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A REVIEW OF ACTIONS BEING
TAKEN IN THE UNITED STATES TO CONTROL
QUESTIONABLE CORPORATE PAYMENTS

PAPER PRESENTED BY
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DLG 04395



Over the past few years many American corporations have disclosed payments made to government officials of other countries, their political parties or others to obtain business advantages. The payments usually were made as petty corruption to facilitate favorable action, to gain competitive advantage over others, or because of extortion by corrupt officials or their agents.

Some corporations are said to have falsified their records, lied to auditors, used off-the-books or "slush" funds and, in some cases, illegally deducted on their Federal income tax returns, to reduce their taxes, the improper foreign payments as normal and necessary business expenses.

These revelations have had a political impact in those other countries concerned, have diminished the international

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stature of multinational corporations, and have undermined confidence in public and private institutions of the Western World.

In the United States as a result, there has been much scrutinizing by the Government of the behavior of American corporations to identify the form and extent of questionable or illegal payments and to determine actions necessary to discourage and prevent such payments in the future.

The United States is not alone in these efforts. Several international organizations, private institutions and many governments are taking similar courses of action. But, with the expansion of the marketplace and the resulting development of large multinational corporations, new problems have arisen which require new solutions.

ACTIONS BY THE UNITED STATES CONGRESS

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The Congress of the United States has responded vigorously to these problems with a series of actions over the past two years.

Hearings by Congressional Committees

SEN 01306

The Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee held hearings on the circumstances that led to, and the legality of, corporate payments

made outside the United States. The hearings in mid-1975 focused on questionable foreign payments by the Exxon, Gulf Oil, Mobil, Northrop, and Lockheed corporations. ^{CNG 01871} ^{CNG 01527} ^{CNG 00420} ^{CNG 01426}

The Senate Banking, Housing and Urban Affairs ^{SEN 00700} Committee held a hearing in August of that year focusing on the questionable payments by Lockheed.

In October 1975 the Subcommittee on International Trade of the Senate Finance Committee held hearings on a resolution to protect the ability of the United States to trade abroad. ^{SEN 04107} The resolution, #265, was passed by the Senate on November 12, 1975. It states that the U.S. Special Trade Representative for Trade Negotiations and other officials should start negotiations on the development of a code of conduct for international trade.

The Senate Banking, Housing and Urban Affairs Committee and the Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee held more hearings concerning Lockheed Aircraft Corporation in early 1976.

During the Banking Committee hearings, it was argued that the bribes and the question of Lockheed's ability to repay some loans, which the U.S. Government had guaranteed, were related. But Lockheed stated that its questionable

foreign payments had not involved any funds received from the loans which the Government had guaranteed.

The Subcommittee on Multinational Corporations released during its hearings many documents showing an extensive pattern of payments by Lockheed in Japan and Europe. These revelations touched off the political repercussions now familiar to us all in Japan, Italy, and the Netherlands, jeopardized some of Lockheed's foreign sales, and prompted several nations to begin similar investigations of questionable corporate payments.

^{TNT 00708}
The Subcommittee on Priorities and Economy in Government of the Joint Economic Committee held hearings in March 1976 to determine the policy of the U.S. Department of State on the issue of corporate bribery in other countries. It was announced that the United States would propose a multilateral agreement on corrupt practices before the United Nations

⇒ Commission on Transnational Corporations, DLG 05549

Meanwhile, the Senate Banking Committee completed action on a bill to deal with "corrupt overseas payments by American business enterprises" which it forwarded to the Senate itself in July 1976. The Senate passed that bill in September but it was not acted on in the House of Representatives.

The bill

- prohibited direct or indirect payments made to a foreign official to assist a company's business dealings with that government,
- requires corporations registered with the U.S. Securities and Exchange Commission to keep accurate books and records and to maintain a system of internal accounting controls to insure that management would be able to prevent future prohibited payments, and
- makes it illegal to mislead an accountant by lying or by making statements that exclude material facts.

