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Payments by American corporations to foreign government officials or others to obtain business advantages have had a political impact on the countries involved and have undermined confidence in public and private institutions. In response, a series of actions were taken by the President and Congress. Findings/Conclusions: Hearings were held by congressional committees and bills were introduced dealing with: circumstances and legality of corporate payments, development of a code of conduct for international trade, and U.S. policy and criminal penalties related to corporate bribery. Laws were passed with provisions for discontinuing foreign assistance or foreign tax benefits where illegal bribes were determined. A task force, established by former President Ford, provided interim suggestions and proposed legislation with payments-reporting requirements. A proposed international agreement on corrupt practices was introduced at a United Nations forum. Actions by concerned Government agencies included enforcing securities regulations, utilizing antitrust laws, determining tax fraud; presenting criminal cases, and auditing transactions. The private sector also has been seeking solutions. GAO, in auditing negotiated contracts, generally refers violations to the
PR[illegible]. (HTW)

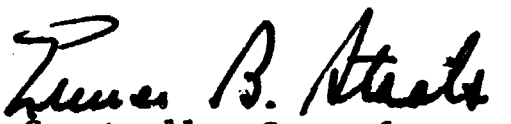
# Summary Of Actions Being Taken In The United States To Control Questionable Corporate Payments In Foreign Countries


OP-77-1

MAY 2, 1977

## FOREWORD

Much interest has been expressed in congressional hearings and in the news media about questionable foreign payments by American corporations. In addition, during General Accounting Office reviews of the implementation of the Emergency Loan Guarantee Act, several members of the Congress expressed concern with foreign sales commission payments by the Lockheed Aircraft Corporation. Because of this widespread interest, we have compiled the accompanying summary of the initiatives underway in the public and private sectors to deal with the problem of questionable foreign payment practices.



Comptroller General
of the United States

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# CHAPTER 1

## THE PRESIDENT AND THE CONGRESS RESPOND

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.

These revelations have had a political impact in those other countries concerned, have diminished the international stature of multinational corporations, and have undermined confidence in public and private institutions of the Western World.

The President and the Congress responded vigorously to the problems of questionable payments with a series of actions over the past two years.

### Hearings by Congressional Committees

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.

The Senate Banking, Housing and Urban Affairs 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. The resolution, Number 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 its Federally guaranteed loans were related. But

Lockheed stated that its 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 disclosures touched off political repercussions in Japan, Italy, and the Netherlands, jeopardized some of Lockheed's foreign sales, and prompted several nations to begin investigations of questionable corporate payments.

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.

Meanwhile, the Senate Banking Committee completed action on a bill (S. 3664) to deal with "corrupt overseas payments by American business enterprises" which it forwarded to the Senate body in July 1976. On September 15, 1976, the Senate passed S. 3664 but it was not acted on in the House of Representatives.

In September 1976 hearings were held on an identical bill (H.R. 15481) by the Subcommittee on Consumer Protection and Finance of the House Interstate and Foreign Commerce Committee. However, action by the House was not completed prior to the congressional recess in October 1976.

On January 18, 1977, a new Senate bill (S. 305) was introduced which contains, among other measures, the same provisions as the bill of the previous year. On April 6 the Senate Banking Committee reported out S. 305, which makes it a crime to offer or to pay money to a foreign government, official, politician or agent to obtain or hold business in that country, or to influence its laws. The bill also makes it illegal for a company to falsify its records to conceal such payments. In addition, it provides for fines of up to $500,000 for each violation.

In the House a new bill (H.R. 1602) 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, International Relations Committee, 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 Overseas Private Investment 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 in August 1976, but it was not acted on by the Senate.

The Senate adopted Resolution 516 on October 1, 1976, supporting United States participation in the Organization of Economic Cooperation and Development's "Declaration of OECD Member Governments 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."

