MITIGATING THE RISK OF CORRUPTION IN EMERGING MARKETS THROUGH BEST PRACTICES AND DATA ANALYTICS

by

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Abstract

Corporations continually work to increase profitability through an enhanced revenue stream and a larger market share. An emerging trend is for companies to expand overseas and develop the untapped potential of international markets. This strategy contains many unknowns; including the amplified risk of corruption when entering emerging markets such as Brazil, Russia, India, and China (BRIC). In order to mitigate corruption, companies must realize the corruption dynamic of each country and the parameters set forth by the legal landscape. The Foreign Corrupt Practices Act (FCPA or "the Act") is a United States regulation that prohibits bribery of foreign officials and requires the maintenance of accurate books and records. To realize the benefits of emerging markets, organizations must implement a compliance program to deter and detect corrupt activities and thereby avoid FCPA violations. In response to the increased globalization and subsequent corruption-focused investigations, regulators and external parties have recommended numerous concepts for compliance. Prescribed best practices include the application of a risk-based compliance program, clear policies and procedures, and constant education. However, in order to close control gaps and timely detect suspicious behavior, the implementation of data analytics is critical. This paper will review the enhanced corruption risks of doing business in BRIC nations, the requirements under the FCPA, and how to build a comprehensive compliance program to deter and detect corruption through best practices and data analytics. Keywords: Economic Crime Management, Raymond Philo, Foreign Corrupt Practices Act, BRIC, Compliance, Best Practices, Data Analytics.

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Introduction

Multinational corporations take strategic steps to expand their market share, maintain an innovative edge, and reduce operational costs. Decisions made today will drive the future sustainability of organizations and determine if their implementation approach acquired the sought after result. A common strategy is a move into emerging markets. However, as is true with any business decision, a risk/reward calculation must be evaluated. A shift to emerging markets can result in the aforementioned benefits but can also lead to a crippling downside – corruption. By understanding the current dynamic of emerging markets and the legal landscape that American companies operate under, businesses can reduce their corruption risk. This requires a comprehensive understanding of industry best practices and the implementation of data analytics to detect corrupt activities within the organization.

Emerging markets will be defined as Brazil, Russian, India, and China for the purpose of this study. BRIC's have historically suffered from limited governance and oversight, a divergent organizational culture, and contrasting business processes with the Western world. For those reasons, corporations take on additional risks when doing business in developing nations. Since regulatory risks are heightened in BRIC nations, companies need to be cognizant of potential sanctions. If ignored, the revenue growth or operational optimization could be nullified because of the direct, indirect, and reputational costs from an investigation alleging systemic corruption.

Once the corruption risks from doing business in BRIC nations are understood, implementing compliance best practices is integral. The Foreign Corrupt Practices Act is a United States regulation at the center of global compliance. By reviewing current information published by the enforcement bodies of the FCPA and analyzing recent enforcement actions, the elements of a comprehensive anti-corruption compliance program will be clear. Sound policies, procedures, and internal controls will mitigate the likelihood of corruption on the front end and reduce the chance of prosecution after-the-fact.

A truly effective compliance program develops mechanisms to not only deter corruption, but to detect it in a time sensitive fashion. Data analytics process structured and unstructured data to determine patterns and anomalies. Once discovered, scenarios that fall outside established benchmarks are analyzed to determine appropriate next steps. By applying data analytics to high-risk transactions and relationships, anti-corruption compliance becomes proactive and a value-add to the organization. Companies can reap the potential benefits from BRIC's by applying robust internal controls and integrating methods to capture violations early.

This paper will review the detrimental effects of corruption, why those risks are heightened in emerging markets, and how to build a comprehensive anti-corruption compliance framework using learned best practices and data analytics. The corruption dynamic of BRIC nations will be evaluated, FCPA enforcement actions analyzed, and a program for deterring and detecting corruption recommended.

Literature Review

Detrimental Effects of Corruption

Corruption is commonly defined as, “the abuse of power by a public official for private benefit” (Tanzi, 1998). Acts of corruption can include nepotism, identity theft, and money laundering. For purposes of this paper, corruption will be limited to bribery: the offering or giving something of value to a public official in order to influence their official duty (Otusanya, 2011). Bribery hinders economic growth, threatens democratic values, and attacks the underlying principles of the global marketplace (Department of State, 2001). Mitigating corruption also provides several benefits: domestic and foreign aid can be evenly distributed; the cost of doing business reduced; and businesses can operate within a level playing field (Ardichvili and Jondle et al, 2012).

Research finds that corruption is directly correlated to economic growth. Utilizing per capita gross domestic product, Kaufmann and Kraay (2002) report that countries with a low rate of corruption achieve a greater domestic growth rate. Further, investors are not willing to invest in a country perceived as corrupt because speculating in an unstable economy is problematic (Tanzi and Davoodi, 1998). The volatility and lack of transparency often tied to corruption-rich countries is just one drawback. The United Nations Compact estimates that global corruption adds a 10% “corruption tax” and another 25% price increase to products developed in BRIC nations (Bajoria, 2011). The manufactured cost inflation results in a highly inefficient market and undermines the economic pillar of competition.

The increased business expansion towards international markets places a greater trust on the ability of public officials to make sound procurement decisions, set effective technical standards, and ensure public safety (Otusanya, 2011). A byproduct of this reality is that more public officials are accepting bribes in the course of their civic duty. This is confirmed through a World Bank report that estimates $1 trillion in bribes are paid globally each year (AAPPG, 2006). Countries with the greatest propensity for public corruption suffer from a stunt in domestic progress more than their non-corrupt counterparts (Ertimi and Saeh, 2013). The underground economy and corresponding revenue reduction are additional factors for the underdevelopment of corruption-rich countries. Underground economies operate without government oversight thus increasing tax evasion. Diminished tax revenues reduce funding for public services, eliminates jobs, and forces those remaining to accomplish more without fair compensation. By perceiving a level of inequality, government officials are incentivized to defraud their post and accept bribes to supplement their income. Consequently, public officials rationalize that earning additional income through illicit means is acceptable because they feel undervalued and abused.

Even though there are proponents that believe bribery increases efficiency, the argument is short-sighted and does not focus on long-term effects. The pro-bribery point of view focuses on facilitation payments to speed up bureaucratic delays while producing somewhat of a marriage between organizations and individuals from diverse cultures (Perkins, 2010). Unfortunately, bribes are rarely one time payments and likely increase in both size and favor. A payment to speed up a routine government action may quickly escalate to a bribe that secures business.

