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Fresenius Medical Care: A Case Study on the FCPA

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Introduction

Fresenius Medical Care AG and Co. KGaA (FMS) is the leading provider of dialysis products and services in the world. As of December 2018, there were over 112,658 Fresenius employees caring for 333,331 patients in 3,928 dialysis centers (FMC, 2018a). In additional to dialysis treatment, it offers related laboratory and diagnostic services, patient support services such as clinical monitoring and follow-up assistance, delivery of supplies, and dialysis services to patients hospitalized with end-stage renal disease. Fresenius also develops, manufactures and distributes products for dialysis to patients, treatment centers, hospitals and independent distributors.

The company is headquartered in Bad Homburg, Germany and trades on the Frankfurt Stock Exchange. FMC has North American headquarters in Waltham, Massachusetts and lists shares on the New York Stock Exchange as American Depositary Receipts (ADRs). As an ADR, FMC is subject to additional regulations and monitoring in order to comply with Sarbanes-Oxley and portions of the NYSE Corporate Governance Rules. Additionally, because FMC operates in healthcare services and products, it is subject to extensive governmental regulations, including the safety and efficacy of pharmaceuticals, regulatory oversight of clinical research and development, product and regulatory approvals, facilities operation and licensing, product labeling, advertising and promotion, compliance with drug regulations, the collection, dissemination and use and privacy of protected health information, and many others.

In 2018, FMC reported almost $19 billion in revenues and $1.58 billion in net income (applying the euro/U.S. dollar exchange rate at 12/31/18). FMC is organized on a decentralized basis and divided into the regions North America, Europe, Middle East and Africa, Asia-Pacific and Latin America. North America represents its most important region in terms of revenue (FMC, 2018a).

Foreign Corrupt Practices Act Background

The Foreign Corrupt Practices Act (FCPA) of 1977 is a U.S. federal law targeting international corruption consisting of two parts: (1) anti-bribery provisions and (2) accounting provisions. The FCPA was enacted after the SEC discovered widespread global corruption involving over 400 U.S. companies paying hundreds of millions of dollars overseas.

The anti-bribery provisions restrict payments (or promises to pay or authorizing the payment of money/anything of value) to foreign government officials (or political parties, candidates running for office, etc.) in order to obtain or retain business. The payment, offer or promise to pay must be made "corruptly", meaning that the intent is to wrongly influence the recipient to misuse his/her power or position (DOJ and SEC, 2012).

The accounting provisions impose requirements for books and record keeping, as well as additional internal controls requirements, designed to make it harder for companies to conceal or disguise illegal payments (SEC, 2019c). Because investors rely on reported financial statements, the accounting provisions are intended improve corporate disclosures by strengthening the accuracy of the books and records, as well as the reliability of annual audits. The accounting provisions are not just limited to FCPA violations, they are applicable to all public companies and "… form the backbone for most accounting fraud and issuer disclosures cases brought by the DOJ and SEC" (DOJ and SEC, 2012). Both the anti-bribery and books and records provisions of the FCPA apply to all persons in the U.S. as well as all companies trading securities on a U.S. stock exchange (for example, an American Depositary Receipt representing the shares of a foreign corporation).

FCPA violations can lead to civil enforcement actions from the Securities and Exchange Commission (SEC), civil or criminal enforcement actions from the Department of Justice (DOJ), or the two agencies can choose to work together in

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a joint enforcement action. Detection and enforcement of FCPA violations has been prioritized by both agencies, with each maintaining a specialized FCPA Unit dedicated to this specialized and complex area. Both agencies report similar enforcement statistics. From 1977–2018, 92% of defendants have settled FCPA actions with the SEC, and 73% with the DOJ (Stanford, 2019).

In 2017, the DOJ launched a Pilot Program in the Fraud Section's FCPA Unit to encourage more companies to self-report in exchange for prosecutorial declinations and reduced penalties (DOJ, 2016). After the Program ended, the DOJ announced it would revise and permanently include the core components of the Pilot Program in the U.S. Attorneys' Manual. These adjustments to the FCPA Corporate Enforcement Policy are expected to "… incentivize responsible corporate behavior and reduce cynicism about enforcement (DOJ, 2017).