On February 22, 1977, a bill (H.R. 3815) was introduced in the House to make it unlawful for an issuer of securities registered pursuant to the Securities Exchange Act of 1934 to offer, pay or promise to pay, any money, or to offer, give,

or promise to give, anything of value to any foreign official for purposes of influencing any act or decision in his official capacity. The bill provides for fines of up to $1 million. The House Subcommittee on Consumer Protection and Finance held hearings on April 20 and 21 concerning H.R. 3815. Treasury Secretary Blumenthal noted that H.R. 3815 in its present form was acceptable to President Carter, but added that obtaining convictions under the proposed law would be difficult in the international arena.

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 on October 4, 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

On March 31, 1976, former President Ford established the Task Force on Questionable Corporate Payments Abroad. The task force was headed by Secretary of Commerce Elliot Richardson and 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 did not release its final report, but did provide interim suggestions to the President in the spring of 1976, and in mid-January 1977, Mr. Richardson sent a memorandum to the former President summarizing the task force's activities and accomplishments.

In August former President Ford submitted the Task Force's proposed Foreign Payments Disclosure Act to the Congress (S. 3741, H.R. 15149). 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.

Because of its late submission, Mr. Ford's bill did not receive serious consideration before the congressional recess. It is expected to receive a full hearing in the 95th Congress.

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 an ad hoc working group of representatives from the United States and 17 other nations to complete its task by summer 1977. The Ad Hoc Intergovernmental Working Group held its first session from November 15 to 19, 1976. The first session was devoted to the organization of its substantive work and to a general exchange of

views by the delegations. At its second session, held from January 11 to February 11, 1977, the working group adopted a list of major issues to be considered in examining the problem of corrupt practices, particularly bribery, in international commercial transactions by transnational and other corporations as a basis for future work.

Treasury Secretary Blumenthal announced in March 1977 President Carter's full support of the treaty proposal and encouraged early action by the United Nations.

## CHAPTER 2

## ACTIONS BY GOVERNMENT AGENCIES

There has been much scrutinizing by Government agencies of the behavior of American corporations to identify the form and extent of questionable or illegal payments and to determine actions necessary for discouraging and preventing such payments in the future. A brief synopsis of the more significant efforts follows.

### 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 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 and 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.

The courts 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.

Through its enforcement program 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 disclosures 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.

Under its voluntary programs, more than 350 companies had filed reports with the Commission by April 1977 disclosing questionable payments to foreign officials.

On April 28, 1977, the Commission announced that it would make public the names of the recipients of questionable and illegal payments from U.S. companies. This action is being taken in response to requests for release of such information under the Freedom of Information Act.

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."

The Commission issued on January 19, 1977, a rulemaking proposal (Release No. 34-13185) 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 will create a climate which would discourage serious abuses uncovered in this area.

Federal Trade Commission

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 the antitrust laws in combating the practice of making payoffs.

Internal Revenue Service

The 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.

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 Department of Justice for prosecution in the courts.

Department of Justice

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

The Department's Deputy Chief of the Criminal Frauds Division heads a Federal task force which was formed in 1976 to investigate allegations of corporate foreign payments. The task force includes representatives from Justice, the Securities and Exchange Commission and the Internal Revenue Service. Emphasis has been 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.

As a result of its investigations, the task force recently began presenting criminal cases to grand juries in several cities involving illegal foreign and domestic payments by American corporations.

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 determine 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.

## CHAPTER 3

## PRIVATE SECTOR SEEKS SOLUTIONS

The efforts discussed in chapters 1 and 2 evidence a commitment by the Federal Government to maintaining a world marketplace more free of illegal activities and questionable moral and ethical practices than in the past. The Government is not alone in these efforts, for organizations in our private sector are also seeking solutions.

### American Institute of Certified Public Accountants

The American Institute of Certified Public Accountants issued in January 1977 two statements on auditing standards to its membership.

