



China Risk Focus – FCPA versus China Corruption Act

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The U.S. Foreign Corrupt Practice Act (FCPA) was enacted in 1977 after over 400 companies under investigation by the U.S. Securities and Exchange Commission (SEC) admitted to making hundreds of millions of dollars in bribes to foreign government officials, politicians, and political parties to obtain favorable treatment in business being conducted abroad.

From 2010 to date, the SEC charged over 50 different companies with violations of the FCPA.

1. The charges ranged from providing improper cash payments, gifts, travel, and entertainment to actual bribes made to government officials to secure business or regulatory approvals. Of those cases, 14 had some or all of their operations and the FCPA offenses occurring in China, including Eli Lilly and Company subsidiaries, charged with making improper payments to foreign government officials to win business (\$29 million in fines), Tyco International subsidiaries, being charged with making illicit payments to foreign officials in more than a dozen countries, including China (\$26 million paid to settle the charges) and Pfizer subsidiaries being charged with making illegal payments to foreign officials in eight countries including China to obtain regulatory approvals, sales, and increased prescriptions for its products (\$45 million paid to settle the cases).

2. During the Qianlong era (Qing Dynasty) of the 1700s, offences listed in the Great Qing Legal Code included the receipt of bribes and acceptance of gifts by civil servants, as well as extortion by civil servants or their family members. China's modern Anti-Bribery laws were put into place in 1979, in the post-Mao era, when the private sector began growing in China and it became clear that government officials were abusing their power during the economic development of the country.

3. These laws were strengthened and amended in 2011. In January 2013, then President-In-Waiting Xi Jinping resolved in a speech to fight "tigers" and "flies" in an effort to resolve corruption problems in China.

4. China's anti-corruption activities have led to the prosecution of certain foreign firms under China's Anti-Bribery laws. A high-profile corruption case in 2013 involved GlaxoSmithKline, a large multi-national pharmaceutical company in China, in which government officials conducting an investigation alleged that the company used travel agencies to pay billions of Yuan (hundreds of millions of USD) in bribes to doctors and officials to boost the sale of its medicine products.

5. The crackdown on the pharmaceutical company is an example of the anti-corruption enforcement actions the Chinese government has set in motion, with the pharmaceutical company scandal being one of the larger and higher profile examples.

FCPA v. China Anti-Bribery Laws

A comparison of the main provisions of the anti-corruption statutes of the FCPA and the China Anti-Bribery laws shown in the table below indicates that, while the U.S. laws are primarily aimed at bribery by U.S. companies in foreign markets, China's laws include domestic measures, such as commercial bribery and bribery by China's domestic entities and Chinese domestic officials. Further, under the FCPA, receipt of a bribe is not a prosecutable offense, but it is under China's rules.

