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Managing Corruption Risk In Cash-Centric Economies



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In late 2016, India announced a short-deadline plan to eliminate its largest denomination banknotes (500- and 1,000-rupee bills) from circulation. The plan—similar to actions taken by the Indian government in the past—was aimed at curbing illicit activity, including corruption, counterfeiting, drug smuggling, terrorist financing, and (perhaps above all) tax evasion. Due to its population and growing economy, as well as the prevalence of cash transactions within the country, India's cash-elimination plan has commanded significant international attention (and scrutiny). However, India is only the latest country to pursue options for decreasing its economy's dependence on cash. Scandinavian countries—most notably, Sweden—have led the seemingly inevitable progression toward completely cash-free economies. And although less draconian than India's most recent action, the European Central Bank (ECB) has announced plans to stop printing 500-euro banknotes in late 2018. Like India, the ECB cited concerns that the large denomination notes may facilitate criminality.

There are plenty of reasons, in addition to deterring corruption, why countries may aspire to reduce their dependence on cash. For example, cash can be inconvenient to carry, as opposed to a credit or debit card or mobile payment application. Relatedly, cash—particularly in small denominations—is not conducive for large payments, and carrying large amounts of cash can increase personal security risks.

There is a strong correlation between cash-centric countries and perceived corruption.

I. Cash Is (Still) King

Despite the benefits of a cashless economy, and the proliferation of cashless payment alternatives, the over-

whelming majority of the world's consumer transactions are conducted in cash. By some estimates, cash accounts for approximately 85 percent of consumer transactions worldwide—even in the world's least cash-dependent economies, cash accounts for around 40 percent of consumer transactions. See Hugh Thomas, *Measuring progress toward a cashless society*, MasterCard Advisors.

Interestingly, the divide between cash-dependent and noncash-dependent economies does not perfectly track the divide between developed and developing countries. Switzerland, Japan and Germany, for example, have cash-centric economies that appear to be driven by cultural preferences. Cultural considerations aside, there is undoubtedly a concentration of cash-centric economies in Latin America and sub-Saharan Africa. According to a 2014 report, only 51 percent of adults in Latin America and the Caribbean and 34 percent of adults in sub-Saharan Africa owned a bank or mobile money account. See Asli Demircuc-Kunt, et al., *The Global Findex Database 2014, Measuring Financial Inclusion around the World*, World Bank Group (Apr. 2015). There is a strong correlation between cash-centric countries—with large percentages of unbanked residents—in these regions and perceived corruption, as measured by Transparency International's 2016 Corruption Perceptions Index. This correlation is unsurprising: a primary benefit of transacting in cash is anonymity, and anonymity facilitates corruption (in addition to other illicit activity).

In light of these metrics, companies—especially those with international operations—will be hard-pressed to avoid cash transactions altogether, and therefore ignore the corruption risks attendant to such transactions at their peril. Recognizing that economies as divergent as Switzerland and Nigeria do not lend themselves to a one-size-fits-all solution, this article outlines compliance controls that companies may consider to mitigate corruption risk related to cash transactions.

II. Risk Mitigation Steps

From a corporate compliance perspective, cash transactions are especially prevalent across three corruption-related risk areas: (1) travel and entertainment expenses; (2) miscellaneous, low-value expenditures (i.e., petty cash payments); and (3) marketing and accounting practices of third-party agents (e.g., distributors).

A. Travel and Entertainment Expenses

Travel and entertainment (T&E) expenses have long been recognized as a corruption risk area, and companies' failures to implement and enforce adequate T&E controls have resulted in multi-million dollar U.S. Foreign Corrupt Practices Act (FCPA) settlements. Common T&E-related corruption schemes include cash payments to government officials styled as per diem payments or disguised through the submission of inflated T&E expense receipts.

Simple—but sometimes overlooked—steps that companies may take to mitigate T&E-related corruption risk are (1) to encourage the use of corporate credit cards among employees; and (2) to require employees with corporate credit cards to use the cards whenever they are accepted by T&E vendors. Particularly in advanced, cash-centric economies (e.g., Germany), many vendors are able (albeit reluctant) to accept non-cash payments.

A strict—and consistently enforced—policy of requiring the use of corporate credit cards where accepted assists companies to reduce cash transactions. From an internal perspective, the policy provides leverage to employees to insist upon noncash payment methods with a reluctant T&E vendor (e.g., "I'm sorry, but I must pay by credit card, or my employer will not reimburse the expense"). The vendor, in turn, must decide between accepting cashless payment or risk losing the business to a competitor.