Corruption Landscape in BRIC Nations

BRIC nations have held the distinction as the top emerging or developing markets since the start of the 21st century (See Figure 1). Not only has the global media fueled the potential revenue windfall of BRIC’s, but a 2012 Global Intelligence Alliance survey of 430 international managers reported that half of those surveyed expect at least 30% of future revenues to originate from Brazil, Russia, India, and China. Respondents of the survey also stated that entering an emerging market was to gain presence for long-term success, obtain global market share, and to hedge the depreciated growth in domestic or established markets (GIA, 2012). The pressure to succeed and high cost of international integration generates a fertile landscape for businesses to bend rules and focus on the end goal without regard for the legal landscape.

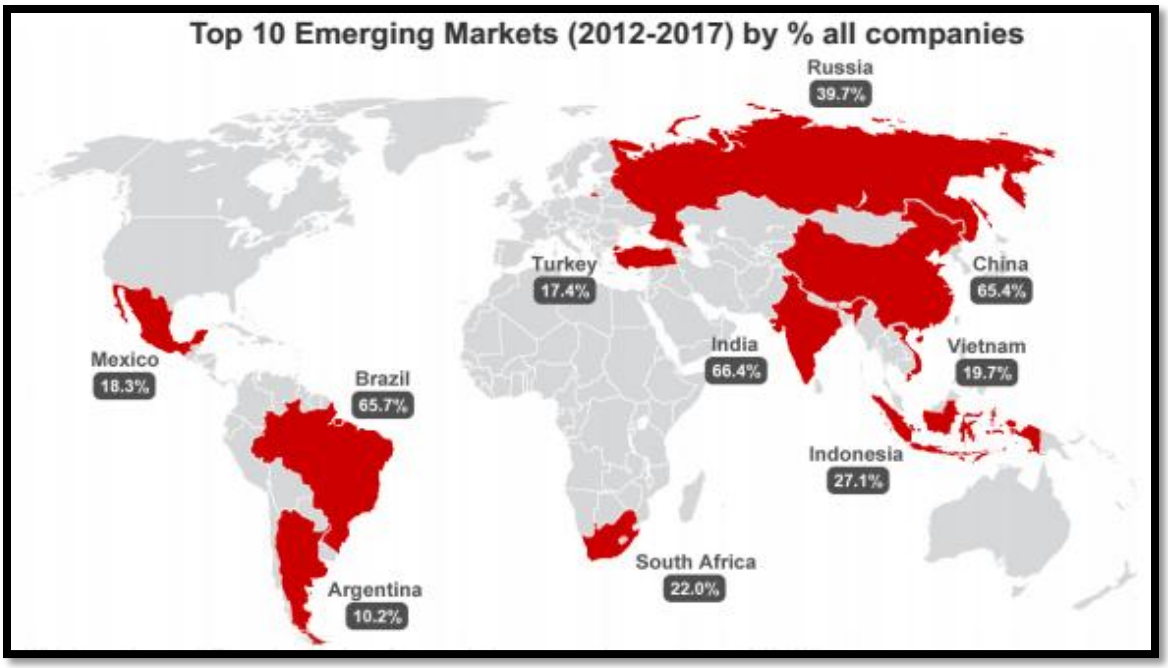

Figure 1 - Global Intelligence Alliance, 2013

Applying a risk-based approach for compliance means focusing on business activities in external environments that are more likely to produce corrupt actions. Research and international enforcement actions have confirmed that corruption risks and motivations are not equal in all parts of the world (Ardichvili and Jondle et al, 2012). Increased competition for market share coupled with weak governance results in an elevated corruption risk in BRIC nations (See Figure 2). As a result, the recent claims of systemic corruption in Brazil, Russia, India, and China have garnered increased scrutiny from investigative agencies. In an effort to bring compliance to their countries, BRIC nations have attempted to accept international anti-bribery conventions prescribed by the Organisation for Economic Co-operation and Development (OECD). Brazil and Russia joined in 2002 and 2012, respectively, and China (although not a member) has passed internal laws that mirror OECD recommendations. India is considered a non-member that maintains a “working relationship” with the OECD. The OECD states there is possibility for India and China to become signatory members in the future (Spahn, 2012). Understanding the lasting effects of corruption and underlying principles in each country will support the declaration that corruption is the “biggest threat to developing nations” (Colvin, 2011).

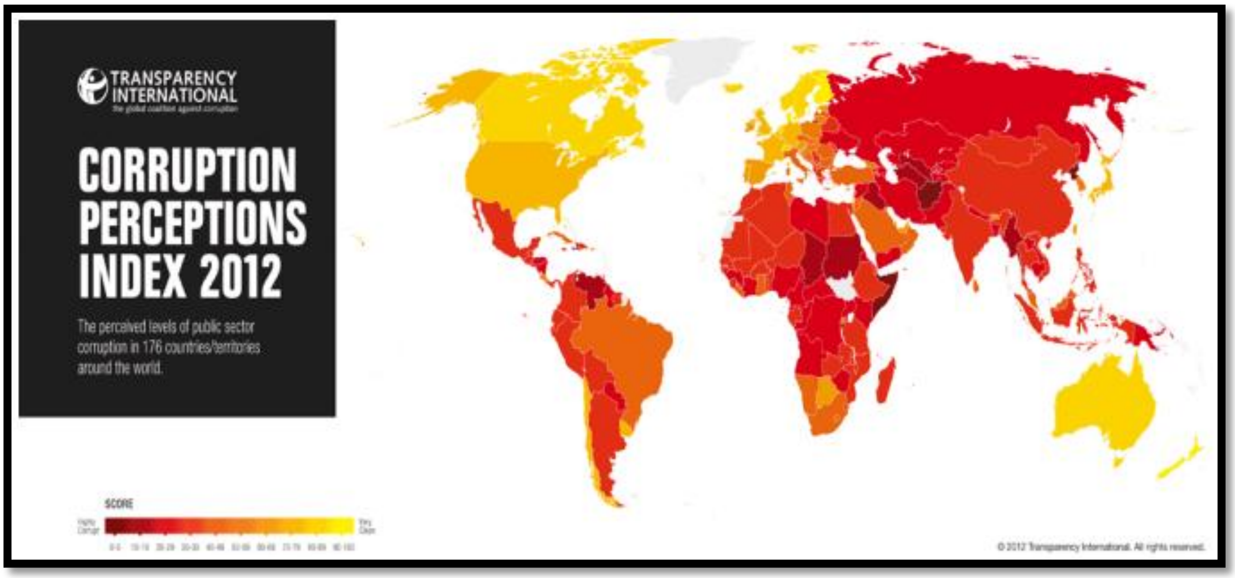

Figure 2 - Transparency International, 2012

Brazil

Despite Brazil’s inclusion in the OECD and passage of laws that mirror the FCPA, the country is still considered to be highly corrupt. Since 2000, corruption has drained the Brazilian government of over $400 billion with an estimated GDP loss of 2.3% in 2011 (Gouvea and Montoya et al, 2013). Brazil’s history of corruption can help explain why bribery continues to be an acceptable business practice. Former Sao Paulo mayor popularized the phrase “he steals but he achieves,” President Collor was implicated in an extensive extortion scandal in 1995, and seven top Ministers resigned for various allegations of systemic corruption within the past two years (Stocker, 2012). These headlines are reinforced by the Brazilian Accounting General Office reporting that 80% of 15,000 audited contracts displayed some level of irregularity. These audits resulted in the firing of over 4,000 public employees for corruption-related charges from 2003 to 2012 (Gouvea and Montoya et al, 2013). Generation-crossing corruption of influential government leaders affirms that bribery is a standard operating procedure.