A Comparison of FCPA and China Anti-Bribery Laws		
Issue	U.S FCPA (1977)	Chinese Anti-Bribery Laws (1979 – amended 2011)
Is bribery of foreign public officials illegal?	Yes	Yes
Are commercial bribery and bribery of domestic officials illegal?	No – The acts of commercial bribery, however, may trigger US Travel Act liability, as well as books and records' liability under the FCPA if there are record-keeping problems.	Yes
Can the receipt of a bribe be prosecuted?	No	Yes
What is the requisite intent for liability to attach?	The FCPA requires the accused to have acted "willfully," "knowingly," and "corruptly." Knowledge, moreover, is defined to include "conscious disregard" or "willful blindness."	"Seeking illegitimate interests" is the criteria in the subjective aspect of a bribe. According to the recent related interpretations of law approved in August 2012, "seeking illegitimate interests" under a crime of bribe offering refers to "that the interests obtained by the briber violate laws, regulations, rules, or policies, or that the briber requires state functionaries to provide assistance or facility in violation of laws, regulations, rules, policies, or professional standards. Whoever seeks competitive edge during economic activities or the organization of personnel administration activities in violation of the principle of fairness and justice shall be determined to 'seek illegitimate interests'".
Can companies be held criminally liable?	Yes	Yes
Is there a "facilitation/grease payments" exception?	Yes, the FCPA exempts small facilitation payments made to expedite or secure the performance of "routine governmental action." That said, the exception is extremely narrow.	No
Is failure to keep accurate books and records an offense?	Yes. Public companies and other "issuers" are required to file periodic reports with the SEC and to maintain accurate books and records.	The failure itself cannot trigger a prosecution of bribe. But the failure itself may constitute another crime according to Amendments to the Criminal Law in 1999. It provides that "Any person who conceals or deliberately destroys accounting records, account books or financial accounting statements that are required to be maintained by law shall, if the circumstances are serious, be sentenced to a fixed term of imprisonment of up to five years or criminal detention, and/or be fined between RMB 20,000 and 200,000. Any entity that commits the crime described in the preceding paragraph shall be fined and the person in charge directly responsible and any other person directly responsible for the offence shall be punished in accordance with the preceding paragraph."
Are "promotional expenses" exempt?	Yes, the FCPA provides an affirmative defense for payments that are reasonable and bona fide business expenses 1) directly related to the promotion, demonstration, or explanation of products or services, or 2) incurred in connection with the execution or performance of a contract with a foreign government or agency.	No

Is the law applied extraterritorially?	Yes. The FCPA applies to acts by US issuers, domestic concerns, and their agents and employees that occur wholly outside the US, and to acts by US citizens or residents wherever they occur.	Yes. Chinese criminal law applies to all PRC citizens (wherever located). It also applies to foreign nationals who commit a crime in China, except foreign nationals who enjoy foreign diplomatic privileges and diplomatic immunities.
Is having robust corporate compliance program a defense?	No. Having robust compliance programs do not provide a defense to liability. That said, having such a compliance program in place can result in a reduced fine under the amended Federal Sentencing Guidelines.	No
Is there a "local law" exception/defense?	Yes. An affirmative defense is available if payment to foreign officials is lawful under the written laws and regulations of the foreign country.	No
What are the potential penalties?	Anti-Bribery Provision: For corporations, a fine per violation of up to \$2M or up to twice the bribe paid or benefit sought or received, whichever is greater; for individuals, a fine of up to \$250,000 or up to twice the bribe paid or benefit sought or received, whichever is greater, and up to 5 years in prison per violation. Books and Records Provisions: For civil violations, up to \$150,000 for individuals and up to \$725,000 for corporations, depending on the circumstances, and subject to regulatory inflation factors; for criminal violations, up to \$25 million for corporations, up to \$5 million and up to 20 years in prison for individuals.	PRC Criminal Law stipulates that "Whoever commits the crime of offering bribes shall be sentenced to fixed-term imprisonment of not more than five years or detention; whoever offers bribes to secure illegitimate benefits, if the circumstances are serious or if heavy losses are caused to the interests of the State, shall be sentenced to fixed-term imprisonment of not less than five years but not more than 10 years; if the circumstances are especially serious, he shall be sentenced to fixed-term imprisonment of not less than 10 years or life-long imprisonment and may also be sentenced to confiscation of property."
Strict liability for failing to prevent bribery	No strict liability either written directly into the statute or interpreted by judicial review.	No
Jurisdiction	US companies and citizens, foreign companies listed on US Stock Exchange, or any person acting while in the US.	Chinese companies and citizens, foreign individuals and companies.

Effective Anti-Corruption Program Elements

With regulatory anti-corruption laws increasing across the globe, an effective anti-corruption compliance program is a necessity. There are three fundamental elements of an effective program:

- 1) Creating and maintaining of a culture of honesty and high ethics and standards;
- 2) conducting a thorough evaluation of the risks of fraud and corruption and ensuring the implementation of the policies, procedures, and controls needed to mitigate such risks and reduce the opportunities for fraud and corruption; and
- 3) ensuring development and functioning of an appropriate oversight process. The three elements of Culture, Evaluation, and Oversight, backed by a strong framework of Policies, Procedures, Processes, and Controls can help alleviate risks.