For certain vendors—and in certain markets—cashless payment is not an option. In such situations, companies may mitigate corruption risk by establishing appropriate internal controls. First, companies may establish value thresholds for various categories of T&E expenses (e.g., meals, travel), with a requirement to obtain preapproval of expenses that exceed the pre-set limitations. Typically, preapproval thresholds must be established on a location-specific or regional basis, to account for cost variations across markets.

Second, companies may establish a list of trusted, preapproved T&E vendors and require employees to use the preapproved vendors whenever possible. In addition to its compliance purpose, this approach may assist companies to control T&E costs. However, such a requirement generally is suitable only for certain classes of T&E vendors—such as hotels, travel agents, couriers and local transportation services—that typically accept cashless payment.

Finally, companies may require managerial review and approval of T&E expense reimbursement requests and related supporting documentation. For this control to be effective, managerial review of reimbursement requests must be sufficiently rigorous that employees are not tempted to submit inflated or counterfeit receipts. Companies may assess the sufficiency of their T&E expense approval process through periodic sampling or internal audits. In addition, companies may incentivize careful review of T&E expense reimbursement requests by incorporating a compliance factor in managers' performance reviews or in determining variable compensation.

B. Petty Cash

In cash-centric economies, companies commonly establish a common cash pool—a petty cash account—to fund miscellaneous, low-value costs, such as purchases of office supplies or courier charges. Petty cash accounts are especially prevalent where employees cannot afford or are unwilling to personally incur work-related expenses and then seek reimbursement from their employer.

Petty cash accounts, if not carefully supervised, may provide the opportunity for a rogue employee to fund (or conceal) improper payments.

Despite their name, petty cash accounts can be quite large and, if not carefully supervised, may provide the opportunity for a rogue employee to fund (or conceal) improper payments. For example, in 2008, Willbros Group Inc., a U.S.-based engineering and contractor

firm, agreed to pay \$22 million to resolve allegations that its employees paid bribes to Nigerian and Ecuadorian government officials. The U.S. Securities and Exchange Commission's complaint alleged, *inter alia*, that the company's employees and Nigerian affiliates "abused petty cash accounts to . . . make repeated bribes to Nigerian tax and court officials."

In countries where petty cash accounts are indispensable, companies must remain vigilant to ensure that the opportunity created by the ready availability of cash does not translate into corruption. As an initial matter, companies may establish a maximum balance for petty cash accounts, to prevent the accumulation of large sums of money to fund improper payments. Like T&E expense preapproval requirements, the maximum petty cash balance should be determined on a location-by-location basis (and re-assessed frequently). In addition, companies should limit employees' physical access to the petty cash account. Specifically, petty cash should be maintained in a single location in a securable container (i.e., a safe). In general, no more than two or three employees should be able to access the petty cash container, in order to make deposits or withdrawals or balance the account.

Similarly, companies should consider prohibiting the use of petty cash for certain categories of transactions—such as travel expenses, employee salaries and cash advances, and payments to regular vendors—as well as any transaction for which a cashless payment method is accepted. All petty cash transactions should be recorded in a single ledger, which should be reconciled on a regular basis (e.g., weekly), in addition to periodic spot counts. Ideally, petty cash reconciliations should be verified by an employee who is not one of the regular petty cash custodians. Companies also should establish a strict requirement that any discrepancies identified during petty cash reconciliation or spot checks be reported promptly (e.g., within 24 hours) and appropriately documented in the company's accounting records.

C. Third Parties

The corruption risks associated with cash transactions are not confined to transactions involving employees, and therefore cannot be addressed exclusively through internal controls. As past settlements have shown, companies may be held criminally and civilly liable for the actions of third parties if employees knew—or had reason to know—of the underlying misconduct. Except in rare circumstances, companies do not have the ability to dictate the compliance procedures and controls adopted by third parties. However, inability to control policy decisions does not excuse companies of their obligation to monitor the actions of third-party agents and intermediaries.

Companies may mitigate the risks posed by third parties' cash dealings by conducting risk-based due diligence and negotiating written contracts with appropriate compliance representations. In particular, companies may seek audit rights in agreements with higher risk third parties and exercise those rights on a periodic basis, as determined by a documented risk assessment. In addition to contractual protections, companies may seek to enforce accounting standards upon third-party intermediaries, through coaching and training if necessary.

III. Conclusion

In many key, strategic markets, cash transactions show no sign of abating; accordingly, companies should ensure that their controls related to high-risk cash transactions are effectively implemented and consistently enforced. Because of the substantial variation in cash dependency among even advanced economies, procedures governing cash transactions often must be jurisdiction-specific, and should be reviewed and updated frequently to account for changes in local circumstances—for example, the rapid growth of cashless payment methods in China, such as Alipay. In addition, companies should assess whether existing controls address the full scope of cash transactions executed by employees or third-party agents.