In the U.S. House of Representatives, hearings were held on an identical bill in September 1976 by the Subcommittee on Consumer Protection and Finance of the House Commerce Committee. However, action by the House was not completed in the 94th Congress which adjourned in October 1976.

On January 18, 1977, a new Senate bill was introduced which contains, among other measures, the same provisions as the bill of the previous year. In the House a new bill also was introduced on January 10 which is identical to the one of the previous year on which action was not completed.

In still another congressional reaction, the House Subcommittee on International Economic Policy of its International Relations Committee ^{HSE01302} held hearings in 1975 and 1976 on the policy effects of corporate payments in foreign countries. Subsequently, the Committee forwarded to the House of Representatives a bill providing for the termination of investment insurance and guarantees issued to U.S. investors by the ^{AGCOO171} Overseas Private Investment Corporation--a U.S. Government corporation--where the investor makes a significant payment to a foreign government official to influence the actions of his government. The bill passed the House of Representatives in August 1976 but it was not acted on by the Senate.

On October 1, 1976, the Senate adopted Resolution 516 supporting United States participation in the Organization of Economic Cooperation and Development's "Declaration on International Investment and Multinational Enterprises." The declaration states, among other things, that "multinational enterprises should not render--and they should not be solicited or expected to render--any bribe or other improper gift, direct or indirect, to any public servant or holder of public office."

International Security Assistance and
Arms Export Control Act

A related development in 1976 was the International Security Assistance and Arms Export Control Act (P.L. 94-329), signed into law on June 30. One of its provisions requires that a report be submitted to Congress within 60 days if the President determines that officials of a foreign country receiving security assistance have obtained illegal or otherwise improper payments from an American corporation in return for a contract to purchase defense articles or services, or extorted money or other things of value in return for allowing a United States citizen or corporation to conduct business in that country. The report shall recommend whether or not the United States should continue the security assistance program for that country. In response to requirements of this act, the State Department adopted new regulations in September. These require the reporting of political contributions and fee or commission payments on foreign military sales and some foreign commercial sales.

1976 Tax Reform Act

The 1976 Tax Reform Act (P.L. 94-455) which became law in October, includes a requirement that all U.S. companies with foreign subsidiaries, report to the Secretary of the

Treasury all direct or indirect payments made to employees, officials or agents of any other government. If determined by the Secretary to be an illegal bribe, the income produced would not be entitled to any foreign tax benefits. Also, foreign bribe-produced income of a domestic international sales corporation will be immediately taxable. The House-Senate Conference Committee on the bill altered the amendment to provide that bribes paid by a domestic international sales corporation to foreign officials will be immediately taxable. Current law provides that such bribes are not deductible, but permits deferral of the tax on the money.

TASK FORCE ON QUESTIONABLE CORPORATE
PAYMENTS ABROAD

At the White House former President Ford likewise was active. He established in March 1976 a Task Force on Questionable Corporate Payments Abroad. Its purpose was to find out whether "additional avenues should be undertaken in the interest of ethical conduct in the international marketplace and the continued vitality of our free enterprise system." This task force has not released its final report, but did provide interim suggestions to the President in the spring of 1976.

In August former President Ford submitted the Task Force's proposed Foreign Payments Disclosure Act to the Congress. This legislation would require that payments made to any individual or entity in connection with an official action, or sale to or contract with a foreign government for the commercial benefit of the individual, company, or foreign affiliate, be reported to the Secretary of Commerce. By requiring reporting of all significant payments, whether proper or improper, the bill avoids problems of definition or proof of bribery and extortion. The report would be made public one year after its receipt.

However, Mr. Ford's bill did not receive serious consideration before the 94th Congress adjourned. It is expected to receive a full hearing in the present Congress, the 95th.

PROPOSED INTERNATIONAL AGREEMENT

Former President Ford also sought priority consideration for the United States' proposed international agreement on questionable corporate payments. Introduced in a United Nations Forum in March 1976, the agreement would result in an international treaty based on the following principles.

