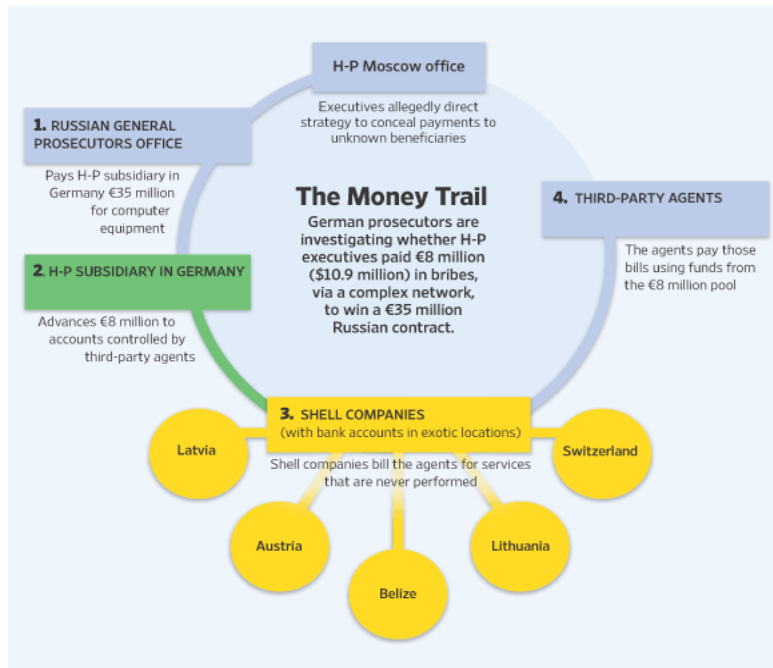


## Red Flags, Hewlett-Packard and Big Papi

As most readers of this blog know, the author is an avid baseball fan. So it was not without some small interest ~~to him~~ when a term most often used in the [Foreign Corrupt Practices Act \(FCPA\)](#) compliance world was used on ESPN's Baseball Tonight to describe a hitter's batting characteristics. ~~This past Sunday~~ Recently, commentator, and former big league manager, Buck Showalter, discussed the current batting slump of Big Papi -David Ortiz, by noting that his inability to hit the off-speed was a **Red Flag** for what is really ailing him, decreased bat speed. Showalter explained that the reason Big Papi's ~~his~~ failure to hit a curve ball was a **Red Flag** ~~which is that it indicates~~ a bigger problem, Ortiz has to amp up to hit a fastball so much now that he is susceptible to being quite easily fooled ~~quite easily now~~ by an ~~the~~ off-speed pitch.

In the FCPA compliance world a **Red Flag** can be equally indicative of a larger problem as well. As reported in The Russia Monitor on May 4, 2010, high-level executives at the [Hewlett-Packard \(HP\)](#) subsidiary made payments, through agents, to the Russian Prosecutor General's office in order to obtain the contract to supply computers to that office. There was a complicated financing scheme used to route payments to offshore accounts beneficially owned or controlled by unnamed Russian officials; funneling the suspected bribes through a network of shell companies and accounts in places including Britain, Austria, Switzerland, the British Virgin Islands, Belize, New Zealand, Latvia, Lithuania, and the US states of Delaware and Wyoming. The bribes were paid through three German agents, who submitted fake invoices for non-existent sales and then paid the money on as bribes to unnamed Russian governmental officials.

As reported in the Wall Street Journal, April 16, 2010 the scheme went something like the following:



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The Wall Street Journal, on April 15, 2010, the WSJ reported that three middlemen are alleged to have paid invoices; using funds provided by HP for equipment ~~they~~ never purchased, to shell companies with bank accounts in Latvia, Lithuania, Austria, Switzerland and Belize. In return, the suspected middlemen allegedly received commissions totaling ~~US\$700,000 several hundred thousand dollars~~, according to court documents. German authorities ~~;~~ reported the investigation, which ~~was~~ started in 2007, when a German tax auditor discovered bank records showing that between 2004 and 2006, ~~an~~ HP subsidiary paid €22 million into the account of ProSoft Krippner GmbH, a small computer-hardware company in Leipzig. The records indicated the payment was made for services performed in Moscow. It was the size of the payment to ProSoft Krippner ~~that~~ caught the tax auditor's attention and he *red-flagged* the matter for transfer to a special prosecution team in Dresden who ~~that~~ handles major corruption cases.

To top it all off, at least one witness has said that the above transaction was internally approved by HP through its then existing contract approval process. In the April 15, 2010, WSJ; ~~April 15~~ article, Mr. Dieter Brunner, a bookkeeper; who is a witness in the probe, said in an interview that he was surprised when, as a temporary employee of HP, he first saw an invoice from an agent in 2004. "It didn't make sense," because there was no apparent reason for HP to pay such big sums to accounts controlled by small-businesses such as ProSoft Krippner, Mr. Brunner said. Mr. Brunner then proceeded to say he processed the transactions anyway because he was the most junior employee

handling the file, "I assumed the deal was OK, because senior officials also signed off on the paperwork".

Just how many **Red Flags** are raised by the above?

- **Offshore Companies**

In a white paper entitled "*Grey Practices in the Russian Business Environment*" Control Risks reviewed what it viewed as some of the more routine "day-to-day schemes that erode the integrity of transactions" in Russia. One of the main tactics utilized to disguise the principal who receives a bribe is through the use of offshore companies, usually located in 'exotic' locations as per the countries listed in the diagram above. ~~to take advantage of weak disclosure requirements to conceal beneficial ownership. Such offshore company is usually located in an 'exotic' location, such as one of the countries listed in the diagram above.~~ Any monies paid by HP to an agent, which were then sent then went to an offshore company to an offshore company. should have been flagged for further inquiry.

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- **Small Sized Agents**

As noted, by the temporary HP employee Dieter Brunner. ~~above,~~ one of the facts that "didn't make sense" to the HP temporary employee, Dieter Brunner, was a such large payment to a such small-sized businesses. One of the **Red Flags** that arises during due diligence on business partners is the size of the company in relationship to the work or services it performs. If a one-man company is receiving a multi-million dollar (or Euro) payment, it should be flagged for further inquiry.

- **Faked Invoices for Goods/Services**

One of the tests of for revenue recognition for of hardware and software is whether the goods and services relating thereto are actually delivered. If the middlemen above did not receive the equipment they allegedly purchased, this should have been picked up by an internal company audit or even simple inventory control and flagged for further inquiry.

The point in all of this discussion is that the FCPA mandates due diligence, due diligence and then more due diligence. If fact or circumstance arises which cannot be immediately explained, then the matter should be referred to Legal or Compliance for additional investigation. If Baseball Tonight can spot a **Red Flag** I hope that any US company, subject to the FCPA, has a compliance program in place to do so as well.

For prior posts on HP and its current FCPA issues, see here and here.

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