommunication companies. In spite of her lack of legislative experience, she was retained and ultimately paid $60,000. Bellsouth International, indirectly a wholly-owned subsidiary of BellSouth International, knew that payments to the lobbyist could implicate the FCPA. Nonetheless, a BellSouth International attorney approved Telefonia's retention of the legislator's wife. BellSouth was found to have "held less than 50 percent of the voting power of Telefonia, but through its operational control, had the ability to cause Telefonia to comply with the FCPA's books and records and internal controls provisions." BellSouth was found to have failed to devise and maintain a system of internal accounting controls at Telefonia sufficient to detect and prevent FCPA violations.

[30] Except for foreign officials, persons not otherwise liable under the FCPA can be prosecuted for conspiring to violate the FCPA. United States v. Castle, 925 F.2d 831 (5th Cir. 1991). However, foreign officials as recipients of the improper inducements cannot be prosecuted. *Id. See also* United States v. Tannenbaum, No. 97-4441 Plea Agreement (S.D.N.Y., filed Aug. 4, 1998), *reprinted in* 4 FCPA REP. 699.583 (2d ed. 2009) (Tannenbaum pled guilty to conspiracy to violate the anti-bribery provisions as part of a scheme to bribe an undercover agent posing as an Argentine procurement officer).

[31] Deming, *supra* note 9, at 490 (citing H.R. REP. 95-831, at 10, (1977)), *reprinted in* 1977 U.S.C.C.A.N. 4120.

and ensure that boards of directors, officers, and shareholders of issuers are aware of and thus able to prevent the improper use of an issuer's assets, the accounting provisions require issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurance that

- transactions are executed in accordance with management's general or specific authorization;
- transactions are recorded as necessary to permit the preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets;
- access to company assets is permitted only in accordance with management's general or specific authorization; and
- the recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.[32]

"Reasonable assurance" of management control over an issuer's assets means "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."[33] The accounting provisions do not mandate any particular kind of internal accounting controls. The standard for compliance is whether a system, taken as a whole, reasonably meets the statute's objectives.[34] "Reasonable assurance" of management control over an issuer's assets means "such level of detail of assurance as would satisfy prudent officials in the conduct of their own affairs."[35]

"Like the record-keeping provisions, the internal control provisions are not limited to material transactions or to those above a specific dollar amount."[36] However, the "prudent man" standard was adopted in 1988 to clarify that the accounting and record-keeping provisions do not require "an unrealistic degree of exactitude or precision."[37] A number of factors are taken into consideration, including the costs of compliance, in determining what a prudent man would do under the circumstances.[38]

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[32] 15 U.S.C. § 78m(b)(2)(B) (2012).

[33] *See id.*, § 78m(b)(7).

[34] STUART H. DEMING, THE FOREIGN CORRUPT PRACTICES ACT AND NEW INTERNATIONAL NORMS 47-48 (2d ed. 2009).

[35] 15 U.S.C. § 78m(b)(7) (2012).

[36] World-Wide Coin Inv. Ltd., *supra* note 10, at 749.

[37] H.R. REP. NO. 576, *supra* note 28.

[38] "The concept of reasonableness of necessity contemplates the weighing of a number of relevant factors, including the cost of compliance."

Id.

1. Elements of an Internal Control System

The purpose of an accounting control system is to ensure that entities adopt accepted methods of recording economic events, protecting assets, and conforming transactions to management's authorization.[39] Through its implementing regulations, the U.S. Securities and Exchange Commission (SEC) has defined internal control over financial reporting under the FCPA as:

> A process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:
>
> (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
>
> (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the registrant; and
>
> (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the financial statements.[40]

The "definition does not encompass the elements in the COSO Report that related to the effectiveness and efficiency of a company's operations and a company's compliance with applicable laws and regulations, with the exception of compliance with the applicable laws and regulations directly related to the preparation of financial statements, such as the [SEC's] financial reporting requirements."[41] However, with respect to the last phrase, the SEC made specific

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[39] *See* H.R. REP. No. 95-831, *supra* note 31.

[40] 17 C.F.R. §§ 240.13a-15(f), 15d-15(f) (2012). In addition, certifications are now required of officers of issuers as to the adequacy of the issuer's disclosure controls and procedures. 15 U.S.C. § 7241 (2012). "Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the [the Securities Exchange Act of 1934] is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure." 17 CFR §§ 240.13a-15(e), 15d-15(e) (2012).

[41] Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Securities Act Release No. 8238, Exchange Act Release No. 47986, 68 Fed. Reg. 36,636, 36,640 (June 18, 2003) [hereinafter Management's Report]. The "COSO Report" was prepared by the COSO. COSO, *Internal Control-Integrated Framework* (1992) [hereinafter COSO Report]. *See also* Management's Report, *supra*. The COSO Report identified an integrated framework, commonly referred to as the

reference to U.S. auditing standards "requiring auditors to consider a company's compliance with laws and regulations that have a direct and material effect on the financial statements."[42]

Moreover, the SEC's interpretative guidance states that "[m]anagement's evaluation of risk assessment should include consideration of the vulnerability of the entity to fraudulent activity (for example, fraudulent financial reporting, misappropriation of assets and corruption), and whether any such exposure could result in a material misstatement of the financial statements."[43] In its evaluation, "[m]anagement may identify preventive controls, detective controls, or a combination of both, as adequately addressing financial reporting risks."[44] "Preventive controls have the objective of preventing the occurrence of errors or fraud that could result in the misstatement of the financial statements. Detective controls have the objective of detecting errors or fraud that has already occurred that could result in a misstatement of the financial statements."[45]

In addition, management is also required to assess and ensure that it has adequate "entry-level" and other "pervasive elements" for an effective system of internal controls for financial reporting.[46] "This would ordinarily include, for example, considering how and whether controls related to the control environment, controls over management override, the entity-level risk assessment process and monitoring activities, controls over the period-end financial reporting process, and the policies

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"COSO Framework," which defines internal control as a "process, effected by an entity's board of directors, management and other personnel. This process is designed to provide reasonable assurance regarding the achievement of objectives" in three categories—effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations. COMMITTEE OF SPONSORING ORGANIZATIONS OF THE TREADWAY COMMISSION, RESOURCES, http://www.coso.org/resources.htm (last visited Dec. 16, 2012).

[42] *Id.* (citing Codification of Accounting Standards and Procedures, Statement on Auditing Standards No. 53 (Am. Inst. of Certified Pub. Accountants 2012) [hereinafter AU 317]). AU 317 specifically refers to illegal acts and addresses the materiality of those acts in terms of the financial statements:

> In evaluating the materiality of an illegal act that comes to his attention, the auditor should consider both the quantitative and qualitative materiality of the act. For example, section 312, Audit Risk and Materiality in Conducting an Audit, paragraph .59, states that "an illegal payment of an otherwise immaterial amount could be material if there is a reasonable possibility that it could lead to a material contingent liability or a material loss of revenue."

See id., § 317.13.

[43] Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Securities Act Release No. 8810; Exchange Act Release No. 55949, 72 Fed. Reg. 35,324, 35,327 (June 27, 2007) [hereinafter Commission Guidance].

[44] *Id.*

[45] *Id.* at 35,327 n. 30.

[46] *Id.* at 35,328.

that address significant business control and risk management practices are adequate for purposes of an effective system of internal control."[47]

2. Broad Reach of Internal Accounting Control Provisions

The provisions of the FCPA relating to internal accounting controls provide an almost endless series of bases for the SEC to take action against an issuer.[48] It must be kept in mind that the FCPA, and the internal control provisions in particular, will always be applied in hindsight by enforcement officials.[49] When fraud or other abuses are involved, especially relating to financial transactions, the question will always arise as to whether the internal controls were adequate. In such situations, the adequacy of the internal controls will rarely be found to be adequate.

Due in large part to their esoteric nature,[50] the internal accounting control provisions are seldom the focus of criminal enforcement activity. But, in a civil enforcement context, these provisions are frequently used. The standard of proof is a preponderance of the evidence. In almost any after-the-fact analysis relating to financial irregularities, the SEC will be able to point to a breakdown of some sort associated with the internal accounting controls of an issuer.[51] Whether the issuer

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[47] *Id.* The terms "entity-level controls," "company-level" controls, and "entity-wide" controls are interchangeably used to describe "aspects of a system of internal control that have a pervasive effect on the entity's system of internal control such as controls related to the control environment (for example, management's philosophy and operating style, integrity and ethical values; board or audit committee oversight; and assignment of authority and responsibility); controls over management override; the company's risk assessment process; centralized processing and controls, including shared service environments; controls to monitor results of operations; controls to monitor other controls, including activities of the internal audit function, the audit committee, and self-assessment programs; controls over the period-end financial reporting process; and policies that address significant business control and risk management practices." *Id.* at 35,326 n. 21.