- The treaty would apply to international trade and investment transactions with governments, such as

government procurement and other governmental actions affecting international trade and investment.

- The treaty would apply equally to those who offer to make improper payments and to those who request or accept them.
- Importing governments would agree to (1) establish clear guidelines concerning the use of agents in government procurement and in other covered transactions and (2) establish appropriate criminal penalties for defined corrupt practices by enterprises and officials in their territory.
- All governments would cooperate and exchange information to help eradicate corrupt practices.
- Uniform provisions would be agreed on for requiring enterprises, agents, and officials to disclose political contributions, gifts, and payments made in connection with covered transactions.

The objective was to have the United Nations Economic and Social Council pass a resolution creating a group of experts charged with writing the text of an international treaty on corrupt practices. The Council adopted a resolution in August 1976 calling for a working group of representatives from 18 nations to complete its task by summer 1977.

UNITED STATES GOVERNMENT
AGENCIES' ACTIONS

In addition to congressional hearings and consideration of new legislation, the U.S. Securities and Exchange Commission and other Government agencies also are conducting investigations.

Securities and Exchange Commission

United States laws dealing with the buying and selling of shares or securities are designed to protect investors from misrepresentation, deceit, or other fraudulent practices by requiring public disclosure of information by those who issue shares or securities. The Securities and Exchange Commission, an independent regulatory agency in the executive or presidential branch of our Government, provides for the fullest possible disclosure to the investing public and protects the interests of the public and investors against malpractices in the securities and financial markets.

The Securities Act of 1933 requires a registration statement to be filed with the Securities and Exchange Commission before a public offering of securities. The Securities Exchange Act of 1934 requires periodic reports and proxy materials to be filed with the Commission by registered companies.

Payments to foreign officials are not specifically required to be disclosed in materials filed with the Commission pursuant to the 1933 Act or the 1934 Act. However, disclosure is required of all material information concerning registered companies and of all information necessary to prevent disclosures that have been made from being misleading. Thus, facts concerning questionable payments must be disclosed insofar as they are material.

Courts in the United States have not yet addressed the issue of whether and under what circumstances questionable payments made by a United States corporation to foreign officials would be material information which should be disclosed to the public. So far, the Commission, through its enforcement and voluntary disclosure programs, has been the sole judge of the materiality of such payments in this country.

The Commission is investigating questionable and illegal corporate payments and practices for the following reasons:

- (1) bribes and kickbacks may involve falsification of accounting records;
- (2) the securities laws require companies to disclose material facts for investors to make informed investment decisions and to assess the quality of management;
- (3) corporate management and their advisors need to become fully aware of these problems and to effectively deal with

them, and (4) to clarify its approach and authority in the area. The main thrust of the Commission's enforcement actions has been to restore the effectiveness of the system of corporate accountability and to encourage the boards of directors to exercise their authority to deal with the issue.

The Securities and Exchange Commission has taken the position that significant questionable payments or smaller payments that relate to a significant amount of business are material and are required to be disclosed. Other questionable payments may be considered material if repeatedly made without broad knowledge and without proper accounting.

As the potential magnitude of the problem became apparent, the Commission sought to encourage voluntary corporate disclosure of the questionable or illegal foreign payments. Accordingly, it advised companies with possible disclosure problems to:

- Authorize an in-depth investigation of the questionable activities by a special independent review committee.
- Request the board of directors to issue an appropriate policy statement on transactions involving illegal or questionable activities in the United States or other countries.

- Consider whether interim public disclosure of the results should be made prior to completion of the investigation.
- Report to the Commission on the final results of the investigation.

In addition, the Commission is encouraging disclosure by the companies of investigations in a current or annual report, registration statement or by some other means of reporting.