Companies doing business in Brazil have been subjected to several FCPA enforcement actions and are likely to have increased scrutiny moving forward. The 2014 World Cup and 2016 Summer Olympics carries a projected budget of over $27 billion with a significant portion applied toward upgrading transportation and telecommunications infrastructure. Both industries are dependent on federal oversight (Gibson Dunn, 2013). Brazilian corruption schemes include the utilization of third parties to conceal bribes in exchange for lucrative revenue streams.

Russia

Russia has the greatest potential for natural resource development of any country in the world (Da Cunha Leite and Weidmann, 2001). Regrettably, investors and businesses have not determined how to fully capitalize on that potential. One of the reasons for this lost opportunity is the high cost that corruption places on doing business in Russia. A 2012 World Bank report determined that Russia ranks 112th of 185 countries to do business in; corruption is listed as the most problematic factor (Schwab, 2012). Further, Transparency International ranks Russia in last place on its Bribe Payers Index (See Table 3). A historical perspective reveals that post-Communist laws, morals, and customs form a framework for modern corruption by not supporting essential law enforcement responsibilities. Enforcement agencies have not received proper staffing and a decreasing budget allows corrupt activities to go undetected (Matirossian, 2004). Supplementing the lack of detection ability is the amount of bureaucrats integral to corruption. In the mid-2000’s, Russia had one government employee for every 100 citizens (Orttung, 2006). This resulted in low wages and a high incentive to accept additional income through bribes.

Russia recorded two high profile cases in the past three years that settled for over $35 million in penalties. Corrupt payments were made to customs officials in both cases. Scrutiny will continue as the 2014 Sochi Winter Olympics received $35 billion to improve infrastructure, telecommunications availability, and security. Adding to the perception of an unbalanced competitive landscape, prominent Russian businessmen have claimed that government officers accepted bribes during the procurement process (Gibson Dunn, 2013). These claims are still being investigated but portions have been confirmed with the formal charging of a subcontractor who overstated expense accounts by $250 million.

India

Similar to Russia, India also employs a high proportion of government workers: ninety percent of India’s 19.5 million state employees are classified as low wage earners. Subsequently, public officials resort to corrupt practices (e.g. kickbacks and bribes) in the course of their daily responsibilities (Chene, 2009). The lack of government oversight and reliance on bribes to enhance income is substantiated by Trace International’s study (2009) that 91% of all bribes were demanded by government officials in exchange for performing discretionary tasks. Corroborating India’s corruption dynamic is an Ernst & Young survey that determined 73% of business managers expect corruption to raise the future cost of doing business and reduce foreign investment.

Fifteen FCPA investigations have sent US agents to India since 2007, with four in the past three years. The trend of employing sales agents and distributors with ties to government officials has been disclosed through the investigative process. Sales agents often act as intermediaries between companies and government officials and provide bribes in exchange for undue advantages. Even though India is attempting to limit corruption by applying over 70% of all investigative resources to corruption-related claims, it has yet to be a successful effort (Gibson Dunn, 2013). India will continue to be a growing market and place of increased scrutiny as it is expected to invest $143 billion in health care, $392 billion in transportation, and $1.5 trillion in energy production by 2030 (Barry, 2010). These industries depend on frequent interaction with government officials.

China

Corruption is estimated to account for 3% of China's GDP while degrading the environment, deteriorating healthcare, and producing social inequalities. China's National Audit Agency reported that $170 billion was misappropriated from 1995 and 2006. Additionally, a historical analysis and survey suggests that 10% of all government spending is attributed to bribes and kick back payments (Gouvea and Montoya et al, 2013). The great toll that corruption places on the country is not reflected in prosecuting those accountable. Of the 881,000 officials that were disciplined for corruption from 2003 to 2008, only 6% were formally indicted (Chen and Zhu, 2009). The rampant corruption combined with the lack of accountability allows corruption to stay at the forefront of acceptable business practice.

Research has established that Chinese anti-corruption laws have not been successful because they clash with the Chinese cultural norm of "guan xi". Guan xi is an entrenched Chinese mindset that business is achieved through relationships and not on established systems, processes, or regulations (TCD, 2011). The established belief system accepts gifts and bribes as an integral component to business relationships.

China was subjected to five FCPA enforcement actions in 2012 and 26 since 2002 (DOJ, 2012). Investigations revealed that businesses utilized third-parties to hide corrupt payments made to government officials. The 2012 investigations disclosed the misrepresentation of illicit payments in accounting records, bribery of public officials, and extravagant gift-giving: expensive bracelets, trips, watches, and clothes were provided by third-party facilitators on behalf of their client to Chinese officials.

Country	Corruption Perception Index (rank out of 176)	Bribe Payer's Index (rank out of 28)
Brazil	69	14
Russia	133	28
India	94	19
China	80	27

Table 3 - Transparency International, 2012

The examples of unsuccessful anti-corruption efforts in BRIC nations should cause businesses to proceed with caution when entering the global market. However, it is possible to thrive and reap the rewards afforded through globalization. Compliance requires an understanding of various regulations followed by the proper application of compliance principles to abide by them. The remainder of this paper will examine the elements of the Foreign Corrupt Practices Act and how to incorporate a comprehensive compliance program focused on deterring and detecting corruption.

Foreign Corrupt Practices Act

The Foreign Corrupt Practices Act (FCPA or "the Act") is a United States regulation intended to prohibit corrupt practices, restore integrity to the international marketplace, and create a level playing field for businesses. Congress passed the FCPA in response to the Watergate scandal where the government discovered that at least 400 companies were paying millions of dollars in bribes to foreign officials in exchange for lucrative contracts (Koehler, 2011). The Act is composed of anti-bribery and accounting requirements that are applicable to companies and foreign companies that do business within the United States or list their shares on a US-based stock exchange.