[48] Stuart H. Deming, *The Foreign Corrupt Practices Act: The Accounting and Record-Keeping Provisions, in* THE FOREIGN CORRUPT PRACTICES ACT AND OECD CONVENTION: MITIGATING AND MANAGING RISKS IN THE CHANGING LEGAL ENVIRONMENT, at B-7 (ABA-CLE 2001) (citing Paul V. Gerlach, Assoc. Dir., Div. of Enforcement, Sec. & Exch. Comm'n, Remarks at the ABA's National Institutes on the Foreign Corrupt Practices Act (Feb. 19, 1999 and Mar. 12, 1999)). A number of factors are considered in assessing the adequacy of a system of internal controls. These include but are not limited to "(i) the role of the Board of Directors; (ii) communication of corporation procedures and policies; (iii) assignment of authority and responsibility; (iv) competence and integrity of personnel; (v) accountability for performance and compliance with policies and procedures; and (vi) objectivity and effectiveness of the internal audit function." United States v. Wittig, 425 F. Supp. 2d 1196, 1216-17 (D. Kan. 2006) (citing Walter Perkel, *Foreign Corrupt Practices Act*, 40 AM. CRIM. L. REV. 683, 690 (2003)). *See also, e.g.*, World-Wide Coin Inv. Ltd., *supra* note 10, *infra* notes 53, 162, 214, and 215.

[49] DONALD R. CRUVER, COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT: A GUIDE FOR U.S. FIRMS DOING BUSINESS IN THE INTERNATIONAL MARKETPLACE (2d ed. 1999).

[50] *See* World-Wide Coin Inv. Ltd., *supra* note 10, at 751 ("The main problem with the internal controls provision of the FCPA is that there are no specific standards by which to evaluate the sufficiency of controls; any evaluation is inevitably a highly subjective process in which knowledgeable individuals can arrive at totally different conclusions.").

[51] One such rare exception involved a cease-and-desist proceeding in 2000 with International Business Machines Corporation (IBM) and its wholly-owned subsidiary in

had knowledge of a defect in the system of controls, improperly-recorded transactions, or other financial activity is irrelevant in the civil enforcement context with respect to the accounting and record-keeping provisions. No proof of intent is required.[52]

A. Relationship with Compliance Program

An issuer's anti-bribery compliance program should not necessarily be separate from its system of internal accounting controls. A natural interplay was intended between the anti-bribery and the accounting and record-keeping provisions. An effective system of internal accounting controls includes a range of review and approval guidelines designed to detect and deter questionable payments. Indeed, the planning, implementation, and monitoring of an issuer's compliance program should be closely linked, if not intertwined, with its system of internal accounting controls.

For issuers engaged in international business, the SEC has determined in a number of enforcement actions that the failure to devise or maintain an effective system to prevent or detect violations of the anti-bribery provisions of the FCPA can constitute a violation of the internal controls provisions of the accounting and record-breaking provisions. A set of internal controls to prevent or detect violations of the anti-bribery provisions should, at the very least, include a formal FCPA policy made applicable to the entire entity, an FCPA compliance program, a practice of

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Argentina, IBM-Argentina, S.A. (IBM-Argentina). Sec. & Exch. Comm'n v. Int'l Bus. Mach., Litig. Release No. 16,839 (Dec. 21, 2000), *available at* http://www.sec.gov/litigation/litreleases/lr16839.htm. The enforcement action was premised upon violations of the books and records provisions of the FCPA for "presumed illicit payments to foreign officials." No violations of the internal control provisions were alleged. In connection with a $250 million contract to modernize the computer system of a commercial bank owned by the Argentine government, IBM-Argentina entered into a $22 million subcontract with an Argentine subcontractor, which in turn, was alleged to have passed on $4.5 million to officials of the Argentine bank. The order, issued in the accompanying administrative proceeding, found that IBM-Argentina's management "overrode IBM's procurement and contracting procedures"; "hid the details of the subcontract" from the technical and financial review personnel assigned to the contract; and "fabricated documentation, including a backdated authorization letter and a document that stated incomplete and inaccurate reasons for hiring [the subcontractor]." *In re* Int'l Bus. Mach. Corp., Exchange Act Release No. 43,761 (Dec. 21, 2000), *available at* http://www.sec.gov/litigation/admin/34-43761.htm, IBM-Argentina recorded the payments as third-party subcontractors expenses that were, in turn, incorporated into IBM's Form 10-K. The order further noted that IBM's policies and procedures had been circumvented and that no employee of IBM in the United States was aware of what had occurred.

[52] Sec. & Exch. Comm'n v. McNulty, 137 F.3d 732, 741 (2d Cir. 1998); Sec. & Exch. Comm'n v. Softpoint, Inc., 958 F. Supp. 846, 866-67 (S.D.N.Y. 1997), *aff'd on other grounds,* 159 F.3d 1348 (2d Cir. 1998); Sec. & Exch. Comm'n v. Sys. Software Assocs., Inc., 145 F. Supp. 2d 954, 958 (N.D. Ill. 2001); World-Wide Coin Inv. Ltd., *supra* note 10, at 749-751. *See also* Ponce v. Sec. & Exch. Comm'n, 345 F.3d 722, 736 n.10 (9th Cir. 2003). However, proof of intent may be required to establish civil liability for aiding and abetting a violation of the accounting and record-keeping provisions. *See id.* at 737; Sec. & Exch. Comm'n v. Autocorp Equities, Inc., 292 F. Supp. 2d 1310 (D. Utah 2003) (knowledge or reckless disregard of the fact that the defendant was aiding or abetting a violation of securities law must be established).

conducting due diligence and maintaining due diligence records on an entity's foreign agents.[53]

The SEC also requires those who are responsible for ensuring compliance with an FCPA policy to have adequate experience and training so that they are equipped to address issues that may arise relative to preventing, detecting, and addressing possible violations of the FCPA.[54] In addition, the SEC has looked to a number of other factors that bear on the adequacy of internal controls, including, among others, the adequacy of due diligence,[55] lack of specificity or accuracy of records,[56] absence of procedures to ensure that payments are not made to foreign officials,[57] and the failure to audit third-party payments.[58]

More recently, in the official guidance issued jointly by the U.S Department of Justice and SEC (FCPA Guidance), internal controls over financial reporting are described as

> the processes used by companies to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements. They include various components, such as: a control environment that covers the tone set by the organization regarding integrity and ethics; risk assessments; control activities that cover policies and procedures designed to ensure that management directives are carried out (e.g., approvals, authorizations, reconciliations, and segregation of duties); information and communication; and monitoring.[59]

Moreover, the FCPA Guidance emphasizes that "[a]n effective compliance program is a critical component of an issuer's internal controls."[60] It notes that "[a] well-constructed, thoughtfully implemented, and consistently enforced compliance and ethics program helps prevent, detect, remediate, and report misconduct, including FCPA violations."[61] What the FCPA Guidance describes as the

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[53] In Sec. & Exch. Comm'n v. Titan, the SEC alleged that Titan failed to devise or main an effective system of internal controls. Sec. & Exch. Comm'n v. Titan, Litig. Release No. 19, 107 (Mar. 1, 2005), *available at* http://www.sec.gov/litigation/litreleases/lr19107.htm.

> Despite utilizing over 120 agents and consultants in over sixty countries, Titan never had a formal company-wide FCPA policy, failed to implement an FCPA compliance program, disregarded or circumvented the limited FCPA policies and procedures in effect, failed to maintain sufficient due diligence files on its foreign agents, and failed to have meaningful oversight over its foreign agents. *Id.*

[54] *Id.*

[55] *Id.*

[56] *See infra* note 211.

[57] *Id.*

[58] *See infra* note 267.

[59] FCPA Guidance, *supra* note 7, at 40.

[60] *Id.*

[61] *Id.* at 56.

"hallmarks" of an effective compliance program adequately addresses the following factors:[62]

1. Commitment from Senior Management and a Clearly Articulated Policy Against Corruption[63]

An effective compliance program requires senior management to have "clearly articulated [entity] standards, communicated them in unambiguous terms, adhered to them scrupulously, and disseminated them throughout the organization."[64]

2. Code of Conduct and Compliance Policies and Procedures[65]

Effective codes of conduct "are clear, concise, and accessible to all employees and to those conducting business on the [entity's] behalf."[66] It must be conveyed in the local language.[67] In tailoring policies and procedures to circumstances associated with an entity and the business it conducts, a compliance program should "outline responsibilities for compliance within the [entity], detail proper internal controls, auditing practices, and documentation policies, and set forth disciplinary procedures."[68]

3. Oversight, Autonomy, and Resources[69]

In addition to ensuring that there is "adequate staffing and resources," one or more specific senior members of management should be designed and assigned responsibility of overseeing and implementing a compliance program. [70] The senior executive should have "adequate autonomy from management, and sufficient resources to ensure that the [entity's] compliance program is implemented effectively."[71] "Adequate autonomy generally includes direct access to an organization's governing authority, such as the board of directors and committees of the board of directors."[72]

4. Risk Assessment[73]

Depending upon the degree to which particular facts and circumstances may increase risks, compliance procedures, such as due diligence, internal audits, and

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[62] *Id.* at 57.