Healthcare Industry

One area that has been identified as a hotspot for FCPA violations is the healthcare industry. Healthcare companies make up the third highest number of violations since the FCPA was enacted in 1977, trailing behind only Oil and Gas, and Industrial Goods (Stanford, 2019). Additionally, many of the U.S. government's efforts to fight foreign corruption in healthcare make headlines because these companies are typically large and publicly traded.

Corruption in the healthcare sector is especially egregious, since the outcomes affect the health and wellness of individuals, and may be the difference between life and death. Additionally, fights against certain diseases (HIV/AIDs, cancer, etc.) can attract massive amounts of funding, providing opportunities for misuse.

The complication of the healthcare systems provide a mix of incentives that can lead to various forms of corruption, including corruption in procurement (of goods, services, contractual standards, healthcare building and construction, expensive technologies, etc.), corruption in payment systems (illegal billing practices, offering kickbacks, performing unnecessary procedures, etc.), corruption in the pharmaceutical supply chain, and corruption at the point of health service delivery (Transparency International, 2006).

According to Transparency International, a non-profit that publishes the annual Corruption Perceptions Index, corruption in the health sector costs hundreds of billions of dollars each year (2006). Quantifying corruption in healthcare is particularly difficult, since many cases can be classified as clinical errors or honest mistakes. Additionally, there are many conflicts of interest between physicians and the healthcare industry, leading to a lot of gray areas that may or may not be considered corruption.

Case Information

In 2012, FMC became aware of allegations that certain conduct in countries outside of the U.S. might violate the FCPA or other anti-bribery laws. The company conducted investigations and voluntarily self-reported this information to the SEC and DOJ.

In 2019, FMC resolved the joint investigation by agreeing to pay $231 million to the DOJ and SEC for violations of the FCPA in connection with its involvement in corrupt schemes in numerous foreign countries to win or retain business. The misconduct was widespread, taking place in 13 countries and allowing the company to benefit from over $135 million (SEC, 2019a). The DOJ non-prosecution agreement and SEC administrative order provide more detail on the improper practices alleged over the period 2009–2016 and are summarized below.

Angola

FMC operated in Angola through a wholly owned subsidiary, FMC Angola, and began selling its products there in 2008, despite having circulated a report that raised several red flags about corruption in the region. Between 2010–2014 FMC entered into an illegal business arrangement with a high- ranking military officer in the Medical Services Divisions of the Angolan Armed Forces and a prominent doctor at several state-owned hospitals in the region. FMC provided these individuals a 35% ownership stake in FMC Angola. This joint venture[1] was used as a mechanism to pay the corrupt doctors (SEC, 2019a).

During the same period, FMC Angola also entered a business relationship with family members of the Military Officer for warehousing storage services. Over $500,000 was paid for "temporary storage" services that never occurred and

[1] A joint venture is a business arrangement in which two or more parties "join forces" to undertake a specific task.

lacked a contract. Additionally, FMC Angola entered into a contract with the company for warehousing storage for $77,300 per month, despite the fact that FMC already had an existing lease agreement for the same service in place, for one-third of the cost. In 2012, an internal audit report flagged this third-party relationship, but senior management continued to make payments until July 2013, when FMC Legal and Compliance concluded there were serious issues present.

Sham contracts were also used to funnel illegal payments to other doctors and government officials in the region. These contracts were signed with no attorney review, no due diligence performed and no documentation. As a result of the corrupt behavior in the region FMC benefitted by over $12.6 million (DOJ, 2019a).

Saudi Arabia

FMC benefited by more than $40 million resulting from corrupt schemes in Saudi Arabia. These schemes included improper payments, sham consulting agreements, improper travel, entertainment and gifts. FMC did not have a compliance officer assigned to the region, despite the ongoing investigations of corruption in several other countries.