The Department of Justice (DOJ) and Securities and Exchange Commission (SEC) are the main enforcement bodies of the FCPA. Criminal violations are prosecuted by the DOJ and the SEC pursues civil actions against issuers (i.e. companies) and their officers, directors, employees, stockholders, and agents. Penalties include the disgorgement of profits and imprisonment for individuals. Violations of the anti-bribery provisions range from millions in fines to decades in prison and, as the statute explains, both individuals and corporations are subject to enforcement actions (Title I – FCPA, 1977). FCPA investigations will also likely include the Federal Bureau of Investigation (FBI), Internal Revenue Service – Criminal Division, and the Department of Treasury's Office of Foreign Assets Control (Resource Guide - pp.5, 2012). Cooperation and assistance of foreign governments and enforcement bodies is common as both the United States and the country where corruption takes place have a vested interest in compliance and recovering financial damages.

Anti-Bribery Provision

The Act's anti-bribery statute is applicable to three categories of persons and entities: issuers, domestic concerns, and persons that do not meet the definition of an issuer or domestic concern but are acting on behalf of a foreign company while inside the United States' jurisdiction. Those subject to the provisions are prohibited from, "offering to pay, paying, promising to pay, or authorizing the payment of money or anything of value to a foreign official in order to influence any act or decision of the foreign official in his or her official capacity or to secure any other improper advantage in order to obtain or retain business."[1] According to guidelines provided by the DOJ and SEC, bribery is evaluated under a "business purpose test" to determine if a competitive advantage was unduly earned (Resource Guide – pp. 12, 2012). The test expands the scope of violations beyond the straightforward act of providing cash to secure new business. Courts have upheld that the following acts fall within the purview of an unwarranted business advantage: (1) Winning a contract; (2) Influencing the procurement process; (3) Circumventing the rules for the importation of products; (4) Gaining access to non-public bid tender information; (5) Evading taxes or penalties; (6) Influencing the adjudication of lawsuits or enforcement actions; (7) Obtaining exceptions to regulations; and (8) Avoiding contract termination.

In order for the DOJ to successfully prosecute a criminal violation of the bribery provision, a willful and corrupt intent must be proven. For a bribe offeror's act to be deemed "corrupt", an intent or desire to wrongfully influence the recipient must be established (Sivachenko, 2013). This provides latitude for prosecutors as the corrupt act does not need to be actually administered or executed. By definition, bribery under the FCPA requires a covered person to provide anything of value to a foreign official. Intuitively, "anything of value" refers to a wide scope of tangible and intangible objects. The FCPA Resource Guide categorizes cash, gifts, travel, entertainment, and charitable contributions as potential bribe payments. The Act does not describe the minimum threshold for gifts or payments as long as there is a presence of corrupt intent. Items of nominal value such as reasonable travel expenses or promotional items will not be heavily scrutinized.

Unlike anti-bribery regulations in other parts of the world, the FCPA allows for facilitating or expediting payments made to foreign officials in furtherance of routine

[1] 15 USC §78dd-1 and §78dd-2

governmental action. This exception allows for the expedition of non-discretionary acts that fall outside the scope of the business purpose test. Examples of permitted facilitating payments include the processing of visas, providing police protection, and supplying utilities. Routine government action does not include a decision to award new business or continue business with a particular party.

Accounting Provision

The second provision of the FCPA requires public companies to maintain an accurate set of books and records and comprehensive anti-corruption internal controls.[2] Both work cohesively to portray confidence in the company's financial position and allow for transparency in the audit process. The accounting provisions necessitate internal controls that reduce the likelihood of corruption and accurate records that produce the economic reality of a business. Companies are required 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." By incorporating accounting standards into the FCPA, corporations are banned from falsifying records to incorporate illegitimate bribes into legitimate accounts. Allowing for latitude and discretion, Congress did not mandate companies to keep records that would add undue burdens without the corresponding benefit.

Parallel to the books and records requirement, the internal control provision mandates that corporations implement and maintain a comprehensive FCPA compliance program. Research has found that weak control environments allow systemic corruption to go undetected longer with greater consequences (Puckett, 2008). Even though the Act does not command a particular set of controls, the following concepts are prescribed by the SEC: (1) Transactions must be executed with managerial authorization; (2) Transactions are recorded in accordance

[2] 15 USC §78m

with Generally Accepted Accounting Principles and to ensure accountability for assets; (3) Assets are accessible only under management's guidance; and (4) Asset accountability is measured at reasonable intervals with appropriate steps taken to resolve any differences. These guidelines generate a compliance program with appropriate controls and proper oversight.

Similar to the anti-bribery provision of the FCPA, "willful intent" is the key element in determining whether criminal or civil charges will be pursued. The SEC can file civil charges against companies and individuals for assisting or causing an issuer to violate the accounting provisions. Individuals who directly or indirectly falsify any book or record expose themselves to additional liabilities. The DOJ and SEC jointly determine the prosecution strategy based on the facts of each case. Companies that fail to maintain an effective compliance program are subject to increased scrutiny not only under the FCPA, but an abundance of other regulations. The Sarbanes-Oxley Act has several requirements that correlate to FCPA compliance and violations of the accounting provision often lead to money laundering and tax evasion charges (Resource Guide – pp.42, 2012). As this paper focuses on the FCPA, other statutes will not be discussed.

FCPA Enforcement Trends

Over the past several years, the DOJ and SEC have committed greater resources to FCPA enforcement. From 2007 to 2011, there have been 70 DOJ enforcement actions against corporations compared to 14 between 2002 and 2006 (See Figure 4). The increased attention and demand to curb corruption is spearheaded by the recovery of over $3 billion in damages from the top ten monetary settlements of the past five years. Siemens and Halliburton garnered international notoriety with financial damages of $800 million and $579 million, respectively (DOJ Enforcement, 2012). With the relative high level of success that the DOJ and SEC have realized, enforcement is sure to continue.

