

HALLMARK VII OF THE
**Ten Hallmarks of an
Effective Compliance Program**

REPORTING AND INVESTIGATIONS

Tom Fox

The Compliance Evangelist

Hallmark VII-Third Parties

A. The Third-Party Risk Management Process

As every compliance practitioner is well aware, third parties still present the highest risk under the Foreign Corrupt Practices Act (FCPA). The Department of Justice Evaluation of Corporate Compliance Programs devotes an entire prong to third party management. It begins with the following:

How has the company's third-party management process corresponded to the nature and level of the enterprise risk identified by the company? How has this process been integrated into the relevant procurement and vendor management processes?

What was the business rationale for the use of the third parties in question? What mechanisms have existed to ensure that the contract terms specifically described the services to be performed, that the payment terms are appropriate, that the described contractual work is performed, and that compensation is commensurate with the services rendered?

This first set of queries clearly specifies that the DOJ expects an integrated approach that is operationalized throughout the company. This means your compliance process must have a process for the full life cycle of third party risk management. There are five steps in the life cycle of third party risk management, which will fulfill the DOJ requirements laid out in the 10 Hallmarks of an Effective Compliance Program and the Evaluation. They are:

1. Business Justification and Business Sponsor;
2. Questionnaire to Third Party;
3. Due Diligence on Third Party;
4. Compliance Terms and Conditions, including payment terms; and
5. Management and Oversight of Third Parties After Contract Signing.

Business Justification. The first step breaks down into two parts: business sponsor and business justification. The purpose of the business justification is to document the satisfactoriness of the business case to retain a third party. The business justification should be included in the compliance review file assembled on every third party at the time of initial certification and again if the third-party relationship is renewed. It is mandatory this document be filled out and completed by the Business Sponsor, who will be the primary contract with the third-party for the life of the business relationship.

Questionnaire. The term 'questionnaire' is mentioned several times in the 2012 FCPA Guidance. It is generally recognized as one of the tools that a company should complete in its investigation to better understand with whom it is doing business. This requirement is not only a key step but also a mandatory step for any third party that desires to do work with your company. If a third party does not want to fill out the questionnaire or will not fill it out completely, run, don't walk, away from doing business with such a party.

One thing that you should keep in mind is that you will likely have pushback from your business team in making many of the inquiries listed above. However, most proposed agents that have done business with U.S. or U.K. companies have already gone through this process. Indeed, they understand that by providing this information on a timely basis, they can set themselves apart as more attractive to U.S. businesses.

Due diligence. Most compliance practitioners understand the need for a robust due diligence program to investigate third parties, but have struggled with how to create an inventory to define the basis of risk of each foreign business partner and thereby perform the requisite due diligence. Getting your arms around due diligence can sometimes seem bewildering for the compliance practitioner.

The purpose is to encourage businesses to put in place due diligence procedures that adequately inform the application of proportionate measures designed to prevent persons associated with a company from engaging in bribery and corruption on their behalf. Due diligence acts as both as a procedure for anti-bribery risk assessment and as a risk mitigation technique. Further both operate as compliance internal controls.

After you have completed Steps 1-3; then evaluated and documented your evaluation, you are ready to move onto to Step 4, the contract. According to the FCPA Guidance, “Additional considerations include payment 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.” This means that you need to understand what the rate of commission is and whether it is reasonable for the services delivered. If the rate is too high, this could be indicia of corruption as high commission rates can create a pool of money to be used to pay bribes. If your company uses a distributor model in its sales side, then it needs to review the discount rates it provides to its distributors to ascertain that the discount rate it warranted.

The contract. You must evaluate the information and show that you have used it in your process. If it is incomplete, it must be completed. If there are red flags, which have appeared, these red flags must be cleared or you must demonstrate how you will manage the risks identified. In others words, you must document that you have read, synthesized and evaluated the information garnered in the business justification, questionnaire and due diligence steps beforehand. As the DOJ and SEC continually remind us, a compliance program must be a living, evolving system and not simply a “check the box” exercise.

Management of the relationship. While the work done in the four steps described above are absolutely critical, if you do not manage the relationship it can all go downhill very quickly and you might find yourself with a potential FCPA or U.K. Bribery Act violation. There are several different ways that you should manage your post-contract relationship. The Evaluation clearly is focused on several key components that you need to evaluate and then re-evaluate during the pendency of the relationship. Incentivizing through compensation issues, training and ongoing

monitoring through oversight and auditing are all key tools that the DOJ expects you to use going forward after the contract is signed.

B. Managing Your Third Parties

The building blocks of any compliance program lay the foundations for a *best practices* compliance program. For instance, in the life cycle management of third parties, most compliance practitioners understand the need for a business justification, questionnaire, due diligence, evaluation and compliance terms and conditions in contracts. However, as many companies mature in their compliance programs, the issue of third party management becomes more important. It is also the one where the rubber meets the road of operationalizing compliance. It is also an area the DOJ specifically articulated in Evaluation that companies need to consider.

In his 2015 *Supply Chain Management Review* article “Put it in Writing: Sharpening Contracts Management to Reduce Risk and Boost Supply Chain Performance,” author Mark Trowbridge provides useful insights into the management of the third-party relationship. While the focus of the article was having a strategic approach to contracts management, the author’s five ways to professionalize the outsourcing of contracts provide an excellent manner to consider steps in the management of third-party relationships.

The key is to have a strategic approach to how you structure and manage your third-party relationships. This may mean more closely partnering with your third parties to help manage the anti-corruption compliance risk. It would certainly lead towards enabling your company to control risk while optimizing the performance of your third parties. To achieve these goals, I have revised Trowbridge’s prescriptions from suppliers to third parties.