From 2007–2012, a wholly owned distributor of FMC (Saudi Advanced Renal Services) made more than $4.9 million in improper payments to publicly employed doctors, government officials and other high-ranking individuals in order to expand its market share in the region. The Saudi Advanced Renal Services General Manager masked these payments as false invoices and unsupported marketing and travel expenditures. Illegal payments were also made to those acting in an official capacity for the Kingdom of Saudi Arabia when government was reviewing, selecting and approving its dialysis products and vendors. These payments were concealed through a check-writing scheme, in which the General Manager wrote checks to Saudi Advanced Renal Services employees that were then cashed and handed back to the GM. FMC improperly recorded these transactions as “Project Marketing Expenses” and “Collection Commissions” when the books and records were consolidated (DOJ, 2019a).

FMC continued to make and hide corrupt payments in the region through a variety of other methods. Influential doctors, including two high-ranking officials at Saudi Technical Organization and the CEO of a charity established by a senior Saudi Official, received payments through sham consulting contracts and commission agreements, with no evidence of service provided. Likewise, improper gifts were given and travel expenses with no business purpose were covered (SEC, 2019a).

Saudi Advanced Renal Services employees also made over $1.76 million in payments to Saudi customs officials in order to clear shipments more quickly or to avoid penalties and fees. These payments were funneled through a third-party freight company and were mischaracterized as “handling charges” or “miscellaneous expenses” (DOJ, 2019a). These various bribes and improper payments were falsified in FMC’s accounting records to conceal their true nature.

Morocco

From 2006–2010, FMC obtained and retained business in Morocco by paying bribes to a Moroccan Official who was also a prominent doctor at two state-owned military hospitals. FMC entered into a sham marketing agreement with the Moroccan Official to secure a business advantage by paying commissions on annual contracts with the hospitals. Some of the illegal payments were disguised as backdated bonus payments and funneled through FMC managers with bank accounts in other countries. The FMC managers would retrieve the funds from their foreign banks and pass the money along to the Moroccan official. Other payments were falsely recorded as commissions in FMC’s books and records.

A separate Moroccan agent was also bribed to obtain a hospital contract and the payments were falsely recorded as marketing expenses. Overall, in Morocco more than $3 million in revenue was earned from the corrupt projects (SEC, 2019a).

West African Countries

From 2007–2016 the same FMC senior official who arranged the bribes in Morocco engaged in similar corrupt activity to win and retain business in West Africa in eight countries: Gabon, Cameroon, Benin, Burkina Faso, Chad, Ivory Coast, Niger and Senegal. Business was obtained or retained through several fraudulent practices, including entering into sham consulting arrangements with government hospital executives, paying kickbacks for dialysis kits sold in public hospitals, concealing payments through third parties, and concealing payments through a third-party distributorship.

Throughout this period, FMC’s books and records lacked appropriate support for these transactions, and accounting records were frequently falsified. Despite many red flags, the legal, compliance and internal audit functions failed to detect and/or prevent the fraudulent behavior. As a result of the illegal arrangements, FMC benefited over $56.7 million (DOJ, 2019a).

Turkey

In Turkey, between 2005–2014, FMC entered into joint ventures with four publicly employed Turkish doctors that had strong relations with state hospitals and agreed to direct patients to FMC Turkey clinics. The doctors did not pay any capital in exchange for the shares. For example, one of the Turkish doctors, who also worked as a professor at a public university, was provided with 35% of the joint venture shares for FMC Turkey (valued at approximately $74,000) and when the joint venture was recapitalized, FMC paid the doctor $356,000 for those same shares. In a second example, in June 2012, FMC entered into a joint venture with a Turkish doctor and paid the initial capital contribution of 20% (valued at $111,000). In August 2012, FMC agreed to purchase the doctor's interest, with the understanding that the doctor would double the number of patients being treated at the clinic. Ultimately, in 2014 FMC purchased the doctor's stake in the joint venture for $451,000 (DOJ, 2019a).

