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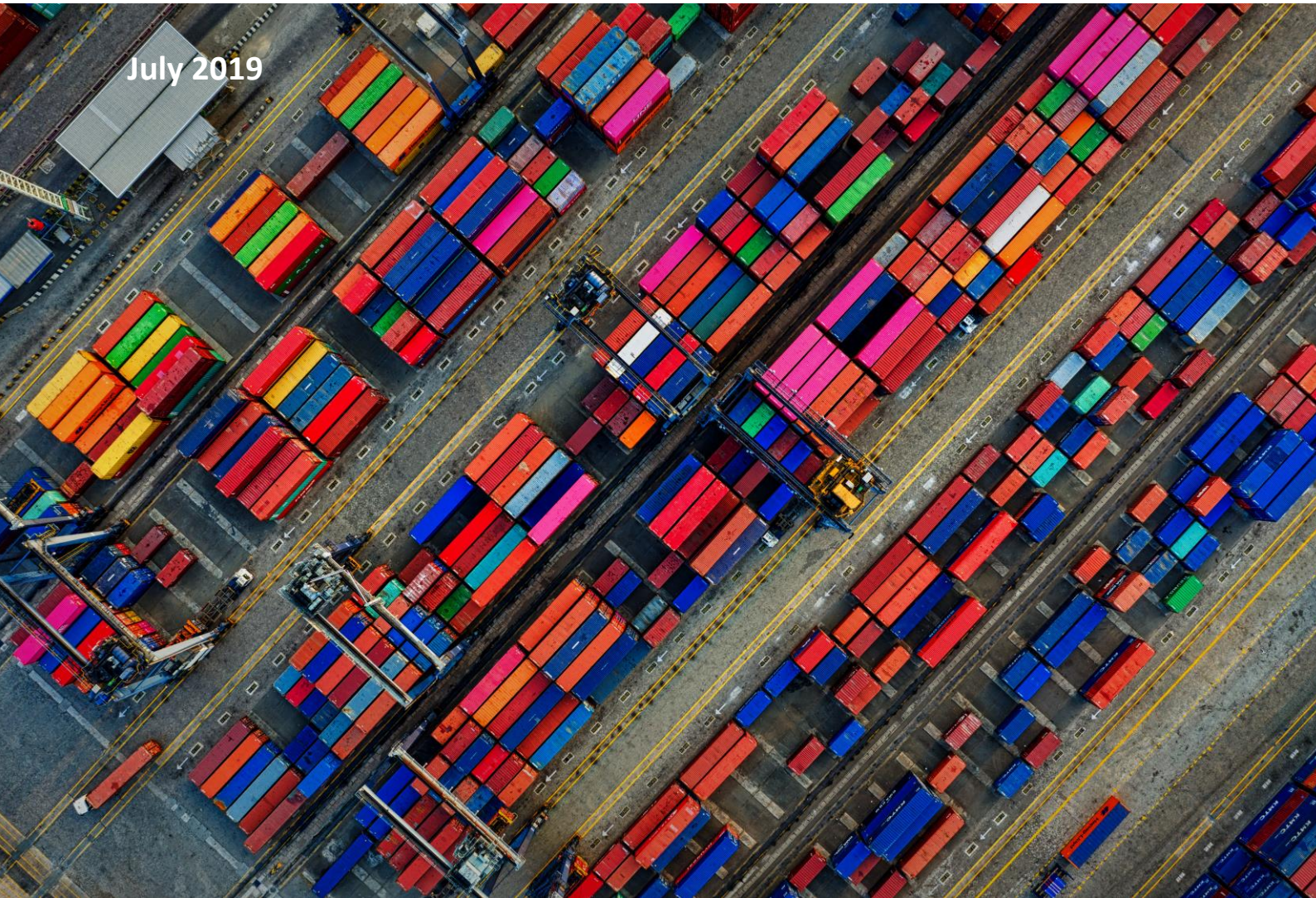
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PSA BRIEF:

SUPPLY CHAIN DUE DILIGENCE AND OFAC

July 2019



Supply Chain Due Diligence and OFAC

On January 31, 2019, the US cosmetics company, e.l.f. Cosmetics, Inc. (“ELF”), agreed to a USD 996,080 settlement for 156 apparent violations of North Korea Sanctions Regulations. ELF received 156 shipments of false eyelash kits from two Chinese suppliers which contained materials sourced from North Korean companies. From April 1, 2012 to January 28, 2017, the total value of these shipments was USD 4,427,019.

ELF’s 2016 reported revenue was over USD 229 million. Considering the total value of the shipments spanning almost five years was less than USD 4.5 million, these shipments make up an extremely small part of the company’s overall business. This shows that the Office of Foreign Assets Control (OFAC) is prepared to penalize companies, even if they themselves do not directly violate sanctions. Companies are also required to ensure all their suppliers and affiliates are compliant.

OFAC reported that at the time of the violations, ELF’s OFAC compliance program was either inadequate or did not exist. ELF’s supply chain review efforts focused on assessing quality assurance issues related to the production process, raw materials, and the end product. In January 2017, the company discovered that most of these shipments of false eyelash kits, which started in April 2012, contained materials sourced from North Korea. According to OFAC’s Economic Sanctions Enforcement Guidelines, the civil monetary penalties for these apparent violations are between USD 2,213,510 and USD 40,833,633.

Penalty Explanation

OFAC’s penalty was reduced because ELF voluntarily self-reported these apparent violations. Additionally, OFAC reported that ELF’s employees appeared to not have any knowledge of the apparent violations, and the associated product does not appear to be a significant part of ELF’s business.

Since self-reporting the apparent violations, ELF instituted a compliance program to mitigate similar future risks. The company has implemented supply chain audits which aim to verify the origin of products and services that are used in the company’s products. ELF will require their suppliers to sign compliance certificates stating their adherence to all US trade sanctions and export controls. ELF has conducted an advanced supplier audit and hired outside counsel to provide US laws and regulations training for key ELF employees in the US and China. Similar trainings were also expanded to include ELF’s Chinese suppliers.

OFAC

OFAC, an agency within the US Treasury Department, administers and enforces US imposed economic and trade sanctions which are primarily against countries and groups of individuals, including terrorists and narcotics traffickers. If an entity is found to have violated US sanctions, OFAC is able to levy large penalties, including imposing fines, freezing assets, and banning entities from operating within the US.

OFAC publishes a list of entities that US citizens are prohibited from doing business with; the Specially Designated Nationals (SDN) list – which includes companies, organizations, individuals, and vessels.

China's Involvement

This case is significant as it gives insight into OFAC's current priorities. While OFAC tends to focus its investigations on US banks and institutions, this recent shift signals the increasing importance for companies to be OFAC-compliant. Additionally, this case shows the necessity for a thorough due diligence program, especially regarding international suppliers. The importance lies, not only with conducting due diligence for every potential supplier, but also each supplier's affiliates and business partners. In ELF's case, OFAC highlights that a more robust program might have prevented these apparent violations altogether.

The obligation for a comprehensive supply chain due diligence program goes beyond the risk of OFAC violations. ELF's supply chain review efforts monitored product quality; however, even for quality assurance purposes, it is essential to conduct all-encompassing and recurring supply chain audits in order to understand all risks (not just quality-related) associated with suppliers – as well as suppliers' networks.

Significance of This Case

Given the possibility of future litigation or regulatory action in a whistleblower case, an outside investigator must have a strong focus on the clean collection of evidence and testimony. Investigators should always be knowledgeable about local laws regarding what kinds of evidence or testimony are admissible in court, and what steps for preservation and documentation of evidence are required.



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