In a May 1976 report prepared for the Senate Banking, Housing and Urban Affairs Committee, the Commission made an analysis of the public disclosures of questionable foreign and domestic activities of 89 corporations. The report concluded that:

"The almost universal characteristic of the cases reviewed to date by the Commission has been the apparent frustration of our system of corporate accountability which has been designed to assure that there is a proper accounting of the use of corporate funds and that documents filed with the Commission and circulated to shareholders do not omit or misrepresent material facts. Millions of dollars of funds have been inaccurately recorded in corporate books and records to facilitate the making of questionable payments. Such falsification of records has been known to corporate employees and often to top management, but often has been concealed from outside auditors and counsel and outside directors."

This year the Commission announced on January 26 a series of rulemaking proposals designed to promote the reliability and completeness of the financial information filed to meet requirements of United States securities laws. These proposals require each issuer of securities or shares to maintain books and records accurately reflecting the transactions and dispositions of assets of the issuer and an adequate system of internal accounting controls to provide reasonable assurance that specified objectives are satisfied.

In order to protect the reliability of financial information and the integrity of the independent audit of issuer financial statements, the Commission is proposing rules to prohibit explicitly falsification of an issuer's accounting records and making false, misleading or incomplete statements by officers, directors, or stockholders to an accountant engaged in an examination of the issuer.

Although not directed solely to the problem of questionable or illegal corporate payments and practices, the Commission believes that these proposals would create a climate which would discourage serious abuses uncovered in this area.

Federal Trade Commission

Another regulatory agency, the Federal Trade Commission, is charged with keeping competition free and fair by preventing the free enterprise system from being stifled, substantially fettered by monopoly or restraints on trade, or corrupted by unfair or deceptive trade practices.

The Federal Trade Commission is trying to determine if United States' laws concerning unfair competition were violated by corporations making questionable payments. The main issue here is whether a corporation making such payments has an unfair

competitive advantage over another that does not make such payments. The Trade Commission's inquiry is the first use of our antitrust laws in combating the practice of making payoffs; no charges have yet been made by the Commission.

Internal Revenue Service

The United States laws governing taxation of business income provide that bribes and kickbacks, including payments to Government officials, made in other countries cannot be deducted in computing taxable income if the payment would be unlawful in the United States. The Internal Revenue Service in our Department of the Treasury is responsible for administering and enforcing these laws.

In April 1976, the Internal Revenue Service issued new instructions to its field offices to help uncover tax evasion and avoidance schemes involving bribes, kickbacks and similar illegal payments. These instructions will be followed in the auditing of about 1200 corporations whose gross assets exceed \$250 million. The Revenue Service's examining officers will direct a minimum of 11 specific questions to present and former officials or employees who have had sufficient authority, control or knowledge of corporate activities so as to be aware of any possible misuse of funds.

For example, one of the questions the examiner will ask is:

"* * * did the corporation, any corporate officer or employee or any third party acting on behalf of the corporation, make, directly or indirectly, any bribes, kickbacks or other payments, regardless of form, whether in money, property, or services, to any employee, person, company or organization, or any representative of any person, company or organization, to obtain favorable treatment in securing business or to otherwise obtain special concessions, or to pay for favorable treatment for business secured or for special concessions already obtained?"

Responses must be in writing and signed by the individual being questioned, either in affidavit form or as a written declaration made under penalties of perjury. If the individual refuses to answer, a summons will be issued. The managing partner of the corporation's public accounting firm also is required to attest to the affidavits submitted by selected corporate officials and key employees.

Under recent arrangements, the Revenue Service also will be examining all Securities and Exchange Commission reports for matters having tax significance.

The Revenue Service has also established procedures to improve its effectiveness in detecting the misuse of corporate funds. Included are guidelines for detecting schemes created for political contributions and bribery in the United States

and other countries. Some of these guidelines call for:

- Examining the books and records of American companies located in other countries.
- Examining international transactions of multinational corporations.
- Working to strengthen cooperative efforts with nations with whom the United States has tax treaties.

The purpose of the new instructions and guidelines is to determine whether corporations have reduced their income taxes by deducting payoffs as expenses. If the Internal Revenue Service charges a corporation with such an act, its officers may face charges of conspiring to violate tax laws, making a false return, and giving a false statement to Internal Revenue agents. If it is determined that a company has committed tax fraud, the case will be referred to the U. S. Department of Justice for prosecution in the courts.