Unlike some of the other regions, FMC's corrupt behavior in Turkey was intentional and premeditated. The SEC administrative order DOJ non prosecution agreement contain details from internal e-mails, meetings, and other communications discussing the specifics of the business in Turkey. In 2007, an executive presentation included a proposal to increase patient volumes and growth by paying salaries/bonuses to publicly-employed doctors and/or entering into joint ventures with the doctors in exchange for increasing patient volumes and growth. Other e-mails document FMC executives questioning and justifying the financing of the joint ventures. It is clear the corrupt behavior in Turkey was well known, and that FMC Turkey failed to maintain a basic compliance and anti-corruption program or reasonable internal accounting controls.

Spain

From 2007–2014, FMC Spain made payments to publicly employed healthcare professionals in exchange for advanced information about public tenders in which it was competing for. Several of these bids were awarded to FMC Spain. The payments were made to influential doctors through several channels, including sham consulting agreements, gifts and travel, and donations to fund projects (DOJ, 2019a).

FMC also provided financial incentives to doctors treating patients in exchange for referring patients to FMC clinics. In other cases, Spanish doctors were incentivized to use more expensive FMC products. The improper payments were made indirectly through consortiums owned by the doctors, business acquisitions, or other contractual agreements. Overall, FMC Spain benefitted by over $23.8 million from the various schemes (SEC, 2019a).

China

In the Asia Pacific region, FMC maintained a separate dialysis service brand called Nephrocare. The Nephrocare clinic business provided bonus payments to publicly employed doctors that had supply agreements with FMC China. These doctors were influential in clinic procurement decisions and e-mails between FMC employees implied the purpose of the bonus payments was to sway clinic decisions, such as the number of treatments provided or the number of new patients treated. The bonuses were paid out when FMC China received its payments from hospitals for purchases. Bonus payments were generally recorded as "center marketing fees" and the problematic nature of this record keeping appeared to be known to employees. In 2014, an internal audit report noted that questionable payments were being made to a third-party agent without corresponding reports showing proof of service, so FMC China stopped making payments through the third party. Between 2007-2014, FMC China benefited by over $10 million from these illegal tactics (SEC, 2019a).

Balkan Region

Between 2007–2014 FMC engaged in improper conduct in the Balkan region, making illegal payments to doctors and government officials in Serbia and Bosnia. In Serbia, FMC made payments to publicly employed doctors and funded side trips and extra accommodations. It also paid over $1 million to expedite the clinic privatization process for dialysis clinics and circumvented paying import taxes. The payments to doctors were first made through a Serbian Agent (which FMC Compliance prohibited) and then through a third-party transport vendor. FMC Serbia senior managers were involved in drafting the quarterly reports required to support the payments.

In Bosnia, FMC paid two healthcare professionals to win a government bid to establish and operate clinics. Despite written report that included the phrase, “removing all problems regarding the tender in Brcko”, there was no investigation into the payments. FMC benefitted by more than $10 million from the illegal conduct in this region (SEC, 2019a).

Mexico

In Mexico, FMC colluded to increase the price per dialysis kit for a tender with Mexico’s state-run social insurance agency. In January 2010, FMC Mexico was awarded part of a government tender at an agreed-upon reimbursement price. In December of that year, the CFO of FMC Mexico executed a retroactive contract with the state-run insurance agency agreeing to pay a commission of $0.40 per treatment performed on patients in 2010 and $0.20 per treatment in 2011. FMC’s internal audit department flagged this transaction and identified several issues relating to the payments. FMC benefitted by over $2 million from this conduct.

Resolution

In 2012, an anonymous whistleblower contacted FMC managers and board members, alleging that certain conduct occurring in Latin America violated the FCPA and anti-bribery laws. An investigation was launched after the tip was received and FMC voluntarily disclosed its findings to the DOJ and SEC (FMC, 2018b).