[63] *Id.*

[64] *Id.*

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] *Id.* at 58.

[69] *Id.*

[70] *Id.*

[71] *Id.*

[72] *Id.*

[73] *Id.*

other appropriate measures, should be correspondingly adjusted to address the heightened risk.[74]

5. Training and Continuing Advice[75]

In a "manner appropriate of the targeted audience," pertinent policies and procedures need to be communicated throughout an entity, including to agents, partners, or collaborating entities, whether through training or certifications or other appropriate measures.[76] Measures also must be implemented to ensure that timely advice can be provided to facilitate compliance with an entity's policies.[77]

6. Incentives and Disciplinary Measures[78]

An entity's compliance program must be applied throughout an entity.[79] No one should be exempted from its application.[80] Disciplinary procedures must be clear and applied consistently and promptly.[81] Incentives for compliance should be encouraged.[82]

7. Third-Party Due Diligence and Payments[83]

As part of its "risk-based" due diligence, the qualifications and associations of third-parties must be understood as well as the business rationale for using the third party.[84] Compliance obligations should be disclosed and commitments obtained from the third parties.[85] Follow-up steps should ensure that the business reasons for using the third party are supported by the terms of any agreements, by the timing and manner in which payments are made, and by there being verification of the work performed.[86] Third-party relationships should be monitored on an on-going basis.[87]

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[74] *Id.* at 58-59.

[75] *Id.* at 59.

[76] *Id.*

[77] *Id.*

[78] *Id.*

[79] *Id.*

[80] *Id.*

[81] *Id.*

[82] *Id.* at 59-60.

[83] *Id.* at 60.

[84] *Id.*

[85] *Id.* at 60-61.

[86] *Id.* at 60.

[87] *Id.*

8. Confidential Reporting and Internal Investigation[88]

A compliance program should include a mechanism for suspected misconduct to be reported on a confidential basis.[89] Policies should also be implemented to ensure that no one making a confidential disclosure fears retaliation.[90] Adequate resources should be provided so that allegations can be properly investigated and appropriate measures taken.[91]

9. Continuous Improvement: Periodic Testing and Review[92]

A compliance program must be regularly tested and reviewed to identify weaknesses, to adjust to changing circumstances and risks, and to develop ways of improving its efficiency and effectiveness.[93]

10. Mergers and Acquisitions: Pre-Acquisition Due Diligence and Post-Acquisition Integration[94]

To avoid legal and business risks, compliance requires that due diligence be performed as part of mergers and acquisitions.[95] The acquired entity should be fully integrated in the internal controls and compliance program of the acquiring entity.[96] This would extend to all aspects of compliance, such as evaluating and monitoring third parties, training employees, and expanding audits to the new additions.[97]

B. Heightened Obligations under Sarbanes-Oxley

At the core of the heightened obligations under Sarbanes-Oxley are those that relate to the accounting provisions of the FCPA.[98] Issuers are required to include in their annual reports an internal control report expressing management's responsibility for establishing and maintaining adequate internal controls for financial reporting and assessing their effectiveness.[99] An attestation by an issuer's

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[88] *Id.* at 61.

[89] *Id.*

[90] *Id.*

[91] *Id.*

[92] *Id.* at 61.

[93] *Id.* at 61-62.

[94] *Id.* at 62.

[95] *Id.*

[96] *Id.*

[97] *Id.*

[98] "At the core of the heightened obligations under the Sarbanes-Oxley Act of 2002 . . . are those that relate to the accounting and record-keeping provisions of the FCPA." Deming, *supra* note 9, at 470-71 (citing Speech of Alan L. Beller, Dir., Sec. & Exch. Comm'n Div. of Corporate Fin., "Investors, the Stock Market, and Sarbanes-Oxley's New Section 404 Requirements" (Jan. 12, 2005), *available at* http://www.sec.gov/news/speech/spch011205alb.htm).

[99] 15 U.S.C. § 7262 (2012).

outside auditor is also required as to management's assessment of the adequacy of the issuer's internal controls.[100]

IV. FINANCIAL SERVICES AND MARKETS ACT 2000

Under the United Kingdom's Financial Services and Markets Act 2000,[101] the Financial Services Authority ("FSA") has jurisdiction over the regulation of banks, building societies, insurance companies, friendly societies, credit unions, Lloyd's investment and pensions advisers, stockbrokers, professional firms offering certain types of investment services, fund managers, and derivatives traders.[102] The FSA has broad rule-making powers,[103] and, in addition, the power to request information and reports,[104] to appoint persons to conduct investigations,[105] and to impose fines and penalties.[106]

Principal 3 of FSA's principles for businesses requires that "[an entity] must take reasonable care to organize and control its affairs responsibly and effectively, with adequate risk management systems."[107] In this regard, the FSA requires that "[an entity] must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the [entity] might be used to further financial crime."[108]

While the FSA does not prosecute breaches of the [UK] Bribery Act,[109] it has "a strong interest in the anti-corruption systems and controls of [entities]" that it supervises.[110] Entities subject to its jurisdiction "are under a separate, regulatory obligation to establish and maintain effective systems and controls to mitigate financial crime risk."[111] "Financial crime risk includes the risk of corruption as well as bribery, and so is wider than the [UK] Bribery Act's scope."[112]

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[100] *See id.*, § 7262(b).

[101] Financial Services and Markets Act, c. 8, 2000 (U.K.) [hereinafter Financial Services Act].

[102] *Id.*, Explanatory Notes, ¶ 7.

[103] *Id.* at § 138.

[104] *Id.*, §§ 165-166.

[105] *Id.*, §§ 167-168.

[106] *Id.*, §§ 205-211.

[107] Fin. Serv. Auth., THE FULL HANDBOOK [hereinafter FSA HANDBOOK], PRIN 2.1.3R (2012).

[108] *Id.*, SYSC 3.2.6R.

[109] Bribery Act, c. 23, 2010 (U.K.) [hereinafter UK Bribery Act].

[110] FINANCIAL SERVICES AUTHORITY, *Financial crime: a guide for firms* pt. I, at 43 (Nov. 2012) [hereinafter FSA Guidelines].

[111] *Id.* Similarly, e-money institutions and payment institutions must demonstrate "that they have robust governance, effective risk procedures and adequate internal control mechanisms." *Id.*

[112] *Id.*

While an entity may take a "variety of approaches" to meet its obligations, "all [entities are required to] take steps to defend themselves against crime."[113] The FSA "may take action against [an entity] with deficient anti-bribery and corruption systems and controls regardless of whether or not bribery or corruption has taken place."[114] In addressing bribery and corruption risks,[115] the approach taken must incorporate a number of basic themes.[116]

A. Governance

Senior management is "responsible for ensuring that an entity conducts its business with integrity and tackles the risk that the [entity], or anyone acting on its behalf, engages in bribery and corruption."[117] "Senior management" must "take *clear responsibility* for managing financial crime risks."[118] An entity's "board and senior management" should "*demonstrate* a good understanding of the bribery and corruption risks by the [entity], the materiality to its business and how to apply a risk-based approach to anti-bribery and corruption."[119]

Financial crime risks, such as corruption and bribery, are to "be treated in the same manner as other risks faced by the business."[120] Issues of "*integrity* and *compliance* with relevant anti-corruption legislation" are to be "considered when discussing *business opportunities*."[121] Senior management is to receive sufficient and timely information relative to pertinent bribery and corruption issues.[122] Members of "senior management [should be] *actively engaged* in the [entity]'s approach to addressing [its] risks [of financial crime]."[123] They should "approve and periodically review the strategies and policies for managing, monitoring [the risk of bribery or corruption]."[124]

B. Structure

Although the organizational structure of entities may differ in how they address financial crime, the "structure should promote coordination and information sharing

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[113] *Id.*, pt. 1, at 10.

[114] *Id.*, pt. 1, at 43. "Principle 1 of [the FSA's] Principles for Business also requires authorised [entities] to conduct their business with integrity." *Id.*

[115] *Id.*

[116] *Id.*, pt. 1, at 10.

[117] *Id.*, pt. 1, at 44. An entity must be "*committed* to carrying out business fairly, honestly and openly." *Id.* (emphasis in original).

[118] *Id.*, pt. 1, at 11 (emphasis in original).