Department of Justice

Having thousands of lawyers, investigators, and agents, this Department plays an important role in protection against corporate criminals and in maintaining healthy competition of business in our free enterprise system.

The Department's Criminal Division has formed a task force to investigate allegations of corporate foreign payments. The task force is studying available information to determine whether violations of existing criminal laws have occurred. Particular emphasis will be placed on possible violations of the mail fraud statutes, the securities laws, the Bank Secrecy Act, as well as statutes prohibiting the submission of false statements to Government agencies.

Department of Defense

Similarly, the Department of Defense has been much concerned about the possibility of questionable corporate payments made by its contractors in defense industries.

The Department's contract audit agency has been heavily involved in audits of transactions and sales agents' fees to make sure that improper and inappropriate costs are not reimbursed through Government contracts. Although the audit agency has no investigative responsibilities, it is alert to the possibility of improper transactions and maintains with its auditors a constant state of awareness. If irregular activity is found during a contract audit, the matter is referred to the Army, the Navy or the Air Force, as appropriate, or other defense agency for investigation.

ACTIONS IN THE PRIVATE SECTOR

All these actions are evidence, I believe, of commitment by the United States to maintaining a world market place more free of illegal activities and questionable moral and ethical practices than in the past. The United States Government is not alone in these efforts. Organizations in our private sector are also seeking solutions.

American Institute of Certified Public Accountants

For example, the American Institute of Certified Public Accountants issued in January 1977 two statements on auditing standards to its membership.

One statement, entitled "The Independent Auditor's Responsibility for the Detection of Errors or Irregularities," stresses that under generally accepted auditing standards the independent auditor has the responsibility to search for errors or irregularities that would have a material effect on the financial statements of the organization being audited. The statement emphasizes the inherent limitations of the audit process but also provides guidance as to procedures to follow when the auditor suspects that errors or irregularities may exist.

The other statement, entitled "Illegal Acts by Clients," provides guidelines for the auditor's conduct when acts such

as illegal political contributions, bribes, and other violations of laws and regulations are encountered during an audit. The statement emphasizes that an audit in accordance with generally accepted auditing standards cannot be expected to provide assurance that illegal acts will be detected. However, it provides suggestions on procedures for identifying illegal acts and actions to be taken by the auditor when they are suspected or found.

New York Stock Exchange

A related action was recently taken by the New York Stock Exchange. It made a rule proposal for companies with common stocks listed by it under which the companies listed by the Exchange have until June 30, 1978, to create audit committees made up of nonmanagement directors who are free of any relationship with the company. The proposed rule has been endorsed by the Securities and Exchange Commission. These independent audit committees would have as their main objective the evaluation of the corporate audit function to determine the adequacy and efficacy of accounting procedures and controls.

GENERAL ACCOUNTING OFFICE AUTHORITY
TO AUDIT PRIVATE COMPANIES

In the United States the General Accounting Office, the supreme audit institution, has legal authority to examine the books and records only of companies doing business with the Government. In the main, this authority is limited to companies holding negotiated, rather than formally advertised, contracts for supplies and services.

The governing laws are made effective by clauses that must be inserted in Government contracts. When the General Accounting Office finds violations of these laws and contract provisions in its audits of negotiated contracts, it refers the case, if it is a civil matter involving a price reduction, to the procuring agency; or, if it is a criminal violation, to the Department of Justice for investigation and possible prosecution.

An important part of the work of the General Accounting Office is evaluating the effectiveness of Government programs and activities. It is here that we can make valuable contributions by evaluating the performance of the Government agencies responsible for administering and enforcing the laws, identifying problems or weaknesses needing correction, and then recommending actions for increased effectiveness.

CONCLUSION

It will require time before all the problems relating to corporate practices of making questionable payments can be resolved. But the commitments made by our Congress and other organizations whose activities I have referred to are positive steps that I believe will take us all in the right direction.