

The Enforcement Angle: Where ineffective control leads

Tom Fox, Compliance Week

THE COSO CUBE



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2013 Framework articulates 17 principles for effective internal control

Control Environment

1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
4. Demonstrates commitment to competence
5. Enforces accountability

Risk Assessment

6. Specifies suitable objectives
7. Identifies and analyzes risk
8. Assesses fraud risk
9. Identifies and analyzes significant change

Control Activities

10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

Information & Communication

13. Uses relevant information
14. Communicates internally
15. Communicates externally


Monitoring Activities

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies

Five Elements of an Effective Compliance Program



The Essential Ingredients of Corporate Compliance

USSG's 7 Elements of an Effective Compliance Program	13 Good Practices by the OECD on Internal Controls, Ethics, and Compliance	Ten Hallmarks of an Effective Compliance Program
1. Standards and procedures to prevent and detect criminal conduct	1. Risk assessment as basis for effective internal controls and compliance program	1. Tone at the Top
2. Leaders understand / oversee the compliance program to verify effectiveness and adequacy of support; specific individuals vested with implementation authority / responsibility	2. Policy that clearly and visibly states bribery is prohibited	2. Written Controls
3. Deny leadership positions to people who have engaged in misconduct	3. Training – periodic, documented	3. Oversight, autonomy & resources
4. Communicate standards and procedures of compliance program, and conduct effective training	4. Responsibility – individuals at all levels should be responsible for monitoring	4. Risk Assessments
5. Monitor and audit; maintain reporting mechanism	5. Support from senior management – strong, explicit and visible	5. Training and Continuous Advice
6. Provide incentives; discipline misconduct	6. Oversight by senior corporate officers with sufficient resources, authority, and access to Board	6. Hiring, incentives and disciplinary measures
7. Respond quickly to allegations and modify program	7. Specific risk areas – promulgation and implementation programs to address key issues	7. Third Parties
NOTE: A general provision requires periodic assessment of risk of criminal conduct and appropriate steps to design, implement, or modify each element to reduce risk	8. Business partners due diligence	8. Confidential Reporting and Investigations
	9. Accounting – effective internal controls for accurate books and records	9. Monitoring and oversight
	10. Guidance – provision of advice to ensure compliance	10. Mergers and Acquisitions
	11. Reporting violations confidentially with no retaliation	
	12. Discipline for violations of policy	Original Source Paul J. McNulty 
	13. Re-assessment – regular review and necessary revisions	

ENFORCEMENT ACTIONS RELATING TO INTERNAL CONTROLS



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HEWLETT-PACKARD

Multi-country bribery schemes. Complete breakdown in internal controls

- Germany: Stuffing the channel for fraud and FCPA bribery funds
- Poland: Some of our \$600,000 is missing
- Mexico: Does AP talk to Compliance?

Total Fine: \$108MM



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LILLY

Four separate bribery schemes in four countries: systemic failure of internal controls

- **China: Fraudulent expense reports by employees**
- **Russia: Third parties billing for non-existent services**
- **Brazil: Distributor outside standard discount range**
- **Poland: Charitable contributions tied to new business or payments**



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SMITH & WESSON

- **No DOJ prosecution**
- **No internal controls present when company went overseas**
- **S&W did not contest charges in administrative proceeding**
- **\$2.1 MM fine and penalty**



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LAYNE CHRISTENSEN

- **Declination by DOJ**
- **SEC cease-and-desist order; \$5.1MM**
- **Mischaracterization of payments**
- **No check with second set of eyes**



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BIO-RAD: THE PENALTIES

- **\$14.35MM to DOJ, declination by DOJ**
- **\$40.7MM to SEC, cease-and-desist order**
- **Mischaracterization of payments**
- **No check with second set of eyes**



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BIO-RAD: THE BRIBERY SCHEMES

Russia: Third parties

Vietnam: Sales commissions

Thailand: Joint venture

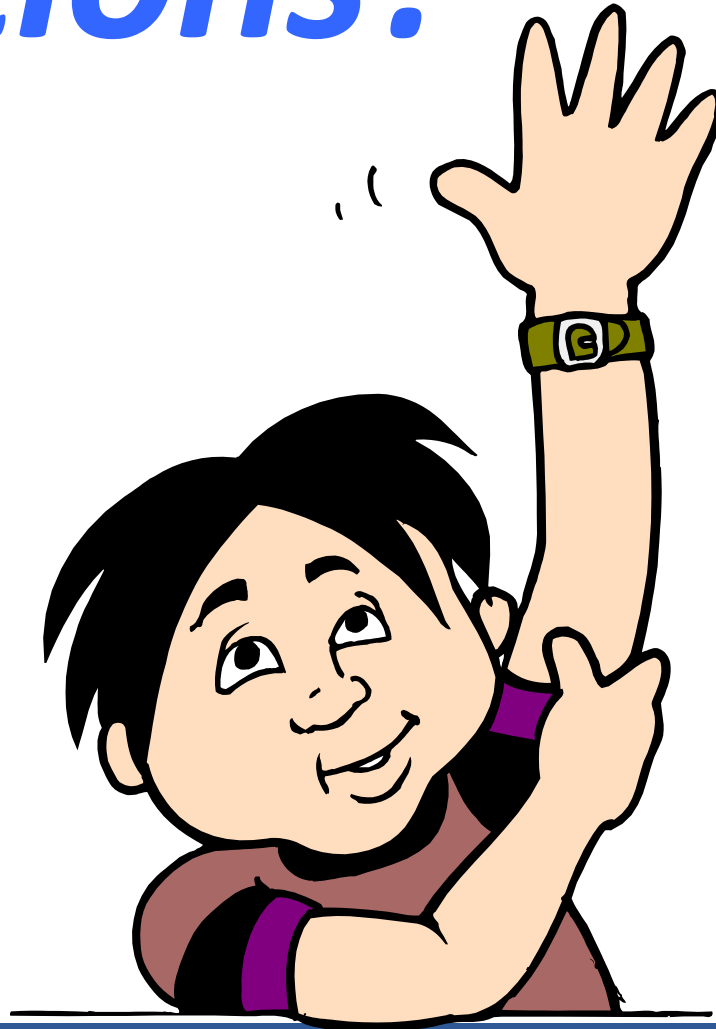
BIO-RAD AND FAILURE OF INTERNAL CONTROL

- **Delegation of authority**
- **Vendor master file**
- **Contracts with third-party representatives**
- **Disbursements of funds**

GOING FORWARD

- **SEC administrative proceedings**
- **Profit disgorgement focus by SEC**
- **Moving yet closer to strict liability?**
- **Dodd-Frank to FCPA liability?**

Questions?



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