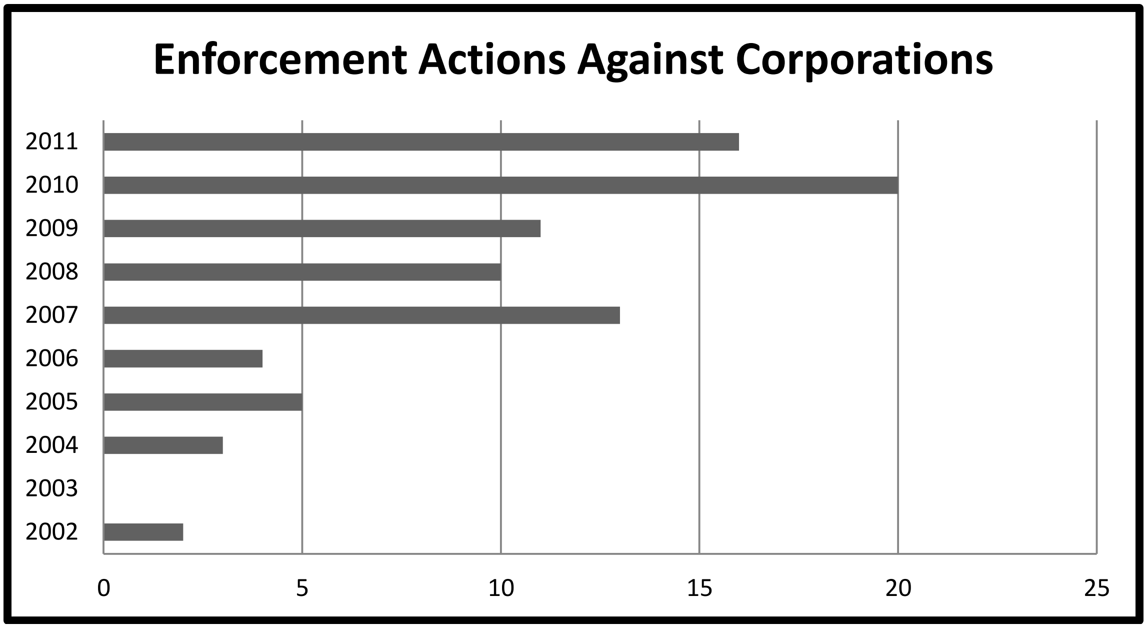

Figure 4 - Department of Justice, 2012

According to a 2013 Trace International report, 39 corporate FCPA cases were initiated in 2012 spanning all BRIC nations and across several industries (Miller Chevalier, 2013). Not only does empirical evidence substantiate that the FCPA will be at the forefront of criminal and civil actions, support exists in the form of proactive training and international sharing of information. The DOJ and SEC jointly issued an FCPA Resource Guide in November 2012 aimed toward industry best practices through education and prosecution transparency. The Resource Guide was a revolutionary step by enforcement agencies because it realized the need for anti-corruption efforts to be applied globally. US officials also coordinate and communicate with international partners on how to deter and combat corruption as evidenced in a 2013 roundtable with over 30 countries (Jaeger, 2013). The DOJ, SEC, and FBI met with judges, prosecutors, regulators, and investigators to develop and exchange information toward the anti-corruption movement.

The Resource Guide provides compliance principles and examples of what behavior could constitute violations. In order to bring those principles to life, it is important to review recent enforcement actions and how different compliance approaches lead to varying prosecution strategies by the DOJ and SEC.

FCPA Case Study: Eli Lilly

Eli Lilly is a global pharmaceutical company headquartered in the United States with offices in 17 countries. According to an SEC filing on 12/20/12, the company violated the FCPA through the activities of their subsidiaries in China, Brazil, Russia, and Poland over a 25 year time period (SEC – Eli Lilly, 2012). From 2006 to 2009, Eli Lilly sales representatives from China submitted inflated expense reports in order to purchase lavish gifts for government-employed physicians. The gifts were provided with the understanding that future Eli Lilly products would be recommended by the physicians to their patients. Sales representatives were often guided by managers to engage in the over-reporting scheme to boost sales commissions and drive productivity. The individual gifts were not substantial on their own, but the wide-ranging violations and direction from senior managers aggregated to a level of severe non-compliance.

Eli Lilly's Brazilian subsidiary violated the FCPA by modifying a previously accepted and legal business practice of selling products to distributors at a discount. Once the distributors purchased the discounted product, a profit margin was attached to the consumer price. The discounts provided to distributors by Eli Lilly ranged from 6.5% to 15%, with the majority being a flat 10%. The subsidiary violated the accounting provision of the FCPA when a sales manager granted discounts of 19% to a distributor without an inquiry from the compliance department. Using funds that were previously allocated for purchases, the distributor spent $70,000 to bribe government officials to purchase Eli Lilly products. The Eli Lilly sales manager was aware of the distributor's intent when granting the unusually high discount. Even though the pricing committee was aware of the deep discount, they did not exercise the necessary due diligence towards the suspicious request.

From 1994 to 2004, Eli Lilly's Russian subsidiary entered into at least 96 agreements with 42 third-party entities for open-ended "marketing or service" agreements. The third parties were often chosen by government officials and inserted into contracts to receive as much as 30% of the proposal price. Eli Lilly did not adequately investigate the third parties or request a clear explanation on the purported services provided. Rather, they remained ignorant to the potential conflict of interests between government officials and intermediaries. After the corporate office of Eli Lilly audited the Russian subsidiary in 1997 and 1999, "business risks" were disclosed and specific recommendations made to modify internal controls to ensure an accurate representation of all services provided. The recommendations were neither implemented nor reassessed by the corporate office and the three most expensive agreements occurred after the audits.

The Poland subsidiary violated the FCPA by providing numerous bribes through a charity controlled by the Director of a government administered health fund. The Director had the direct ability to reimburse hospitals and healthcare providers for the purchase and repurchase of products. By knowingly mischaracterizing payments to the Director's charity as computer purchases, development activities, and educational efforts, Eli Lilly undermined the accounting provision of the Act. Further, Eli Lilly's Medical Grant Committee continued to approve the charitable donations based on fraudulent paperwork. No scrutiny was placed on the relationship with the Director of the government entity.

Eli Lilly exercised a lack of internal control and no sustainable method to identify probable violations of the FCPA's accounting provisions. Additionally, recommendations made by the audit committee were not applied and the compliance program was found to be ineffective. Eli Lilly did not incorporate appropriate due diligence to third party intermediaries and relied on the statements of local employees regarding critical business processes. The company lacked a risk-based approach toward compliance which was evidenced by an absence of scrutiny for off-shore accounts and incongruent sales strategies. Finally, Eli Lilly's corporate headquarters waited five years to investigate potential FCPA violations at its Russian subsidiary.

The SEC claimed Eli Lilly violated both the anti-bribery and record keeping provisions of the FCPA. To civilly settle the investigation, Eli Lilly agreed to pay over $29 million in disgorgements, prejudgment interest, and penalties. The company is also enjoined in Federal Court to continued compliance of all provisions of the FCPA and to retain an independent consultant to review their policies and procedures. Eli Lilly did not admit or deny the allegations.[3] At the time of this writing, the DOJ has not made a determination on their ongoing investigation.

FCPA Case Study: Garth Peterson and Morgan Stanley

Garth Peterson worked as a Managing Director for Morgan Stanley's Real Estate Group (MSRE) in Shanghai, China from 2002 to 2008. Mr. Peterson's duties were to initiate, negotiate, and finalize various real estate investments on behalf of Morgan Stanley (SEC – Morgan Stanley, 2012). By doing so, the company would realize a return on their investment when their real estate portfolio appreciated in value. As Morgan Stanley was considered an issuer within the meaning of the FCPA, Mr. Peterson was subject to the anti-bribery and accounting provisions of the Act.