Ultimately, FMC was able to reach an “agreement in principle” with the U.S. authorities; the DOJ action was resolved through a non-prosecution agreement, requiring FMC to pay a criminal penalty of $84.7 million, and the SEC action was resolved through an internal administrative order, requiring FMC to pay $147 million in disgorgement and interest. As part of the settlement FMC has admitted responsibility for willfully violating the FCPA and agreed the facts described by the DOJ and SEC are true and accurate (DOJ, 2019a). The DOJ found FMC did not qualify for a prosecutorial declination due to several aggravating factors: 1) the company failed to respond timely and/or failed to provide full responses to requests for information, 2) the extensive geographic scope of the violations (13 different countries) and corresponding amount of illegal profits, and 3) the company has not yet tested the effectiveness of the improvements made to compliance programs (DOJ, 2019b).

The SEC also found that, “Despite known red flags of corruption since the early 2000s, Fresenius failed to take basic steps such as providing anti-corruption training or performing due diligence on its agents” (2019b). FMC failed to devote sufficient resources towards its internal accounting controls and compliance programs, which allowed the misconduct to continue undetected for years.

As a result of the investigations, FMC enhanced and committed to continue augmenting its compliance program and internal controls. Business relationships with distributors and third parties that participated in the fraud schemes were terminated, and FMC agreed to improve controls on the selection of and due diligence relating to third parties. Additionally, at least ten employees involved in the misconduct were terminated, asked to leave, or voluntarily left the FMC (DOJ, 2019a).

As part of the settlement, FMC is required to engage an Independent Compliance Monitor to assist with its remediation efforts for at least two years. The Monitor is required to have expertise relating to the FCPA, as well as the experience in the design and review of corporate compliance policies, procedures, practices, internal accounting controls, recording keeping, SOX controls and financial reporting processes (SEC, 2019a). FMC is required to fully cooperate with and retain the Monitor for at least two years. Besides providing additional oversight, the Monitor will make recommendations designed to improve the effectiveness of FMC’s policies and procedures as they relate to the above areas. In particular, the Monitor will conduct an initial review of the policies and procedures at FMC and prepare a written Work Plan, to be submitted to the SEC, documenting remediation recommendations. If the policies and procedures and FCPA compliance program are reasonably designed and implemented to detect violations, after the two-year period is completed, the monitor will certify compliance with the SEC administrative order. If FMC fails to comply with the Monitor, the monitoring period will be extended.

Aftermath

After announcing the $231 million settlement with the DOJ and SEC to resolve the FCPA allegations, Fresenius experienced a public rebuke from investors. At the annual meeting, the approval rate for management’s performance was only 56.81%, with the U.S. proxy advisor Institutional Shareholders Services (ISS) even recommending investors vote against approving the actions of Fresenius management (Reuters, 2019). The vote exemplifies current investor sentiment as shareholders of public companies increasingly demand improvements corporate governance and oversight.

FMC has made several improvements in the area of anti-bribery and anti-corruption (ABC) compliance to ensure that future business opportunities do not violate regulatory obligations (or regional laws), starting with the "tone at the top". A global Chief Compliance Officer, responsible for the worldwide compliance organization with respect to anti-bribery and anti-corruption, was appointed and reports directly to the CEO and regularly provides updates to the Audit and Corporate Governance Committee (SEC, 2019a).

FMC retains local and regional compliance officers and maintains a Compliance Action Line for employees to (FMC, 2019b). It also revised its anticorruption policies, including an extensive Code of Ethics and Business Conduct that applies to all officers, directors, employees, contract workers and agents in all business sections globally. The Code of Ethics is publicly available and easily accessible (FMC, 2019b). Additionally, FMC drafted and implemented principles for all third parties acting on its behalf, including agents, resellers, distributors, consultants, joint venture partners, etc. (FMC, 2019c). Other areas of enhancement in the Compliance Program are increased training for employees, corrective action for failure to follow policies, and improved internal monitoring and review of the compliance procedures.