[119] *Id.*, pt. 1, at 44 (emphasis in original).

[120] *Id.*, pt. 1, at 10.

[121] *Id.*, pt. 1, at 44 (emphasis in original).

[122] *Id.*, pt. 1, at 10.

[123] *Id.* pt. 1, at 10 (emphasis in original).

[124] *Id.* pt. 1, at 44. In this regard, staff should be made aware of senior management's concerns. *Id.* It is a "poor practice" for there to be "[a]n 'ask no questions' culture [that] sees management turn a *blind eye* to how new business is generated." *Id.* (emphasis in original).

across the business."[125] It should also promote accountability and define ultimate responsibility.[126] Those assigned responsibility need to have appropriate seniority and experience as well as "clear reporting lines."[127] Adequate resources need to be provided and should be proportionate to the risk.[128]

C. Risk Assessment

"A *thorough understanding* of its *financial crime risks* is key if [an entity] is to apply proportionate systems and controls."[129] It needs to regularly update its risk assessment and identify new or emerging financial crimes risks.[130] Entities are specifically expected "to identify, assess and regularly review and update their bribery and corruption risks."[131]

A "rigorous and well-documented" risk assessment process, which is "recorded *systematically,*" needs to take place.[132] The risk of "*staff* or *third* parties acting on the [entity]'s behalf *offering* or *receiving* bribes" needs to be addressed "across the business."[133] Compliance units within an entity should be adequately equipped to identify and assess corruption risk.[134]

Policies and procedures need to be adapted on a timely basis to address emerging risks.[135] Indeed, they may need to be broadened to "cover corrupt behaviour not captured by the [UK] Bribery Act."[136] Incentive or remuneration structures also

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[125] *Id.*, pt. 1, at 12.

[126] *Id.*

[127] *Id.* Compliance officials should not be "relatively *junior*" or "lack access to senior management," or be "often *overruled* without documented justification." *Id.* (emphasis in original).

[128] *Id.* In smaller entities, it may be reasonable for staff to have more than one role. *Id.* Yet staff should not be spread too thin. *Id.*

[129] *Id.*, pt. 1, at 13 (emphasis in original). An entity needs to identify and understand its risks of financial crime. *Id.* The more comprehensive the risk assessment, the greater the effectiveness of the risk assessment process. *Id.* Risk assessment should not be "*piecemeal,*" lack coordination, or be "*incomplete.*" *Id.* (emphasis in original). Future plans should also be considered as part of the risk assessment process. *Id.* The larger picture and not just short-term financial results need to be borne in mind. *Id.*

[130] *Id.*

[131] *Id.*, pt. 1, at 45.

[132] *Id.*, pt. 1, at 13 (emphasis in original).

[133] *Id.*, pt. 1, at 45 (emphasis in original). An entity should assess corruption risks "in *all jurisdictions* where the [entity] operates and across all business channels." *Id.* (emphasis in original).

[134] *Id.*

[135] *Id.*, pt. 1, at 13. An entity should assess "where risks are greater and *concentrate its resources* accordingly." *Id.* (emphasis in original).

[136] *Id.*, pt. 1, at 45. "Thorough reviews and gap analyses of systems and controls [should take place] against relevant external events, with strong senior management involvement or sponsorship." *Id.*, pt. 2, at 32.

need to be addressed to ensure that they do not increase the risk of bribery or corruption.[137]

D. Policies and Procedures

"A[n entity] must have in place up-to-date policies and procedures appropriate to its business. These should be *readily accessible*, *effective* and *understood* by all relevant staff."[138] Policies and procedures should be reviewed at a senior level.[139] Timely adjustments need to be made to "*reflect new risks* or *external events*."[140] Steps need to be taken to ensure that policies and procedures are understood by staff.[141]

In addition to being adequately communicated to "relevant staff,"[142] "anti-corruption policies and procedures are [to be] applied effectively."[143] The policies and procedures should be designed to help an entity identify whether someone acting on its behalf is corrupt.[144] How an entity "react[s]" to "suspicions or allegations of bribery or corruption involving people with whom the [entity] is connected" bears upon the effectiveness of its financial crimes systems and controls.[145]

E. Dealing with Third Parties

Entities are "expect[ed] to take adequate and risk-sensitive measures to address the risk that a third party acting on behalf of the [entity] may engage in corruption."[146] An entity should know its third parties and policies should be established relative to their selection.[147] Third-party relationships are to be "*monitored* and *reviewed*."[148] The extent of due diligence should be "determined on a risk-sensitive basis."[149]

Bribery and corruption issues are to be identified as part of the due diligence work on third parties.[150] When the use of intermediaries is being considered, an entity should "satisfy itself that those businesses have *adequate controls* to detect

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[137] *Id.*, pt. 1, at 15.

[138] *Id.*, pt. 1, at 14 (emphasis in original).

[139] *Id.*

[140] *Id.* (emphasis in original).

[141] *Id.*

[142] *Id.*, pt. 1, at 14.

[143] *Id.*, pt. 1, at 46. "Risk-based, appropriate additional monitoring and due diligence . . . [should take place] for jurisdictions, sectors and business relationships identified as *higher risk*." *Id.* (emphasis in original).

[144] *Id.*

[145] *Id.*

[146] *Id.*, pt. 1, at 47.

[147] *Id.*

[148] *Id.* (emphasis in original).

[149] *Id.*

[150] *Id.*

and prevent where staff have used bribery to generate business."[151] The due diligence process should be applied consistently "when establishing and reviewing third-party relationships."[152] Moreover, "due diligence information" should be "kept *up to date*."[153]

An entity's controls with respect to third parties should include a requirement "to establish and record an *adequate commercial rationale* to support its payments to overseas third parties."[154] Adequate due diligence and approval of third-party relationships should take place before payments are made to a third party.[155] "Regular and thorough monitoring of third-party payments" should take place.[156] Along these lines, an entity should be able "*to produce a list* of approved third parties, associated due diligence and details of payments made to them."[157]

F. Staff Recruitment

"[Entities] must employ staff who possess the skills, knowledge and expertise to carry out their functions effectively. They should review employees' competence and take appropriate action to ensure they remain competent for their role. Vetting and training should be appropriate to employees' roles."[158] This includes an employee's likely exposure to financial crime risks in conjunction with their responsibilities and whether the employee is "*competent* to carry out preventive functions effectively."[159]

Care needs to be exercised in ensuring that employee training is appropriately tailored and provided on an ongoing basis.[160] The training should be "in place to ensure staff knowledge is adequate and up to date."[161] It should be "*practical*" in orientation and include "some form of testing."[162] An entity should have "*[w]histleblowing* procedures [that] are clear and accessible, and [that] respect staff confidentiality."[163]

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[151] *Id.* (emphasis in original).

[152] *Id.*

[153] *Id.* (emphasis in original).

[154] *Id.* (emphasis in original).

[155] *Id.*, pt. 2, at 33. There should be "[r]isk-based approval procedures for payments and a clear understanding of why payments are made." *Id.*, pt. 2, at 34.

[156] *Id.* "[F]or example, whether a payment is unusual in the context of previous similar payments [should be checked]." *Id.* An entity should have the "facility to produce accurate [management information] to facilitate effective payment monitoring." *Id.*

[157] *Id.*, pt. 1, at 47 (emphasis in original).

[158] *Id.*, pt. 1, at 15.

[159] *Id.* (emphasis in original).

[160] *Id.*

[161] *Id.*

[162] *Id.* (emphasis in original).

[163] *Id.* (emphasis in original).

G. Quality of Oversight

"A[n entity's] efforts to combat financial crime should be subject to *challenge*."[164] Senior management needs "to ensure that policies and procedures are appropriate and followed."[165] An entity's approach to reviewing the effectiveness of financial crime systems controls should be "*comprehensive*" and should address business risk.[166] "*Findings* of recent internal audits and compliance reviews" should be taken into consideration.[167] Management should "*engage constructively*" with the oversight process and ensure that decisions on the "allocation of compliance and audit resources are *risk-based*."[168]

V. Specific Anti-Bribery Internal Controls

In terms of addressing corruption and bribery risks, what constitutes adequate internal controls is not precisely defined. In general, the criteria are "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."[169] A pattern also emerges when one analyzes the applicable rules, regulations, and guidance issued by the Department of Justice, the SEC, and the FSA as well as the settlements or plea agreements reached with these regulatory agencies.

While the list of considerations described below is not exhaustive, it nonetheless represents a series of specific considerations that need to be in some way considered and addressed to ensure that an entity has adequate internal controls relating to bribery and corruption risks in foreign settings.