Throughout the course of his employment with MSRE, Mr. Peterson leveraged a prior friendship with a Chinese official who had authority over investment decisions in a state-owned enterprise: Shanghai Yonge Enterprise ("Yonge"). By cultivating his relationship with the Yonge

[3] Information used from Case 1:12-cv-02045: U.S. Securities and Exchange Commission v. Eli Lilly and Company

official, Mr. Peterson developed a profitable collection of real estate investments. The investigation disclosed that a sizeable portion of Mr. Peterson's success was a direct result of preferential treatment from his friend. As is culturally expected in China, Mr. Peterson understood that he would need to repay the unspoken debt by providing fair and just compensation. To do so, Mr. Peterson took advantage of his position at Morgan Stanley and developed a scheme to purchase a portion of a lucrative skyscraper by forming a shell company with the Yonge official and a Canadian attorney. The shell company, Asiasphere, purchased 12% of "Tower 2" from MSRE in 2006 at various increments. The transaction was backdated to a reduced 2004 strike price resulting in an immediate return on the investment. Immediately after the purchase cleared, the Chinese official's ownership stake in Tower 2 was valued at $2.88 million. Mr. Peterson received over $350,000 in dividend distributions from Asiasphere's equity.

Applying his intimate knowledge of Morgan Stanley's internal controls, Garth Peterson was able to stay undetected from the company's anti-corruption compliance program. The joint DOJ and SEC investigation divulged that Mr. Peterson knowingly made false statements, sent untruthful emails, and purposely circumvented detection efforts by his employer. For example, following the 12% Tower 2 purchase in 2006, Mr. Peterson wrote in an email to a Morgan Stanley employee that, "…Asiasphere Holdings Limited is 100% beneficially owned by Shanghai Yonge Enterprise…a PRC [People's Republic of China] company…".

Mr. Peterson pled guilty to violating the accounting provision of the FCPA and was sentenced to nine months in prison. The corresponding SEC investigation required Mr. Peterson to relinquish his stake in Tower 2 (valued at $3.4 million), pay disgorgements of $250,000, and be permanently disbarred from the securities industry. The case against Mr. Peterson is a success for both the DOJ and the SEC. However, the true value of this case study is in understanding why the agencies refused to formally investigate Morgan Stanley. Both agencies cited the company's immediate disclosure of the potential violation, continued cooperation during the investigation, and robust internal controls as reasons for not prosecuting the company.

Morgan Stanley's compliance program was adequately staffed, continually updated, and appropriately disseminated to all employees. Internal controls were incorporated to detect and prevent improper payments and segregated power so no one employee had unchecked authority. The company employed dedicated anti-corruption specialists, randomly audited personnel in high-risk areas, and analyzed expense reports to identify suspicious payments. The above compliance efforts expanded to Morgan Stanley offices across the world, including China. Morgan Stanley successfully displayed that Mr. Peterson was aware of prohibited activities under the FCPA and received at least 35 FCPA compliance reminders, certified his understanding of FCPA compliance principles on several occasions, and attended at least seven FCPA trainings. As a direct result of Morgan Stanley's proactive efforts to educate and monitor FCPA compliance, Mr. Peterson could not claim ignorance.[4]

Evidenced by the case studies of Morgan Stanley and Eli Lilly, the DOJ places a significant emphasis on organizations deterring and detecting corrupt activities. Morgan Stanley trained employees on FCPA compliance, applied specific internal controls to detect corruption, and promptly reported violations to authorities. Conversely, Eli Lilly did not enforce their compliance mechanisms, applied limited due diligence to high risk transactions, and contained knowledge of violations. Comparing the cases also substantiates that corruption can occur to an organization regardless of their compliance efforts, but proactive steps can limit the damage. Morgan Stanley identified red flags quickly, reported violations promptly, and established that

[4] Information used from Information and Judgment from Case 1:12-cr-00224-JBW: United States of America v. Garth Peterson.

their existing anti-corruption compliance program worked. Their reward was a declination letter explaining they would not be the subject of an FCPA investigation. Building on the lessons learned in this case, it is important to understand the FCPA compliance framework prescribed by the DOJ and SEC and the unique ability of data analytics to deter and detect corruption.

Recommendations

FCPA Compliance: Best Practices

Corporations subject to the FCPA are motivated to comply with the anti-bribery and accounting provisions of the Act for a number of reasons. Violations could result in substantial fines, a strain on relationships with vendors and distributors, and reputational damages to external stakeholders. Corporations should also realize that compliance is not simply a regulatory requirement but can also provide a distinctive value-add to their overall business plan. An effective anti-corruption program increases the comfort level for prospective partnerships and increases transparency for potential investors. Strong internal controls, accurate accounting records, and a compliance program that deters and detects misfeasance will aid in future market sustainability. Realizing the benefits of a comprehensive anti-corruption program requires a two-tiered approach of deterrence and detection. Industry best practices will establish guidelines to reduce corruption from occurring on the front end and the implementation of data analytics will limit the potential loss exposure.

An anti-corruption compliance program should be championed through leadership, constantly monitored, and effective. Procedures must be understood by all parties with a clear communication charter to allow for proper disclosure. Further, unless management disciplines violators in a consistent and equitable fashion, employees will perceive that policies will not be enforced and morale will decrease. Even though company-specific factors (e.g. size, industry, growth projections) will vary, corporations doing business in BRIC nations must be especially aware of the external environment.

Companies that choose to expand into Brazil, Russia, India, or China must increase pre-transaction due diligence, closely monitor third party relationships, and update processes when new risk factors arise. Incorporating a risk-tailored compliance program is also cost effective because it supports how most companies allocate resources. For instance, if the same business unit or manager is consistently implicated for unethical actions or approves suspicious transactions, more attention should be appropriated to determine causal factors. Beyond the business sense of applying resources where they are required, the DOJ and SEC strongly recommend compliance programs to be properly supported through staff and resources. Current guidance identifies the need for a risk-based compliance program as well as several others concepts that work together to develop the compliance framework.

The Resource Guide does not provide mandatory elements that lead to compliance. Rather, it explains general principles that, when effectively implemented, should result in an effective anti-corruption program. Organizations subject to the FCPA are encouraged to integrate the following: (1) Commitment from senior management against corruption; (2) Code of conduct and compliance policies and procedures; (3) Oversight, autonomy, and resources; (4) Risk assessments; (5) Training and continuing advice; (6) Incentives and disciplinary measures; (7) Third party due diligence; (8) Confidential reporting and internal investigation; (9) Periodic testing and review; and (10) Pre-acquisition due diligence and post-acquisition integration (Resource Guide – pp.57, 2012). Each element serves a specific purpose for compliance and the Guide succinctly explains how each factors into an anti-corruption program. The list focuses on the importance of education and training, the proper alignment of incentives, and the application of clear policies. Risk assessments ensure resources are properly distributed and managers that demonstrate the importance of compliance will be a powerful force. When policies are circumvented and FCPA violations are ongoing, there must be a clear charter to identify, reconcile, and hold accountable those responsible.