For its internal audit function, FMC enhanced its controls relating to compliance and international bribery laws. In 2019, its Internal Audit departments performed "… numerous compliance-related audits at Fresenius and in the business segments across the world, which also included audit steps relating to corruption, antitrust law, data protection and IT security". In 2019, the Global Internal Audit department performed 45 audits (FMC, 2019(a)). Additionally, the effectiveness of the internal control system, risk management and internal audit systems fall under the review of the settlement-mandated corporate Monitor. From a review of the most recent annual report (2019) it appears at least some of these changes have been effective. For the first time in five years, FMC identifies a material weakness in its internal controls for revenue recognition for determining the transaction price for certain revenue arrangements and the timely adjustment of the variable compensation when new information is received. The control deficiency did not result in a material weakness, but its detection, disclosure and potential mitigation show commitment on the part of FMC to improving internal compliance and adhering to the SEC-DOJ settlement agreement.

In addition to the above compliance enhancements, FMC announced in 2018 that it would be changing its external auditing firm starting with the financial year 2020 (FMC, 2018c). KPMG was the longstanding auditor, having performed the audit for the past decade. However, the auditor change coincided with mandatory auditor rotation rules in the European Union and KPMG was never named in any of the investigations or litigation against FMC. PwC was recommended and appointed by FMC and will serve as the new principal auditor for the year ending December 31, 2020.

The FMC FCPA case is unique in both its breadth and depth. The illegal payment schemes were many and varied, including some "new" variations not seen previously, and the corruption extended over a ten-year period. FMC managers and employees were able to circumvent internal controls and continue paying bribes despite many flagged transactions and policies, demonstrating the evolution of corruption in several countries over a decade.

Discussion Questions

1. The corruption at FMC was extensive, extending across multiple countries for almost ten years. Briefly summarize the illegal behavior and explain how it violates the dual provisions of the FCPA.
2. Describe how the three elements of the fraud triangle (opportunity, pressure/incentives and rationalization/attitudes) were present in at FMC.
3. One of the novel components of the fraud scheme was the use of joint ventures to disguise illegal payments. Explain how corrupt JVs were used in Angola and Turkey.
4. From 20072016, numerous red flags were raised at FMC by internal audit teams, legal counsel, management, and others. Describe some of these instances and FMC's response.
5. How much did regulators estimate FMC was able to benefit from the illegal conduct and how does it compare to the SEC and DOJ fines? Who was ultimately hurt and who ultimately benefitted from the illegal actions?
6. Explain some of the negative consequences FMC faced resulting from the FCPA violation (aside from the SEC/DOJ fines).
7. Despite the vast scope and length of the corruption, FMC was able to obtain a non-prosecution agreement. How was it able to cooperate with the DOJ/SEC?
8. List some of the remediation efforts taken by FMC. What changes have been implemented to promote compliance with the FCPA and other anti-corruption laws?
9. In addition to the financial penalties, FMC agreed to retain an independent compliance monitor. Explain this part of the settlement.
10. Two types of fraud are relevant for auditor consideration during financial statement audits (AS 2401): fraudulent financial reporting and misappropriation of assets. Which of these is applicable in the case of FMC?
11. What audit firm was responsible for the annual audit? What is the role of the external auditor in the detection/prevention of this type of fraud?
12. Describe some of the ethical issues faced by FMC employees over the course of the fraud. Do you think these issues had an effect on employee performance, satisfaction, or retention?
13. What options are available to employees who want to report suspected misconduct and how does FMC ensure they are aware of these options?

Exhibit 1

Learning Objectives	**Discussion Questions**
(1) Students will explain the two provisions of the FCPA and describe how FMC violated these provisions.	Q(1); Q(3)
(2) Students will identify how the fraud triangle applies to FMC in various countries.	Q(2)
(3) Students will understand the importance of implementing and maintaining a system of internal controls in connection with the prevention and detection of fraud.	Q(4)
(4) Students will identify the negative consequences associated with FCPA violations.	Q(5); Q(6)
(5) Students will describe the remediation efforts taken by FMC in order to promote compliance with the FCPA and other regulation.	Q(7); Q(8); Q(9); Q(13)
(6) Students will research and identify regulatory guidance provided for auditors as it relates to fraud.	Q(10); Q(11)
(7) Students will identify ethical issues arising in the case and discuss the importance of ethics in accounting.	Q(5); Q(12)

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