The Biomet SEC Complaint: Lessons for Internal Audit

On March 26, 2012, both the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) announced the resolution of enforcement actions against Biomet Inc. a US entity, which manufactures and sells global medical devices around the world. It is headquartered in Fort Wayne, Indiana. The Company admitted to a lengthy run of bribery and corruption of doctors to purchase its products. The FCPA Blog reported that the "company will pay a criminal fine of $17.3 million to resolve charges brought by the DOJ. It also agreed with the SEC to settle civil charges by paying $5.5 million in disgorgement of profits and pre-judgment interest." In this post I will review the SEC Complaint and discuss the facts it posited regarding the Company's internal auditors to draw out some lessons for an Internal Audit Department's role in Foreign Corrupt Practices Act (FCPA) compliance programs.

Bribery and Corruption Facts

The Company engaged in an eight (8) year scheme to bribe and corrupt doctors in the countries of Argentina, Brazil and China to induce the physicians to purchase Biomet products. The SEC complaint reported that "2000 to August 2008, Biomet Argentina employees paid bribes to doctors employed by publicly owned and operated hospitals in Argentina in exchange for sales of Biomet's medical device products. The doctors were paid approximately 15-20 percent of each sale." In Brazil, the SEC Compliant reported that from 2001 until 2008, Biomet's "Brazilian Distributor, paid bribes to doctors employed by publicly owned and operated hospitals to purchase Biomet's implants. Brazilian Distributor paid the doctors bribes in the form of "commissions" of 10-20 percent of the value of the medical devices purchased." In China, Biomet subsidiaries and its Chinese distributor paid from 5% up to 25% commissions to doctors for the sale of its products which were used during surgeries and also paid for Chinese surgeons to travel for training "including a substantial portion of the trip being devoted to sightseeing and other entertainment at Biomet's expense."

Biomet Bribery Box Score

Country	**Bribe Rate**	**Total Amount Paid**	**Loss or Write Off**
Brazil	10 to 20%	$1.1	$4.2MM
China	5 to 25%	Not reported	Not reported
Argentina	15 to 20%	$466,000	Not reported
Costs			**Fine or Profit Disgorgement**
DOJ Fine			$17.3MM
SEC Profit Disgorgement			$5.5 MM
Documented Cost			$29.7 MM

Internal Audit

The SEC Compliant reported that the Company's Internal Audit was not only aware of the bribery program but discussed it in Memorandum to the Company's home office, including the head of the Company's Internal Audit Department. For instance in Argentina, the Company's head of Internal Audit noted, as early as 2003, "circulated an internal audit report on Argentina to Senior Vice President and others in Biomet in Indiana in which he stated, "[R]oyalties are paid to surgeons if requested. These are disclosed in the accounting records as commissions." The internal audit report described the payments to surgeons, but only in the context of confirming that the amount paid to the surgeon was the amount recorded on the books." However, the Company's Internal Audit Department, took no steps to determine why royalties were paid to doctors or why the payments to the doctors were 15-20% of sales. Internal Audit did not obtain any evidence of services which the doctors might have performed entitling them to the payments. The SEC Complaint noted that Internal Audit "concluded that there were adequate controls in place to properly account for royalties paid to surgeons without any supporting documentation" and Internal Audit's only "recommendation was to change the journal entry from "commission expenses" to "royalties."

Biomet's Director of Internal Audit is reported to have "instructed an auditor to code improper payments being made to doctors [in China] in connection with clinical trials as "entertainment." The Director of Internal Audit also reported that Biomet's "Brazilian Distributor makes payments to surgeons that may be considered as a kickback. These payments are made in cash that allows the surgeon to receive income tax free . . . . In the consolidated financials sent to Biomet, these payments were reclassified to expense in the income statement."

The SEC Complaint also noted that "Biomet's books and records did not reflect the true nature of those payments. The Company's payments were improperly recorded as "commissions," "royalties", "consulting fees", "other sales and marketing", "scientific incentives", "travel" and "entertainment." The SEC Compliant concluded with the following "False documents were routinely created or accepted that concealed the improper payments."

Lessons Learned for Internal Audit

The SEC Complaint had some very clear guidance for the role of Internal Audit in detecting bribery and corruption in a *best practices* FCPA compliance program. First and foremost, if there are any types of commission payments being made, Internal Audit needs to review the documentation supporting why such payments are being made. A review of contracts or other legal requirements which may obligate a company to make such payments should be a basic undertaking in any internal audit. After an internal auditor has determined if commission payments are legally authorized, the internal auditor should review evidence that such commission payments have been earned. In other words, is there any evidence in the company's books and records that the person or entity performed services which might have entitled them to such commission payments?

Another role delineated in the SEC Complaint for Internal Audit is to correctly classify payments so that the books and records of the company accurately reflect them as expenses. As noted, the Director of Internal Audit instructed that bribes paid during clinical trials of the Company's products should be reclassified as 'expenses'. Further, while specifically stating that Biomet was assisting Brazilian physicians to evade the payment of taxes on income, he directed that such bribes be classified on the Company's books and records once again as 'expenses.'

Of course the costs in the Bribery Box Score listed above does not reflect the 3+ years of investigative costs, loss of sales in the three countries which it pulled out from or the anticipated cost of its upcoming three year monitorship. All I can say with certainty is that the cost for non-compliance is much higher than the cost of complying with the FCPA. The SEC Compliant gives clear guidance from what it expects from internal audit in a FCPA compliance program. I recommend that these steps be implemented much sooner rather than later.