A comprehensive anti-corruption compliance program will incorporate these certain basic principles, including ensuring the procedures in place are proportional to the risks faced by the entity, and having commitment by the top levels of management of the entity. Additionally, appropriate risk assessment procedures, adequate due diligence, communication and training and monitoring and review procedures are advised (and in some cases required). A thorough annual risk assessment is one way an entity can understand the extent to which potential events might impact the company's objectives, including those objectives related to the China Anti-Bribery or FCPA compliance. As noted in the comparison of the China Anti-Bribery and the FCPA regulations, however, while having a robust compliance program helps to reduce the risk of inappropriate cross-border payments, it is not a defense that can be used when dealing with regulatory actions under the rules.

Companies doing business in China should adopt a formal approach to oversee the risk assessment process and develop an anti-corruption program that minimizes corruption vulnerabilities. An annual risk assessment is fundamental to developing a

strong compliance program and includes assessing the likelihood and impact of the risks of doing business in China (and other countries). The assessment identifies and evaluates possible responses to the risks identified. In that process, management evaluates options in relation to an entity's risk appetite, cost versus benefit of potential risk responses, and the degree to which a response will

reduce impact and/or likelihood. Responses are selected and executed based on evaluations of the portfolio of risks and responses. Control activities are the policies and procedures that help ensure that risk responses, as well as other entity directives, are carried out. They occur throughout the organization, at all levels and in all functions.