Consolidate third parties but retain redundancy. It is incumbent that consolidation in your third-party relationships to a smaller number to “yield better cost leverage.” From the compliance perspective, it also should make the entire third-party lifecycle easier to manage, particularly steps 1-4. However, a company must not “over-consolidate” by going down to a single source supplier. You should build a diversified supplier base, with a through “dual-sourcing.” From the compliance perspective, you may want to have a primary and secondary third party that you work with in a service line or geographic area to retain this redundancy.

Keep tabs on subcontracted work. This is one area that requires an appropriate level of compliance management. If your direct contracting party has the right or will need to subcontract some work out, you need to have visibility into this from the compliance perspective. You will need to require and monitor that your direct third-party relationship has your approved compliance terms and conditions in their contracts with their subcontractors. You will also need to test that proposition. In other words, you must require, trust and then verify.

Make sure your company is legally protected. This is where your compliance terms and conditions will come into play. Consider a full indemnity if your third party violates the FCPA

and your company is dragged into an investigation because of the third party's actions. Such an indemnity may not be worth too much but if you do not have one, there will be no chance to recoup any of your legal or investigative costs. Another important clause is that any FCPA violation is a material breach of contract. This means that you can legally, under the terms of the contract, terminate it immediately, with no requirement for notice and cure. Once again you may be somewhat constrained by local laws but if you do not have the clause, you will have to give written notice and an opportunity to cure. This notice and cure process may be too long to satisfy the DOJ or SEC during the pendency of a FCPA investigation. Finally, you need a clause that requires your third party to cooperate in any FCPA investigation. This means cooperation with you and your designated investigation team but it may also mean cooperation with U.S. governmental authorities as well.

You also need the ability to move between third parties if the need arises. This is the redundancy issue raised above. You do not want to be stuck with no approved freight forwarders or other transporters in a certain geographic area. If a compliance related matter occurs, you may well need certain contractual rights to move your work and to require your prime third party to cooperate with the transition to your secondary third party.

Keep track of your third parties' financial stability. This is one area that is not usually discussed in the compliance arena around third parties but it seems almost self-evident. You can certainly imagine the disruption that could occur if your prime third-party supplier in a country or region went bankrupt; but in the compliance realm there is another untoward red flag that is raised in such circumstances. Those third parties under financial pressure may be more easily persuaded to engage in bribery and corruption than third parties that stand on a more solid financial footing. You can do this by a simple requirement that your third party provide annual audited financial statements. For a worldwide logistics company, this should be something easily accomplished.

You should take advantage of automated financial tracking tools to keep track of material changes in a third parties' financial stability. You should also use your in-house relationship manager to regularly visit key third-party relationships so an on-the-ground assessment can be a part of an ongoing conversation between your company and your third parties.

Formalize incentives for third-party performance. One of the key elements for any third-party contract is the compensation issue. If the commission rate is too high, it could create a very large pool of money that could be used to pay bribes. It is mandatory that your company link any commission or payment to the performance of the third party. If you have a long-term stable relationship with a third party, you can tie compensation into long-term performance, specifically including long-term compliance performance. This requires the third party to put skin into the compliance game so that they have a vested, financial interest in getting things done in compliance.

By linking contractual compensation to performance, there should be an increase in third party performance. This is especially valuable when agreed upon key performance indicator (KPI)

metrics can be accurately tracked. This would seem to be low hanging fruit for the compliance practitioner. If you cannot come up with some type of metric from the compliance perspective, you can work with your business relationship team to develop such compliance KPIs.

You should rank third parties based upon a variety of factors including performance, length of relationship, benchmarking metrics and KPIs. This is a way for the compliance practitioner to have an ongoing risk ranking for third parties that can work as a preventative and even proscription prong of a compliance program and allow the delivery of compliance resources to those third parties that might need or even warrant them.

Auditing third parties. Critical to any best practices compliance program and an important tool in operationalizing your compliance program, this is a key manner in which a company can manage the third-party relationship after the contract is signed and one which the government will expect you to engage in going forward.

Document review and selection is important for this process, you should ask for as much electronic information as possible well in advance of your audit. Request the following categories of documents; trial balance, chart of accounts, journal entry line items, financial and compliance policies, prior audited financial statements, bank records and statements, a complete list of agents or intermediaries and revenue by country and customer.

Regarding potential interviewees, focus on those who interact with government entities, foreign government officials or third parties, including those personnel involved with:

- Business leadership;
- Sales/marketing/business development;
- Operations;
- Logistics;
- Corporate functions such as human resources, finance, health, safety and environmental, real estate and legal

For the interview topics, there are several lines of inquiry. Remember this is an audit interview, not an investigative interview. Avail yourself of the opportunity to engage in training while you are interviewing people. The topics to interview on include:

- General policies and procedures;
- Books and records pertaining to FCPA risks;
- Test knowledge of FCPA and U.K. Bribery Act including facilitating payments and their understanding of your company's prohibitions;
- Regulatory challenges they may face;
- Any payments of taxes, fees or fines;
- Government interactions they have on your behalf; and

- Other compliance areas you may be concerned about or that would impact your company, including: trade, anti-boycott, anti-money laundering, anti-trust.

Managing your third-parties is where the rubber meets the road in your overall third-party risk manage program. You must execute on this task. Even if you successfully navigate the first four step in your third-party risk management program, those are in reality the easy steps. Managing the relationship is where the real work begins.