The Guide is not the only set of compliance principles offered to the general public. Government enforcement priorities often lead to increased attention by accountants, attorneys, and consultants. These professionals provide guidance based on extensive cross-industry experience and intimate understanding of effective methods. This paper does not sponsor a particular firm but simply provides additional concepts and guidance for FCPA compliance:

1. Management's tone at the middle and bottom of the organization will determine the effectiveness of the tone from the top. 2. Financially immaterial transactions need to be scrutinized for fraud and corruption as they may rise to material liability resulting in management distraction. 3. Concisely articulated zero tolerance programs will deter FCPA violations. **Table 5 – Deloitte**
4. Clear policies and procedures regarding acceptable gifts, travel, and donations will decrease those accounts from containing illicit payments. 5. Apply a baseline risk assessment to identify the probability and associated damages of violations and apply resources accordingly. 6. Integrating a process to disseminate guidance to agents and consultants regarding due diligence and corruption violations will decrease unpermitted actions. 7. Engaging in pre and post due diligence of subsidiary and joint venture partners will limit liabilities. **Table 6 – Gibson Dunn**
8. Red flags for corruption include the refusal of agents to sign anti-corruption plans, sales representatives with former governmental ties, and unclear invoicing or accounting records. 9. Obtain payment, personnel, and background data from vendors, distributors, and other third parties to better answer compliance concerns. 10. Implement anonymous channels for employees, vendors, and distributors to voice concerns and report suspicious or inconsistent behavior. **Table 7 – Dickinson Wright, PLLC**

FCPA Compliance: Data Analytics

The application of data analytics to make better informed business decisions has been implemented in numerous industries over the past decade. Examining raw business data provides evidence-based inferences that can verify or disprove a particular theory or concept. Data analytics supports corruption deterrence and provides key information for corruption detection. Once a history of transactions or communication is made available, disparate data sets can be aggregated, stratified, clustered, and queried to provide a comprehensive understanding of corruption risks (Molaro, 2013). By highlighting inconsistent behavior or helping to explain the motivation of complicit parties, data analytics becomes a critical element in corruption detection.

Corruption Detection

An MIT survey found that data analytics has not been integrated into mainstream use because there is a lack of understanding on how analytics can improve the business process (LaValle and Lesser et al, 2011). The survey also explained that executives were not as concerned with their ability to get data; they just do not understand what data can provide. By recognizing patterns, trends, and anomalies companies can identify red flags and determine how to proceed in a time sensitive fashion. The DOJ and SEC place a significant focus on the ability of a company to detect FCPA violations in a timely manner as long lasting corruption schemes signify a weak compliance program.[5] To combat this concern, the proper implementation of data analytics can display to enforcement bodies that their detection abilities are effective and a violation was the product of a rogue employee. Data analytics is objective and facilitates the identification and resolution of various business risks. The process leverages technological capabilities and quantifies results across broad platforms (Ramanathan and Sarulatha, 2013). Numerous software packages are available to facilitate the process, but all implement Computer

[5] Title 9, Chapter 9-28.000: Principles of Federal Prosecution of Business Organizations.

Aided Audit Techniques (CAAT's). CAAT's utilize spreadsheets to detect patterns, text mining to highlight keywords, and statistical analysis to predict high risk behavior (Shipman and Morgan, 2013). This element provides a deterrence effect through its detection capabilities and allows compliance to move beyond the capabilities of internal audit and reduce control gaps.

The Association of Certified Fraud Examiners reports that only 14% of fraud or corruption is detected by internal audit activities (ACFE, 2012). The low success rate is directly correlated to the role and purpose of the internal audit department. Internal auditors are not specifically tasked to identify corruption and consequently run control-related queries and tests. These tests are not developed to identify high-risk transactions and only review a sample of records to determine their accuracy. Further, as corruption is naturally deceptive, those engaged in bribery will understand the internal audit process and develop schemes to circumvent the system. In order to detect corruption across all business units, data analytics filters structured and unstructured data to detect suspicious transactions and high-risk relationships.

Structured data is information that lies within a record or file; accounting records, financial transactions, and vendor databases are considered to be structured. Structured data can be analyzed based on the field names within and queried to identify relationships between numerous databases. Conversely, unstructured data cannot be easily separated into database format because of the nature of the information. Emails, blog entries, and word documents are examples of unstructured data (LaValle and Lesser et al, 2011). Text mining unstructured data can identify specific phrases and build relationships between seemingly unrelated entities. Applying a comprehensive method to utilize unstructured and structured data together will allow compliance programs to focus on specific risk factors.

Conceptual Application

During the course of an FCPA investigation, the DOJ attempts to identify five elements: (1) The complicit internal party; (2) A corrupt intention; (3) The illicit transaction; (4) The bribe recipient; and (5) The undue advantage promised or received in response to the bribe (Walden, 2011). Uncovering those elements will likely mean an FCPA violation was committed. To maintain consistency with regulators, FCPA data analytics should follow the structure outlined by the DOJ. As explained by the MIT study, organizations already possess the necessary information to perform data analytics. In fact, a common hurdle is the excessive amount of information that companies have at their disposal. The goal is to funnel an unintelligible amount of records and documents into a workable capacity. This exercise can be accomplished by applying benchmarks to detect unexpected anomalies across numerous variables.

A logical first step is to distinguish high-risk transactions or parties that may be complicit in corrupt activities. To do this, data analytics can be applied to several variables to determine benchmarks and compliance models. The patterns and anomalies of established benchmarks allow a company to properly narrow their search to those employees, vendors, and transactions that are not within an expected standard. Even though patterns and outliers will not definitively determine which employee is engaged in corruption or bribery, the scope of possibilities will be reduced (Stewart-Smith, 2013). To obtain accurate results, analysis needs to be limited to one concept at a time (i.e. results will be invalid if an analysis is performed for different external environment). For instance, determining the frequency of expense submissions by sales agents involves several variables: the agent, time period, account list, and travel schedule. The agent whose territory and client list is contained within a 50 mile radius will submit a different expense report than the agent who travels internationally. Comparing the expense patterns of agents in a similar role will provide both the benchmark of acceptable behavior and which scenarios require additional investigation.

