Ten Steps to Limit Corruption Allegations in China

Transparency International's 2012 Annual Corruption Perceptions Index ranked China 80th among 176 countries. By comparison, the United States ranked 19th and Denmark ranked first as being least corrupt. But China recently has begun making visible efforts to clean up its image, both by strengthening its anti-corruption rules and cracking down on enforcement. High-profile investigations announced by China's Ministry of Public Security regarding bribery allegations against at least one leading pharmaceutical company and other multinationals in late July are causing many companies doing business in the PRC to take note.

Here are ten steps that multi-national companies operating in China should undertake to not run afoul of an increasingly intolerant regulatory environment:

1. Understand China's Anti-Corruption Laws

Although some perceive that the PRC laws on bribery are vague and complex, recent events demonstrate that China is increasingly aggressive in rooting out corrupt business practices. As a signatory to the recent United Nations Convention Against Corruption, the PRC's anti-corruption laws comply with the UN requirements. PRC laws also prohibit most conduct that violates the Foreign Corrupt Practices Act (FCPA) and even commercial bribery that does not involve a state-controlled entity. After passage of these laws, the PRC court issued guidance to assist in interpreting them. If company executives have a question regarding compliance, consult with a reputable PRC-qualified attorney.

2. Eschew Gifts and Entertainment

While many sales force employees at multinationals regard the bestowing of desirable gifts or entertainment on Chinese public officials in decision-making roles as standard operating procedure to help facilitate the purchase or adoption of their companies' products, companies must institute a zero-tolerance policy regarding corruption. Chinese law, the FCPA and the UK Bribery Act absolutely prohibit companies from paying bribes to foreign government officials and political figures. The presentation of a gift, however small, can violate these laws if authorities can demonstrate that it is given with the intent to obtain or retain business or can be construed as providing improper advantage. Indeed, PRC rules require any gift that might affect an official's impartial exercise of his public function be turned over to the state. As an initial matter, the company should set standards for gift giving that are implemented by an experienced local compliance director. The local compliance director should have the support and backing of senior management to deny requests that fall outside the compliance polices of the company and local law. Lastly, employees should only give gifts that are for official, rather than personal, use, and should present them openly and in front of a group of people.

3. Vet Third Parties

Third parties are the single biggest risk to companies doing business in China. In 2012, every US FCPA enforcement action involved a third party such as a contractor, subcontractor or consultant. Steps should be taken to assess the need for, and evaluate the background and qualifications of, third parties hired to facilitate business for a company. Do not ignore any red flags in a background report, and keep careful records of any due diligence undertaken and then scrutinize the results of that due diligence.

4. Monitor All Travel Arrangements

Request for travel is common from PRC officials in China. In recent years, we've seen Chinese travel agencies used as a conduit for bribes to government officials. Since 2007, nine reported FCPA resolutions involved travel agents or travel-related corrupt activity. For example, one US telecom company faced actions by US regulators after spending millions of dollars for more than 300 trips for Chinese government officials. The stated travel purpose was for the inspection of factories and to train the officials in how to use the company's equipment, when, in reality, the officials instead visited tourist destinations such as Hawaii, Las Vegas, the Grand Canyon, Niagara Falls, Disney World, Universal Studios and New York City. Companies can avoid corrupt behavior in this regard by ensuring that the compliance policy for travel is adequate to address the corruption risk in the culture. Create or update your travel policy to require a specific business basis for the trip, mandate approval be granted by senior managers only and require the submission of a detailed itinerary that lists each line item separately to ensure items such as stipends, per diems and unintended leisure travel do not creep into otherwise legitimate travel plans.

5. Institute Risk-Based Compliance

The government-issued *A Resource Guide to the U.S. Foreign Corrupt Practices Act* states, "DOJ and SEC will give meaningful credit to a company that implements in good faith a comprehensive, risk-based compliance program, even if that program does not prevent an infraction in a low risk area because greater attention and resources had been devoted to a higher risk area." Consequently, a company should implement specific anti-corruption risk controls tailored to the environment. For example, a company whose only customer is the Chinese government faces considerable risk of corruption, so it should develop compliance policies that address that risk and specifically lay out procedures and protocols for the employees interfacing with government officials on behalf of the company to follow.

6. Provide Compliance Training

If employees are trained on the law and understand the reasons behind the compliance policy, companies will likely experience a measurable decrease in their corruption risk. The higher the risk, the more important in-person training supplemented by a web-based training module, certifications and oversight becomes. Companies should evaluate position titles that present high-risk and target these employees for higher level anti-corruption training. These positions could include those in sales and marketing; employees that interact with government officials; personnel charged with maintaining agency external relationships; human resource personnel with international responsibilities; and appropriate legal, compliance and finance personnel. In addition, training should be offered in the local language where appropriate.

7. Make Internal Audit and Finance Accountable

Internal audit and finance teams should share joint responsibility for anti-corruption compliance with company lawyers and compliance professionals when operating in high-risk markets. In a recent FCPA enforcement action, the SEC described the failure of the internal auditor to detect a corrupt transaction as a failure of leadership. According to the SEC, company management "had the ability to review or cause internal audit to review" suspect transactions; the failure to do so decreased the ability of the internal audit to "provide an independent internal control function." To avoid this, many companies are investing in specific anti-corruption training for audit and finance personnel. This team of professionals should have the full support of company leadership, including local management, to implement monitoring and, as necessary, enhanced controls or remedial steps to address anti-corruption risk.

8. Conduct Business Combinations Due Diligence

Several reported FCPA cases highlight the important of anti-corruption due diligence in the context of business combinations in China. The failure to identify an FCPA issue in advance of a merger, joint venture or other business combination has been credited, in one instance, with the complete loss of the value of the investment. Conduct a risk assessment of the company to identify high-risk areas within the business where corruption is more likely to occur. Although much depends on the company's stake in the venture, even minority stakeholders would be wise to exercise caution and ensure that appropriate risk-based due diligence is conducted. Companies should engage in documented due diligence prior to closing a merger or other business combination. The documentation usually starts with due diligence questionnaires issued to key managers, co-investors and relevant consultant followed by interviews related to responses that raised red flags, and also should include documentation to verify the answers to certain types of questions.

9. Determine If Chinese Employees Are Viewed as Foreign Officials

The Chinese government operates through a complex web of state-owned enterprises (SOEs), in key industries such as aviation, oil and gas, telecommunications and healthcare. US enforcement authorities interpret the term "foreign officials" to apply not only to bureaucrats, but also to employees of SOEs given their status as an "instrumentality" of the state. Multinationals seeking to limit potential corruption liability should closely review this question and exercise care in determining whether employees of any company are indeed "foreign officials" for purposes of anti-corruption laws.

10. Monitor, Audit and Enforce Compliance Policies

Anti-corruption programs must be embedded in the way a company does business. Compliance begins at the C-level, but it is up to middle management to deliver and reinforce the importance of anti-corruption compliance to ensure that it reaches employees most vulnerable to corrupt conduct. Those with compliance responsibilities must regularly monitor the effectiveness of compliance polices and their enforcement. Those found in serious violation of anti-corruption policies should face real and transparent consequences for their behavior so that employees understand that management takes corruption seriously.

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