A. Overarching Considerations

For an entity to have adequate internal controls, it must take into consideration and account for a number of factors that are not limited to bribery and corruption risks in foreign settings. These considerations are foundational to the adequacy of any set of internal controls as they are overarching in nature and apply throughout an entity and to those acting on its behalf. From these overarching controls, more specific controls may be derived to address specific areas of concern.

1. Policies and Procedures

An entity should have "*clear documentation* of [its] approach to complying with its legal and regulatory requirements."[170] It should not rely "on passages in [its] staff code of conduct that prohibit improper payments, but [with] no other *controls*."[171] The policies and procedures should be tailored to address the particular needs of an

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[164] *Id.*, pt. 1, at 16 (emphasis in original).

[165] *Id.*

[166] *Id.* (emphasis in original).

[167] *Id.* (emphasis in original).

[168] *Id.* (emphasis in original).

[169] 15 U.S.C. § 78m(b)(7) (2012).

[170] FSA Guidance, *supra* note 110, pt. 1, at 14 (emphasis in original).

[171] *Id.*, pt. 1, at 46 (emphasis in original).

entity instead of being simply adopted from another entity or model forms.[172] They should be "clear, concise, and accessible to all employees and to those conducting business on the [entity's] behalf."[173]

An entity should set out "behaviour expected of those acting on its behalf."[174] Similarly, there should be "*unambiguous consequences* for breaches of the [entity]'s anti-corruption policy."[175] The consequences should be "commensurate with the violation" and "applied reliably and promptly."[176] An entity should assess the extent to which its staff and agents comply with its anti-corruption policies and procedures.[177] "Policies and procedures are [to be] *regularly reviewed* and *updated*,"[178] especially "in light of events."[179] "[A] good compliance program should constantly evolve" to adjust as the scope and nature of an entity's activities change along with the legal and other aspects of the environment in which it operates.[180]

2. Implementing Anti-Bribery Policies

While most entities have written policies, and even procedures, many often fail to follow up in implementing the policies and procedures that have been adopted. The failure to implement and consistently enforce anti-bribery polices can constitute a basis for finding the absence of adequate internal controls.[181]

Responsibility for anti-bribery and corruption systems and controls should be "clear" and "documented."[182] "[O]ne or more specific senior executives within an organization" should be "assigned responsibility for the oversight and

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[172] *Id.*, pt. 1, at 14. "Effective policies and procedures require an in-depth understanding of [an entity's] business model, including its products and services, third-party agents, customers, government interactions, and industry and geographic risks." FCPA Guidance, *supra* note 7, at 58.

[173] *Id.* at 57.

[174] FSA Guidance, *supra* note 110, pt. 1, at 46.

[175] *Id.* (emphasis in original).

[176] FCPA Guidance, *supra* note 7, at 59.

[177] FSA Guidance, *supra* note 110, pt. 1, at 46.

[178] *Id.*, pt. 1, at 14 (emphasis in original).

[179] *Id.* An entity's anti-corruption policies should not be allowed to become "*out of date*." *Id.*, pt. 1, at 46 (emphasis in original). An entity should respond "to external events that may highlight weaknesses in its anti-corruption systems and controls." *Id.*

[180] FCPA Guidance, *supra* note 7, at 61-62.

[181] In the action taken by the FSA against Willis Limited in 2011, the failure by Willis to implement its anti-bribery policies was found to be one of the indicators of a lack of adequate internal controls. Fin. Serv. Auth., Final Notice to Willis Limited, at 3 (July 21, 2011), *available at* www.fsa.gov.uk/pubs/final/willis_ltd.pdf [hereinafter Willis Limited]. Despite introducing "improved policies and guidance which were aimed at mitigating its bribery and corruptions risks," Willis Limited failed to take steps to ensure that the improved policies were carried out, including failing to carry out sufficient due diligence on third parties. *Id. See also* FCPA Guidance, *supra* note 7, at 60.

[182] FSA Guidance, *supra* note 110, pt. 2, at 31.

implementation of [an entity's] compliance program."[183] Those assigned to such responsibility "must have appropriate authority within the organization, adequate autonomy from management, and sufficient resources to ensure that the [entity's] compliance program is implemented effectively."[184]

Senior management must be committed to instilling a "culture of compliance" to ensure that compliance policies are implemented and "reinforced" at all levels of an entity.[185] Policies and procedures are to be "*disseminated* and *applied* throughout the business."[186] In particular, polices and procedures need to be communicated to "relevant staff,"[187] and "where appropriate, [to] agents and business partners."[188]

3. Adequate Training and Guidance

The training, including refresher training and training materials, should be "of *consistent quality* and [should be] *kept up to date.*"[189] "[G]ood quality, standard training on anti-bribery and corruption [should be provided] for all staff."[190] The "staff responsible for training others [should have] adequate training themselves."[191] "Staff in higher-risk roles [should be] subject to *more thorough vetting*" and training.[192] "Staff vetting" should never be a one-time "exercise."[193]

Training should not dwell "unduly on *legislation and regulations* rather than practical examples."[194] "[T]he information should be presented in a manner appropriate for the targeted audience, including providing training and training materials in the local language."[195] An entity should also develop "appropriate measures, depending on the size and sophistication of the particular [entity], to

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[183] FCPA Guidance, *supra* note 7, at 58. Responsibility for compliance should be "apportioned to either a single senior manager or a committee with appropriate Terms of Reference and senior management membership, reporting ultimately to the board." FSA Guidance, *supra* note 110, pt. 2, at 31.

[184] FCPA Guidance, *supra* note 7, at 58.

[185] *Id.* at 57.

[186] FSA Guidance, *supra* note 110, pt. 1, at 14 (emphasis in original). "A compliance program should apply from the board room to the supply room—no one should be beyond its reach." FCPA Guidance, *supra* note 7, at 59.

[187] FSA Guidance, *supra* note 110, pt. 1, at 14.

[188] FCPA Guidance, *supra* note 7, at 59.

[189] FSA Guidance, *supra* note 110, pt. 1, at 15 (emphasis in original).

[190] *Id.*, pt. 2, at 35.

[191] *Id.*

[192] *Id.*, pt. 1, at 15 (emphasis in original).

[193] *Id.* "[S]taff records [should be kept] setting out what training was completed and when." *Id.*, pt. 2, at 35.

[194] *Id.*, pt. 1, at 15 (emphasis in original). "[P]ractical examples of risk and how to comply with policies [should be provided]." *Id.*, pt. 2, at 35.

[195] FCPA Guidance, *supra* note 7, at 59. "For example, [entities] may want to consider providing different types of training to their sales personnel and accounting personnel with hypotheticals or sample situations that are similar to the situations they might encounter." *Id.*

provide guidance and advice on complying with the [entity's] ethics and compliance program, including when such advice is needed urgently."[196]

The "*content*" of training should have the "sign-off" of management.[197] Training needs should be identified.[198] There should be "*training logs* or tracking of employees' training history."[199] Staff training should not be neglected "in the belief that robust payment controls are sufficient to combat [bribery] and corruption."[200] "The [entity should satisfy] itself that staff *understand* their responsibilities."[201] An entity should test "staff understanding and [use] the results to assess individual training needs and the overall quality of the training."[202]

Whistleblowing and "escalation procedures" should be part of training and be "clear" for "reporting suspicions, and communicating these to staff."[203] "[A]lternative reporting routes [should be provided] for staff wishing to make a whistleblowing disclosure about their line management or senior managers."[204] "[C]onfidentiality of those who raise concerns" should, in addition to being "respect[ed],"[205] be protected against retaliation.[206] A "senior manager" should "oversee the whistleblowing . . . and [be] a point of contact [for individuals'] concerns about their line management."[207]

4. Compliance Officials Must Have Sufficient Experience and Training

It is essential that compliance officials have sufficient competence in terms of experience and training to address relevant compliance issues.[208] Some entities may

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[196] *Id.*

[197] FSA Guidance, *supra* note 110, pt. 1, at 15 (emphasis in original).

[198] *Id.*

[199] *Id.* (emphasis in original).

[200] *Id.*, pt. 2, at 35.

[201] *Id.*, pt. 1, at 15 (emphasis in original).

[202] *Id.*, pt. 2, at 35. This could include "computerised training [containing] a test." *Id.*, pt. 1, at 15.

[203] *Id.*, pt. 1, at 15; pt. 2, at 36.

[204] *Id.*, pt. 2, at 36. "An effective compliance program should include a mechanism for an organization's employees and others to report suspected or actual misconduct or violations of the [entity's] policies on a confidential basis and without fear of retaliation." FCPA Guidance, *supra* note 7, at 61 (footnote omitted).

[205] FSA Guidance, *supra* note 110, pt. 2, at 36

[206] FCPA Guidance, *supra* note 7, at 61.

[207] FSA Guidance, *supra* note 110, pt. 1, at 36.

