

## INTERNAL CONTROLS AND FOREIGN SUBSIDIARIES

*Michael Volkov, Partner, Mayer Brown LLP, Washington, D.C.*

*Corruption, Crime & Compliance: <http://corruptioncrimecompliance.com>*

Under the FCPA, public companies are required to maintain accurate books and records and an effective system of internal controls. Enforcement and compliance efforts focus more on anti-bribery issues than books and records and internal controls. If bribery occurs, a books and records violation will occur. Books and records enforcement is always in hindsight and pegged to bribery conduct.

The FCPA requires every issuer to make and keep records “in reasonable detail” in order to record accurately and fairly transactions and dispositions involving the company’s assets. There is no materiality requirement for a books and records violation. A company or individual may be criminally liable for knowingly falsifying a book, record or account. Inadvertent mistakes or omissions do not constitute a knowing criminal violation. Similarly, insignificant or technical accounting errors will not constitute an internal accounting controls violation.

The SEC enforces the civil penalties for these provisions and is only required to show by a preponderance of the evidence that such a violation has occurred. There is no *scienter* requirement for a civil violation. The Justice Department enforces criminal violations where there is a knowing falsification of books and records and/or violation of internal controls.

Books and records violations typically involve –

- A failure to record an improper transaction like a bribe or a kickback
- A false record intended to disguise portions of an improper transaction
- A failure to include specific information (e.g. the purpose of payment) which would disclose the nature of the illegal or unauthorized payment.

The internal controls provisions require companies to maintain a system of internal accounting controls to provide reassurances that:

- Transactions are executed in accordance with management authorization
- Transaction are recorded as necessary to prepare accurate financial reports and maintain accountability of assets
- Access to assets is restricted to those authorized individuals
- Records are maintained to compare accountability to existing assets at reasonable intervals

The internal controls must be carefully tailored to the overall corruption risks, including the industries involved, the geographic areas where the company is operating, the level of foreign government interactions, the use of third parties, and the company's business model.

A global company can run afoul of the books and records provision when a foreign subsidiary violates these requirements and the foreign subsidiary's financial books are incorporated into the global company's books and records and financial reports. The global parent has to have majority control of the foreign subsidiary for such a violation. If the global company owns less than 50 percent of the foreign company, there is no liability for books and records. However, the global company has to proceed in "good faith to use its influence to the extent reasonable under the circumstances" to have the related company design and maintain a system of internal controls. If the company can demonstrate a good faith effort to convince the related company, it will enjoy a conclusive presumption of compliance with the books and records and internal controls requirement.