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Educational Case

Baker Hughes: Greasing the wheels in Kazakhstan (FCPA violations and implementation of a corporate ethics and anti-corruption compliance program)



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Mark Holtzblatt ^{a,*}, Norbert Tschakert ^{b,1}

^a Monte Ahuja College of Business, Cleveland State University, 1860 E. 18th Street, Monte Ahuja Hall, Cleveland, OH 44115-2214, United States

^b Bertolon School of Business, Salem State University, 352 Lafayette Street, Salem, MA 01970, United States

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ABSTRACT

This case discusses the Foreign Corrupt Practices Act (FCPA) violations of Texas-based Baker Hughes, in connection with its oil service operations in Kazakhstan. You will assume the position of a newly assigned audit committee member who is trying to understand Baker Hughes' FCPA violations related to its Kazakhstan operations. Your investigation will involve the examination of the SEC court complaint, press releases, government and company publications and 10-K annual reports.

Baker Hughes' FCPA experiences illustrate the corruption risks and difficulties that multinational corporations encounter in conducting international business. The subsequent creation of a new Baker Hughes Code of Conduct, FCPA Compliance Guide, and Anti-Corruption Compliance Program provide you with a view of the corporate governance policies that companies can implement to help avoid costly penalties and investigations.

Case questions address FCPA bribery, accounting and internal control provisions, 10-K filings, red flags indicating bribery (warning signs), and auditor's responsibilities in uncovering illegal acts.

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* Corresponding author. Tel.: +1 216 875 9711; fax: +1 216 687 9212.

E-mail addresses: m.holtzblatt@csuohio.edu (M. Holtzblatt), ntschakert@salemstate.edu (N. Tschakert).

¹ Tel.: +1 978 542 6627; fax: +1 978 542 6027.

1. Introduction

Put yourself into the position of a new member of the Baker Hughes audit committee. The audit committee is crucial to the governance of Baker Hughes through its monitoring of the financial accounting, reporting, and internal control processes of the company. Your new responsibilities require you to assess numerous risks and to evaluate control activities. The audit committee's responsibilities also include: reinforcing and monitoring external audit quality; monitoring the effect of the business and regulatory environment on Baker Hughes' compliance program; and ensuring that internal audit is properly focused on key areas of risk ([KPMG Audit Committee Institute, 2012](#)). One important area of risk is the risk of corruption, including that related to the Foreign Corrupt Practices Act (FCPA):

Audit Committees are often directly involved in assessing whether management has developed and is maintaining an effective compliance program to address corruption risk . . . While recent trends suggest that FCPA enforcement has increased, guidance from regulators has provided clarity regarding proactive steps companies can take to mitigate their corruption exposure. An effectively designed, implemented, and managed compliance program tailored to a company's specific risk areas is paramount. The audit committee plays an integral role in confirming these objectives are met ([Deloitte, 2013](#)).

Baker Hughes is a Texas-based public company that helps the oil and gas industries develop their reservoirs. Baker Hughes has 58,000-plus employees in more than 80 countries ([Baker Hughes Inc., 2013](#)). In 2007, Baker Hughes rose to the top of an exclusive list, but obviously not one that it aspired to. On April 26, 2007, the company announced that:

... it was settling a federal probe alleging that it violated the Foreign Corrupt Practices Act (FCPA), and that it would pay fines and penalties in excess of \$44 million, which at the time was the largest combined punishment under the FCPA ([Baker Hughes, 2007a](#)). The company's punishment included an \$11 million criminal penalty, a \$10 million civil penalty, the requirement to disgorge almost \$20 million in ill-gotten profits and prejudgment interest of \$3.1 million. Moreover, the company reported that the five-year internal probe cost over \$50 million, involved 330 lawyers, 31 forensic accountants, the review of hundreds of thousands of pages of hard-copy documents and 1.69 tetra-bytes of electronic data (the equivalent of 90 million pages) from computers in 20 cities on four continents ([Baker Hughes Inc., 2007b](#)).

You look out upon your desk at the many documents you have collected in your desire to determine what had led to such a corporate debacle. The documents include the original court complaint of the SEC vs. Baker Hughes and Roy Fearnley, press releases, government publications, 10-K annual reports, and other materials. You want to ascertain that Baker Hughes was implementing the necessary actions to prevent such problems from recurring.

At this stage of your review of relevant documents, you had narrowed your investigation to the questionable actions of Roy Fearnley, a previously hired employee for operations in Kazakhstan. The Republic of Kazakhstan is located in Central Asia and Eastern Europe and it is the ninth largest country in the world ([Kazakhstan.com, 2013](#)). It holds 4 billion tons of proven recoverable oil reserves and is estimated to be in the top-10 oil-producing nations in the world by 2015 ([GlobalEdge, Michigan State University, 2013](#)). The website of Transparency International lists Kazakhstan as a highly corrupt country ([Transparency International, 2014](#)). You decide to first investigate the recent trend in the number of newly initiated FCPA enforcement actions and the size of penalties assessed.

2. FCPA enforcement actions and fines are increasing

The FCPA prohibits companies, employees, and agents from giving anything of value to foreign government officials in order to obtain or retain business. The law also requires public companies to maintain robust internal controls and accurate record-keeping on the expenditure of corporate

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