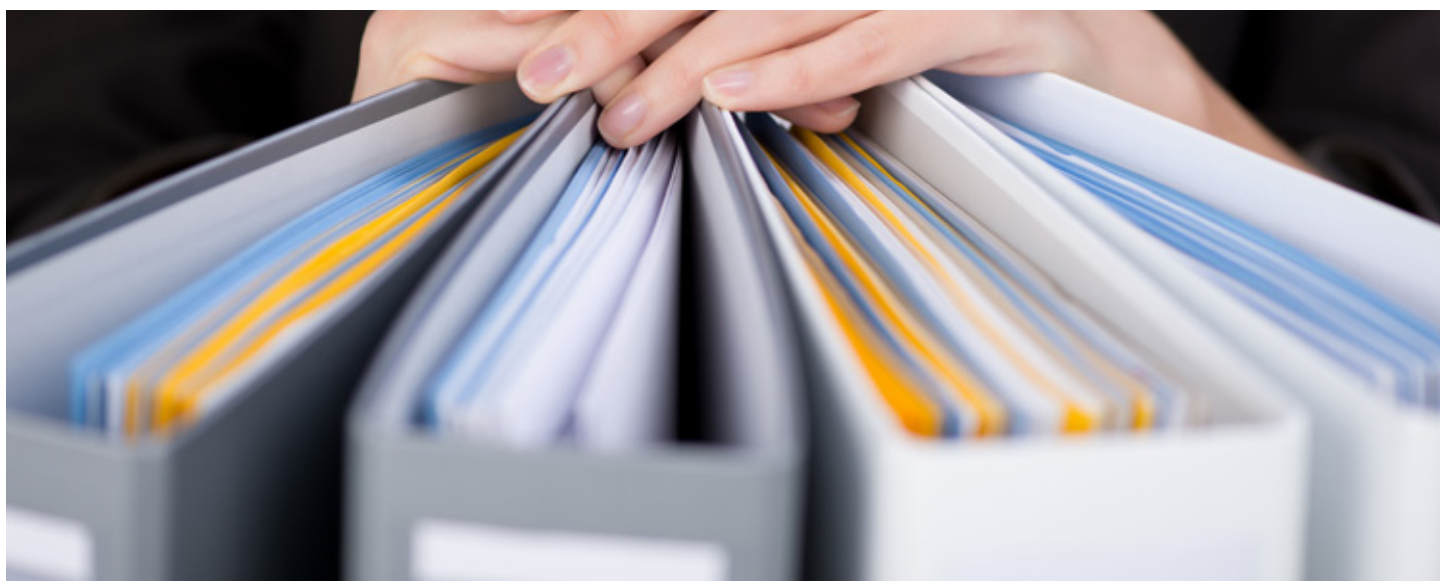
Conclusion

While the risks a company faces operating in China can be challenging, the rewards and opportunities can outweigh certain of those risks with the implementation of an effective anti-corruption program. The risks of cross-border payments can be reduced through a combination of prevention, deterrence, and detection measures.

In 2011, a global retailer voluntarily announced an internal investigation over permitting, licensing, and inspections in its China operations, and whether those were in compliance with the FCPA, which was expanded to include Brazil and China in 2012.⁶ This investigation resulted from annual compliance audit procedures and highlights how effective annual monitoring can identify potential areas of remediation and allows an entity to control risk.

Improving governance and internal controls practices to avoid risk can also help entities maintain healthy relationships with its stockholders, lenders, vendors, and customers. It is one way to ensure that what an entity's competitors and investors think about its competence, integrity, and economic health is the message it wants to send.

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Royalty Audit

Capital Verification Audit

Valuation Services

Corporate Valuation

Damage Assessment Valuation

Intellectual Property Valuation

Asset Valuation

Special Purposes Valuation

Corporate Finance

Debt Restructuring

Acquisition, Disposal & Financing

Mergers & Acquisitions

Transaction Advisory

M&A Divesture

M&A Integration

Financial Due Diligence

Business Services

Company Registration & Maintenance

Market Entry Advisory

Updating Company Certificates

Annual Inspection & Reporting

Company Secretarial Services

Company Ownership Transferring/Corporate Restructuring

Background/Credit Checking

Company Deregistration & Bankruptcy

HR Support Services

China Visa Services for Expatriates

Social Welfare Structures

Outsourcing Services

Accounting & Bookkeeping

Budgeting & Forecasting

Financial Statement Preparation

Head Office Reporting

Financial Management

Interim Financial Management

Finance Manager Function

CFO Function

Cash Flow Management

Treasury Management

Set-up of Bank Account

Payroll Services

Payroll Processing Setup

Expatriate Employees

Local Employees

Secondment & Temping Service

Chop Custodian Services

Taxation Services

Individual Tax Planning (IIT)

Tax Immigration & Investment Review

US & Overseas Personal Income Tax Planning & Filing

IIT Tax Payment Facilitation

Application for Individual Income Tax Refund

Expatriate Staff Individual Income Tax Staff Filing

Local Staff Individual Income Tax

Company Taxation (CIT)

Tax Consulting

Corporate Tax Planning

Business Restructuring

Value Chain Review

Onshore / Offshore Investment

Transfer Pricing

Tax Compliance

Tax Due Diligence

Tax Deregistration

Negotiation of Tax Penalties

Tax Refund Application

Tax Representatives for Tax Audit

VAT & Customs Duty Clearance

PRC Tax Receipt Verification

VAT Application

VAT & Sales Tax Filing

Corporate Income Tax Reporting

Specialist Accounting & Risk Management

Internal Controls

Systems

Risk Management

Sarbanes - Oxley (SOX 404)

GAAP, SEC & IFRS Compliance

US GAAP

US GAAP Financial Statement Preparation

US GAAP Conversion

Other GAAP

GAAP Conversion

Public Company Compliance

Financial Statement Preparation

IFRS

IFRS Accounting Repackaging

IFRS Financial Statement Preparation

IFRS Public Company Compliance

SEC

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Labour Legal Advisory

Workforce Downsizing Advisory

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