One statement (SAS No. 16), 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 (SAS No. 17), 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

The New York Stock Exchange recently made a rule proposal for companies with common stocks listed by it under which the companies have until June 30, 1978, to create audit committees made up of nonmanagement directors. 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 LEGAL AUTHORITY TO AUDIT COMPANY BOOKS AND LAWS RELATING TO IMPROPER PAYMENTS TO SECURE CONTRACTS

The authority of the General Accounting Office (GAO) to examine the books and records of companies doing business with the Government is, in the main, limited to those holding negotiated rather than formally advertised contracts for supplies and services. Contracts negotiated by the Department of Defense are governed by section 2313 of Title 10 of United States Code, which provides that the Comptroller General is:

> "entitled * * * to examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to, the contract or subcontract."

Similar laws exist regarding contracts negotiated by other Federal agencies.

It should be noted that the access to company records is limited to (1) negotiated contracts, and (2) records that are directly pertinent to the negotiated contracts. Thus, GAO, as a general proposition, may not conduct a far reaching and exhaustive examination of any company's books of account or corporate records.

Specific Laws Regarding Improper Payments

There exist several statutes that bear upon the question of improper payments made to secure Government contracts. These statutes are in turn implemented by clauses that must be inserted in Government contracts. Should GAO, in its audits of negotiated contracts, find violations of these laws and contract provisions, it generally refers the matter to the procuring agency, if it is a civil matter involving a price reduction, or to the Department of Justice for investigation and possible prosecution, if it is a criminal violation.

Section 22 of Title 41 of the United States Code (Civil Code) requires that all contracts or agreements (with only certain specific exceptions) must contain an express condition that no member of or delegate to Congress shall have any share or part of such contract or agreement, or receive any benefit from such contract or agreement.

This matter is further dealt with in the Criminal Code. Section 431 of Title 18 of the United States Code provides for criminal penalties for members of or delegates to Congress, or resident commissioners who have a prohibited share of a Government contract. This provision does not apply to corporations in which the person may hold stock (18 U.S.C. §433).

The Code also provides that contracts made in violation of this law are void and the Government can recover any money paid under the contract.

This statutory requirement is implemented by the "Officials Not to Benefit" clause that is inserted in all Government contracts. GAO, as noted before, generally has authority only to audit negotiated contracts, while this statute applies to all contracts. Should GAO discern as a result of its audit that there was a seeming violation of the statute, the matter would be referred to both the procuring agency and the Department of Justice.

Perhaps most pertinent to the question of improper payments made to secure Government business is the so-called "Covenant Against Contingent Fees." First required by Executive Order in 1941 (No. 9001, 6 Fed. Reg. 6787), the requirement was later incorporated in statutory provisions (10 U.S.C. §2306(b) and 41 U.S.C. §254(a)). The requirement is implemented by insertion of the "Covenant Against Contingent Fees" clause.

Under the requirement, a contractor must warrant that no person or selling agency has been employed to secure the

contract on a commission or contingent fee basis except for bona fide employees or bona fide established commercial or selling agencies maintained by the contractor for the purpose of securing business.

Should this requirement be violated, the Government may annul the contract or deduct from the contract price the full amount of the contingent fee or commission.

In 1962, Congress provided in Title 10, United States Code (Civil Code), section 2207, that all contracts using Defense Department appropriated funds must contain a clause providing for stringent penalties if gratuities are given by a contractor or his agents or representatives to any Government official in an effort to secure a contract or receive favorable treatment. This requirement is implemented by insertion of the "Gratuities" clause in covered contracts.

Violation of the requirement may result in termination of the contract. If this is done, the Government may sue for damages for breach of contract, and seek as an added penalty to recover no less than 3 nor more than 10 times the cost of the gratuities paid or given. These remedies are in addition to the penalties provided for in the Criminal Code.

The "Anti-Kickback Act" prohibits any subcontractor from making a gift to a prime contractor or his employee as an inducement for the award of the subcontract (41 U.S.C. §§51-54). The law provides that the United States may recover the amount so paid. While the law does not expressly provide for cancellation of the subcontract, the Supreme Court has held that that was a proper remedy for public policy reasons. The law also provides that for the purpose of enforcing the law, GAO has the "power to inspect the plants and audit the books and records" of any prime or subcontractor engaged in performing a negotiated Government contract.