[208] Leaving compliance issues to a young, inexperienced attorney has been found to constitute inadequate internal controls. In *In re* BellSouth Corp., Exchange Act Release No. 45279, 2002 WL 47167 (Jan. 15, 2002), BellSouth was found to have violated the internal control provisions. Bellsouth International, indirectly a wholly-owned subsidiary of BellSouth International, knew that payments to the lobbyist could implicate the FCPA. BellSouth was found to have failed to devise and maintain a system of internal accounting controls at Telefonia sufficient to detect and prevent FCPA violations. Among the factors

not be large enough or otherwise be unable to support an attorney or expert with the requisite expertise on a full-time basis. However, having access to such expertise, such as through outside counsel or other experts, may suffice where compliance officials can, when needed, secure guidance and support.[209]

A. Systemic

An entity must have in place an effective series of systemic controls that also have an important application in deterring and addressing bribery and corruption risks. These controls are procedural in nature and apply throughout an entity. While not specifically directed to bribery and corruption risks, their effective implementation and active enforcement are essential to limiting and timely addressing bribery and corruption risks.

1. Accurate Record-Keeping

Records must be maintained "that in reasonable detail accurately and fairly reflect the transactions and dispositions of [] assets."[210] Adequate procedures need to put in place to ensure that there is adequate specificity in the records of the third party as to the reasons or purpose of payments.[211] Generic terms are to be avoided.[212] In order to adequately monitor and control risks, there is a need for adequate documentation and sufficient specificity as to the rationale, and other material information, for making payments.[213]

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cited was that BellSouth International officials "knew, or should have known, that the attorney lacked sufficient experience or training to enable him properly to opine on the matter." *Id.* at *3.

[209] *See, e.g.*, FSA Guidance, *supra* note 110, pt. 2, at 32.

[210] 17 C.F.R. §§ 240.13a-15(f)(1) (2012).

[211] In the complaint filed by the SEC in Sec. & Exch. Comm'n v. Aon Corp., Case No. 1:11-cv-02256 (D.C.C., 2011), it was alleged that the internals were inadequate since there was reliance upon generic terms as opposed to requiring specificity in records for payments to third parties and a lack of procedures to ensure that third-party payments were not made to foreign government officials. *See* Sec. & Exch. Comm'n v. Aon Corp., Litig. Release No. 22203, (Dec. 20, 2011), *available at* http://www.sec.gov/litigation/litreleases/2011/lr22203.htm.

In the complaint filed by the SEC in Sec. & Exch. Comm'n v. York Int'l Corp., Civ. No. 07 CV 01750, (D.D.C. 2007), *available at* http://www.sec.gov/litigation/complaints/2007/comp20319.pdf, a violation of the anti-bribery provisions was alleged in addition to violations of the internal controls and record-keeping provisions. The violation of internal control provisions was based on York International Corp.'s failure "to devise and maintain an effective system of internal controls to prevent or detect numerous violations, as shown by: (1) the extent and duration of the illicit payment schemes, (2) the involvement of multiple subsidiaries and numerous managers and employees, and (3) the improper recording of these payments in the books and records." Sec. & Exch. Comm'n v. York Int'l Corp., Litig. Release No. 20319, 91 SEC Docket 2139. (Oct. 1, 2007).

[212] *Id.*

[213] *See* Willis Limited, *supra* note 181, at 2. Among other failures on the part of Willis Limited, the FSA pointed to the numerous times that "the reason for sharing commission was inadequately recorded . . . . In almost all cases, [there was] a very brief description of the

2. Compensation or Remuneration Structure

"[R]umuneration structures [should be assessed to determine whether they] give rise to increased risk of bribery and corruption."[214] For example, a determination needs to be made as to whether "individual bonus awards [are made] on the basis of several factors, including a good standard of compliance, not just the amount of income generated."[215] Where possible, it is a "good practice" for there to be "[d]eferral and clawback provisions for bonuses paid to staff in higher in positions."[216] In addition, consideration needs to be given to instituting "positive incentives [that] can also drive compliant behavior."[217]

3. Conveying Critical Information to Senior Management and Oversight Officials

It is essential that those with oversight responsibilities, such as boards of directors and audit committees, receive timely and sufficient information in order to monitor whether pertinent bribery and corruption risks are being effectively mitigated.[218] The management information should include "information about third parties including (but not limited to) new third party accounts, their risk classification, higher risk third party payments for the preceding period, changes to third-party bank account details and unusually high commission paid to third parties."[219] "Swift and effective senior management-led response [should be taken] to significant bribery and corruption events, which highlight potential areas for improvement in systems and controls."[220]

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reasons for the commission payment and did not state in detail what services it would receive in return beyond, for example, introduction services. *Id.* at 9.

[214] FSA Guidance, *supra* note 110, pt. 2, at 35.

[215] *Id.*

[216] *Id.* An entity should not have "[b]onus structures for staff in higher risk position which are directly linked (e.g. by a formula) solely to the amount of income or profit they produce, particularly when bonuses form a major part, or the majority, of total remuneration." *Id.*

[217] FCPA Guidance, *supra* note 7, at 59-60.

[218] In taking action against Willis Limited, the FSA found that "throughout the Relevant Period, the only management information provided to the relevant boards and committees relating to Overseas Third Parties was of a financial nature . . . . It did not include sufficient information that would have enabled Willis Limited to evaluate how well the anti-bribery and corruption systems and controls were performing. Willis Limited, *supra* note 181, at 17. *See also* FSA Guidance, *supra* note 110, at 31; 17 CFR §§ 240.13a, 15d-15(e) (2012).

[219] FSA Guidance, *supra* note 110, pt. 2, at 31. It would be a "poor practice" for there to be "[l]ittle or no [management information] sent to the Board about higher risk third party relationships or payments." *Id.* Similarly, it would be a "poor practice" to fail to include "details of wider issues, such as new legislation or regulatory developments in [management information]." *Id.* The inability of an entity's information technology systems to produce necessary management information would also be indicative of a "poor practice." *Id.*

[220] *Id.* Preferably, "[a]ctions taken or proposed in response to issues highlighted by [management information] are [recorded] and acted on appropriately." *Id.*

4. Assessment of Risk

In allocating its resources,[221] an entity needs to determine where it may be exposed to bribery and corruption risk.[222] Consideration should be given to "risk associated with the products and services" being offered by the entity, "the customers and jurisdictions with which [an entity] does business," and a[n entity]'s "exposure to public officials and public office holders and [its] business practices" such as its "approach to providing corporate hospitality, charitable and political donations and [its] use of third parties."[223] Effective due diligence as to bribery and corruption risks should also be undertaken in assessing risks associated with prospective acquisitions.[224]

Risk assessment should be "a *continuous* process based upon the best information available from internal and external sources."[225] Risks and gaps in the risk assessment process are to be "addressed in a *coordinated* manner across the business and information is shared readily."[226] "A risk-based approach [should be used] to dealing with adverse information raised by vetting checks, taking into

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[221] "Assessment of risk is fundamental to developing a strong compliance program . . . ." FCPA Guidance, *supra* note 7, at 58.

> One-size-fits-all compliance programs are generally ill-conceived and ineffective because resources inevitably are spread too thin, with too much focus on low-risk markets and transactions to the detriment of high-risk areas. Devoting a disproportionate amount of time policing modest entertainment and gift-giving instead of focusing on large government bids, questionable payments to third-party consultants, or excessive discounts to resellers and distributors may indicate that [an entity's] compliance program is ineffective.

Id.

[222] FSA Guidance, *supra* note 110, pt. 1, at 45.