Once suspicious transactions are identified, determining the presence of a corrupt intent is the next step. This is inherently difficult because of the fine line between poor judgment and an intentionally corrupt act. However, this is especially critical because of the ramifications following the discovery of a corrupt intention. In order to accurately capture intent, companies must combine structured and unstructured data analytics. Structured data will narrow the scope of those possibly involved in bribery while a review of unstructured data can identify a malicious intent.

Analyzing certain phrases and patterns of communication can provide additional evidence depicting a corrupt scheme. As violators will attempt to avoid detection, it is unlikely to find an email or general ledger comment stating, “Bribe for Russian Minister of Defense.” However, the examination of text comments within general ledger accounts such as cash disbursements, consultation fees, marketing expenditures, and cost of sales will provide helpful insight (IIA, 2012). Within those accounts, specific keywords like “facilitation pay”, “incentive payment”, “pay on behalf of”, and “volume contract facilitation” should raise red flags (Walden, 2011). Applying these keywords to company-specific concepts will depict which employee uses those words most often and in which situations. The results would be aggregated and compared against the business environment to determine if it is likely that a violation occurred.

Analyzing emails follows a process similar to text analysis within the general ledger or expense reports. Uploading specific phrases and summarizing the outcome can reveal which employees are asking for cash to “get things done” or submitting ambiguous expense reports. Emails could also implicate employees, agents, or vendors that are co-conspirators. The communication chain that is built through messages sent and received could expand the scope of a search. Combining text analytics of accounting documents with the details listed in emails allows compliance teams to focus on high-risk circumstances.

Complementing the ability to detect suspicious internal behavior, data analytics can also identify which external parties are receiving illicit payments. Running queries by country, customer, and third parties that receive large payments initiates the detection process. From this, the same process of obtaining supporting documents and reviewing unstructured data can lead to the discovery of violations. Further, analyzing the sales price and depressed profit margin attributable per customer and product can be a useful application. Applying simple economics, decreasing margins can be explained with higher production costs, a lower sales price, or a combination of the two. To properly apply corruption data analytics to this concept, raw materials, operational expenses, and volume discounts must be consistent across the analyzed variables. Once this is confirmed, evaluating comparable customers and products against realized profit margin can produce significant results. By identifying lower profit margins attributed to one product or manager, companies can narrow their search and focus on the appropriate party. The process then reverts back to an analysis of all information regarding the specific transactions or entities.

Corruption varies in magnitude and process. For that reason, detecting corruption through data analytics must be flexible to capture novel methods. Analyzing structured data can identify anomalies and unstructured data can substantiate a corrupt intent. However, when these processes do not provide results, other methods must be implemented. These methods will vary based on the specific risks and dynamics of each business, but reviewing certain cash disbursement accounts can highlight areas of greater risk (Golden and Skalak et al, 2011).

Enforcement actions and research has demonstrated that the Travel and Entertainment (T&E) and Charitable Donation accounts are often compromised in the furtherance of corruption.

By analyzing the frequency and volume of T&E payments made on a country-specific basis, certain trends will emerge. Countries with greater T&E balances and activity (without reason) should draw additional scrutiny. Once a country or locale is identified, drilling down the travel habits of employees and level of entertainment provided and authorized is critical. If supporting documents are missing, incomplete, or inconsistent there is a greater likelihood that funds are applied outside of acceptable policies. Complicit parties also understand the paper trail left by cash transfers. The increased scrutiny that arises from cash payments and lavish gifts results in the utilization of a charity as an intermediary. Applying data analytics to charitable donations can present unexpected charitable donations, a pattern of contributions, or unlikely donations. For instance, a Chinese subsidiary of a US-based energy company consistently donating $50,000 to a Brazilian charity should be vetted. Supporting documents should be reviewed and appropriate due diligence performed to determine conflicts of interest.

The final element to determine a violation of the FCPA is whether there was an undue advantage provided under the business purpose test described by the Resource Guide. Applying proactive data analytics can identify which business unit is experiencing an unexpected growth, a sales agent whose commission relies heavily on one party, or a significant reliance on one vendor. Analyzing the year over year revenue trend for customers in high-risk countries will display the accounts where transactions could be easily hidden from auditors. Discovering that there is no explainable reason for a shift in revenue or how a new account was obtained would lead to additional review of unstructured data. Compiling information across these variables can explain whether the bribe offeror obtained an undue advantage.

Applying data analytics is a process that analyzes numerous variables to determine whether trends are within a set boundary. Identifying an agent that is over-performing, a product line that allows for deep discounts, or internal commentary regarding a need to "move the deal along" are triggers for additional inquiry. From there, high-risk scenarios can be properly investigated to allow for pragmatic decision making. If properly implemented, data analytics can identify concerns quickly and make global compliance manageable.

Conclusion

Corporations entering the global market evaluate the potential for profitability against the numerous risks associated with a change in business strategy. A key assessment to make is the corruption risk of doing business in certain countries. Engaging Brazil, Russia, India, or China poses a heightened risk of corruption because of weak governance and a lack of transparency. By understanding the unique external environment of BRIC nations and the legal landscape of operation, companies can mitigate the likelihood of corrupt activities. The FCPA sets the parameters of prohibited behavior and subsequent enforcement actions provide the groundwork for compliance.

The varying enforcement approaches undertaken by the DOJ and SEC toward Morgan Stanley and Eli Lilly should motivate companies to enact strong internal controls and a comprehensive compliance program. Morgan Stanley applied inclusive internal controls and FCPA training to its employees at a level that was deemed sufficient by the DOJ and SEC. This resulted in a declination letter being sent to the company and charges brought only against the offender, Garth Peterson. On the other hand, Eli Lilly suffered from a lack of institutional control and compliance mechanisms that were ineffective. Data analytics could have proactively detected the high-risk behavior between Mr. Peterson and the government official by analyzing information readily available to the company. Additionally, each subsidiary of Eli Lilly exhibited violations that likely could have been detected with data analytics. This may have allowed the company to be favorably viewed by the DOJ and SEC and avoid a formal investigation.

Implementing compliance concepts discussed in the FCPA Resource Guide provides an anti-corruption framework through industry best practices. The model prescribed by the DOJ and SEC along with guidance from outside sources allows corporations to be better positioned to meet regulatory requirements. However, integrating data analytics will shift compliance from reactive to proactive. Data analytics detects suspicious transactions and relationships by utilizing a holistic set of structured and unstructured data. This provides the flexibility to identify suspicious transactional patterns and unexpected anomalies to determine illicit payments, the corresponding business advantage, and a corrupt intention. Incorporating a mechanism to determine areas of greater risk will result in a more focused appropriation of resources and greater effectiveness of FCPA compliance. This information allows companies to detect violations sooner and reduce their exposure. Companies that implement a comprehensive compliance program through best practices and data analytics will reduce their corruption risk and realize the benefits of emerging markets.

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