[223] *Id.*

[224] FCPA Guidance, *supra* note 7, at 62. Due diligence "is only a portion of the compliance process for mergers and acquisitions." *Id.* The "acquiring [entity should] promptly incorporate[] the acquired [entity] into all of its internal controls, including its compliance program. [Entities] should consider training new employees, reevaluating third parties under [the entity's] standards, and, where appropriate, conducting audits on new business units." *Id.*

[225] FSA Guidance, *supra* note 110, pt. 1, at 13 (emphasis in original). These steps should be taken on a timely basis. *Id.*, pt. 2, at 32. "Regular assessments of bribery and corruption risks [should be taken] with a specific senior person responsible for ensuring this is done, taking into account the country and class of business involved as well as other relevant factors." *Id.* Steps should be taken to ensure that "review teams have sufficient knowledge of relevant issues and supplementing this with external expertise where necessary." *Id.* From the reviews, "clear plans" need to be made to "implement improvements arising from reviews, including updating policies, procedures and staff training." *Id.* An entity should "respond to external events which draw attention to weaknesses in [its] systems and controls." *Id.*

[226] *Id.*, pt. 1, at 12 (emphasis in original). Entities "will want to consider taking 'lessons learned' from any reported violations and the outcome of any resulting investigation to update their internal controls and compliance program and focus future training on such issues, as appropriate." FCPA Guidance, *supra* note 7, at 61.

account its seriousness and relevance in the context of the individual's role or proposed role."[227]

"Relying entirely on an individual's market reputation or market gossip [should not be] the basis for recruiting staff."[228] Staff should be vetted "on a risk-based approach, taking into account financial crime risk."[229] "Carrying out enhanced vetting [should not] only [take place] for senior staff when more junior staff are working in positions where they could be exposed to bribery or corruption issues."[230] "Temporary or contract staff [should not receive] less vigorous vetting than permanently employed colleagues carrying out similar roles."[231]

5. Monitoring

Care also needs to be exercised to ensure that [the] policies and procedures "are applied consistently and effectively."[232] The "effectiveness of policies, procedures, systems and controls" should be monitored by "*[i]nternal audit* or another independent party."[233] An entity needs to check on an ongoing basis to ensure "compliance's operational role in approving new third-party relationships and accounts."[234] Audit findings and compliance lessons should be shared between and among business units.[235]

B. Third Parties

Third parties can include a broad range of individuals and entities, such as suppliers, vendors, and agents, not directly in the employ of an entity. An agent can include consultants, attorneys, distributors, representatives or anyone acting on behalf of the entity. Under basic agency principles, anyone acting on behalf of an entity can expose an entity to liability.[236] Historically, third parties, and especially agents, have been a leading basis by which entities have been exposed to criminal or civil liability for improper inducements.[237] As a result, internal controls must be

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[227] FSA Guidance, *supra* note 110, pt. 2, at 34. Among the factors that need to be kept in mind is "whether staff in higher risk positions are becoming vulnerable to committing fraud or being coerced by criminals." *Id.*

[228] *Id.*

[229] *Id.*

[230] *Id.*

[231] *Id.* at 35.

[232] *Id.*, pt. 1, at 14.

[233] *Id.* (emphasis in original). Indeed, "[a]nti-bribery systems and controls [should be] *subject to audit*." *Id.*, pt. 1, at 44 (emphasis in original).

[234] *Id.*, pt. 1, at 47 (emphasis in original).

[235] *Id.*, pt. 1, at 16.

[236] *See, e.g.*, DEMING, *supra* note 34, at 68-69.

[237] "FCPA enforcement actions demonstrate that third parties, including agents, consultants, and distributors, are commonly used to conceal the payment of bribes to foreign officials in international business transactions. Risk-based due diligence is particularly important with third parties . . . ." FCPA Guidance, *supra* note 7, at 60.

particularly focused on third parties where the degree of risk of corruption or bribery is more apt to be heightened.

1. Due Diligence of Third Parties

A consistent component of internal controls of any entity doing business in foreign settings through foreign agents is the need to conduct diligence on third parties.[238] Policies and procedures should "*clearly define* a 'third party'."[239] The degree of due diligence can vary depending upon the risks associated with where a third party conducts business on behalf of an entity.[240] An entity should have "a detailed understanding of the business case for using [third parties]," including "a clear understanding of the roles [of the third parties]."[241] "[V]ague explanations" should not be accepted.[242]

Higher or extra levels of approval should be required for high-risk third-party relationships.[243] "More robust due diligence on and monitoring of higher risk third-party relationships" should take place.[244] In particular, "[w]here [an entity] uses third parties to generate business, these relationships [should be] subject to *thorough due diligence* and management oversight."[245] "[A]ppropriate *scrutiny* of and *approval* [should take place] for relationships with third parties that introduce business to the [entity]."[246] "A 'one size fits all' approach to third-party due diligence" should be avoided.[247] Whenever necessary, an entity should "bolster insufficient in-house knowledge or resource[s] with external expertise."[248]

An entity should not rely "heavily on the informal 'market view' of the integrity of third parties as due diligence."[249] Nor should an entity rely on "the fact that third-

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[238] Similarly, in the action taken against Willis Limited, the FSA found that Willis did not perform sufficient due diligence on third parties. Willis Limited, *supra* note 181, at 2. *See also* Litig. Release, *supra* note 53.

[239] FSA Guidance, *supra* note 110, pt. 1, at 47 (emphasis in original).

[240] *E.g.*, FCPA Guidance, *supra* note 7, at 60. The determining factor is not whether the agent is based in a low risk country or may be a national of a country where the risk of corruption is very low. Rather, the critical factor is where the agent actually acts on behalf of an entity.

[241] FSA Guidance, *supra* note 110, pt. 2, at 32. *Accord*, FCPA Guidance, *supra* note 7, at 60. "Among other things, the [entity] should understand the role of and need for the third party and ensure that the contract terms specifically describe the services to be performed." *Id.*

[242] FSA Guidance, *supra* note 110, pt. 2, at 32.

[243] *See id.* An entity should ensure that "current third-party due diligence standards are appropriate when business is acquired that is higher risk than existing business." *Id.*, pt. 2, at 33.

[244] *Id.*, pt. 2, at 32.

[245] *Id.*, pt. 1, at 47 (emphasis in original).

[246] *Id.* (emphasis in original).

[247] FSA Guidance, *supra* note 110, pt. 2, at 32. FCPA Guidance, *supra* note 7, at 58.

[248] FSA Guidance, *supra* note 110, pt. 2, at 32.

[249] *Id.*

party relationships are longstanding when no due diligence has ever been carried out."[250] An entity should also not assume that "third-party relationships acquired from other [entities] have been subject to adequate due diligence."[251] A very basic identity check should never suffice as due diligence on higher risk third parties.[252]

"[R]easonable steps [should be taken] to verify the information provided by third parties during the due diligence process."[253] Forms for third parties should "ask relevant questions and clearly state which fields are mandatory."[254] Due diligence on third parties should also be documented.[255] Accurate central records should be maintained "of approved third parties, the due diligence conducted on the relationship and evidence of periodic reviews."[256]

An entity should not rely "exclusively on *informal* means to assess the bribery and corruption risks associated with third parties, such as staff's personal knowledge of the relationship with the overseas third parties."[257] Among others, the due diligence should include "[u]sing commercially-available intelligence tools, databases and/or other research techniques such as internet search engines to check third-party declarations about connections to public officials, clients, or [other pertinent parties]."[258]

2. Monitoring Third Parties in High Risk Areas

It is critical that the conduct of third parties on behalf of an entity in high-risk areas be carefully monitored.[259] An entity's compliance function should have "*oversight* of all third-party relationships," and it should monitor "this list to identify risk indicators, for example a third party's political or public service connections."[260]

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[250] *Id.*

[251] *Id.*, pt. 2, at 33.

[252] *Id.*, pt. 2, at 32.

[253] *Id.*

[254] *Id.*

[255] *Id.* In its complaint against Titan, the SEC alleged that there were inadequate internal controls due, in part, to the failure to maintain due diligence files on Titan's foreign agents. Litig. Release, *supra* note 53.

[256] FSA Guidance, *supra* note 110, pt. 2, at 33.

[257] *Id.*, pt. 1, at 47 (emphasis in original).

[258] *Id.*, pt. 2, at 33.

[259] In the action taken by the FSA against Aon Limited, the FSA found that the UK subsidiary of a U.S. issuer, Aon Corporation, failed to maintain adequate internal controls, in part, due to its failure to conduct diligence of third parties acting on its behalf. FINANCIAL SERVICES AUTHORITY, FINAL NOTICE TO AON LIMITED (Jan. 6, 2009), *available at* www.fsa.gov.uk/pubs/final/aon.pdf [hereinafter Aon Limited]. The FSA found that "Aon Ltd's payment procedures did not require adequate levels of due diligence to be carried out either before relationships with Overseas Third Parties were entered into or before payments were made. Its authorization process did not take into account the higher levels of risk that certain parts of its business were exposed to in the countries in which they operated." *Id.* at 2. *See also* Litig. Release, *supra* note 53.

[260] FSA Guidance, *supra* note 110, pt. 1, at 47 (emphasis in original).

Indeed, an entity should review "in sufficient detail its relationships with third parties on a regular basis to confirm that it is still necessary and appropriate to *continue with the relationship*."[261] It should not be assumed "that long-standing third-party relationships present no bribery or corruption risk."[262]

"Adequate due diligence [should take place] on new suppliers being added to the Accounts Payable system."[263] Third-party relationships should be "reviewed and approved by compliance, risk or committees involving these areas."[264] Consideration needs to be given to "why it is necessary to use a third party to win business and what services would the third party provide to the [entity]?"[265] The business rationale for the use of overseas third parties needs to be established and recorded.[266]

3. Monitoring Third Party Payments

Particularly in high risk jurisdictions, entities with subsidiaries or agents located in those jurisdictions, or which are otherwise active in those jurisdictions through subsidiaries or agents acting on their behalf, need to undertake special care to monitor third-party payments to ensure transparency as to what is really taking place.[267] For instance, whether payments are being made for legitimate services or to

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[261] *Id.* (emphasis in original).

[262] *Id.*

[263] *Id.*, pt. 2, at 34.

[264] *Id.*, pt. 2, at 32. Those approving third-party relationships should have not a conflict of interest or be perceived as not being in a position to make a dispassionate decision. *Id.*

[265] *Id.*, pt. 1, at 47.

[266] Willis Limited, *supra* note 181, at 2.

[267] FCPA Guidance, *supra* note 7, at 60. "Where appropriate, this may include updating due diligence periodically, exercising audit rights, providing periodic training, and requesting annual compliance certifications." *Id.*

In the complaint filed by the SEC in Sec. & Exch. Comm'n v. Oracle Corp., No. CV 12-4310 CRB (N.D. Cal. 2012), the SEC alleged that Oracle Corporation violated the internal control provisions of the FCPA due to the failure on the part of its Indian subsidiary (Oracle India) to put in place adequate controls to prevent its employees from creating and misusing proceeds of sales that had been "parked" with its distributor. Then, Oracle India employees would direct its distributor to disburse payments out of these "parked" funds to "vendors." Several of the vendors were "storefronts" that did not provide any services. Although Oracle India was heavily involved in working with the customers in selling the products and services and negotiating the final price, the actual purchase order was placed by customers with Oracle India's distributor. The distributor bought the product and services from Oracle India at a lower price and then resold the product and services at the negotiated price with the Indian government. The difference in price was "parked" in a side fund to pay third parties. The SEC alleged that though Oracle India was aware that distributor discounts created a margin of cash from which distributors received payments for their services, it failed to audit or compare the distributor's discount against the customer's price to ensure that excessive discounts were not being built into the pricing structure. The SEC also alleged that despite the existence of Oracle policies requiring approvals for payment of marketing expenses, "Oracle failed to seek transparency in or audit third party payments made by distributors on Oracle India's behalf. This would have enabled Oracle to check that payments were made to appropriate recipients." The resolution of the SEC's allegations against Oracle demonstrates how loose practices of

be shared with government officials.[268] Procedures need to be in place to ensure that third-party payments are not made to foreign government officials.[269] Employing a "healthily sceptical approach," third-party payments should be checked "individually prior to approval, to ensure consistency with the business case of that account."[270]

Consideration should be given to the "level of bribery and corruption risk posed by a third party when agreeing [to] the level of [a] commission [or payment]."[271] "[C]ommission limits or guidelines [should be set] which take into account risk factors related to the role of the third party, the country involved and the class of business."[272] An entity should avoid "[p]aying high levels of commission to third

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foreign subsidiaries can expose an issuer to liability regardless of lack of intent or knowledge on the part of their parent company. Nor do violations of the anti-bribery provisions need to be involved. However, the specific facts of the SEC's complaint against Oracle suggests a scenario whereby the side fund of the distributors could have been used as a vehicle to make improper inducements to foreign officials.

In the Final Notice issued by the FSA against Aon Limited for failing to implement adequate controls, Aon Ltd was found to have "failed to monitor its relationships with Overseas Third Parties in respect of specific bribery risks. After a relationship had been approved and set-up for payment, neither the relationship nor the payments were routinely reviewed or monitored." Aon Limited, *supra* note 260, at 2.

[268] In Sec. & Exch. Comm'n v. Baker Hughes Inc., No. H-07-108 (S.D. Tex. 2007), *available at* http://www.sec.gov/litigation/complaints/2007/comp20094.pdf, the SEC's complaint against Baker Hughes included allegations of violations of the books and records and internal controls provisions of the FCPA in Nigeria, Angola, Indonesia, Russia, Uzbekistan, and Kazakhstan. Baker Hughes made payments in Kazakhstan and other countries either to agents or to other individuals, including public officials, in circumstances that reflected either to agents or to other individuals, including public officials, in circumstances that reflected a failure to implement sufficient internal controls to determine whether the payments were for legitimate services, whether the payments would be shared with government officials, or whether these payments would be accurately recorded in Baker Hughes' books and records.

For example, commission payments were authorized to an agent under circumstances where the company failed to determine whether portions of the payments were funneled to government officials; in Indonesia, certain freight forwarders were paid to import equipment using a "door-to-door" process under circumstances in which the company failed to adequately assure itself that portions of such payments were not being passed on to Indonesian customs officials; in Nigeria, payments were authorized to certain customs brokers to facilitate the resolution of alleged customs deficiencies under circumstances in which the company failed to adequately assure itself that such payments were not being passed on, in party, to Nigerian customs officials; and in Angola, an agent was paid more than $10.3 million in commissions under circumstances in which the company failed to adequately assure itself that such payments were not being passed on to employees of Sonangol, Angola's state-owned oil company, to obtain or retain business in Angola. *Id.*

[269] Litig. Release, *supra* note 212, where the SEC also alleged that the lack of adequate internal controls for the reason that Aon failed to put effective procedures in place to ensure that third-party payments are not made to foreign government officials.

[270] FSA Guidance, *supra* note 110, pt. 2, at 34.

[271] *Id.*, pt. 2, at 33.

[272] *Id.*

parties used to obtain or retain higher risk business, especially if their only role is to introduce the business."[273] "[P]ayment terms and how those payment terms compare to typical terms in that industry and country, as well as the timing of the third party's introduction to the business" should be subject to review.[274]

Third parties should be "paid *directly* for their work."[275] Consideration should be given to confirming and documenting that "[a] third party is actually performing the work for which it is being paid and that its compensation is commensurate with the work being provided."[276] The controls should include "[c]lear limits on staff expenditures, which are fully documented, communicated to staff and enforced"; limits on "third-party payments from Accounts Payable to reimbursements of genuine business-related costs or reasonable entertainment;" and the requirement that "the reasons for third-party payments via Accounts Payable are clearly documented and appropriately approved."[277]

4. Third Party Bank Accounts

"[R]easonable steps [should be taken] to ensure that bank accounts used by third parties to receive payments are, in fact, controlled by the third party for which the payment is meant."[278] "[I]nstructions from third parties [should not be accepted] to pay [a] commission to other individuals or entities which have not been subject to due diligence."[279] "[R]edundant" third-party accounts should not be left "live" on accounting systems "because third-party relationships have not been regularly reviewed."[280]

VI. CONCLUSION

Given their esoteric nature, understanding internal controls and their application to deterring and limiting corruption and bribery risks can be challenging. In the absence of precise definitions or bright-line standards, it can be even more challenging in determining whether an entity's internal controls are adequate. But in various forms, a growing body of useful guidance is beginning to emerge, particularly from the SEC and FSA, through the implementation of rules and regulations and settlements reached as well as the issuance of specific guidance.

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[273] *Id.* Commissions should be paid "to third parties on a [one-time] fee basis where their role is pure introduction." *Id.*

[274] FCPA Guidance, *supra* note 7, at 60.

[275] FSA Guidance, *supra* note 110, at 47.

[276] FCPA Guidance, *supra* note 7, at 60.

[277] FSA Guidance, *supra* note 110, pt. 2, at 34. Procedures need to be instituted "to check thoroughly the nature, reasonableness and appropriateness of gifts and hospitality" *id.* "to check whether third parties to whom payments are due have been subject to appropriate due diligence and approval" *id.*, pt. 2, at 33; to impose "limits on different types of expenditure, combined with inadequate scrutiny during the approvals process." *Id.*, pt. 2, at 34.

[278] *Id.*, pt. 2, at 33.

[279] *Id.* Along these lines, an entity should not rely upon "bank details from third parties via informal channels such as email, particularly if email addresses are from webmail (e.g., Hotmail) accounts or do no appear to be obviously connected to the third party." *Id.*

[280] *Id.*

The emerging guidance demonstrates that enforcement officials in the United States and United Kingdom follow the same basic principles in determining whether an entity has adequate internal controls. An increasingly clear set of considerations now exist that need to be addressed in ensuring that an entity has adequate internal controls for bribery and corruption risks. Any entity subject to the jurisdiction of either the SEC or FSA is accordingly well advised to consult the emerging guidance developed by both agencies in determining whether its internal controls are adequate.

Even for entities not subject to the jurisdiction of the SEC or the FSA, the concepts associated with adequate internal controls in the context of anti-bribery compliance are highly relevant. In addition to providing a highly useful resource of considerations for compliance programs or instituting adequate procedures,[281] they provide insight as to mechanisms that have been recognized as necessary and useful in limiting and detecting corruption and bribery risks.

[281] *See, e.g.*, 18 U.S.C.S. app. § 8B2.1 (2012); UK Bribery Act, *supra* note 109, § 7(2).